Venture Capital

June 2016
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Section 1

Executive Summary
What is Venture Capital?

Overview

Definition

• Venture capital is money provided by an outside investor to finance a company that is new and growing
• Typically seeks new, disruptive businesses with a perceived long-term growth potential that will result in a large payout for investors
• Venture capital generally follow a series of financing rounds which include:
  – Seeding round: start up capital is provided by an angel investor to finance a business idea
  – Angel round: the investor purchases an equity stake
  – Series rounds: financing provided by VCs in exchange for an equity stake
• Venture capital realises returns from investments via an exit method:
  – Initial Public Offerings (IPOs)
  – Trade Sales
  – Management Buyouts (MBOs)
  – Liquidation

Involved Parties

• Limited Partners:
  – Investors who contribute money to a VC fund in exchange for ownership shares in the fund
  – Liability is limited to the amount of capital they contribute
  – Includes high net-worth individuals and pension funds
• General Partners:
  – Managers of the VC fund
  – Liability is unlimited
• Entrepreneurs:
  – Individuals who have business ideas or who are currently developing a business
  – They seek VC financing in exchange for an equity stake in their business
• Underwriters:
  – Become involved in an IPO exit of venture capital investments
  – Usually an investment bank

Sources: Australian Private Equity and Venture Capital Association Limited, Australian Government
What is Venture Capital?

Investors

- Super and Pension Funds
- High Net Worth Individuals
- Sovereign Wealth Funds

Government

- Australian Government

Venture Capital Firms/Funds

- Starfish Ventures
- Blackbird
- BlueSky
- AirTree

Start-Ups

- Edrolo
- Pocketbook
- Canva
- nitro
- catch22
- bugcrowd
- Campaign Monitor

Investors

- Invest to diversify portfolio with expectations of high growth
- Provides return on investment

Government

- Co-Investment Funds
- Provides grants, assistance, incubator and accelerator programs

Venture Capital Firms/Funds

- Provides capital for business operations and value add via expertise
- Equity stake at initial investment and return at exit

Source: Australian Government, Australian Private Equity and Venture Capital Association Limited
Venture Capital Landscape

Financing in Australia

Overview of 2015

- VC funds raised from $126m to $368m in 2015; a compounded annual growth of 193%.
- This was driven by the allowance of superannuation investment in Australia.
- The seven VC funds raising new capital included Brandon Capital Partners, Medical Research Commercialisation Fund 3 (MRCF3), AirTree Ventures’ and the OneVentures Innovation and Growth Fund.
- Majority of funds raised to focus on seed and early-stage ventures

Australian VC Funds Raised by Fiscal Year

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>$mm</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY06</td>
<td>143</td>
</tr>
<tr>
<td>FY07</td>
<td>357</td>
</tr>
<tr>
<td>FY08</td>
<td>352</td>
</tr>
<tr>
<td>FY09</td>
<td>175</td>
</tr>
<tr>
<td>FY10</td>
<td>158</td>
</tr>
<tr>
<td>FY11</td>
<td>100</td>
</tr>
<tr>
<td>FY12</td>
<td>240</td>
</tr>
<tr>
<td>FY13</td>
<td>152</td>
</tr>
<tr>
<td>FY14</td>
<td>126</td>
</tr>
<tr>
<td>FY15</td>
<td>368</td>
</tr>
</tbody>
</table>

Number of Funds Raising by Fiscal Year

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY06</td>
<td>4</td>
</tr>
<tr>
<td>FY07</td>
<td>4</td>
</tr>
<tr>
<td>FY08</td>
<td>6</td>
</tr>
<tr>
<td>FY09</td>
<td>9</td>
</tr>
<tr>
<td>FY10</td>
<td>13</td>
</tr>
<tr>
<td>FY11</td>
<td>3</td>
</tr>
<tr>
<td>FY12</td>
<td>4</td>
</tr>
<tr>
<td>FY13</td>
<td>3</td>
</tr>
<tr>
<td>FY14</td>
<td>5</td>
</tr>
<tr>
<td>FY15</td>
<td>7</td>
</tr>
</tbody>
</table>

Investment Focus of Funds Raising (FY15)

- Seed/Early Stage VC: 23%
- Balanced/Later Stage VC: 77%
Venture Capital Landscape

Investments in Australia

Overview

- VC investments in Australia have fluctuated heavily over the years, peaking at $535mm in FY14.
- Unlike the US, investee companies in Australia are more focused on consumer and industrial sectors rather than technology and media.
- Investee companies tend to be mostly in the start-up and late stage phase, unlike the US which tends to be more focused on seed and early-stage venture investments.

