The Rise of the Venture Secondary Market

June 2021

The venture capital ("VC") market has evolved and grown substantially over the past decade. Until recently largely viewed as a more nascent private markets asset class, VC is starting to reach maturation, with secondaries transactions being a strong driving force. Investors are realizing that an investment into a VC fund is not necessarily a 15-year marriage, as secondaries transactions can provide investors with flexibility and means for exit outside of the traditional IPO or M&A route. This has changed the perceptions of venture capital and made it more accessible to a wider range of investors (e.g., defined benefit plans).

While no longer a niche category, VC secondaries represent an area in which few investors have expertise or strong track records, and one that has typically thrived during times of uncertainty and volatility. This combination of an underserved space with favorable market conditions is generating strong interest from investors, who have become increasingly aware of the opportunity to diversify their portfolios and access venture returns with a shorter holding period, quicker drawdowns, a mitigated J-curve, and vintage-year diversification. Due to these characteristics, secondaries are more palatable in general for more risk-averse investors, as well as those who may not have much VC expertise but wish to add the asset class to their portfolios.

Mapping the Venture Secondaries Universe: What types of venture secondary transactions are available to investors?

Venture Capital secondaries transactions can be split into two main categories: direct interest transactions and fund interest transactions. Each has unique attributes, dependent on the parties involved, resulting in a market of three core secondary transaction types:

Fund Interest Transactions

- LP Interest: A Limited Partner ("LP") in a venture fund chooses to sell its pro-rata interest to a buyer.

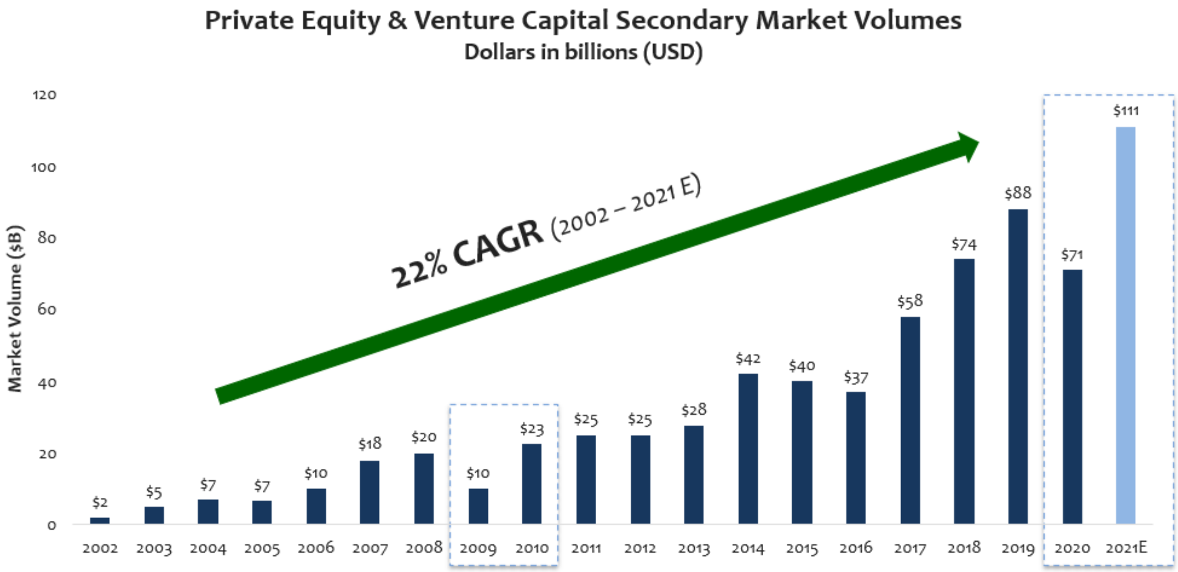
- GP-Led Restructure: A structured process where LPs are given the opportunity to seek liquidity through a fund restructure. LPs may either choose to sell interests or to roll interests into new fund vehicles with reset economics. In a GP-led restructuring, General Partners ("GPs") receive crystallized carry and an opportunity to continue to manage portfolio assets.

Direct Interest Transactions

- Direct Company Secondaries: Company shareholders, early-stage investors or long tenured employees sell ownership interests. These can be in the form of individual transactions or structured tender processes orchestrated by Companies or brokers.

