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How to contact us

West Coast Bureau Chief
Lawrence Aragon
laragon@buyoutsinsider.com, 415 469 1183

Senior Reporter
David Bogoslaw
david.bogoslaw@peimedia.com, 212 796 8321

Reporter
Ryan Hibbison
ryan.h@peimedia.com, 646 921 2383 ext 108

Contributors
Keith Button, Claire Coe Smith, Toby Mitchenall, Chris Witkowsky

Managing Editor, Production: **Mike Simlett**

Production Manager: **David Sharman**

Senior Production Editors: **Tim Kimber, Adam Koppeser**

Production Editors: **Nicholas Manderson, Jeff Perlah**

Copy Editors: **Helen Burch, Eric Fish**

Art Director: **Mike Scorer**

Head of Design: **Miriam Vysna**

Art Director – Americas: **Allison Brown**

Senior Designers: **Denise Berjak, Lee Southey, Rebecca Worrell**

Designers: **Pio Blanco, Ellie Dowsett**

Marketing Solutions Director, Private Equity Group:
Alistair Robinson
alistair.r@peimedia.com, +44 20 7566 5454

Subscriptions and Reprints
subscriptions@peimedia.com

Customer Services
customerservices@peimedia.com

Editorial Director, US: **Rich Melville**

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Insight

Funds Portfolio valuations take center stage amid public market turmoil

What is a venture fund worth today? That's the multi-million-dollar question being asked by both LPs and GPs. And it is a question they'll be asking at least until the first quarter of next year, ***writes Lawrence Aragon***.

That is when GPs present their LPs with their audited portfolio valuations. Until the audit happens, LPs and GPs can only look at things like 409A filings and new financing rounds to try to come up with a reasonable estimate. That can be a stomach-churning experience, based on two high-profile examples.

Payment company Stripe told employees in July that's its internal share price was about $29, down from $40 in its prior 409A valuation, *The Wall Street Journal* reported. That means Stripe's overall valuation dropped by about 28 percent from $95 billion to $74 billion, something that will eventually be reflected in the funds held by the company's investors, including Andreessen Horowitz, Atomico, Founders Fund, Sequoia Capital and Union Square.

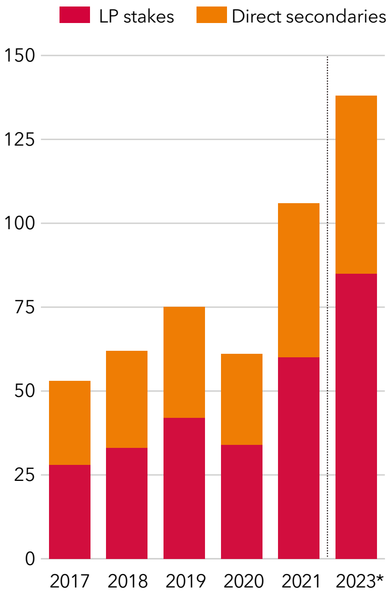
Another indigestion-inducing example of a steep drop in valuation is Stripe's payments peer Klarna. The company announced in July that it closed a new financing round that

valued the company at $6.7 billion, an 85 percent drop from the $45.6 billion valuation it recorded about a year earlier. Klarna investors that will have to adjust their fund values include Atomico, Canada Pension Plan Investment Board, Sequoia, SoftBank Investment Advisors, Silver Lake and TCV.

LPs spooked by what happened with Klarna and Stripe have little choice but to sit tight. VC funds being sold on the secondary market are selling for steep discounts. "I think all the bids are 40 to 60 percent off, and I know that because I'm bidding," Hans Swildens, CEO and founder of Industry Ventures, tells *Venture Capital Journal*.

Even at the high end, the bids are coming in at a 25 percent discount. "If the seller gets 75 cents on the

The VC secondaries market surpassed $100bn in volumes last year, Industry Ventures estimates ($bn)



Source: Industry Ventures *Prediction

dollar, that's probably in the top 10 percent of bids," Swildens says. "And [the bids] go all the way down to 60 to 70 percent off."

To be fair, very few LPs are selling VC portfolios at such a steep discount. In fact, the volume of VC secondaries deals has declined sharply this year. Industry Ventures' investment pace is about half of what it was in the first six months of last year. "Year over year, cash out the door is probably down 50 percent in Q1 and Q2," Swildens says. (That includes dollars spent on direct investments as well as secondaries and other deals.)

Still, Industry Ventures has been able to close some deals this year. "We have been buying, and we have been buying in the range of 75 cents to 40 cents on the dollar," Swildens notes.

Does that mean the value of a venture portfolio is 40 to 75 percent of what it was a year ago? Only if you sell immediately. Anyone who doesn't have to sell should sit back, grab a drink and watch the show. ■

↑

"How many [companies] will be focused on seizing the moment to get the right people at a more reasonable salary and to try and get market share?" ***Sunil Mistry****, a partner at KPMG Private Enterprise, explains how some companies may find a silver lining in the likely approaching recession*

↑

Ups & downs

↓

"Almost everyone is going to need to hunker down and ride this out for however long it will last… and that's still the $64,000 question: how long is this going to last? It's not clear yet." ***Conor Moore****, head of KPMG Private Enterprise in the Americas, says companies will need to rein in financing expectations as the US economy continues to slow down*

↓

The big numbers

Select data points from the *Q2 22 Venture Pulse Report* produced by KPMG Private Enterprise

5%
Percentage of funds that held a close in 2022 on more than $1bn

$6m
Median deal size for global early-stage VC deals in Q2 2022

$10.8bn
Total amount raised in the top 10 fund closes in Q2 2022

97
Number of companies to earn unicorn status in Q2 2022

$158.6bn
Total capital raised by VC funds in H1 2022

8,420
Number of venture deals done globally in Q2 2022

3
Number of $1bn-plus VC deals done in the US during Q2 2022

37%
Percentage of global venture capital committed to software deals in Q2 2022

$285.5bn
Total global venture deal value in the year to July 20, 2022

Note: Percentages are estimates by *VCJ* based on analysis of the report

World Fund founding partners (from left): Danijel Visevic, Craig Douglas, Daria Saharova and Tim Schumacher

Climate **World Fund sees nothing but blue skies ahead**

Climate tech VC in Europe got a boost recently with PwC Germany committing an undisclosed amount to World Fund, which aims to close on €350 million by the beginning of next year, ***writes Keith Button.***

PwC is now an anchor LP in the fund, along with Ecosia, the tree-planting search engine add-on, and a third anchor investor who will be announced later this year, according to Craig Douglas, one of World Fund's four founding partners.

Other LPs of note include German soccer player Mario Götze; Trivago co-founder Rolf Schrömgens; Econos, a German sustainable investing platform; and Verena and Philipp Pausder, respective founders of the Fox & Sheep kids app and Thermondo energy company.

World Fund intends to fill two significant investment gaps in European climate tech: when technology advances from the lab to market – typically funded by seed and Series A rounds – and when the technology leaves the pilot stage to scale up, which is funded at the Series B round. World Fund will write checks of €1 million to €10 million per company.

Eurocentric

The fund invests only in European companies, with the aim of catching up to US climate tech funding. US climate tech companies raised \$56.6 billion in 2021, compared with \$18.3 billion for their European counterparts, according to World Fund.

> "If anything, LP interest is stronger than ever, as LPs are looking for safe harbors in the economic storm"
>
> Craig Douglas
> World Fund

Several US firms have climate funds in the works: Fifth Wall, a Los Angeles proptech investor, raised \$500 million for its inaugural climate fund in July; Buoyant Ventures of Chicago closed on more than \$50 million toward a \$100 million climate fund in August; and Union Square Ventures of New York is raising \$200 million for its second climate fund, USV Climate 2022, according to the Oregon State Treasury, which committed \$20 million.

"Despite the [public] market sell-off, we have not seen any slowdown in LP/investor interest over the last three months or so," Douglas told *Venture Capital Journal*. "If anything, LP interest is stronger than ever, as LPs are looking for safe harbors in the economic storm. Climate tech is most certainly a safe harbor and VC has proven in the past to be a crisis-effective asset class."

Since 2021, World Fund has invested in six deals, which are performing at 1.5 times gross multiple on invested capital (MOIC). Portfolio companies include QOA, which produces an alternative to cocoa; Space Forge, a European space tech start-up looking to develop the world's first returnable satellite that would produce materials impossible to manufacture on Earth; and Juicy Marbles, which is developing plant-based filet mignon. World Fund requires each company it invests in to aim to reduce carbon dioxide emissions by 100 megatons per year.

The CO2-reducing investment criteria is also good for returns, because start-ups that can deliver will be the most valuable companies of the next decade, Douglas said. He points to a seven-year study by right. based on science, which shows that European stocks aligned with the goals of the Paris climate agreement have outperformed the market. ■

Defense tech **Marlinspike is raising debut VC and growth fund**

Marlinspike Partners, a firm with hefty governmental and investment experience, is raising its debut fund for early-stage and growth investments in technology to bolster national security, ***writes Chris Witkowsky***.

The firm made a series of deal-by-deal investments before launching Marlinspike Disruptive Technology Fund I in January, sources told affiliate publication *Buyouts*. It held a first close in January and has raised more than $25 million so far, sources said.

Marlinspike invests in companies developing technology for national security needs in space, aerospace, cybersecurity, AI and autonomy. The tech aims to be "dual use," meaning it can be used by both the government and private industry.

"Escalating great power competition with China and Russia will drive massive American investment, innovation and scaling of new technologies," the firm noted.

Marlinspike has invested about 32 percent of the capital from its first close in three companies: Elroy Air, a drone delivery company; Voyager Space, a space infrastructure company; and Privateer Space, a company co-founded by Apple co-founder Steve Wozniak that focuses on tracking, monitoring and navigation of space debris.

Several first-time funds have used the strategy of investing while fundraising, adding early deals to the fund as a way of eliminating some of the blind-pool risk for LPs who commit later. New LPs to Marlinspike's fund can commit at the initial cost basis of the investments (even if they've been written up), with a catch-up fee, the source said.

Fund I has a seven-year term, four-year investment period, and a 2 percent management fee, with a 20 percent carried interest rate, sources said. The pool also will charge a 1 percent management fee and 10 percent carry on co-investments, they said.

Its investment split will likely be around 60-70 percent in Series A and B-level companies, 20-25 percent growth stage, and the remaining portion in seed stage investments, the source said.

Spiked with opportunities

The firm's pipeline of opportunities is robust, according to a Q1 investor letter seen by *Buyouts*. "We sourced 90 opportunities in Q1, and our plan for the year calls for sourcing and evaluating between 200 and 250 companies," it said.

Marlinspike Partners was formed in 2020 by Neil Keegan, chief executive and co-managing partner; Mislav Tolusic, co-managing partner; and partner Mark "Turk" Powell.

Prior to launching Marlinspike, Keegan ran a single-family office called Roanoke Capital Management starting in 2009, according to his LinkedIn profile. He also spent six years at Goldman Sachs early in his career, and served in the US Navy.

> "Escalating great power competition with China and Russia will drive massive American investment, innovation and scaling of new technologies"
>
> Marlinspike

Tolusic previously was a partner at Crumpton Ventures starting in 2008, and before that he was a senior portfolio analyst at Highland Capital Management, his LinkedIn profile notes. Other executives at Marlinspike include Chip Walter, a Navy and intelligence veteran who previously worked for Northrop Grumman's venture capital arm, and co-founder John Mastal. ■

Diversity **L'Attitude champions Latino-founded start-ups**

The number of venture funds focused on Latino-founded companies is small, but it just got a big boost from a firm led by veteran Latino business executives, ***writes Lawrence Aragon***.

L'Attitude Ventures, a venture fund focused on Latino-founded start-ups, recently closed on $100 million for its sophomore fund from a host of major investors, including JPMorgan Chase.

"We closed on 22 LPs in Fund II with a balanced distribution, just under half being corporates and the rest comprised of family offices and one major university endowment," chief executive Sol Trujillo tells *Venture Capital Journal*. "We admitted our first LP in mid-August of last year, so we've finished fundraising ahead of our one-year mark."

In addition to JPMorgan, the fund's other investors include Bank of America, Barclays, Cisco Investments, MassMutual, Nuveen Investments, Polaris Limited Partners (Oscar Munoz), Royal Bank of Canada and UC Investments. The general partnership also committed $10 million to the total.

L'Attitude, based in San Diego, launched in 2019 and closed its debut fund the following year on an undisclosed amount.

It is among just a handful of VCs dedicated to investing in Latinos. Others include Debut Capital, which makes pre-seed and seed investments in Black, Latino and Indigenous founders; Epakon Capital, which makes seed and early-stage investments in US Latinos and Latin America; Leap Global Partners, an early-stage investor focused primarily on "Latinx founders and start-ups that view Latinx markets as critical to their long-term success"; and VamosVentures, which makes pre-seed and seed investments in diverse founders, including Latinos.

L'Attitude's team comprises Trujillo, the onetime chief executive of Orange, Telstra and US West; president Gary Acosta, co-founder and CEO of the National Association of Hispanic Real Estate Professionals; and partners Kennie Blanco, a former investor at BlackRock, Laura Moreno Lucas, a former managing director at Nasdaq and Oscar Munoz, United Airlines' former boss.

Trujillo's short-term goal is to achieve an aggregate net return of 3x invested capital for Fund II.

"The long-term ambition of L'Attitude Ventures is to consistently be the first major source of institutional capital for Latina/Latino founders, and, given the growth of this cohort, we're going to need a lot more capital," he says. "With demonstrated performance, we hope to raise a $500 million Fund III in two to three years, followed by another sizable fund and so on. In 10 years, we should have a multibillion-dollar AUM firm that will endure for many generations."

Fund II has already backed 22 companies. It focuses on investments of $200,000 to $2 million in early-stage businesses led by Latinos and is especially interested in technology-based solutions aimed at areas including workforce development, healthy communities and financial advancement.

L'Attitude Ventures partners (from left): Gary Acosta, Kennie Blanco, Laura Moreno Lucas, Oscar Munoz and Sol Trujillo

Tech concentration

To those who say you cannot produce top-quartile returns by focusing on a particular demographic, Trujillo responds: "We not only know the pipeline of Latino founders is large and growing, where Latinos represent 1 in 4 net new businesses in the US, but also know these businesses are in industries that tend to generate top-quartile returns."

There is no shortage of Latino entrepreneurs with promising companies that need seed capital.

