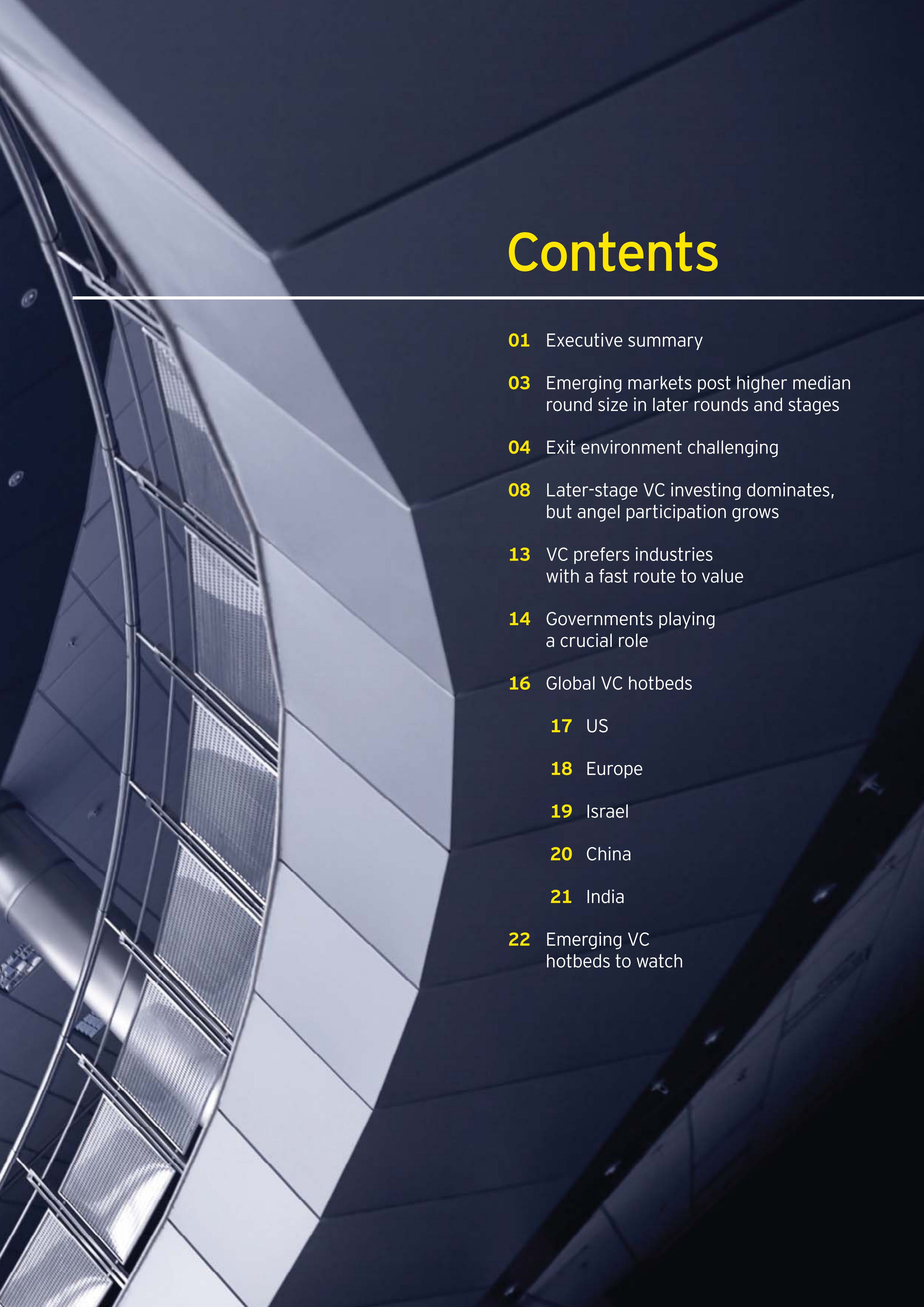
Adapting and evolving

Global venture capital insights and trends 2014

Building a better working world



Contents

Welcome

2013 was a turning point for venture capital (VC) investment. As economic conditions improved in many markets, increasing levels of liquidity, coupled with strengthening investor confidence and a more positive exit environment, resulted in a slight increase in the global total of VC investment compared to 2012. However, this report reveals a fascinating range of variation in VC activity in different geographic hotbeds in 2013 that highlights some enduring truths about the VC industry: namely, its ability to constantly adapt and react to changes in market conditions and consistently support the growth of the world's most dynamic start-up companies and to deliver returns for investors.