The Growing Opportunity in the Venture Secondary Market

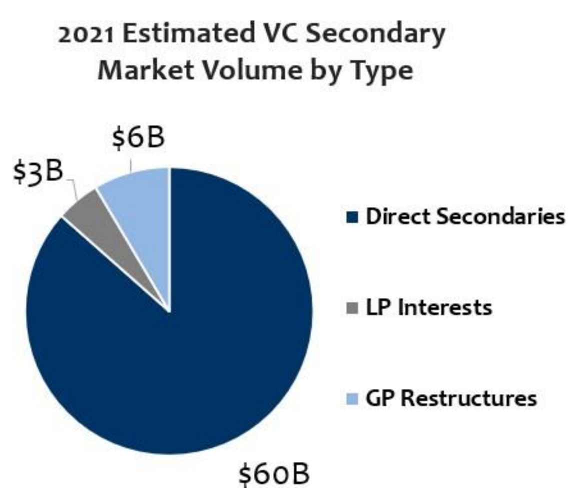
The private capital secondaries market is growing, with 2021 projected to be a record year. Market volumes are expected to surpass the $88 billion closed in 2019. While the global pandemic has certainly exacerbated liquidity concerns for some investors, these sellers exist in all market conditions, as liquidity issues are not necessarily correlated to macro conditions, particularly among high-net worth individuals and smaller family offices.



Source: Greenhill Cogent and Park Hill. Data as of 12/4/2020.

Secondary VC Transaction Volumes

In considering the VC portion of the secondaries PE market, we project that total Market Volume could be as large as ~$70bn in 2021 (direct secondaries: $61 billion, LP interests: $3 billion and GP Restructures: $6 billion). This is much larger than traditional estimates (typically based only on LP Interests and broadly marketed GP Restructures) and growing due to venture direct secondaries transactions, which represent as much as a staggering 87% of the overall market size. In the context of the pre-covid secondary market volume for PE and VC of $88 billion in 2019, the venture secondaries opportunity set is much larger and more meaningful than most realize when directs are included.

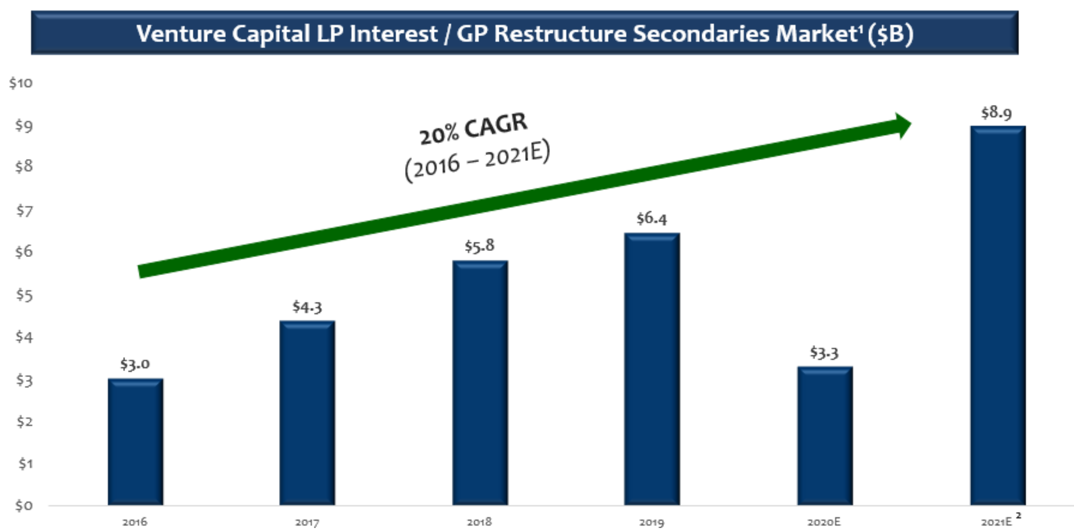


Source: Greenspring internal sources.

To put the market opportunity into even greater perspective for investors, the projected 2021 estimated total market cap of Series B or greater VC-backed companies is more than $1.1 trillion. Portion just 5% of that to secondary transactions, and the market opportunity for direct secondary deal flow equates to ~$60 billion. This is expected to increase year-over-year, with estimates for 2025 projecting a $1.8 trillion market cap.