"According to a 2021 report by the Stanford Latino Entrepreneurship Initiative, 19 percent of the Latino-owned employer businesses create, develop and sell a technology or software products, compared to 14 percent of white-owned employer businesses," Trujillo says. "And within those percentages, the Latino businesses have a greater concentration in AI, cloud-based solutions, specialized software, robotics and specialized equipment, which goes against widely held beliefs among the general investment community that Latino entrepreneurs are not in technology." ■

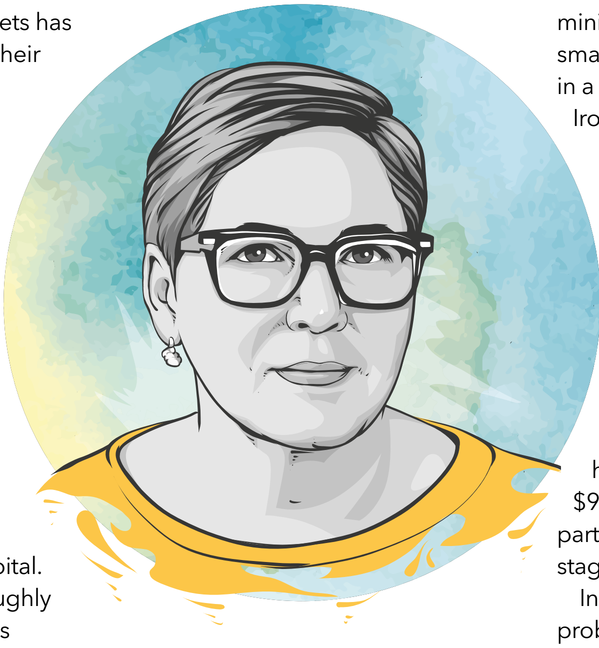
LP profile **Maryland steers a steady course**

Turmoil in public markets has some LPs rethinking their allocations to private funds, but not the Maryland State Retirement and Pension System, ***writes Lawrence Aragon***.

The $66.6 billion pension system is "not taking a pause," senior portfolio manager Dana Johns tells *Venture Capital Journal*. "We are still investing on plan."

This year, Maryland is on pace to commit around $2 billion overall to private equity, including venture capital. Its PE allocation stands at roughly 20 percent, which is above its 16 percent target, but it has the flexibility to go above its target by up to 5 percent.

That is not to say Maryland is sanguine about the public market downturn. With roughly 28 percent of the pension's money in public equities, the denominator effect has made its PE portfolio a larger share of the pie.



The long of it

"We're not immune to short-term impacts, but we are long-term investors," Johns says. "Venture capital in particular is a very important part of our portfolio that we've been building over the past five or six years."

Johns says she expected portfolio valuations to be "flat to a little down" for Q2 and Q3, but she was heartened by the underlying health of portfolio companies as of July. "We are not seeing any degradation in the underlying portfolio company fundamentals," she says. "There is a lot of cash sitting on balance sheets – and there will be cost-cutting measures," which will make the money last longer.

> "That's why I'm so calm, while my counterparts on the public side are probably a little bit more stressed out"
>
> Dana Johns
> Maryland SRPS

VC currently accounts for about 12 percent of Maryland's private equity portfolio, which is below the 14 percent industry benchmark it measures itself against. The bulk of the PE portfolio, around 65 percent, is in buyout funds, with the remainder in growth equity.

Maryland invests in venture funds in two ways. First, it invests directly in funds that have the capacity to take a $75 million commitment, its minimum ticket size. To get access to smaller, early-stage funds, it invests in a fund-of-one managed by Tiger Iron Capital.

Big cat power

Maryland invests roughly $100 million a year into Tiger Iron, which breaks that amount into $5 million to $10 million checks for venture funds investing in Series A and B rounds. Since it began the effort in 2015, the state pension has committed approximately $900 million to around 15 general partners that manage multiple early-stage funds.

In some ways, Maryland is probably better positioned for the current public market downturn than some of its peers. It chose to lean into private equity and held that stance even while others were notching big gains from a public market run-up.

"We continue to believe in this asset class despite recent market turbulence," Johns says. "Our job is manager selection, and we have allocated to managers who are disciplined and have been through different market cycles and know how to build recession-resistant portfolios."

Maryland's strategy paid off during the pandemic. "That is when our allocation to the different [private] asset classes really protected the portfolio," Johns says.

She continues to believe in the long bet on venture capital and other forms of private equity, so she doesn't lose sleep over rising interest rates or a possible recession. "That's why I'm so calm, while my counterparts on the public side are probably a little bit more stressed out." ■

India **Alternatives giant Kotak eyes venture capital**

As China asserts more control over its tech economy, its neighbor to the south is looking more appealing to investors, ***writes Lawrence Aragon***.

Sequoia Capital had no difficulty raising $2.85 billion for funds targeting Indian and South-East Asian start-ups, while Lightspeed India Partners closed on $500 million for its fourth early-stage fund – double the size of its previous effort.

That bodes well for Kotak Investment Advisors Ltd, the alternative assets subsidiary of Kotak Mahindra Bank – the investor plans to raise a VC fund and a fund of funds.

KIAL is already India's biggest homegrown alternatives player, with about $5.7 billion in assets under management or advisement. It has funds dedicated to PE, real estate, infrastructure and other sectors.

"We are constantly identifying opportunities across the alternative investment spectrum and curating investment platforms for our domestic and global investors with dedicated and competent investment teams with deep expertise," Srini Sriniwasan, KIAL's founder and managing director, tells *Venture Capital Journal*.

KIAL is expected to start fundraising for its venture effort some time after summer, with a target of around $200 million. The fund of funds, which will back both VC and PE funds from other managers, will target the same amount, largely marketing to Kotak's private banking clients. KIAL already has regulatory approval for the FoF, and started the fundraising process in early August.

Both funds are expected to charge the standard 2 percent management fee and 20 percent carry.

Big-name backers

Investors in KIAL funds are mostly sovereign wealth funds and pensions, many of them from South-East Asia and the Middle East. Less than 10 percent of its LPs are in the US. Big names behind KIAL funds include Abu Dhabi Investment Authority, Allianz Germany, British International Investment and GIC, Singapore's sovereign wealth fund.

KIAL's venture fund won't chase after consumer tech or fintech companies, which have already attracted a lot of capital. "Many of those business models are essentially copycat business models of what is in other parts of the world," Sriniwasan says.

Instead, KIAL will focus on Indian life sciences and biotech companies, a space where it has already had success. For example, it was an early backer of two Indian pharma companies now publicly listed: Sun Pharmaceutical Industries, the world's fourth-largest generic drugmaker; and Biocon, India's largest biopharmaceutical firm.

The pharma and healthcare space "requires domain knowledge for people to understand what's going on, and portfolio companies require investors to display the ability to understand what we are doing and add value and networks to them," Sriniwasan notes. KIAL has already used its balance sheet to invest in 14 healthcare start-ups, ranging from diagnostics to genomics.

"We are seeing dynamism at the crossroads of technology and healthcare," he says, "where [firms] are trying to provide interesting solutions and catering to the unique requirements of the Indian market, both from a cost and time perspective." ■

> "We are seeing dynamism at the crossroads of technology and healthcare"

Srini Sriniwasan
Kotak Investment Advisors Ltd

Developing markets **Three reasons why Latin America is a smart bet**

Expert view by **Oliver Henry, TheVentureCity**

Emerging markets are performing better than expected. In fact, the 25 largest developing markets are in strong financial shape at the moment, including many countries in Latin America. Despite global pessimism from investors, Latin America is once again showcasing why it's a smart bet for US-based VCs.

For one, investors in the US are realizing that they've been caught up in sexy ideas and new verticals at outsized valuations, and they need to gravitate toward novel solutions solving critical problems in markets that are ripe for disruption. Research already shows that entrepreneurs from emerging markets have better survival rates than their counterparts in the US, which lends itself well during downturns. Entrepreneurs from emerging markets know how to do more with fewer resources, and they have a lean mentality that leads to longer runways and resilient business models.

Latin America checks all these boxes, and even in the face of new challenges, verticals like fintech continue to thrive in the region. Also, few locations are more prepared to capitalize on the benefits of Web3 than Latin America. Here's why there is tremendous value and returns to capture in the region.

> "Despite global pessimism from investors, Latin America is once again showcasing why it's a smart bet for US-based VCs"

1 Fintech success sows the seeds for other start-ups to grow

Fintech is booming in Latin America, with $5 billion of the total $7.5 billion invested in the region last year going to fintech companies. Not only is it cheaper for Latin American entrepreneurs to build tech tools and platforms, but they can internationalize relatively quickly because of the shared languages and customs between markets.

Latin America has prime conditions for fintech to grow from the ground up. Smartphone adoption is high; South America has one of the largest internet penetration rates in the world; and 90 percent of millennials in the region can access digital wallets. Whereas other locations must navigate existing technological infrastructures and user behaviors, Latin American fintechs can implement mass, sophisticated solutions from the ground up.

Fintech is the foundation upon which other companies are being built. Cryptocurrency projects, Web3 and decentralized apps all have fintech at their core. We're

already seeing fintech hubs arise in Latin America, such as in São Paulo, which is home to fintech unicorns Neon and Creditas. These spaces will breed other hotbeds for fintech knowledge, tools and collaboration, especially given the community nature of founders in Latin America. For instance, Mexico-based logistics company Nowports has launched a fintech tool for inventory financing that enables players to use cargo as collateral for loans.

Such collaboration with fintech at its core will fuel business and economic activity in the region, which will shape a strong, successful start-up ecosystem.

> “We're already seeing fintech hubs arise in Latin America, such as in São Paulo, which is home to fintech unicorns Neon and Creditas”

2 Investment beyond capital goes further in Latin America

The US investment landscape has been witnessing a shift toward investors offering resources beyond capital for some time now. Founders are increasingly asking investors to offer more than dollars, to bring their experience, network and resources to the table. It's why more micro-VC funds have been popping up in the US – because they hyper focus on specific geographies and building network effects amongst other investors on behalf of their founders.

For Latin American founders navigating early fundraising stages and building the first iterations of their product, operational support and wisdom from investors is all the more impactful. At TheVentureCity, we have US investors based in Latin America to work closely with our portfolio founders. We provide operational support, fundraising tactics, strategic insights and any other resources to ensure our start-ups flourish faster. Our in-house data science team helps founders evaluate customer data to achieve product-market fit, and our operating partners advise them around scaling in the region.

We also encourage start-ups to work with us without entering into an investment agreement. We invite them to team up with us for a month to delve into their product and go to market motion, allowing both parties to explore striking a deal at the end of the period.

Doing so enables us to support companies where there isn't a vested interest yet – of which there are many in Latin America – and to tap into early opportunities with cutting-edge technology.

3 Latin American entrepreneurs are often product-led

Product-led companies are twice as likely as sales-led companies to grow more than 100 percent annually. Evidence of this is that 58 percent of high-growth SaaS companies have product-led growth strategies in place. We're seeing more product-led businesses pop up precisely because of the organic hypergrowth it can spur, which proves even more important during a VC downturn.

Sales-led growth, as a principle, centers around marketing and hiring that can be expensive. This strategy effectively raises customer awareness of a product, but not necessarily the quality of it. By building a product that people genuinely love and solves a core user problem, and building strong user metrics and adoption around core functionality, companies don't have to spend as much on marketing initiatives, and can scale in a more sustainable way. Take Brazilian online learning platform Descomplica, which used a product-led growth mentality to grow throughout the pandemic. After rolling out courses specifically designed for on-the-go mobile learning, the platform now has 5 million monthly users and has raised more than $130 million in financing.

Utilizing a product-led growth mindset when operating in Latin America allows founders to organically grow efficiently from a capital perspective and prioritize customer experience. Ultimately, when funding volume slows, investors pay closer attention to metrics like retention, CAC, LTV and cashflow management – all optimized through a product-led growth approach.

Latin America's start-up longevity is real, and it remains largely unexplored by US investors. The momentum we saw in the region last year was overdue and revealed the potential of its entrepreneurs and businesses. Investors who cross Latin America off their lists because of the global funding slowdown will miss significant opportunities. And US investors who want to build a reputation in Latin America and enjoy outsized returns in the future need to start exploring trends and building relationships in the region today. ■

Oliver Henry is investment manager at TheVentureCity, a global early-stage venture fund focused on making the entrepreneurial ecosystem more diverse, cross-border and fairly funded

True Wealth Ventures: Kerry Rupp (left) and Sara Brand

GP profile **Women-focused True Wealth Ventures beats target**

In a sign of progress for women-led venture funds, True Wealth Ventures recently closed on $35 million for its oversubscribed sophomore fund, ***writes David Bogoslaw***.

The Austin, Texas-based firm makes seed investments in women-led start-ups that aim to improve human and environmental health. It previously raised $19.1 million for its debut fund in 2016.

The fact that Fund II was oversubscribed is an encouraging sign, in and of itself, considering the greater difficulties many emerging venture funds typically have in raising capital, let alone funds led by women GPs. Many female fund managers say they encounter both unconscious and explicit bias from many of the LPs they approach, who are predominantly white men.

True Wealth founding general partner Sara Brand tells *Venture Capital Journal* that women represent 75 percent of the LPs in Fund II by dollars and about 80 percent by number.

"When we closed Fund I, 80 percent of our investors were women, and that wasn't something we were proactive about or even aware of when we started raising Fund I," Brand says. When she and general partner Kerry Rupp polled their female investors, "the vast majority had never invested in venture before, and the vast majority of those had never been invited to invest in a venture capital fund before."

In a statement about the new fund, Brand said: "While our primary mission continues to be getting early-stage capital to female founders whose core value proposition is improving environmental or human health, our secondary mission has been to facilitate more women investing into this asset class as LPs."

Brand says: "Given the lack of funds going to women entrepreneurs and the lack of women at VC funds leading investment decisions, it seems kind of obvious in retrospect that there'd be so few women investing in this asset class because it's so male-dominated."

Fund II will invest in seed-stage deals, with Brand and Rupp assuming board seats. The fund will target software, hardware and packaged goods start-ups.

First checks typically range between $500,000 and $1 million. True Wealth Ventures LPs often co-invest an additional 50 percent on top of the fund's investment, with total rounds most often ranging up to $3.5 million and $4 million.

True Wealth has already made three investments from Fund II since its first close in May 2021. It has backed Aeromutable, which applies aerospace technology to the trucking industry to improve vehicle efficiency and safety; De Oro Devices, a maker of mobility devices that assist people with mobility disorders; and Flourish, which educates women about how to build sustainable healthy habits in nutrition, hydration, sleep, stress, relationships and movement.

The firm intends to invest in 15 companies from Fund II. Those start-ups must be women-led, meaning at least one woman with significant decision-making power must be on the founding or executive team.

With women projected to control two-thirds of investable assets by 2030, "We realized there are a lot of reasons that it's important that we get more women investing in venture," Brand says. ■

PEI

New York
130 West 42nd Street
Suite 450
New York
NY 10036
T: +1 212 633 1919

London
100 Wood Street
London
EC2V 7AN
T: +44 20 7566 5444

Hong Kong
Room 1501-2, Level 15,
Nexxus Building,
No. 41 Connaught Road, Central,
Hong Kong
T: +852 2153 3240

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Editor's letter

That is not a siren song you hear from Europe

Lawrence Aragon
lawrence.a@peimedia.com

What a difference a couple of years can make. The last time *Venture Capital Journal* took a close look at the European venture market in 2019, annual dealmaking totaled $49.6 billion. Last year, it hit a record of about $117 billion, and it is on pace to do the same again this year, according to Dealroom.co.