Distribution of Investments by Sector (FY15)

- Industrial: 34%
- Tech, Media, Telecom: 9%
- Consumer: 10%
- Financial Services: 8%
- Biotech/Sciences: 5%
- Other: 34%

Distribution of Investments by Stage (FY15)

- Seed: 3%
- Start-up: 21%
- Other early stage: 9%
- Late stage VC: 9%
- Other VC: 58%

Source: Australian Private Equity and Venture Capital Association Limited
Section 2

Government Initiatives
Australian Federal Government Initiatives

Timeline

1984:
Management and Investment Companies Program, first government initiative launched to foster an Australian VC Industry

1992:
Pooled Development Funds Act 1992 was passed

1997:
$130m Innovation Investment Fund established

1999:
$30mm Commercialising Emerging Technologies Program established

2001:
$2.9b innovation action plan to fund education and R&D

2002:
Venture Capital Act introduced to launch Venture Capital Limited Partnerships Program

2011:
Board of Taxation initiates review of Venture Capital Act

2015:
New PM announces $1.1b National Innovation and Science Agenda

2016:
Tax Laws Amendment (Tax Incentives Bill) passed

Australian Government Initiatives

Overview of Key Programs

Management and Investment Companies

- Venture Capital firms were designated as Management and Investment Companies under *Management and Investment Companies Act 1983*
- Superannuation and pension funds which invested in MICs could claim a 100% tax deduction
- Requirements:
  - MICs hold shares in new businesses and start-ups for at least 4 years
  - Funds invest no more than 20% of their capital into any one company

Innovation Investment Fund

- Started in 1997 under the Howard government
- Terminated in May 2014 as part of new, emergency budgetary measures
- Details:
  - Australian government would match private sector funding at a ratio of 1:1 for start-up businesses
  - Public funding would not exceed more than *$100mm*
  - Qualitative factors to be considered include the VC's experience and investment strategy

Venture Capital Limited Partnership Program

- Requirements to become a VCLP
  - Incorporated limited partnership
  - Pay tax in Australia
  - Have at least $10mm committed capital
- Benefits of becoming a VCLP
  - Flow-through taxation
  - Foreign partners exempt from capital gains tax
- VCLPs must invest in a predominately Australia business with less than *$250mm* in assets for more than one year

Early Stage VC Limited Partnership Program

- Requirements to become a ESVCLP
  - Incorporated limited partnership
  - Pay tax in Australia
  - Have between $10mm-100mm committed capital
- Benefits of becoming a VCLP
  - Flow-through taxation
  - All partners exempt from capital gains tax
- VCLPs must invest in a predominately Australia business with less than *$50mm* in assets for more than one year

Australian Government Initiatives

Impact of Key Programs

Past Government Schemes

- **Management and Investment Companies 1984:**
  - Was largely unsuccessful at fostering innovation
  - Failure attributed to more incentive to invest in later-stage businesses rather than early-stage ventures resulting in lack of supply of funds

- **Innovation Investment Fund 1997:**
  - IIFs increased supply of funds for risky early stage high-tech start-ups
  - However, relative to private equity, the supply of venture capital in Australia is still negligible

Government Funded Success Companies

- **ResMed**
  - Healthcare company which manufactures devices to treat breathing and sleep-related disorders
  - Listed on the ASX in 1999

- **Gekko Systems**
  - Company which develops mining technology products and equipment
  - Has operations in 44 countries worldwide

- **Atlassian**
  - Enterprise software development company
  - Listed on the NASDAQ in 2015 with a record valuation of $US4.4bn

Venture Capital and Private Equity in Australia

Sources: Australian Private Equity and Venture Capital Association Limited, Australian Government, University of Wollongong, Company Websites
Section 3

Venture Capital Firms and Investment Case Studies
Australian Venture Capital Firm: AirTree Ventures

Overview

History

- AirTree Ventures was founded by former Microsoft executive Daniel Petre, and former Expedia MD Craig Blair in June 2014.
- The firm raised $56.4 million from 17 investors in 2014, including clients from Westpac, UBS, Macquarie Bank as well as several high net worth individuals.
- AirTree focuses on seed and early-stage venture investments with Australian entrepreneurs.