Fund Interest Transactions

The venture secondary market continues to be a beneficiary of the growth in the primary venture market over the last five years, which has resulted in a solid inventory of funds for the secondary market. The market is expected to see continued and significant growth, dominated by the high projected volume of GP-Led restructuring transactions. The traditional secondary market for venture, including LP interests and broadly marketed GP restructures, in 2019 was around $6.4 billion, and 2021 is expected to be a record year with a forecasted volume of $9.1 billion.[1]



Source: Pitchbook – The 10% CAGR is estimated using a conservative discount to the actual 17% CAGR in Series B or greater Median Post-Money Valuations from 2010-2020.

The Rise of GP-led Secondaries

GP-led restructurings are newer in VC than in PE and are no longer just the domain of troubled funds These transactions serve as a viable liquidity tool which can be used to support both existing and new relationships and are likely to play an increasingly significant role in the venture secondary market going forward. GP Led restructurings are winning transactions for all stakeholders, providing managers with additional exit options, more time to accelerate portfolio growth and relieve selling pressure, benefitting LPs through

[1] 2016-2020E: Evercore venture capital secondary volume. 2021E derived from 2021 secondary volume estimate across PJT Park Hill while assuming Evercore's 2019 venture capital figure % of total private equity, which is 8%.

liquidity or the option to roll their interests, and giving new investors opportunities to invest in discounted assets with meaningful upside and shorter-term liquidity.

Considerations for Investing in the Growing Opportunity Set

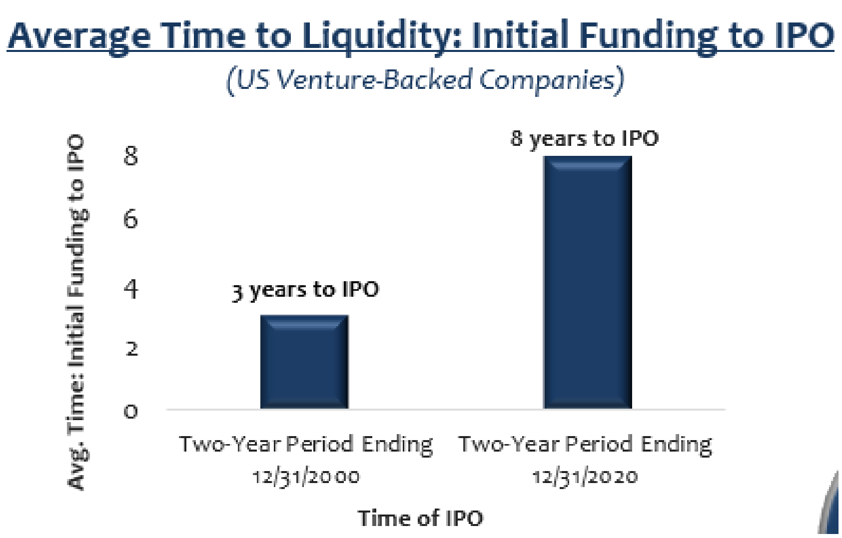
With such a large and growing universe of secondary opportunities, GPs with relationship and informational advantages will be best positioned to compete in this market. In general, secondaries can be difficult to price accurately, and it can be hard to get a good handle on what kind of discount you are getting, especially on a portfolio of funds or a portfolio of directs. Experienced investors in funds that have holdings in those companies over time therefore have important insight into their valuations, which can make a real difference in the ability to make nimble and informed decisions in a competitive market. In addition, being known to companies and funds over time can result in being a preferred partner. The combination of this relationship and informational advantage can be the key to having a significant advantage in the growing venture secondaries market.

Secondary Market Growth Drivers: Are They Here to Stay?

What is driving the mammoth increase of opportunity in this evolving secondary VC market? The answer is that there are a number of tailwinds and fundamental drivers within the venture secondary ecosystem that contribute to the increasing rise in opportunity.