Mind you, these numbers are relatively small compared with the US, where dealmaking reached nearly $330 billion in 2021. But what is important is that the numbers continue to go up for Europe, and that the gains are substantial.

> **“Start-ups don't have to move to the US for capital and support like they used to”**

In March 2020, we declared “VC finally makes the map in Europe.” In this month's cover story (p. 14), senior reporter David Bogoslaw explains why European VC has become a port in a storm, as macroeconomic troubles roil the US.

Simply put, the market has matured to such an extent that start-ups don't have to move to the US for capital and support like they used to. They can stay at home and be successful, as evidenced by the proliferation of unicorns. There are about 130 European start-ups valued at $1 billion or more today, which is more than twice the number that CB Insights reported in 2019.

What's more, the value of exits by European start-ups hit a high of €142.5 billion last year, more than three times the previous high of €42 billion set in 2018, PitchBook reports.

If you hear Europe calling, listen carefully. It isn't a siren song.

Lawrence Aragon

Port in a storm

Cover story

As economic troubles roil the world's largest economies, investors are finding refuge in Europe's maturing and stable venture market, reports David Bogoslaw

The US has seen a sharp decline in dealmaking this year, as venture capitalists try to figure out how to price deals and rationalize their pace in an economic downturn. The same cannot be said for Europe. Nearly $60 billion flowed into European start-ups and late-stage companies in the first half of this year, the second-highest amount on record.

What's more, the European venture market continues to churn out $1 billion-plus unicorns at a record pace, something not even the collapsing value of Klarna can undo.

What explains the difference between the two markets? There are a number of reasons:

- Start-up valuations did not get as bloated in Europe as they did in the US.
- Most of the investments made in Europe have until recently been in early-stage start-ups, whose capital needs are generally much lower than those of late-stage companies and therefore less vulnerable to a projected capital crunch in the event of an extended market downturn.
- Higher-quality funds and portfolio companies have been socking away capital in preparation for periods of market volatility.
- Europe has matured into a key part of the global venture market. More and more VCs in the US and elsewhere recognize they must stay engaged in Europe so as not to lose out on compelling talent and investments.

Success breeds success. As unicorns proliferate, the market is expected to attract more capital, which will be spent to produce more

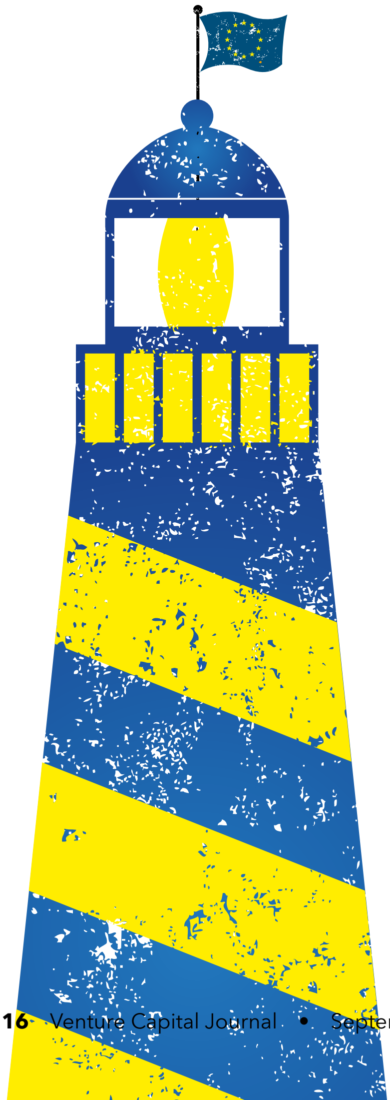
unicorns, and so on. For all of these reasons, both GPs and LPs tell *Venture Capital Journal* they are optimistic about Europe even as a growing number of economists foresee a recession for the world's largest economies.

Lower valuations

If you're looking for a bargain on an early- or late-stage company, Europe is more attractive than the US.

In the first year of the pandemic, the median pre-money valuations for late-stage and early-stage companies in the US were already more than triple and four times, respectively, those of their European counterparts, and the valuation gap has widened over the past year and a half.

The median pre-money valuation for late-stage companies in Europe is more than three times less than in the US – about $29.3 million compared with $100 million as of Q1, PitchBook reports.



The story is even better for early-stage companies, where the median pre-money valuation is more than five times less for European start-ups than for their US counterparts, or about $12.4 million compared with $70 million as of Q1, per PitchBook.

One factor that prevented valuations in Europe from getting as inflated as they did in the US is a smaller and less enabling IPO market that provided far fewer opportunities for high-priced exits than in the US.

The number of VC exits in the US spiked 67 percent from 1,123 in 2020 to 1,875 in 2021, with almost 90 percent of those in 2021 achieved through public listings, according to PitchBook. That's a far larger IPO market than in Europe and Israel, where 142 European and Israeli start-ups went public through December 6, PitchBook notes.

Europe's less mature capital markets and less available liquidity actually works to its advantage during economic downturns, says Oliver Kahl, a principal at Munich-based MIG Capital, which makes early-stage investments in deep-tech companies. "When the markets are in a downturn, the capital markets are the ones that react more strongly and immediately," he says. "And that's something that is not felt here in Europe so much."

Jessica Archibald, managing director of fund of funds Top Tier Capital Partners, agrees that European venture funds and start-ups won't be as adversely impacted by public market volatility.

Many of Europe's VC funds are newer, having launched just five to 10 years ago, with portfolio companies that aren't yet mature enough to be raising pre-IPO or even late-stage rounds. "It still feels like the good funds

"When the markets are in a downturn, the capital markets are the ones that react more strongly and immediately. And that's something that is not felt here in Europe so much"

OLIVER KAHL
MIG Capital

are getting raised very easily, regardless of location," says Archibald.

The entire fundraising process, from announcing a new fund to LPs, going through due diligence and holding a first close, is still being completed relatively quickly, she says. "That's a sign that there are plenty of investors out there willing to invest in the top part of the ecosystem, whether it's [in] the US or Europe."

Sustained appetite

In Europe, LPs now have attractive opportunities because there are fewer there than in the US. Although some VC funds remain hard to access, LPs like the fact that if they're willing to take a little more risk, they can scale with those that are still growing in fund size, and reap the benefits, which is harder in the US, says Archibald.

She suspects other LPs such as endowments and pension funds are investing in Europe for the same reason Top Tier is. "You have a belief that innovation is global, so I don't care where the apps on my smartphone have been created," she explains. "That became so much clearer through the pandemic. You don't know and you don't care where people are working."

Combine that with lower valuations for tech start-ups than in the US and a growing track record of exits and realized performance over time, and global investors that already have exposure to the US and Asia are saying, "Let's make sure we have all three legs" of the stool and are "not excluding a large part of the venture ecosystem," Archibald adds.

When it comes to company formation, European VCs are on par with those in the US in writing checks below $5 million in seed and other early-stage funding rounds, says Ross Morrison, a partner in the London office of Adams Street Capital, a fund of funds manager with about three quarters of its assets invested in early-stage funds.

This is not to say fundraising will be easy for European funds. What capital is available will go to funds that are performing well, whether measured by multiples, IRR or distributions. Emerging managers, on the other hand, will struggle to attract funding, LPs say.

Vital Laptenok, a general partner at Flyer One Ventures, which has offices in Kyiv and London, has a brighter outlook for new managers. He says there's still room for emerging venture funds to get in the game, especially if they focus on just one industry, or a narrow area like sustainability, and can support their portfolio companies with specific knowledge and relationships. This has not traditionally been the strength of European VC fund managers, which tend to be generalists, Laptenok says.

> *"[Many start-ups are] not going to come to the US for capital. They're going to stay in Europe"*
>
> **JESSICA ARCHIBALD**
> **Top Tier Capital Partners**

However, fundraising challenges will likely be alleviated by the flywheel effect made possible by the growing quality, sophistication and depth of capital accumulated by entrepreneurs over the last two decades, says Tom Wehmeier, a partner at Atomico in London. Many founders come from the ranks of operators who helped to build earlier start-ups.

"Every successful company that gets built has a leveling-up effect in creating more talent that's been through the cycle," Wehmeier notes. "It creates capital liquidity that gets reinvested back into the ecosystem, and each time there's a success case, it sets a new bar for ambition."

Atomico has seen this firsthand as the firm was started in 2006 with proceeds from Skype, the first global breakout company to emerge from Europe. Wehmeier points to the many companies started by Skype alumni that have gone on to become investors themselves, including Eileen Burbidge, former director of product for Skype, who founded Passion Capital, an early-stage venture firm in London.

Higher-quality VC funds have been socking away cash in preparation for periods of elevated market volatility and have urged their portfolio companies to do the same, says Morrison of Adams Street.

He believes the best funds have amassed enough capital to enable their portfolio companies to weather the volatility until the public markets rebound, which could take up to two years. They can also use the cash they have accrued to acquire struggling companies as private markets consolidate, he says.

In downturns like the current one, MIG Capital's focus is first and foremost on its existing portfolio. "When it's harder to raise money, VC funds want to make sure the [companies] you have invested in do well and will survive" before considering new investments, Kahl says.

MIG, which has been able to raise nearly one fund a year since 2004, is currently reserving 20 to 30 percent of its total assets to be able to keep funding portfolio companies if fundraising headwinds persist for an extended period. That's more than the firm would have set aside in prior years, Kahl notes.

Funds with reserves will also be well positioned to take advantage of lower valuations on new deals. An excess supply of start-ups should bring down the price of equity.

"Every successful company that gets built has a leveling-up effect in creating more talent that's been through the cycle"

TOM WEHMEIER
Atomico

While it's still early days for declining valuations, Kahl hears from companies raising rounds that they are no longer able to dictate a price to VC funds as they could previously. "These days, we hear statements like 'let the market decide,'" he says.

Venture funds poured $58.6 billion into European start-ups in the first half of this year, the second-highest level of deployment in a half-year after investing $59.9 billion in the first six months of 2021, according to data compiled by Dealroom.co and Silicon Valley Bank UK. Capital infusions in Q2, however, fell 18 percent from Q1, they say.

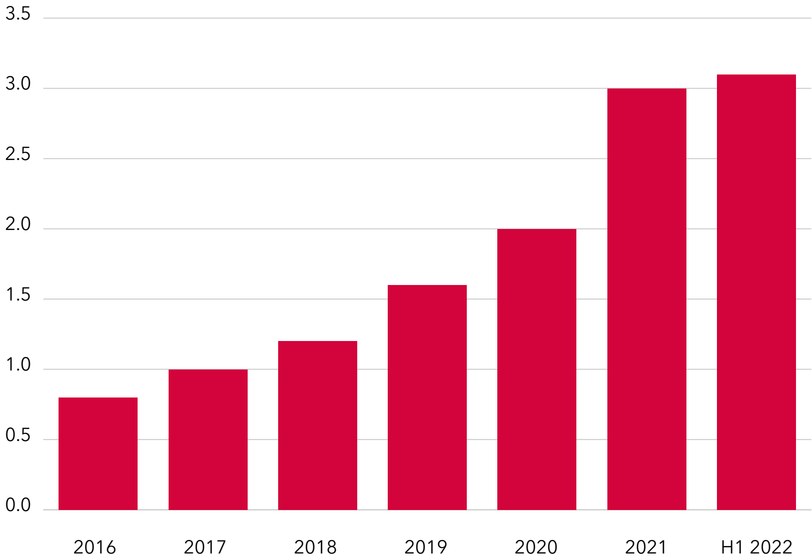
Foreign investors contributed close to half (47 percent) of the capital deployed to start-ups from January through June, and nearly 60 percent of the money that went into rounds of $100 million or more.

Investment in European early-stage start-ups rose to an all-time high for a six-month period, up 21 percent to $16.9 billion from $14 billion in H1 2021. Late-stage funding fell worldwide, but the 8 percent decline in Europe was smaller than the 19 percent drop in the US.

European start-ups continue to draw a larger share of global venture capital, now accounting for 20 percent of global funding versus 17 percent last year, Dealroom.co and Silicon Valley Bank UK say.

Some late-stage investments may continue to thrive due more to the structural evolution of certain sectors like biotech during the 10-year VC boom than to greater confidence in the inherent ability of late-stage over early-stage funds to ride out a potentially prolonged bear market.

Combined enterprise value of European start-ups ($trn)



Source: Dealroom.co

Abundant talent and FOMO

Investors from outside Europe are realizing they need to be actively investing in the region if they want to stay abreast

New managers find tougher market

Emerging VC managers in Europe are finding fundraising more challenging this year as LPs prioritize their existing portfolios, investors tell *Venture Capital Journal*.

But there are still plenty of investors eager to back new funds, says Christoph Klink, a partner in the Berlin office of Antler, an early-stage investor that also operates an accelerator.

LPs are attracted to new managers because research shows GPs with "a very pointed investment thesis" often produce high returns in their first and second vintage funds, Klink says.

"A number of fund of funds programs have started to allocate more to emerging managers," he adds, "but with a very careful approach to picking the right managers with the right underlying strategy, a differentiated approach and good access to dealflow."

Among Europe's notable newer firms is La Famiglia, one of Europe's few female-led VCs. The Berlin-based firm, which invests in seed and early-stage rounds across Europe, closed on $41.4 million for its debut fund in 2017 and $58.2 million for Fund II in 2020, according to PitchBook. La Famiglia started marketing its third fund earlier this year.

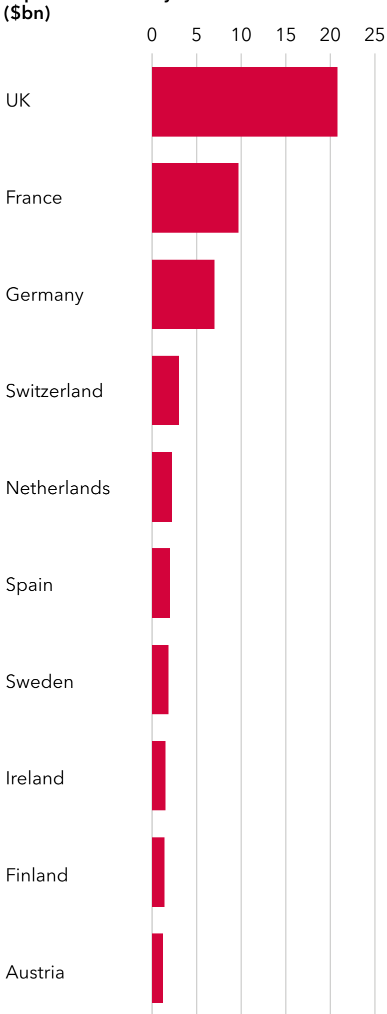
"They have a number of robotics deals," Klink says. "They go deep and have a great network in the industrial space, really leveraging that successfully for the success of their portfolio companies." La Famiglia also has "built a credible supporter base [to back] more female entrepreneurs, which the European ecosystem has too few of."