A number of trends emerged or gained momentum in 2013. Angel investors are becoming more significant and better organized, expanding their presence at the start-up stage as VCs become more risk averse and shift their attention to later-stage investments. Technology has enabled new mechanisms such as crowdsourcing, which is changing the funding environment at the early seed stages. Corporates looking to fund innovation gaps or to reinvest surplus cash are pioneering new ways to collaborate with fast-growth businesses and with VCs. And governments in many countries are becoming more "switched on" in terms of taking positive steps to create entrepreneurial ecosystems in which venture finance can thrive.

These changes have challenged VC players to change and raise their game. They have become more global in their geographic outlook, more sophisticated in their analysis of opportunities and more innovative in terms of how, where and when to invest. The result has been a trend toward consolidation among those unable to read or respond to the changing environment. It has also seen new funds established in new markets and a greater appetite for investment in rapid-growth markets including Russia, Brazil and Mexico.

In this, our 11th annual report on VC, we examine key developments in the industry and analyze the VC hotbeds of the US, Europe, China, Israel and India, as well as some of the markets emerging onto the VC scene.

As markets continue to improve in 2014, we hope you find this report to be a valuable source of insight as you adapt to the changing VC environment.

Bryan Pearce
Global VC Leader, EY

Executive summary

A solid year that ended well

2013 was a solid year for the global VC industry. Reversing the decline seen in 2012, investment levels rose 2% to US$48.5b This somewhat flat performance masks an exceptional fourth quarter in which investment soared by 10% and the number of rounds by 10%, reflecting improving economic fundamentals toward the end of the year and paving the way for a stronger 2014.

European and Israeli rebound fails to counterbalance flat US and Chinese decline

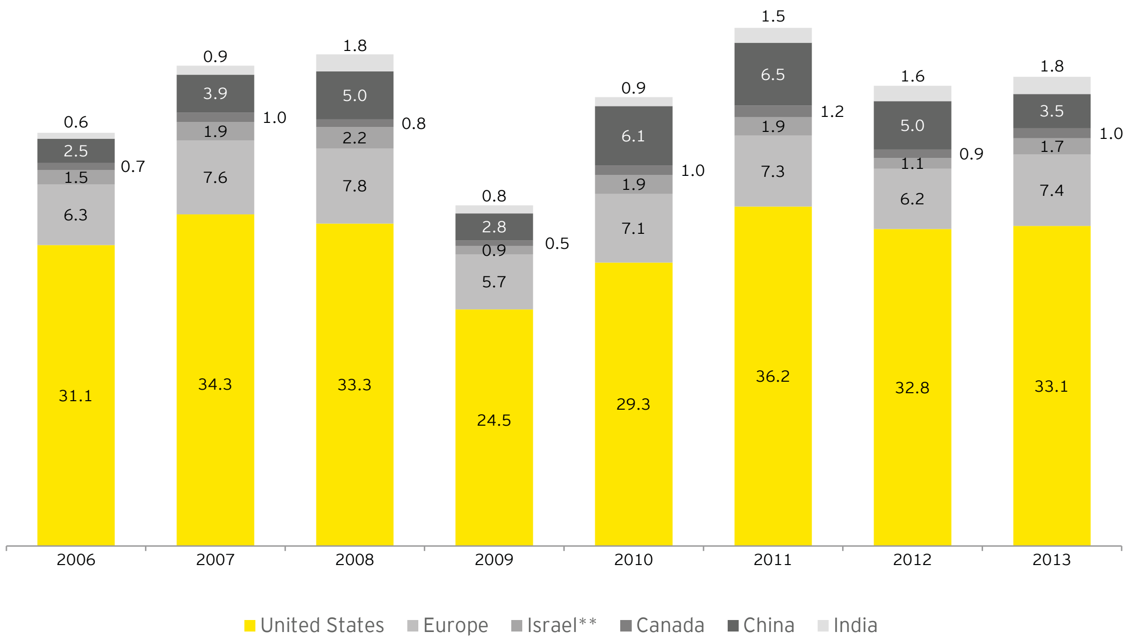
Stronger signs of growth in the US economy, which account for 68% of global VC activity, came too late in the year to make a significant impact on the overall figures.