1. Companies Are Staying Private Longer

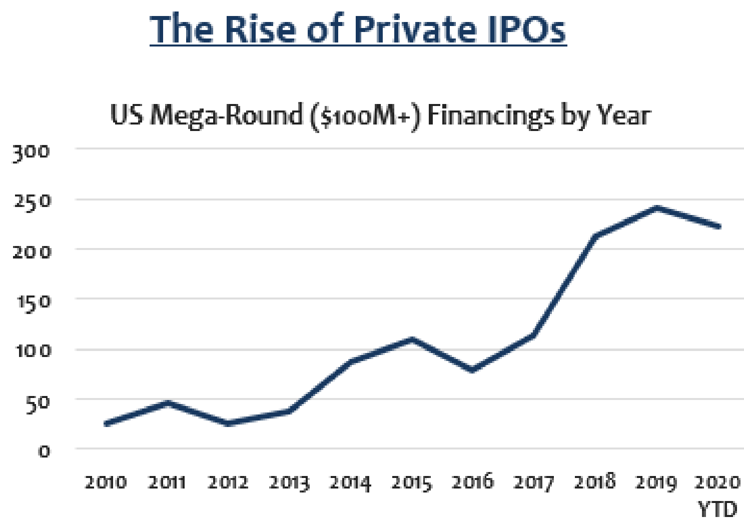
The average time to liquidity (from initial funding to IPO) has increased from three years in 2000 to eight years in 2020. Companies are staying private for longer and building to larger scale, size and value which is captured privately and remaining unrealized in portfolios longer. Growth and maturation in the venture asset class has also resulted in more private capital to support large, late-stage and secondary transactions rounds.



Source: Average Time from Initial Equity Funding to IPO: ThomsonOne.

2. The Rise of “Private IPOs”

The last decade has seen a large increase in private IPOs, with the number of pre-IPO large-scale financing rounds ($100+ million) increasing nine times from ~25 in 2010 to around 225 in 2020. Simultaneously, a tremendous amount of capital is now available for later and growth stage companies. This further perpetuates time to liquidity extensions in the market.



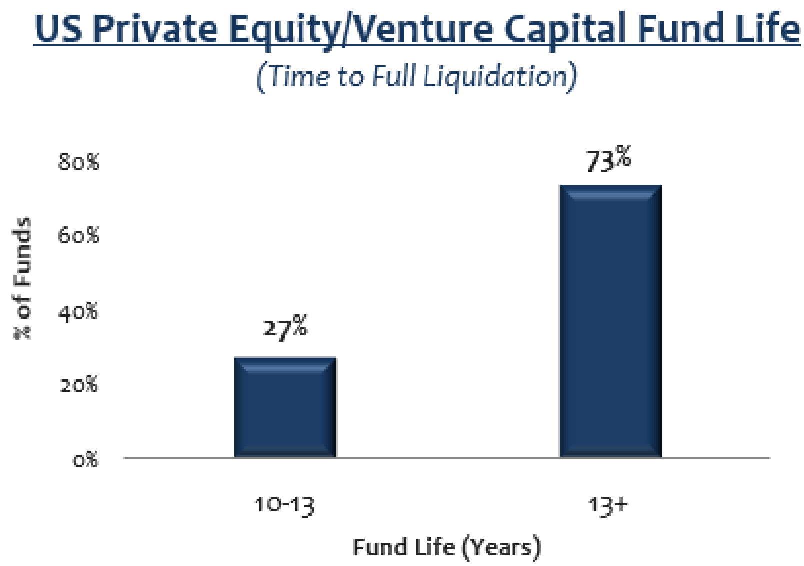
Source: The Rise of Private IPOs: Q3 2020 Pitchbook NVCA Venture Monitor.

3. Higher Valuations

With companies staying private and locking up more value for longer, private companies are capturing a disproportionate share of market value. Currently, the average of the top 25 private US VC-backed companies is in excess of $15 billion. The increased time to liquidity and higher valuations ultimately culminate in early stakeholders, founders, and employees seeking liquidity options well before the ultimate exit event. In instances such as these, secondary purchasers can be valuable service providers to key stakeholders seeking liquidity while continuing to build and grow their companies pre-exit.

4. Extended Fund Life

GPs can choose to extend their Funds’ life as result of the increased unrealized value in their portfolios. The data suggests that this is only becoming more prevalent, with the proportion of funds whose life is 13 years (73%) far outweighing those with a life of 10-13 years, extending well beyond the typical 8-10 year mark for original fund term plus extensions. Venture LPs are therefore increasingly interested in generating cash-on-cash returns with an increasingly illiquid asset, an outcome made possible through secondary sale transactions. These transactions also serve to provide investors with flexibility and means for exit outside of the traditional IPO or M&A route, whereby they may take liquidity and even reinvest a portion of their proceeds back into the venture market.