Another new fund garnering attention is AENU, which launched in July with €100 million from family and friends of founders Fabian and Ferry Heilemann. Formerly known as Pirate Impact, AENU evolved out of the Heilemann brothers' family office and will invest about 80 percent of its capital in climate impact start-ups working on carbon removal, energy storage or alternative proteins. The remaining 20 percent is earmarked for companies addressing social inequality in both Europe and the US. The evergreen fund will write checks for €500,000 to €5 million for eight to 10 new companies per year.

Climate impact is an area in which Europe has an opportunity to get an edge over other parts of the world "because the European investor population is a bit more aware of the need and of the potential of building great climate tech businesses," Klink notes.

While AENU only recently emerged, the Heilemanns have a lengthy track record. Fabian was a partner at Germany's Earlybird Venture Capital and Ferry co-founded and was CEO of the logistics tech unicorn Forto. The brothers aim to grow AENU's capital under management to €500 million by 2026.

Top 10 countries by investment in H1 2022 ($bn)



Source: Dealroom.co

of the talent and unique mini-industries emerging in countries such as Ukraine, Archibald says. (Fewer companies are based in Ukraine since the start of the Russia-Ukraine war, but a lot of development teams remain there.) Many of the people starting companies are "not going to come to the US for capital. They're going to stay in Europe."

That has spurred major VC firms such as Battery Ventures, General Catalyst and Sequoia to open offices in Europe in recent years.

Just as specific cities in the US have become identified with certain kinds of start-ups, regional specialization has emerged within Europe. When it comes to unicorns, Scandinavia is now known for its gaming and communications companies, including Angry Birds, Candy Crush Saga, Skype and Spotify, while London has gained a reputation as a fintech hub.

US investors are increasingly disinclined to ignore any of these varied regions in Europe, just as several years ago nobody wanted to ignore emerging start-ups in China or India. "I don't know whether it's a fear of missing out, or a portfolio diversification, but I think that's driving some investors to Europe," says Archibald.

The rise of partnerships between VC firms like MIG and academic centers such as Technical University of Munich is also helping to identify talent worthy of investment. Numerous tech companies have been spun out of universities including Delft in the Netherlands that have developed innovative technologies, says Kahl.

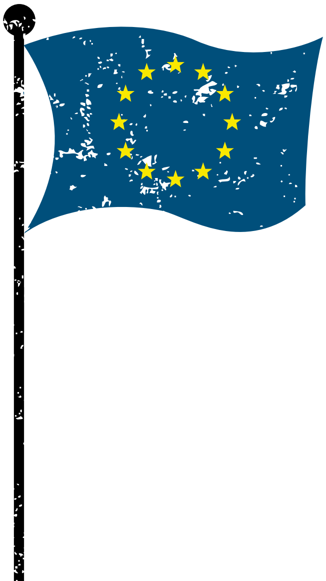
Pent-up demand

While public listings in Europe account for a fraction of exits for European VCs, the M&A market is quite robust.

In fact, some big sectors rely almost entirely on acquisitions for new products and innovations. For example, European drug companies have

"There is a large group of willing [pharma] buyers for the best innovation out there"

SANDER SLOOTWEG
Forbion



"made themselves fully dependent on buying innovation from the outside," with about 80 percent of approved drugs currently originating from smaller biotech companies, says Sander Slootweg, a managing partner at Forbion, a Dutch VC firm with about €2.3 billion in AUM that invests across all stages of life sciences development. "That is quite difficult to reverse."

Because pharma companies still have strong balance sheets, "there is a large group of willing buyers for the best innovation out there," Slootweg says.

He estimates big pharma has roughly €500 billion in reserve for acquisitions over what could be a very fallow period for capital.

Forbion has raised nearly €470 million for its Growth Opportunities Fund II with an aim to close on €600 million sometime over the summer. "That shows there's still plenty of interest with our LPs in this strategy," Slootweg explains. "But I can imagine across the board that LPs will have to think through the new market circumstances and will have to prioritize where they will still play and where [they will] not."

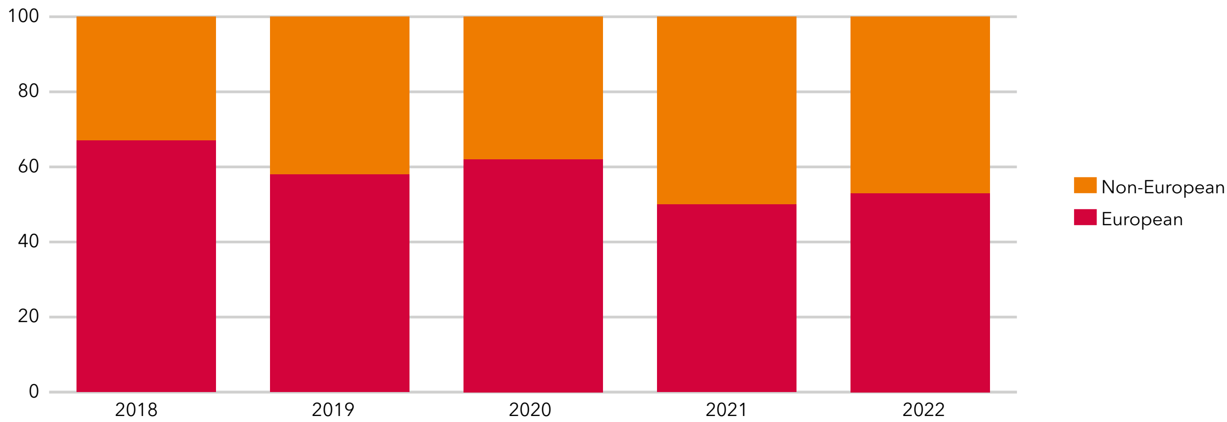
Despite minimal change so far in acquisition valuations, Archibald says she expects the number of acquisitions to climb in Europe and elsewhere. "Especially with the public markets the way they are, there's a lot of potential acquirers sitting on a lot of cash. Usually what we see is when the public markets go down, the number of acquisitions goes up."

The extent to which target companies' acquisition prices hold up "depends on the vintage year of the VC Funds," Massimiliano Magrini, co-founder and managing partner of United Ventures in Italy, says via email.

"There will be a trade-off with funds with good portfolio companies that

Continued on page 25

Start-up investment: European vs non-European investors (%)



Data as of August 8, 2022
Source: Dealroom.co

Three LPs offer perspectives on European VC

Some limited partners are finding it harder to get access to really good venture funds in Europe, many of which are heavily oversubscribed from their existing LPs. Ten years ago, there might have been two or three funds that were inaccessible to new investors, whereas now it's more likely 10 or 12.

That's one of the notable changes in a more mature European VC market, according to limited partners that invest in European venture funds. *Venture Capital Journal* spoke with three active investors to get them to share their insights: Top Tier Capital, Skandia Mutual Life Insurance and the Wellcome charitable foundation.

While there's little sign that GPs are finding it hard to raise funds at this time, deployment of cash to portfolio companies is down as many start-ups are well-capitalized and fewer of them are raising new rounds.

All three LPs *VCJ* spoke with say they are not letting the market downturn compromise their commitment to long-term commitments to their portfolio fund managers. They are mostly focused on early-stage funds, whose start-ups are raising smaller rounds than later-stage companies and are far enough away from potential exits to not have to worry about reduced valuations in the near future.

Track record and net returns are, of course, the priority for all of these LPs when considering a manager, but they are also weighing domain expertise, value-add capability and what founders are saying about their backers.

Top Tier

Michelle Ashworth says Top Tier has commited to 12 Euro funds

Top Tier manages $8.1 billion in funds of funds that invest in venture managers worldwide. The US-based firm launched its dedicated European venture fund of funds in 2019 with €260 million. Before that, it invested in European funds opportunistically for a long time. The European FoF is nearly completely deployed at this point, though some dry powder remains.

Michelle Ashworth, venture partner in Top Tier Capital Partners' London office, splits her time as a venture partner between Top Tier and the Church Commissioners, a £10 billion ($12 billion; €14 billion) endowment at the Church of England. The two portfolios have a reasonable amount of overlap but differ in their degrees of focus and investment capacity.

With a slightly broader platform than an endowment, Top Tier isn't constrained by how much capital it's allowed to invest in any one calendar year. But their approach and the kinds of managers they target are roughly the same: established venture firms with strong track records.

Top Tier has commitments to 12 European venture funds, including Balderton Capital, HV Capital, Index Ventures, Medicxi and Local Globe. It focuses on early-stage funds, which historically have produced higher multiples and better performance than later-stage investments. But Ashworth also supports early-stage managers with fairly strong performance "that have gone on to raise select funds, opportunity funds – slightly later-stage funds."

Current public market conditions are largely irrelevant to the early-stage funds that Top Tier will invest in this year because none of their portfolio companies are likely to be ready to exit for another six to eight years.

That's not so when investing in later-stage funds where "entry valuations fluctuate a lot more and there's a lot of uncertainty [among people] worried they'll catch a falling knife," Ashworth says.

She says she isn't aware of specific pockets in Europe where entry valuations are a lot lower than elsewhere, and even if they could be found, it's not "something that we would chase as an LP."

As for sectors, Ashworth believes LPs generally do better to invest with very good generalist managers and let them choose which sectors they deploy capital in rather than targeting funds focused on fintech, semiconductors or other subsectors.

There are some exceptions, however. Top Tier allocates up to 20 percent of each of its fund vehicles into healthcare and looks for dedicated healthcare tech VC managers to do so.

What does Top Tier look for when vetting a manager? Mostly the strength of the GP's track record, gauging performance by both IRR and multiples. In addition to monitoring multiples achieved at individual company exits, Ashworth looks at net multiples for the funds as a whole each quarter.

With value-add increasingly important for VCs, Ashworth also wants to see that VC firms are staffed with experts in each individual sector being targeted who can provide tailored market advice to portfolio companies.

Skandia

Stefan Fällgren of Skandia, which is just over $3 billion in size

As an investor that manages roughly $56 billion in a pool of private pensions that employers pay into for 12 million people, Skandia Mutual Life Insurance has a much longer tolerance than most LPs for long-term investments across market cycles. For workers who start accruing pension savings in their 20s, that can mean commitments of 50 to 70 years, says Stefan Fällgren, an investment director in Skandia's private equity and infrastructure group who manages the venture program and also invests in buyout funds.

Skandia's 15-year-old venture program is currently just over $3 billion in size, he notes.

"We run a concentrated portfolio strategy targeting western Europe and the US and have 15 active venture managers – 12 in the US and three in Europe," Fällgren says. (Skandia doesn't disclose the names of the VC funds where it is an investor.)

Skandia's US VC exposure is bigger because US venture is a much larger market than in Europe. "But we also get more exposure to European companies through US-based firms, which are becoming more and more active in Europe," Fällgren says. He believes US funds give his program more exposure to very strong European companies, albeit at a slightly later stage.

The life insurance company gets exposure to early-stage companies through its few European VCs. Fällgren notes that some European GPs are doing more Series A rounds in Europe. On the whole, it has "quite large commitments per fund, which makes it [hard to invest in] small, local, early-stage firms in Europe," he explains.

Skandia typically allocates a total of $200 million to $300 million to VC each year, but commitments can be lumpy, Fällgren notes. Last year was a busy one for re-ups, but he expects fewer this year. "Deployment pacing is coming down with less financing rounds compared to 2021, so companies are well-capitalized. If you don't need to raise money this year, you probably will wait."

The investor looks for long-term relationships. It has been with some managers through five or more fund cycles, and Fällgren says he prefers to stay with all his funds for at least five to seven cycles.

Skandia invests in funds focused on various kinds of tech in the broad sense, from fintech to enterprise to SaaS to consumer applications, with some funds also investing in life sciences and IT companies. The LP also has exposure to pure biotech managers.

When vetting VCs, Fällgren places priority on building trusting relationships with GPs that are transparent in sharing information. Among the red flags he watches for is whether a VC manager has raised a lot of funds in a row whose performance is too volatile.

Of particular interest is a firm's culture, including succession planning. "We want firms that want to invest in junior colleagues and career paths," Fällgren says. "[That is an indicator of] the likelihood that this organization will continue thriving not just for a few years but for many years out."

Wellcome

Wellcome is a global charitable foundation that primarily funds health research in three major areas: climate-related health, infectious diseases and mental health. Nearly one-third of its £41.6 billion investment portfolio was allocated to private equity in 2021, including $7.5 billion to venture funds.

Geoffrey Love says Wellcome invests to deploy charitable capital

Wellcome's VC portfolio is weighted to where it finds the best opportunities, which have been mainly in the US over the past 28 years, with allocations to funds in India and China added starting in 2006, says Geoffrey Love, head of VC at the London LP, who spoke to *VCJ* through email. Europe has been part of the VC portfolio from the start, but Wellcome's exposure there has grown in recent years.

"Europe is in a really interesting place for VC right now, finally living up to its promise," Love points out. "That said, the number of VCs who can stand shoulder-to-shoulder with, say, their US counterparts is small. Our European VCs are pan-regional rather than country-specific, as we feel flexibility in approach is essential."

Citing selectivity as a key to carefully vetting managers, Love has limited his fund relationships to the mid-teens.

"New additions are very rare, but over the past couple of years we've been able to invest with a couple of managers who'd previously been hard-closed but who wanted to broaden or upgrade their LP base," he says. "We're not currently looking to add any further relationships."

Wellcome does not disclose the names of the VC funds it backs, but it is known to be a longtime investor in funds managed by Sequoia Capital.

While Love is happy with the returns his GPs have earned in recent years, he emphasizes that Wellcome invests to deploy charitable capital into healthcare research rather than for typical investment gains.

In vetting VCs, he looks at a fund's track record and domain expertise. How a firm is perceived by entrepreneurs and other VCs also comes into play. Entrepreneurs have told Love they rarely find VC managers at the seed stage to be insightful, empathetic or useful. They also complain about managers who are complacent and unprepared, who don't attend board meetings or can't make a decision without conferring with their partners.

Love views European VC as "still relatively nascent in terms of matching experienced capital with ambitious founders to create companies that really make a dent in the universe." Decades of success and experience of US-based VCs give them a perspective that few in Europe have and "is one of the reasons US VCs have been able to make their presence felt here," he says.

European VCs have "a bit of catching up to do," Love adds, "and I imagine if the trends we're seeing continue this could happen quite quickly."

Tech universities help Europe's venture ecosystem mature

Just as Stanford sits at the center of Silicon Valley's venture ecosystem, technical universities in Europe are increasingly sharpening their game in training engineers and research scientists for careers as entrepreneurs and generating both ideas and talent for the larger industry.