The remarkable rebound in Europe, which saw a 19% rise in capital invested and 6% rise in the number of deals, although highly encouraging, was not enough to drive significant movement in the global total. Europe accounts for only 15% of global VC activity.

China, the third largest hotbed in the global VC rankings, had a poor year in which the value of deals fell by US$1.5b, marking the lowest point for the country since 2009. In previous years, China has been a close second to Europe in terms of its global significance for VC activity, but the closure of the domestic stock exchanges during 2013 had a significant impact on the sector, as China declined from 11% of global VC dollars invested in 2012 to 7% in 2013.

Global annual VC investment 2006-13

	2006	2007	2008	2009	2010	2011	2012	2013
Totals: (Rounds)	4,991	5,805	5,435	4,748	5,349	5,820	5,741	5,753
Totals: (US$b)	42.7	49.7	50.8	35.2	46.4	54.7	47.6	48.5



Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

India, fourth in the global VC rankings, saw an increase in dollars invested of 13%, reflecting strong interest in its consumer services sector, although the number of rounds fell back slightly. Israel performed strongly with a US$0.6b rise in the value of investments — 55% up in terms of value and 18% up in terms of the number of rounds. However, with these economies accounting for just over 7% of the global industry, such improvements, while highly significant in local terms, do little to move the global needle. Canada, which accounts for 2% of global VC activity, also had an extremely strong year, with volumes up 23% and value up 14%.

VC investment by region 2013

Region	Invested capital (US$b)	Invested rounds	% change (amount invested)	% change (deals)	% of the global VC activity
United States	33.1	3,480	0.9%	-4.6%	68.2%
Europe	7.4	1,395	19.4%	5.7%	15.3%
Canada	1.0	176	14.4%	23.0%	2.1%
China	3.5	314	-30.0%	20.3%	7.2%
India	1.8	222	12.5%	-2.2%	3.7%
Israel**	1.7	166	54.5%	17.7%	3.5%
Total	48.5	5,753	1.9%	0.2%	100%

Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

Emerging markets post higher median round size in later rounds and stages

Across all markets, median deal values in the seed and first round classes fell or saw little change compared to 2012 — confirming the global pattern that most VCs prefer to make bigger investments at the second or later investment stage, when companies are perceived to be partially de-risked.

Only the developed markets of the US and Europe made notable investments in businesses at the start-up stage of development in 2013. Europe and Israel were the only regions to record a slight increase in median deal size at the product development stage.

Later rounds and development stages dominated by emerging markets

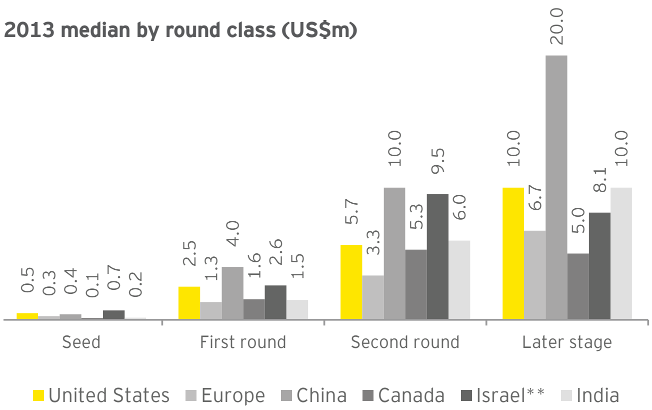
As expected, second and later-stage investment rounds continued to see relatively high median deal sizes across all geographies in 2013. However, this trend was particularly marked in the rapid-growth markets, with China recording the highest median round size in both second and later rounds.