Source: US Private Equity/Venture Capital Fund Life: InstitutionalInvestor.com, "The New Reality of the 14-Year Venture Capital Fund."

With these dynamics at play, the universe of secondary transactions, whether direct secondaries, LP interest or GP restructuring, will continue to grow. Moreover, transactions of each type are winning propositions for General Partners, Limited Partners and the venture asset class as a whole, only serving to reinforce the growth in the secondaries market and making it an increasingly important avenue for accessing the innovation economy.

Redefining the Private Capital Secondary Market – VC vs. Buyout

Historically, the secondary market within private markets has lent itself to the buyout universe and has traditionally been perceived as a market for investors to sell their holdings under distressed circumstances at a significant discount. However, over the past decade we have seen a significant emergence of the VC secondary market. The changes have presented a vastly different opportunity set for both sellers and buyers looking to secondary sales as a portfolio management tool to either obtain liquidity where sufficient returns have been realized or to seek "hard to access" investment opportunities in high growth VC-backed companies. There are several distinct dynamics that differentiate the buyout market from the VC secondary market driven by several key factors, including:

- **Due Diligence & Sourcing:** Venture is a difficult asset class to diligence due to the lack of information at the company level, therefore the need to have deep relationships to identify, price and source opportunities is critical. This inefficiency is the source of the higher returns' available in the VC market vs the buyout market.

- **Fewer Brokers Involved:** Venture secondaries are smaller in Net Asset Value (NAV) and overall transaction size relative to buyout counterparts. Since brokers get paid on commission, they tend to gravitate towards the higher dollar transactions, leaving fewer intermediaries that focus on the venture asset class.

- **GP Transfer Restrictions:** GPs, especially top quartile performing GPs, are highly restrictive regarding who you can transfer or sell an interest to. When this happens, the buyer universe becomes quite limited, often consisting only of existing LPs.

- **Limited Buyer Universe:** The buyer set in venture is severely limited relative to the buyout secondary market and other alternative asset classes. This has subsequently allowed for less competition within the VC market.

- **Macro Environment:** The added uncertainty and volatility that COVID-19 has brought to the market has resulted in a clear distinction between the thriving companies within traditional venture-backed sectors such as software, tech-enabled businesses services companies and healthcare, while the traditional PE buyout companies have experienced their own challenges resulting in discounts and subsequent arbitrage value-add. As a result, the VC secondary market has typically thrived during times of uncertainty.

The VC secondary market continues to demonstrate a win/win dynamic for all key stakeholders involved in a direct or fund secondary sale.

- **LP and Shareholder Benefits (Sellers):** The VC secondary market has emerged as a viable exit and liquidity path for funds and shareholders including founders, early employees, or seed investors. While sellers still have the opportunity to lock in gains from high performing investments, they do not need to wait for an IPO or sale to achieve full liquidity and instead can consider liquidity options for partial or full liquidity through a secondary transaction.

- **GP Benefits (Sellers):** GPs have an array of options to achieve liquidity, generate cash on realized gains, while receiving monetized carry and resetting economics on a new fund vehicle. GPs are incentivized to pursue these deals as 1) they can incur carry on previously unrealized value in their portfolios and 2) are able to continue to steward their portfolios going forward with additional economics. Additionally, and as a result the relationship driven industry, the higher caliber GPs are afforded the opportunity to hand-select which LPs they want to purchase direct or fund interests.

- **Investors (Buyers):** The infamous J-Curve is a great illustration of where investors with a secondary portfolio can leverage an opportunity to invest in a unique risk-reward portfolio with often discounted assets that possess meaningful upside and shorter-term liquidity horizons. However, the scarcity of information and the need to have deep relationships to access deals and perform the right level of due diligence will remain critical to succeeding in the secondary VC market. GP access is always important, but particularly so during periods when buyers can benefit from specific company level insights—or be burned by idiosyncratic risk. Furthermore, the ability for a buyer to leverage GP relationships will be critical particularly at a time when the viability of underlying company assets may be uncertain due to the pandemic.

Aside from alpha seeking investors, a secondary portfolio is ideal for investors who are looking to construct a newly established VC program but are more attune to a risk adverse portfolio. Secondaries can be more palatable in general for investors because they avoid the J Curve, have quicker drawdowns with shorter holding periods while still producing “venture” returns. This makes it easier for more risk averse investors, who may not have much VC expertise, to get comfortable with a venture allocation within their portfolio.