More and more universities, including Technical University of Delft in the Netherlands, RWTH in Aachen, Germany and the Technical University of Munich (TUM), have launched incubators that give students resources and access to networks to help take their ideas from conceptualization through prototype and eventually to commercial product.

"That might also be one of the reasons you do see this influx of international investors into Europe," says Oliver Kahl, a partner at Munich-based VC firm MIG Capital. University- and research institute-based incubator programs are a sign of a maturing ecosystem, which has attracted investors from outside Europe to look "more closely at European spinouts of universities and start-ups in general," he says. TU Delft currently hosts six places where high-tech companies can develop, including YES!Delft, a non-profit incubator created in 2005 to help start-ups and scale-ups become successful companies without taking equity from them.

Setting up entrepreneurs 'to fail'

For all their capacity as a source of talent and ideas, Europe's technical universities until recently have been failing their communities, too often "setting up potential entrepreneurs to fail, not succeed," says Atomico partner Tom Wehmeier. That is reflected in feedback from founders who have been through the experience and are frustrated by bureaucracy, negotiation over IP rights and universities' "very aggressive terms around equity shares, [often up to 50 percent], and even future royalties upon commercialization," Wehmeier notes.

As Europe's VC ecosystem has matured, and with growing awareness of the commercial and strategic value created by successful tech stories, "it's created a mindset shift where more and more of Europe's leading universities have started to look at the ways they can strip back some of the barriers that have existed," he adds.

Wehmeier praised UnternehmerTUM, TUM's incubator, for its proactive efforts to examine how to best empower and enable rather than hinder founders. Its full-stack approach to providing capital, resources and networks is a "great flagship example that we would often point others towards," he says, adding that its track record speaks for itself.

TUM's incubator has become practically a mini venture ecosystem of its own. After launching in 2011, it spawned an independent VC firm, UVC Partners, and launched eight venture labs. The labs are designed to be springboards for deep-tech innovations, providing focused domain expertise in areas such as aerospace, food/agro/biotech, healthcare and robotics/AI.

In 2021, start-ups funded by TUM and UnternehmerTUM raised €3 billion, or roughly 18 percent of Germany's VC volume by euros that year. Between 70 and 80 start-ups are founded at the incubator each year, including success stories such as Isar Aerospace, Kumovis and Twaice. UnternehmerTUM has produced three unicorns so far: Celonis, which offers software as a service to improve business processes; Lilium, an electric jet maker; and Personio, whose software digitalizes the personnel management processes of small and midsized companies.

UnternehmerTUM began offering lectures on entrepreneurship as early as 1998. Entrepreneurial thinking is important for bringing innovative technologies to market and thus making the economy and society more sustainable, Helmut Schönenberger, the incubator's co-founder, tells *VCJ* via email. The focus of its support is on B2B tech start-ups.

UnternehmerTUM is also a key contributor to the Munich Urban Colab, a collective where engineering and research students collaborate with representatives of Munich municipal agencies, such as its utilities and transportation subsidiaries, to develop sustainable technology to turn Munich into a "smart city." Students "experience the entrepreneurial process first-hand," says Schönenberger. They also benefit from the exchange in the innovation ecosystem at regular networking events and can get involved in venture projects themselves."

Kahl meets regularly with Colab directors and other incubators at universities in Europe to discuss project-based ideas before they become start-ups. While MIG won't invest at an early stage, it tracks how start-ups are progressing and might invest down the road. Says Kahl, "It's really important to be in the loop with what's going on at these places and be connected to founders at an early stage. That's one of the prime sources for our dealflow."

Continued from page 20

need to exit despite suboptimal market conditions, but traditionally funds starting to invest in a period dominated by 'bear' markets historically have been the best performers."

Unicorn factory

The enthusiasm about Europe may come down to a simple fact: VCs have found tremendous success, judging by the proliferation of unicorns.

Europe has 133 privately backed companies valued at $1 billion or more, including 44 that earned that distinction this year, according to CB Insights, which ran the calculation on July 27.

That's not to mention another 250 or so companies that M&A firm i5invest has identified as "soonicorns," meaning they are likely to reach a valuation of $1 billion or more in the next 24 months.

"Isn't that an amazing fact? It's a forward leading indicator of future growth within the ecosystem," says Morrison of Adams Street. "We are creating the same velocity in new companies in tech as what the US has done."

To be fair, Europe still has a long way to go to match the unicorn production volume of the US, which CB Insights says is home to about 630 such creatures, including 130 birthed this year.

"We are creating the same velocity in new companies in tech as what the US has done"

ROSS MORRISON
Adams Street

Ten most active Europe-based VCs for Europe in past 12 months

Name	Country	City	Rounds	Total (€m)
Speedinvest	Austria	Vienna	68	1,789
Seedcamp	UK	London	64	808
Octopus Ventures	UK	London	56	1,095
Global Founders Capital	Germany	Berlin	52	2,008
Index Ventures	UK	London	50	3,819
High-Tech Gründerfonds	Germany	Bonn	49	488
HV Capital	Germany	Munich	45	1,294
LocalGlobe	UK	Camden Town	39	667
btov Partners	Switzerland	St Gallen	34	942
Cherry Ventures	Germany	Berlin	33	660

Data is for 12 months ended August 8, 2022
Source: Dealroom.co

Where Europe remains behind the US is in building "a wall of capital to sustain that growth," Morrison says. But he is confident that the money is coming. The best global investors are being drawn to Europe's venture market because they recognize that Europe is now competing on the global stage, he says.

As more capital flows into the market, privately held European companies one day soon may no longer have to worry about money to fuel future development. ■

Surviving the crypto winter

Firms with newly raised crypto funds are expected to capitalize on the lower valuations resulting from the crash in cryptocurrency prices, writes Keith Button

The meltdown in cryptocurrency prices and resulting damage to crypto companies has not dampened venture capital's overall interest in the space. Crypto-focused VC funds are actively investing and see the market reset as an opportunity.

In June, the value of bitcoin dropped to its lowest point since December 2020. Other cryptocurrencies suffered similar fates, or worse, prompting crypto exchanges Binance, Celsius and CoinFLEX to freeze withdrawals.

Then, in early July, crypto lender Voyager Digital filed for Chapter 11 bankruptcy protection. It had previously disclosed that crypto hedge fund Three Arrows Capital had defaulted on a loan worth more than $670 million.

Revelations about overleveraging and the interconnectedness of crypto companies have struck fear into VC investors, especially those that had failed to properly screen for those issues, says Robert Le, senior financial technology analyst for PitchBook.

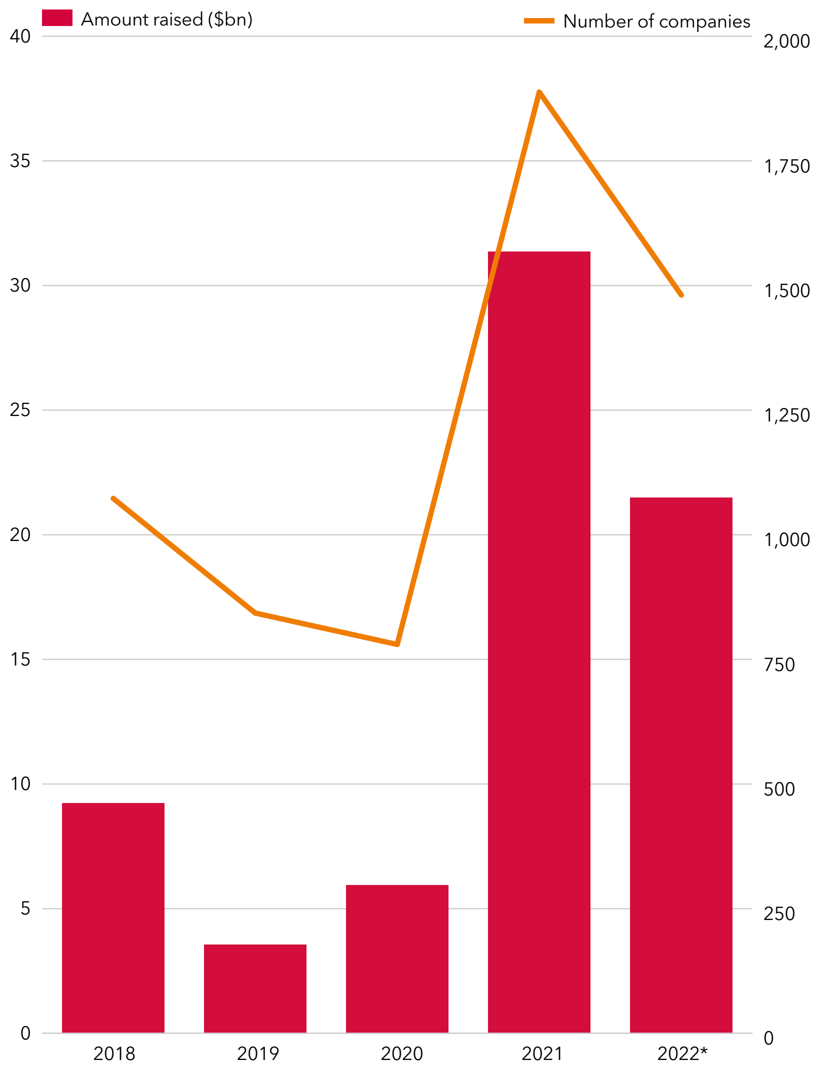
"In 2021, a lot of these deals happened with little, if any, diligence," he tells *Venture Capital Journal*. "In this environment, investors are going to do much more due diligence in these investments, which they should be doing anyway."

Case in point: crypto lender Babel Finance, which suspended withdrawals and redemptions of crypto assets in June, was given a $2 billion valuation by VCs a month earlier, raising $80 million in Series B financing.

Crypto dealmaking has held steady after VCs last year invested a record $31.4 billion in about 1,900 companies in the crypto and blockchain space, including crypto trading, decentralized finance, NFTs and gaming, according to PitchBook. So far this year, they invested another $21.5 billion in about

> *"There are many groups in the industry that did not implement proper risk management [or] implement proper lending processes"*
>
> **ELLIOT CHUN**
> **Architect Partners**

VCs have poured nearly $58bn into almost 4,300 crypto and blockchain companies since 2020



Source: PitchBook. *Data as of August 11, 2022

1,480 crypto companies as of August 11.

There was a hiccup in the first part of June, with blockchain companies raising just $900 million. Some founders avoided fundraises and some saw term sheets rescinded, Le says.

"We expect to see a lot of down rounds and flat rounds in the crypto space," Le adds. The effect will be similar for blockchain companies outside crypto trading, such as those that provide infrastructure or services to crypto companies, blockchain gaming companies, and Web3 and decentralized finance companies, he says.

There's usually a lag of one to three quarters for the effects of the macro market to show up in VC funding rounds, and some companies will likely try to avoid devaluations by waiting out the market.

"A lot of the crypto companies that raised capital in 2021 have some runway – they can sit on their cash and have a little bit of runway of at least 12 to 18 months, depending on their burn rate," Le notes.

The fact is, crypto and blockchain companies have raised a ton of capital since 2020.

But founders do not want their companies to suffer the same fate as crypto lender BlockFi. Last year, BlockFi raised $400 million in a round that valued the company at $5 billion. However, after running into trouble, it took out a line of credit with FTX in July in a deal that gave FTX the option to acquire BlockFi for no more than $240 million.

"We're not going to see a lot of that maybe until later in the year, but we're definitely going to see a lot of valuation decrease," Le says. And the valuation reset is expected to happen across all of tech, not just with crypto companies.

Culling the herd

Elliot Chun, a partner at M&A adviser Architect Partners, tracks VC and growth equity investment in crypto companies. In the first quarter, Chun was seeing about 45 transactions raising $650 million to $700 million per week. By June, transactions per week had dipped into the mid-to-high-20s, raising less than $400 million, and in the third week in June, there were 23 transactions for $190 million.

The lower valuations that will follow will be more reasonable and healthier for the crypto industry in the long run, Chun says.

"Our view is that removing market vulnerabilities is important to the proper growth of the crypto industry," he says. "There are many groups in the industry that did not implement proper risk management. They did not implement proper lending processes. They do not implement proper customer diligence in terms of ongoing diligence."

The current difficulty for crypto companies "is a long-term good thing and long-term important to happen so that groups that do not have proper processes in place and risk management in place understand that they have a potential to go away," Chun adds. "There's a consequence of not doing this right; there's a consequence of not having this and, generally speaking, crypto hadn't seen the consequences of not having those important things in place."

For generalist venture capital investors that moved into the crypto and blockchain space over the last two years, Le expects to see a pull back, as the crypto devaluations and resulting fallout makes them more skeptical about the business.

Meanwhile, crypto-focused VC investors should benefit from less competition for deals. Crypto specialists with freshly raised capital include Electric Capital, which closed on $1 billion for two crypto funds in March; Haun Ventures, which raised $1.5 billion for two Web3 funds in March; crypto-focused Dragonfly Capital, which closed a $650 million fund in April; and Andreessen Horowitz, which closed on $4.5 billion for its a16z Crypto fund in May.

Crypto-focused VCs are "going to be able to get better valuations and concentrate on the best projects, the best founders and the best protocols," Le says.

"This is going to be a good opportunity for us to look at how we utilize this funding to make strategic acquisitions that would complement our current product suite"

JON KAPLAN
FalconX

"In 2021, a lot of these [crypto] deals happened with little, if any, diligence. In this environment, investors are going to do much more due diligence in these investments, which they should be doing anyway"

ROBERT LE
PitchBook

Acquisition mode

There will also be more opportunity for mergers and acquisitions by strategic buyers. Coinbase and FTX have a lot of cash on their balance sheets for potential acquisitions, Le says. Also, traditional financial institutions that have been trying to build in-house technology for custody or other cryptocurrency services may find cheaper alternatives through acquisitions in the current environment.