Current Investments

- Current notable investments:
  - 90 Seconds, a cloud video production platform, allowing brands to plan and shoot videos anywhere in the world.
  - Prospa, an online small business lender, that approves small unsecured loans within 24 hours.
  - Canva, an online graphic design platform catering for both designers and non-designers alike.
  - Brosa, an online design furniture store that connects master craftsmen to Australian homes

Expertise

- AirTree seeks opportunities with start-ups that aim to disrupt financial services and real-estate marketplaces, favouring companies that are generating revenue but not necessarily cash flow positive.
- The firm has successful investments in
  - Online marketplaces
  - Software-as-a-Service (SaaS) businesses
  - Next generation finance
  - Media and marketing platforms

Sources: AirTree Ventures, Crunchbase
Australian Case Study: eBay

AirTree Venture’s Investment

<table>
<thead>
<tr>
<th>Company Overview</th>
<th>Investment Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
<td><strong>Fund Name</strong></td>
</tr>
<tr>
<td>Ebay is a global e-commerce website which provides an online auction system and marketplace that connects buyers and sellers of new and used goods.</td>
<td>Ecorp</td>
</tr>
<tr>
<td><strong>Business Model</strong></td>
<td><strong>Year of Investment</strong></td>
</tr>
<tr>
<td>Ebay’s revenue is generated via a system of fees for listing products, services and a fee for successful sales.</td>
<td>1997</td>
</tr>
<tr>
<td><strong>Founder</strong></td>
<td><strong>Series Round</strong></td>
</tr>
<tr>
<td>Pierre Omidyar</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Year Founded</strong></td>
<td><strong>Amount Invested</strong></td>
</tr>
<tr>
<td>1995</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Date of Listing</strong></td>
<td><strong>Equity Stake</strong></td>
</tr>
<tr>
<td>September 21, 1998</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>IPO Price</strong></td>
<td><strong>Year of Exit</strong></td>
</tr>
<tr>
<td>$1.87</td>
<td>2002</td>
</tr>
<tr>
<td><strong>Current Price</strong></td>
<td><strong>Exit Method</strong></td>
</tr>
<tr>
<td>$24.12 (26 May 2016)</td>
<td>Trade Sale to eBay Global</td>
</tr>
<tr>
<td><strong>Ticker</strong></td>
<td><strong>Exit Price</strong></td>
</tr>
<tr>
<td>NASDAQ: EBAY</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Annual Revenues (USD)</strong></td>
<td><strong>Return</strong></td>
</tr>
<tr>
<td>$8.59bn (2015)</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Transaction Volume</strong></td>
<td></td>
</tr>
<tr>
<td>2 billion (per day)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Crunchbase, eBay annual reports, AirTree Ventures, NASDAQ
International Venture Capital Firm: Accel Partners

Overview

History

• Accel Partners was founded in 1983 by former executives of Adler & Company, Jim Swartz and Arthur Patterson.
• Since its inception, Accel has raised 19 funds amounting to a total of $19.56 billion from private investors.
• Accel’s investment scope covers seed, early-stage ventures, and private equity with a particular focus on innovative technologies across the U.S., Europe and Asia.

Timeline of Key Funds Raised

<table>
<thead>
<tr>
<th>Date</th>
<th>Fund Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2000</td>
<td>Accel Fund VIII</td>
<td>$1.6bn</td>
</tr>
<tr>
<td>December 2008</td>
<td>Accel Growth Fund: $480mm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accel London III: $525mm</td>
<td></td>
</tr>
<tr>
<td>June 2012</td>
<td>Accel Europe Fund: $500mm</td>
<td></td>
</tr>
<tr>
<td>March 2015</td>
<td>Accel India IV: $305mm</td>
<td></td>
</tr>
<tr>
<td>March 2016</td>
<td>Early Stage Fund XIII: $500mm</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accel Growth Fund IV: $1.5bn</td>
<td></td>
</tr>
<tr>
<td>April 2016</td>
<td>Accel London V: $305mm</td>
<td></td>
</tr>
</tbody>
</table>