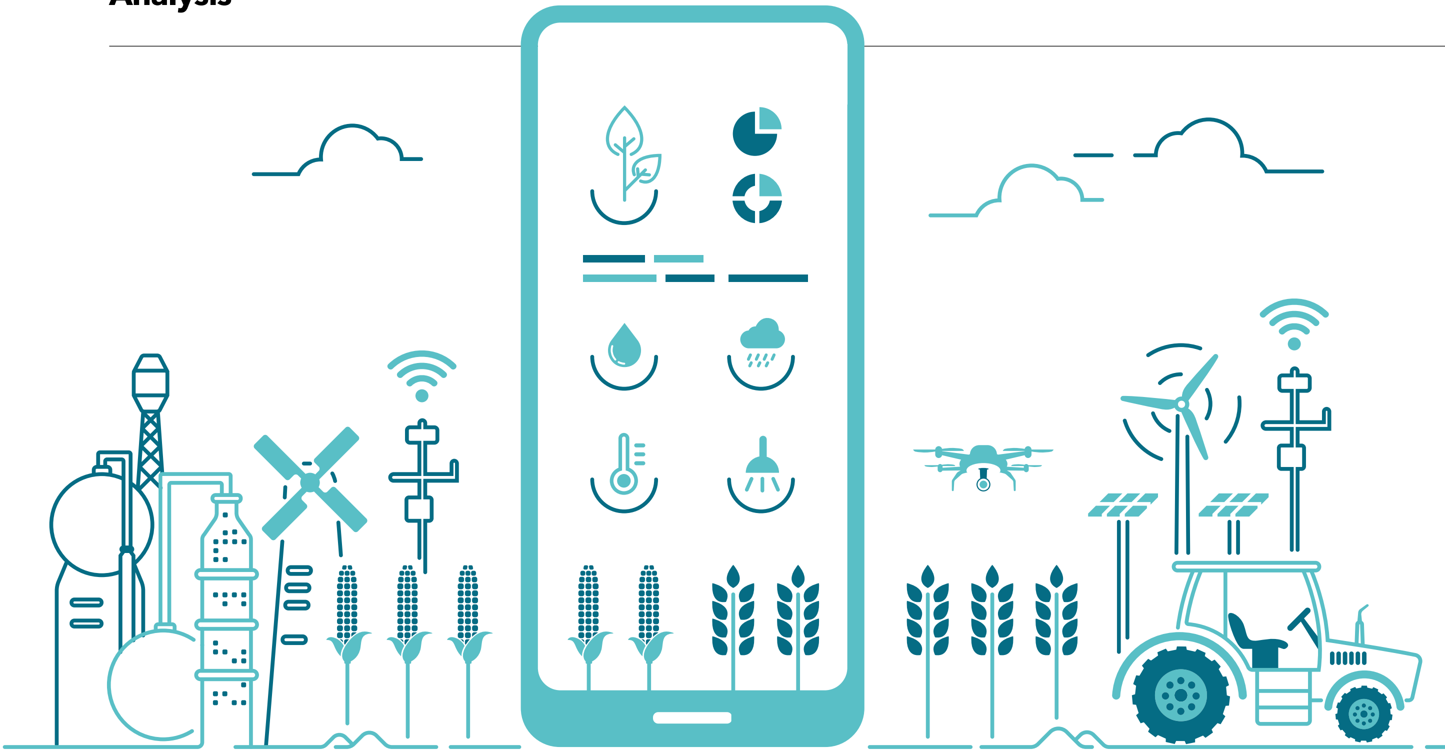
One such buyer could be FalconX, a self-described crypto prime broker that raised $150 million in June in a Series D that boosted its valuation to $8 billion.

"Obviously, some businesses will be repriced," says Jon Kaplan, head of revenue for FalconX. "It's going to be a really interesting time to look at M&A, especially in this environment where quality companies are going to rise to the top. This is going to be a good opportunity for us to look at how we utilize this funding to make strategic acquisitions that would complement our current product suite."

Christine Kang, a principal at Thoma Bravo, one of the investors in FalconX's latest round, tells *VCJ* that the company's profitability and strong cash position put it in a good place to acquire customers, teams and products.

VC firms are loath to admit it, but in the current environment most are focused on protecting their crypto companies that have the best chance of survival. For those lucky few, VCs will devote maximum effort and capital, through bridge rounds, if necessary, because they will not have enough time and capital to extend across their entire portfolio, Le says.

"The rest of the companies, unfortunately, they're either going to get acquired or they're going to fail," he notes. "That's just the nature of VC." ■



Agtech is in full bloom

Investments in technology for agriculture have soared, fueled by worries about food security, writes Claire Coe Smith

The agricultural technology space enjoyed one of its busiest quarters on record for venture capital activity in Q1, at a time when public market volatility was causing slowdowns in many other VC verticals and hit agtech stock prices.

"Over the past several years, agtech has been on this strong upward trajectory, with $12.1 billion raised over the last 12 months and fundraising up 46 percent year-on-year," PitchBook senior analyst Alex Frederick tells *Venture Capital Journal*. "There are a number of sectors and technologies that are seeing increased interest, with one of the top segments this past quarter being agrifinance and e-commerce."

In the first quarter, a total of $3.3 billion went into 222 agtech deals. Q1 ranks second only to Q3 2021 for VC deal value over the past three years for agtech, with record levels of capital coming into the industry on the back of concerns about food security, data-driven productivity gains and a focus on more environmentally friendly agriculture.

Many of the deals in that segment are developing marketplaces and e-commerce solutions for emerging markets, where the majority of food production is done by smallholders and there are challenges around inefficient infrastructure and nascent markets. Indoor farming was also an active segment, as producers look for ways to increase productivity in the face of fast-growing food demand.

"Food security is one of the main drivers of activity in the agtech space," Frederick says. "We are seeing a real rise in populations long-term that is driving long-term food demand, and at the same time supply has been severely constricted, even prior to the war in Ukraine, due to a rise in extreme weather events and shifting climates. The war in Ukraine diminished global supplies of fertilizer and agricultural goods, including wheat, corn and vegetable oil, pushing the cost of farming up quite significantly on all fronts."

At the same time, there's an intensifying focus on new technologies and techniques that can reduce the significant contribution of greenhouse gas emissions by the agricultural industry, with a lot of investment going into areas like carbon-monitoring tools, biochemicals, field machinery to improve soil health and feed additives that reduce fermentation in the digestive systems of animals.

An emphasis on sustainability saw ADM Capital recently secure an $80 million commitment from Los Angeles County Employees' Retirement Association as part of its fundraising for Cibus Fund II, a follow-up for the strategy launched six years ago with a focus on channeling institutional capital toward sustainable food and farming.

Alastair Cooper, ADM's head of early-stage investments covering global food and agriculture, says: "We are really talking about a massive supply-demand imbalance and some significant changes need to be made. For this to happen, we are going to need a revolution or food transition in the same way that we have seen with energy transition. That is basically about the adoption and integration of new technology into new processes that are much more resource efficient, much more sustainable and much healthier for the planet and for humans."

Catch-up time

Agtech is a natural market for venture investors to address, Cooper says. "Agriculture and food production is way behind other industries in terms of technology adoption, but disruption is now coming in fast. Last year we saw a lot more generalist capital coming into the space, as well as impact and ESG capital starting to invest in the opportunity.

"The corporate world of big agriculture and big food has also seen a lot of M&A in the last few years and so R&D and innovation at that corporate level has contracted. That is now happening at the venture level, so those corporates are becoming active venture investors, looking to back those companies and make acquisitions as they break out."

Last year was a record year for agtech VC exit value, which topped $20 billion in cumulative value and saw more than 50 deals, more than half of which were acquisitions.

In addition to strategics, generalists and impact investors moving into the space, there is also a growing population of dedicated agtech funds building momentum. In February, Serra Ventures, an early-stage tech investor based in Chicago, announced it had raised more than $45 million for its first dedicated agtech fund, tapping corporate and institutional investors as well as high-net-worth individuals.

"We had three prior multi-sector funds, and agtech has always been one of the sectors that we have liked to invest in," says Serra chief executive Tim Hoerr. "We had done 11 agtech deals and those ended up being the highest performing categories in our previous funds.

"We also had a couple of large corporate LPs in the agtech space that had joined those other funds and we had talked about a sector-specific approach to help them access deal-flow to support their innovation and R&D," he adds.

> *"We had done 11 agtech deals and those ended up being the highest performing categories in our previous funds"*
>
> **TIM HOERR**
> **Serra Ventures**

Serra's agtech fund will back companies positioned to respond to the consumer trends disrupting the food and agricultural sector and the pain points emerging in supply chains.

"We were concerned whether the same quality of dealflow that we had been seeing in our multi-sector funds would translate into an agtech focused fund," Hoerr says. "We have been very pleasantly surprised by the sustained pipeline of really high-quality agtech deals."

ADM's Cibus fund has similarly seen an uptick in activity: "Five years ago we were look at one agtech deal a day; now it's four or five, so that has changed significantly," Cooper says. "When we first started raising capital for this six years ago, people didn't really get this space or understand its importance. Now, everyone is grasping the food transition and the importance of the tailwinds impacting this space."

PitchBook data shows the strong funding momentum has elevated median deal sizes and valuations across most stages, with the majority of growth at the early stage. There, deal sizes climbed 59 percent and pre-money valuations soared 67 percent year-on-year.

"When you think about the macro events going on, it will be interesting to see how those shifting conditions impact agriculture technologies and categories going forward," says PitchBook's Frederick.

"Some of the more capital-intensive areas, like indoor farming and robotics, may find it challenging to continue to raise funds. On the other hand, there is this whole group of companies working in biologicals, using living organisms to replace fertilizers, where we see continuing advances. Given the surge in fertilizer prices, we will see if there is an increase in funding for those companies as more farmers adopt those solutions out of necessity."

For now, the agtech space is attracting plenty of new investors and generating sufficient dealflow to keep everyone busy. ■

Taking a colorful approach

New fund Colorful Capital aims to address structural impediments faced by LGBTQ+ founders, writes David Bogoslaw

It began in fun last summer, amid the pandemic, with a conversation among friends about how many people from the LGBTQ+ community are represented in the impact investing and sustainable finance spaces.

"Somebody should start a list," Megan Kashner, a professor of sustainability and social impact at Northwestern University's Kellogg School of Business, recalls someone saying.

Kashner was quickly introduced to William Burckart, CEO of The Investment Integration Project (TIIP), which encourages system-wide thinking to inform portfolio construction choices. And what started as a casual phone call about holding a Zoom cocktail party to gather all the LGBTQ+ investment pros they knew turned into a serious discussion about addressing discrimination that LGBTQ+ entrepreneurs face in raising capital.

Taking stock of the abundance of intellect, experience, access to capital and thought leadership in their professional networks, the people on the Zoom call asked each other, "What do we owe our community?"

"What could we be doing that we're not already doing?" Kashner asks. They considered the wealth gap uncovered by research Kashner conducted with an MBA student about the restricted access that start-ups with LGBTQ+ leaders have to early-stage funding.

The result is Colorful Capital, which was launched by Kashner and Burckart in early June with a calling to provide capital and support to undervalued founders across varied industries – people who together have raised less than 1 percent of all US venture funding.

Forward thinking

Pride Month has become a time when companies dial up their public expression of appreciation for their LGBTQ+ employees and customers, only to have it recede from view once July arrives. Colorful Capital is one of a handful of investment organizations that want to level the playing field for business owners from this community. Others include Chasing Rainbows, Gaingels and Pride Fund.

LGBTQ+ entrepreneurs are often kept outside the circles of connection and acceptance among VC funds, which are dominated by white cisgender males. These founders have faced unanswered calls and emails, and find it hard to raise money when no investor

is willing to step up to lead a funding round.

The number of founders in the US who identify as LGBTQ+ is anyone's guess due to serious undercounting in official data collection on the venture capital industry. Most LGBTQ+ entrepreneurs do not come out to prospective investors for fear of it having an adverse impact on their fundraising efforts, Colorful Capital has found.

Kashner's efforts to get a grasp of the wealth creation gap in the LGBTQ+ community started with a literature review to find out what research had been published and what the data revealed. She and Martín De Leon supplemented this with qualitative interviews with LGBTQ+ founders of start-ups to document examples of the structural obstacles they face in fundraising. The resulting baseline study, *Barriers & Exclusion*, analyzes a limited pool of relevant statistical data and shows that

> *"It's not just demonstrating that these are incredibly venture-backable, viable, impressive founders and enterprises in their own right… but beyond that it can serve to attract other capital"*
>
> **WILLIAM BURCKART**
> **The Investment Integration Project**

LGBTQ+ entrepreneurs have less access to early-stage capital and face discrimination when fundraising.

As valuable as that is, "none of this allows us to put a number to what we think the factor of underrepresentation or undercounting is [in the LGBTQ+ led start-up community]," Kashner says. "We face many challenges in quantifying the LGBTQ+ community, [let alone] quantifying the volume, or lack thereof, of capital that flows into ventures founded by LGBTQ+ founders."

Currently, one of the few databases that provides quantifiable information about the LGBTQ+ entrepreneurship experience is the Pride Economic Impact Index (SPEII). StartOut, a nonprofit that supports LGBTQ+ entrepreneurs, created the index by asking founders for self-identification and self-reporting. StartOut's findings conclude that LGBTQ+ start-up founders are absent in two-thirds of US cities with 50 or more high-growth entrepreneurs. SPEII also reports that LGBTQ+ founders have raised $13 billion in venture capital, just 0.7 percent of the $1.8 trillion raised overall.

Colorful Capital is now raising an inaugural fund of $20 million to narrow that fundraising gap. The idea for the fund arose from recognition that founding and owning a business is a key mechanism to address the real differentials in wealth creation experienced by LGBTQ+ people, notes Burckart of The Investment Integration Project.

"We intend to invest significantly and do so from a position of trust as members of the community, avoiding issues of implicit bias that often come up when traditional VCs encounter intersectional identities," says Burckart. "It's not just demonstrating that these are incredibly venture-backable, viable, impressive founders and enterprises in their own right, and our investment can do that, but beyond that it can serve to attract other capital, taking away some of the risk or some of the other reasons they might not invest."

Kashner notes that VC investing has been dominated by people who are of one gender identity and one cultural identity. That is starting to change in the same way that talent attracted to

Angels, rainbows and pride

Colorful Capital is the latest in a small group of VC funds intent on improving access to capital for LGBTQ+ founders.

Gaingels, founded in 2014, is among the first investment groups dedicated to supporting LGBTQ+ founders. The New York investment syndicate is comprised of more than 2,700 individuals who have invested $600 million in more than 1,000 companies since 2019. Gaingels is led by managing director Lorenzo Thione, who co-founded Powerset, a natural-language search engine, which was acquired by Microsoft for $100 million in 2008. The most recent of Gaingels' 44 exits is Grove Collaborative Holdings (NYSE: GROV), a San Francisco-based eco-friendly retail company that listed publicly on June 17 through a SPAC.

Pride Fund 1, based in Columbus, Ohio, is a $10 million fund that Loud Capital launched in 2020. Led by CEO Densil Porteous, Pride Fund 1 provides resources and capital to start-ups led by LGBTQ+ executives at the pre-seed, seed and Series A funding stages. Its portfolio companies include College Cash, a platform that helps companies boost brand awareness by compensating users with money that goes toward paying down their college loan debt.

Chasing Rainbows was founded last November by Ben Stokes. It focuses exclusively on providing support to LGBTQ+ founders who often lack access to vibrant funding networks. Chasing Rainbows has raised about $160,000 through AngelList and has backed six start-ups with ticket sizes of $10,000 to $15,000 each.

Unlike other LGBTQ+ funds, Chasing Rainbows concentrates on very early pre-seed funding, filling the role of friends and family funders that LGBTQ+ founders often miss out on due to ostracization by their own families or conscious and unconscious bias among traditional investors.

"I realized there was a big difference, a big gap, particularly in pre-seed or early-stage funding for LGBT founders," Stokes tells *Venture Capital Journal*. As Pride Fund and Gaingels have become more successful, they've moved further upstream to seed and Series-A rounds. "What that means is that founders that they've usually been investing in don't have them to rely on anymore, so they have to find somebody else."

Stokes has established partnerships across the VC ecosystem from seed to Series B and above to safeguard "the success of the founders that I invest in from day one because I'm ensuring they are going to get subsequent rounds of funding from these other funds."

Most founders find Stokes directly through LinkedIn, but more are starting to contact him through a programming board at StartOut that he co-chairs, which regularly holds virtual events to bring investors together.

"What that has meant is I have this great network of people [to support founders with] lots of mentoring opportunities," Stokes says. "It's a great network for investors as well."

"We face many challenges in quantifying the LGBTQ+ community, [let alone] quantifying the volume, or lack thereof, of capital that flows into ventures founded by LGBTQ+ founders"

MEGAN KASHNER
Northwestern University

and retained by the larger financial industry has begun to change.

"The decision-making on early-stage investing hasn't moved much in terms of the decision-makers of where to place capital," Kashner says. In order to advance, she says, "we have to move forward beyond Pride Month, beyond DE&I programming, beyond affinity employee groups, beyond celebrating the perhaps few but wonderful staff at any industry company… to actually changing the way that money flows." ■

David Rubenstein's 10 rules to pick a fund

Here are the things Carlyle's David Rubenstein looks for when investing in a fund, writes Toby Mitchenall

David Rubenstein is co-founder and non-executive chairman of The Carlyle Group, but he is also a fund investor in his own right.

At a recent event in Zurich, hosted by his daughter Ellie Rubenstein's private equity firm Manna Tree, he gave attendees – in less than two minutes – his 10-step guide to fund due diligence.

"When I look at investing in funds from my own account, these are the rules I have.

1 "Look at the track record. That's the best indicator of future performance… although not perfect."

2 "Was the track record achieved by people still in the organization? Sometimes [firms] have great track records and the people who achieved it have left."

3 "Have the people investing the fund put a lot of their own money into it?"

4 "Are the younger people doing the legwork, are they going to get an economic stake… are they going to have some carried interest in it?"

5 "Does the organization have a reputation for good ethics: in other words, are they being sued for fraud or things like that?"

> *"Does the organization have a reputation for good ethics… are they being sued for fraud or things like that?"*
>
> **DAVID RUBENSTEIN**
> **Carlyle**

6 "Look at who the other investors are. Smart money knows how to find good deals and it's very rare to find a great fund where nobody you have ever heard of is investing in it. Generally, people who know how to look at funds are going to find the best funds."

7 "Look at the organization's ability to keep people. If… people are always leaving an organization, that is an important indicator."

8 "Whether or not an organization has made its track record in an area that's still relevant in the future… Because maybe somebody was good at investing in buggy whips, then the automobile comes along and being an expert in buggy whips is probably not such a great thing."

9 "Next I would say – probably most importantly – whether you can get information from that organization on a timely basis when you need [it]."

10 "Whether you feel that the organization's focus is on you, an investor, more than they, the organization. You have to make sure that… they have a fiduciary mindset and that they are more worried about your outcome than their outcome."

"I use these standards when I invest in funds, and I invest in a lot of funds now," he said. ■

Analysis

LPs wrestle with challenging market

Faced with macroeconomic stressors, LPs are asking whether they should pull back from private assets or sit tight, write David Bogoslaw and Gregg Gethard

Pity the limited partner who is being asked to look into the future without a crystal ball. Should they pull back from private assets in light of the downturn in public markets and a growing consensus that a recession is looming? Or should they stay put?

Sentiment among investors in venture capital funds is divided into two camps based on how much experience they have in the market, says Hilary Wiek, lead analyst for fund strategies and sustainable investing at PitchBook. Wiek previously served as director of investments for the Saint Paul & Minnesota Foundations and director of public and private equities for the South Carolina Retirement Systems Investment Commission.

"If people are newer to VC and are starting to see a lot of press around write-downs and turmoil going on there, and if they were there just chasing returns, I think they might do some serious pausing right now to try to figure out what they've gotten into," Wiek says.

"Longer term investors who have been in VC for a while will have seen these cycles before and will be more likely to understand that you need to just continue investing there because there are good years and bad years, but you're not going to be able to pick them far in advance."

Wiek's analyst's report, *Insights into LPs' Approach to 2022's Market Challenges*, speculates how private market investors may be rethinking their commitments. She shared some thoughts specifically about venture capital with *Venture Capital Journal*.

Private equity funds have exposure to a broader range of sectors than venture capital funds, which are dominated by tech and healthcare, Wiek says. "Which is why VC is anecdotally taking bigger hits right now when it comes to valuations because they are less diversified, and they are very focused on something

that is seeing a fair amount of [pricing declines]."

Even so, Wiek does not believe LPs are likely to immediately reduce their allocations to private assets to rebalance their portfolios to adjust for sharp declines in public asset valuations that have pushed their allocations to private assets above target levels – the so-called denominator effect.

Kelly DePonte, managing director of placement agency Probitas Partners, says many LPs have shown flexibility in coping with the denominator effect. The State of Wisconsin Investment Board provided an example of this agility earlier in 2022 when it extended the range of its target allocation to private equity to avoid having to make impulsive portfolio decisions.

More significant for many LPs today is the slackening pacing of distributions. A slowing of money coming back from the portfolio makes it tougher for LP institutions to expand their private equity programs into new relationships.

The $25.25 billion Kansas Public Employees Retirement System is one LP that had to correct its course because of the pacing of its distributions. The system reduced the amount it will allot to PE along with the size of individual commitments throughout at least the rest of 2022.

"That's a reason why there is a sense of fatigue in the LP base," says Logan Henderson, the founder and CEO of alternative asset digital investment platform Gridline. "Cashflows have been negative since 2018 as many funds are still in the investing part of the J-Curve, meaning capital outflows have exceeded the money coming back to LPs for several years now."

Bart Molloy, a partner at placement agency Monument Group, says this has been especially true of LPs with heavy exposure to venture capital.

"We have seen huge gains in venture capital," Molloy says. "But they're largely paper gains, with often only a small proportion that having come back into LPs' pockets. This year, some LPs might be considering decreasing their bite size or even dropping managers to make the math work, given the number of decisions they have to make."

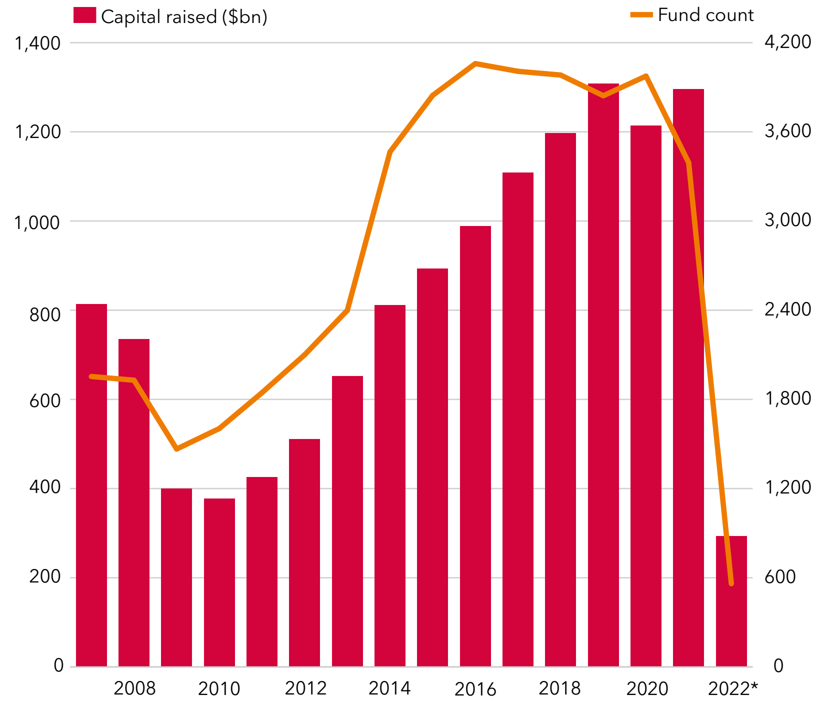
History as a guide

Wiek notes that LPs had a muted reaction to the market volatility when the US economy was rocked by disruptions in the early months of the pandemic. "While LPs did take a breath in Q2 2020, the fact that there was only a 7.2 percent decline in [private capital] fundraising from 2019 to 2020 indicates that LPs have a longer-term mindset when it comes to consistently putting money to work into the private markets," she writes in her report.

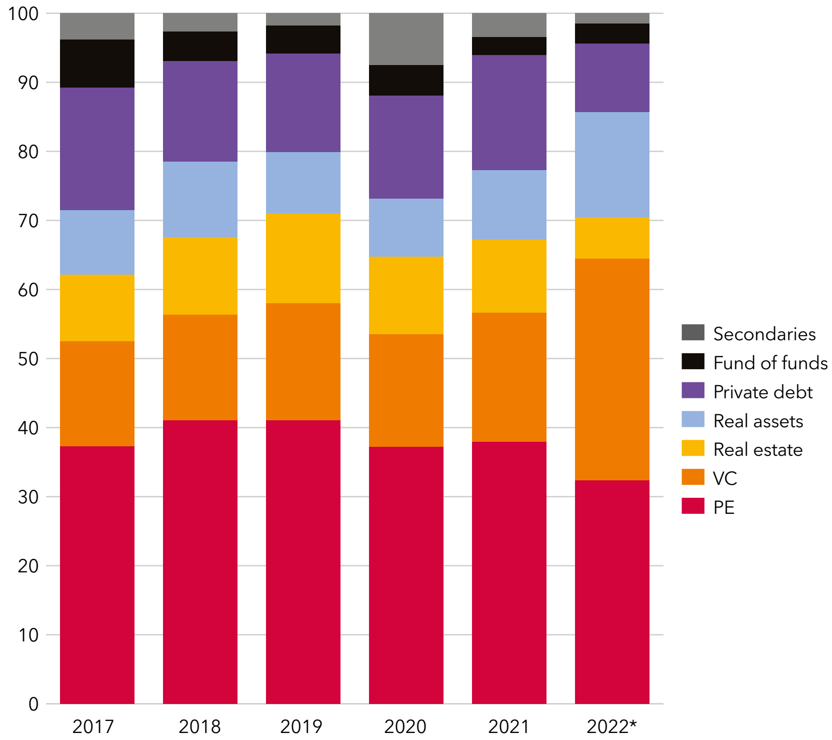
"That said, the mix did shift as allocators tactically decided to place their bets into more venture capital and

> *"The really big money tends to go to private equity, so it's easier to scale back your commitment to a PE fund"*
>
> **HILARY WIEK**
> **PitchBook**

Private capital fundraising activity



Private capital by type (%)



*As of March 31, 2022
Source: PitchBook

private debt at the expense of private equity and real estate."

That view is consistent with data in Rede Partners' *Liquidity Index* report published in May 2021, which showed a striking turnaround in LP sentiment in the first half of 2021 from the second half of 2020, when the liquidity index had fallen significantly to below 50. The report notes that LPs overall expected to deploy less capital over the following 12 months.

By May 2021, the liquidity index score had rebounded to 66, its highest since 2017, with only 8 percent of LPs surveyed saying they would reduce PE commitments in the coming 12 months and 40 percent saying they expected to increase their commitments.

However, that turnaround was driven by expectations for unprecedented exit velocity in 2021 – fueled in part by "a wall of SPAC capital seeking investment opportunities" – which evaporated this year amid macroeconomic challenges.

Greater flexibility

One reason Wiek believes sell-offs spurred by a desire to rebalance allocations will be minimal near term is due to revisions many LPs made to investment policy statements after the global financial crisis, allowing greater flexibility. Those changes included widening target ranges, for example, from a hard 20 percent target with a tight band of drift, and in some cases allowing the portfolio to be outside the targeted range for one or two consecutive quarters before considering ways to bring it back to the desired allocation, per her report.

Even at LPs that have not altered their investment policy statements to be more flexible, an investment committee can still decide to diverge from that policy if the members believe it makes sense. "Very few have such a harsh trigger that they must follow it and there's absolutely no choice in the matter," Wiek says.

Over the longer term, however,

some LPs may realize they have "committed a large amount of money and [they] still have to service that commitment, but [they] now have less assets with which to service that commitment," she notes. "It may bring them to some ideas about resizing commitments going forward" rather than resorting to fire sales any time soon.

LPs keen to reduce future commitments may prefer to target their PE fund allocations rather than those in VC funds because they make bigger commitments to PE funds, which are generally larger than VC funds and seen as less risky.

"This year, some LPs might be considering decreasing their bite size or even dropping managers to make the math work given the number of decisions they have to make"

BART MOLLOY
Monument Group

Noting that the size of VC mega-funds is typically one-fifth or one-10th that of PE mega-funds, Wiek says, "The really big money tends to go to private equity, so it's easier to scale back your commitment to a PE fund."

Paring future commitments to VC funds will therefore have a smaller total portfolio impact than cutting commitments to PE funds, she adds.

In deliberating over future commitments, Wiek doubts LPs will opt to pull back entirely from riskier asset classes like VC. "If you want access to certain VC funds, if you believe you're with top-tier managers, skipping a fund can mean that you don't get called the next time."

In times of uncertainty, when investors feel that risk is heightened, they're less likely to take a chance on an emerging manager, Wiek says.

That said, "VC has seen more support for GPs raising their first or second fund than PE has," she notes. "I attribute that to people being more willing to take risk in general if you're getting into VC, and you're excited by exciting new things just by being in VC. And some aspect of that exciting new thing could be a new fund manager, someone with a great new story or who's spun out of a great old firm and decided that this is the new great way to do things."

A number of new managers have made successful debuts this year, including MaC Venture Capital, a seed investor based in Los Angeles, which raised $203 million for its second seed-stage fund; Vertical Venture Partners, an early-stage firm in Palo Alto, California, which secured $90 million for its third vehicle; and Vine Ventures, an early-stage firm in New York that closed its second fund on $140 million.

Investors more adverse to risk will stick with what's familiar, often re-upping with an existing fund manager, Wiek says. And where LPs have a new allocation to an area they haven't invested in before, if they see higher risk, they're more likely to choose the

"Capital outflows have exceeded the money coming back to LPs for several years now"

LOGAN HENDERSON
Gridline

name brand than an up-and-coming manager.

"So, a lot of money accrues to the big-name PE firms all the time," she says. "It's the old adage from the 1970s, where they say you don't get fired for buying IBM. You don't get fired for hiring Blackstone is the modern equivalent of that."