Notable Past and Current Investments

Source: Accel Partners, Crunchbase
# International Case Study: Facebook

## Accel Partner’s Investment

### Company Overview

<table>
<thead>
<tr>
<th>Description</th>
<th>Facebook is a social networking platform which connects users to family, friends, acquaintances and new connections.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Model</td>
<td>Facebook’s revenue is generated via sponsored advertisements and virtual gaming fees.</td>
</tr>
<tr>
<td>Founder</td>
<td>Mark Zuckerberg</td>
</tr>
<tr>
<td>Year Founded</td>
<td>2004</td>
</tr>
<tr>
<td>Date of Listing</td>
<td>September 18, 2012</td>
</tr>
<tr>
<td>IPO Price</td>
<td>$38</td>
</tr>
<tr>
<td>Current Price</td>
<td>$119.47 (26 May 2016)</td>
</tr>
<tr>
<td>Ticker</td>
<td>NASDAQ: FB</td>
</tr>
<tr>
<td>Annual Revenues (USD)</td>
<td>$17.928bn (2015)</td>
</tr>
<tr>
<td>Current Active Users</td>
<td>1.65 billion</td>
</tr>
</tbody>
</table>

### Investment Details

<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Accel IX Strategic Partners, LP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year of Investment</td>
<td>2005</td>
</tr>
<tr>
<td>Series Round</td>
<td>Round A</td>
</tr>
<tr>
<td>Amount Invested</td>
<td>$12.7mm</td>
</tr>
<tr>
<td>Initial Equity Stake</td>
<td>15%</td>
</tr>
<tr>
<td>Year of Exit</td>
<td>No Exit Yet</td>
</tr>
<tr>
<td>Future Exit Method</td>
<td>Public Offering of Shares</td>
</tr>
<tr>
<td>Current Stake</td>
<td>10%</td>
</tr>
<tr>
<td>Estimated Current Value</td>
<td>$344bn</td>
</tr>
</tbody>
</table>

Source: Crunchbase, Facebook annual reports, Accel Partners, NASDAQ
Section 4

Conclusion
Conclusion

Summary

**Australian Venture Capital Industry**

- The Australian venture capital industry remains small relative to the private equity industry, despite increasing attempts to stimulate activity in this sector
- Australian VC culture tends to be more risk-averse than other countries, resulting in less investments in seed and early-stage ventures
- Aggregate fundraising in the industry has started to increase, driven by more superannuation allocation to VC funds
- At an investment level, Australian companies seeking VC funding tend to be more consumer and industrial oriented due to the small Australian technology sector

**Role of Government**

- The Australian Government has historically played and will continue to play a significant role in the venture capital industry
- Their involvement has had the aim of encouraging innovation, developing new businesses and ultimately benefiting the economy via increased specialisation, workforce skills and employment
- Numerous initiatives undertaken include:
  - Management and Investment Companies
  - Innovation Investment Fund
  - Venture Capital Limited Partnership Program
  - Early Stage VC Limited Partnership Program

Source: Australian Private Equity and Venture Capital Association Limited, Australian Government, The Payroll Blog
# Future of Venture Capital in Australia

## Overview

### Consensus View

- General consensus amongst industry commentators is that the Australian venture capital market is unlikely to be as successful as its American counterpart

<table>
<thead>
<tr>
<th>Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>- The technology sector (mainly comprised of health and biotechnology, communications and information technology) contributes to a significantly smaller proportion of total venture capital in Australia than in the U.S.</td>
</tr>
<tr>
<td>- Lack of start-up skills and funding for start-ups available due to a comparatively more risk averse investment culture</td>
</tr>
<tr>
<td>- Clusters (such as Silicon Valley) are unlikely to be formed given Australia’s significantly smaller geographical dispersion of economic activity</td>
</tr>
</tbody>
</table>

*A Silicon Valley-style hub will be very difficult to develop in Australia.*

## Potential for Growth

- Nevertheless, increasing attention is being paid to Australian start-ups in a changing economy:
  - Incubator programs have been implemented to develop start-up skills (e.g. ATP Innovations, a leading technology business incubator, has partnered with several universities to help educate students in innovation)
  - The government has provided incentives for entrepreneurs through tax, grants and education programs in an aim to stimulate economic activity, especially in niche markets and sectors

*Incubators and government initiatives remain the main source of growth for the Australian venture capital industry.*

Sources: Australian Financial Review, Australian Government