One reason "that can be different in VC is there's more limited fund sizes," Wiek adds. "So maybe you can't get into Sequoia. Even though you wouldn't be fired for hiring Sequoia, Sequoia may not have availability in their fund, versus Blackstone seems to have endless capacity to absorb LP assets if they're willing to throw money at them.

"Maybe that is another reason why emerging managers have a somewhat better shot because you can't always get into the top-tier venture firms." ■

Japanese venture market comes of age

In a sign of progress for the Japanese venture market, the nation's $1.44trn Government Pension Investment Fund recently made its first disclosed commitment to a venture fund, writes Claire Coe Smith

Just 3 percent of Japanese venture capital funding came from pension funds last year, compared with 32 percent in the United States. But in a country where the start-up investment environment has long been dominated by banks and corporations, VC funds are gathering momentum and fundraising is on the rise.

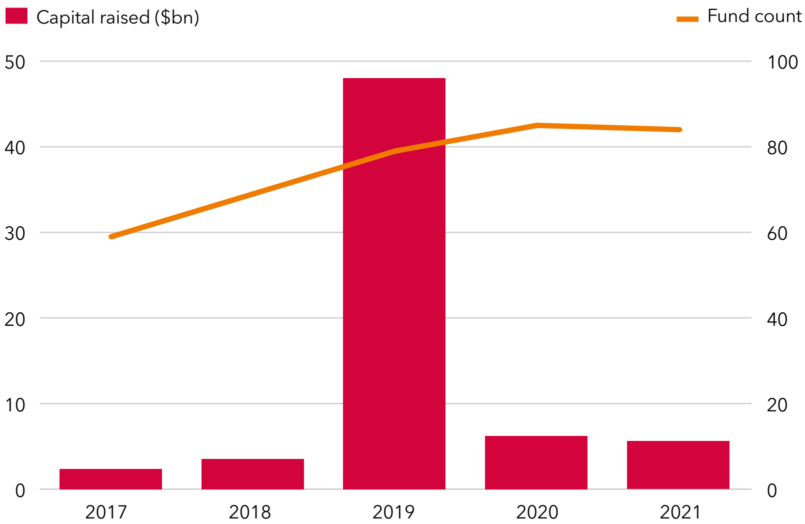
Globis Capital Partners raised its first incubation fund in 1996, pioneering hands-on venture capital in Japan. Now, Japan's massive Government Pension Investment Fund has just backed Globis's latest fund, which held a first close on ¥50 billion ($366 million; €358 million), with hopes to reach ¥70 billion by the end of this year.

The commitment from GPIF, which manages ¥191.6 trillion, marks the first time the pension has disclosed an investment in a VC fund. The move is seen as a welcome fillip to the venture space, where a lack of capital has been blamed for the fact that only six unicorns have emerged in the world's third-largest economy, compared to 600 in the US.

"This is a chicken and egg problem," Globis general partner Emre Yuasa tells *Venture Capital Journal*. "Previously, we had few entrepreneurs, and the need for venture money was small. But, as entrepreneurs have started to create bigger companies, they are demanding larger investment, and as those companies become successful, the returns are coming back to venture capitalists and enabling us to raise larger funds."

In the past decade, that cycle has accelerated, spurred on by what Yuasa describes as "the smart phone shift" around 2015. Another boost came in 2018 when online flea market operator Mercari went public as Japan's first venture-backed unicorn, at one point hitting a valuation of $7 billion. Globis invested in Mercari out of its fourth fund.

Fundraising by Japan-based venture firms



Source: PitchBook

Trail blazer

"That was really a pivotal moment, generating huge returns for venture funds," says Yuasa, who specializes in investments in fintech, AI, blockchain, drones and internet media. "We believe there are many more companies like Mercari to come."

Japan's government wants to accelerate even more investment in start-ups. The ruling Liberal Democratic Party is working on a plan for tax breaks and other measures that it hopes will pump ¥10 trillion into start-ups every year. "We have to revamp taxes and regulations to create a start-up-friendly environment," Takuya Hirai, Japan's first digital minister, said in a June 21 story in *The Japan Times*.

Institutional investors have shied away from the Japanese venture market in part because the asset class was in its infancy and couldn't accommodate large commitments from pension funds. Also, Japanese LPs have historically been more risk averse than their international peers.

But that is changing now. "As the funds and the ecosystem are growing, venture capitalists are raising larger funds and institutional investors can write larger checks because they are able to allocate those resources to due diligence as it passes their minimum check size," says Yuasa. "As the success story grows, investors are more willing to take on those risky investments."

The government has been a long-term supporter of the ecosystem, investing through initiatives including SME Support Japan and the Japan Investment Corporation. But the arrival of the mighty GPIF could herald a sea change.

"It is now up to the venture capital funds to persuade GPIF to invest, and to present a persuasive track record," says Yuasa, who notes that he could not comment on individual LP commitments to the Globis fund.

Yuasa adds: "When we started, a lot of venture funds were corporate subsidiaries or bank subsidiaries, who might write checks to start-ups but asked for collateral or personal guarantees in return. So, it was not real VC investment. We started very small and gradually grew. We now have several unicorns in our portfolio."

> *"[Mercari's IPO] was really a pivotal moment, generating huge returns for venture funds"*
>
> **EMRE YUASA**
> **Globis**

In addition to Mercari, successful investments by Globis include current affairs app SmartNews, which recently entered the US market.

Cultural shift

The amount of money being raised by start-ups in Japan has trebled in the past five years to ¥800 billion, and Yuasa says there is a cultural shift taking place. "Japanese people have not historically been known for starting their own businesses and taking risks, with the most talented preferring to pursue careers in major corporations or government," he explains. "But that sentiment is changing. Now, if you asked the top graduates coming out of university in Tokyo, a lot of them will say they want to join a start-up or start their own business."

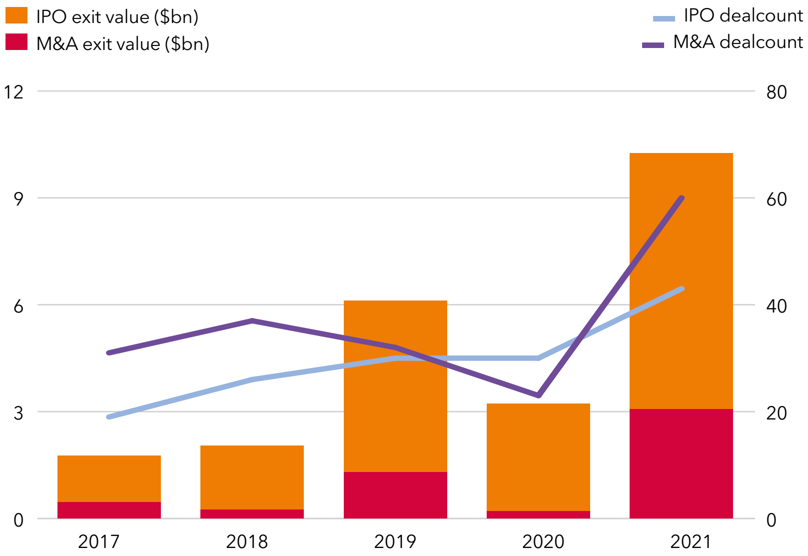
Another challenge has been a lack of strategic M&A by large Japanese corporations, which have preferred to spend their own large R&D budgets to develop technology in house rather than acquire companies.

"That has meant start-ups having to rely on IPOs for an exit route, and we haven't been able to solve that problem yet," says Yuasa. "We have seen some cases where big international corporations have been acquiring start-ups, but we will need to see more of that to have a vibrant ecosystem."

In September last year, PayPal bought Japanese buy now/pay later start-up Paidy for $2.7 billion as it sought to expand its local capabilities, distribution and relevance. Japanese VCs are hoping for more similar deals.

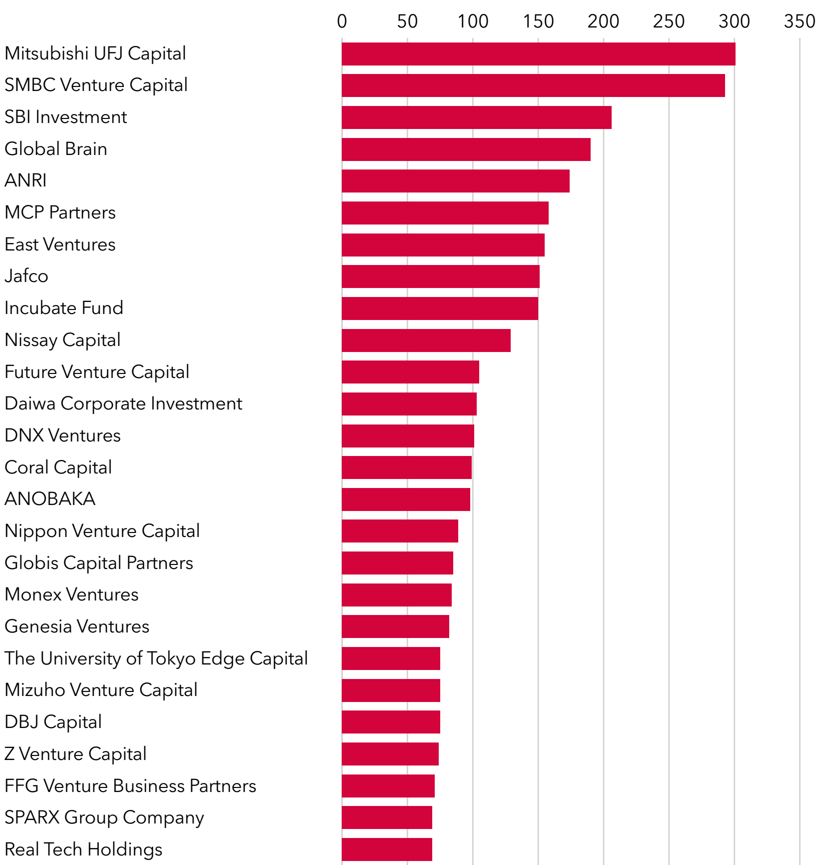
"If we are able to create that deal path, that will enable us to write checks to companies that we haven't been able to fund before," says Yuasa, pointing to deep-tech companies where R&D

Japan VC-backed exits via IPO and M&A



Source: PitchBook M&A data includes acquisitions and buyouts

Most active VC investors in Japan by number of investments, 2017-22



Source: PitchBook – 2022 data as of August 2, 2022

"We have to revamp taxes and regulations to create a start-up-friendly environment"

TAKUYA HIRAI
Digital Minister of Japan

and commercialization take a long time and the 10-year fund cycle of a venture firm struggles to capture the opportunity.

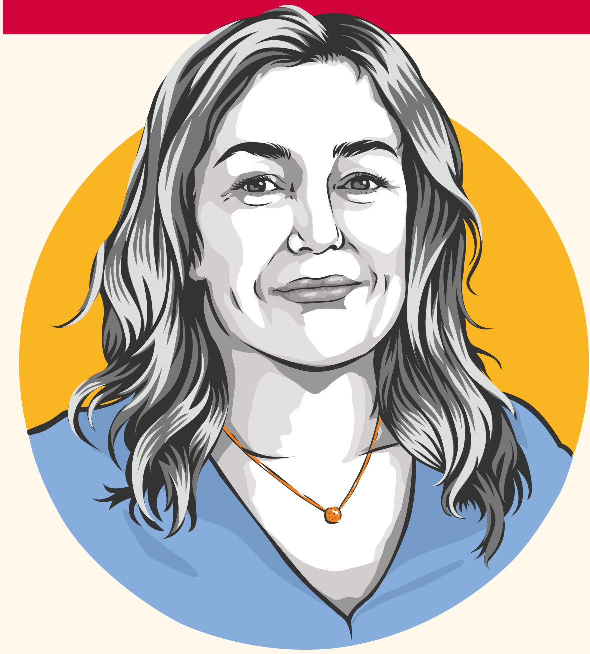
For now, the Japanese venture community remains small and concentrated in Tokyo, with Globis's competitors including DCM Ventures, Eight Roads Ventures and World Innovation Lab, which has operations in Silicon Valley as well as Japan. Global funds have largely stayed away, but that may change.

"We saw a huge inflow of interest by international players last year, before the market crash, especially at later stage," says Yuasa. "Series A and B rounds are too early for them, but they made some later-stage investments."

VC heavyweight Sequoia Capital made its first investment in Japan in late 2020 through its Chinese arm when it purchased a stake in construction app Andpad, a Globis portfolio company.

Yuasa says there is healthy competition and points to a number of investment themes producing a strong deal pipeline, including the digital transformation of traditional industries, as well as healthcare and robotics. "The ecosystem of start-ups is definitely growing, but competition is also increasing, so we can't just sit and wait for them to come to us," he adds.

Raising money from international LPs remains a challenge, but more than 25 years after Globis launched as Japan's first hands-on venture fund, the market is finally coming of age. ■



Getting personal

Joanna Drake, the co-founder and managing partner of Magnify Ventures, a new venture firm focusing on the 'care economy,' answers 10 questions from Ryan Hibbison

When you ask kids what they want to be when they grow up, the three most common responses are a doctor, a musician or a teacher. When Joanna Drake was a kid, she had a very different ambition: "to become the ambassador to Japan."

She hasn't achieved that dream (yet), but after spending part of her childhood in Tokyo, she has laid the groundwork in case she gets the call. Drake graduated from UC Berkeley with a bachelor's in political economy, focusing on the Japanese industrial state. After studying Japanese business and language at Tokyo's Keio University, she got her master's in East Asian studies, focusing on Japanese business, at Stanford University. Drake is now co-founder and managing partner of Magnify Ventures, which recently closed on a debut fund of $52 million anchored by Melinda French Gates's Pivotal Ventures. Based in Los Angeles, Magnify targets early-stage companies operating in parenting and family life, the future of work, household optimization, and longevity. Before founding Magnify, Drake spent over seven years as a GP at Core Ventures Group. Earlier in her career, she was president of new media and later COO and CSO at Current TV.

She currently lives in San Francisco, but her Japanese roots are front and center in her life (and her house).

What's the most unusual thing in your house?
Probably the full single women's Kimono and Obi hanging in my hallway (it was a wedding gift).

Best pizza topping? Artichoke hearts.

Favorite activity outside of work?
A tie between dancing and hiking.

Last book you read, and would you recommend it?
Humor, Seriously by my friend Jennifer Aaker, because life is too intense and we all need to learn how to laugh more.

Favorite band or musical artist? Indie artist Sean Hayes.

Favorite travel destination? Inevitably, Tokyo.

Will you retire early, late or never? Never retire.

Favorite food?
The most perfect food in the world is avocado.

Beer, wine or (fill in the blank)?
I'm definitely a wine woman. Pinot is my go-to.

Dream job as a kid? To become the ambassador to Japan.