2013 median deal size by round class

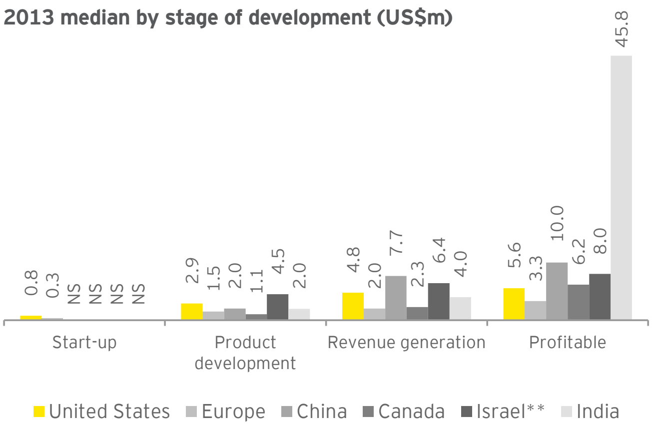
In terms of median deal size by stage of development, China and India were larger than other regions. India was notable at the profitable stage with a median round size of US$45.8m — 4.6 times larger than China, which was in second place, and 8.2 times that of the US.

Companies in China are typically more developed, further along in their life cycle and poised to exit within 18 to 24 months, which increases their valuation and is why their median rounds are higher than in other regions. India had three deals that were worth more than US$200m, which is why they saw a jump in their median deal size.

2013 median by round class (US$m)



2013 median by stage of development (US$m)

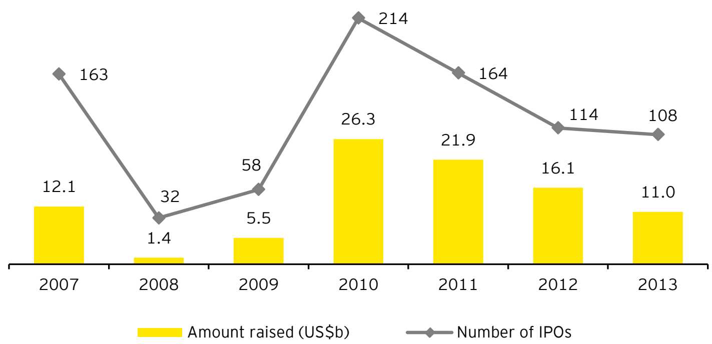


Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

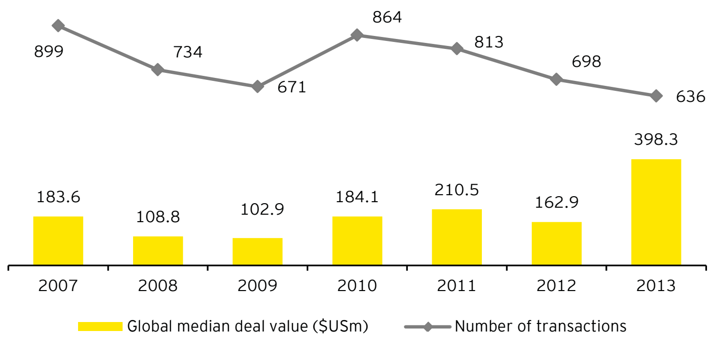
Exit environment challenging

The exit environment in 2013 was marked by some interesting variations by geographic hotbed. Globally, both the number of, and amount raised from VC-backed initial public offering (IPO) exits decreased in 2013, with 14.6% of VC portfolio companies exiting via IPO, up from 8.9% in 2012. The number of VC-backed mergers and acquisitions (M&A) exits also fell on a global basis. However, median valuations for M&A rose across all markets, indicating a broadly positive environment going forward. With IPO momentum building through the last quarter of 2013 and into 2014, and many older companies sitting in VC portfolios ready to go public when the time is right, we believe it is likely that 2014 will see a rising VC appetite positioned to take advantage of the improving exit environment globally.

Global VC-backed IPOs 2007-2013



Global VC-backed M&A 2007-2013



Source: Dow Jones VentureSource, 2014

US leads the way in VC-backed IPOs

The US continued to be the most active market for venture-backed IPOs in 2013. The number of deals (74) rose nearly 50%, with biopharmaceuticals the leading sector for new listings in terms of both volume and value. However, despite the increase in the number of US venture-backed IPOs, the amount raised fell back by 27% to US$8.2b, a significant proportion of which was accounted for by Facebook.

At US$100.9m, the median amount raised prior to IPO by US businesses in 2013 was the highest since our records began in 2007, indicating strong confidence in the potential of these companies to achieve high valuations at IPO in 2014. Indeed, US companies that did choose to go public have been rewarded by strong returns. The average first day "pop" of businesses that listed in 2013 was 29.7% while by mid-February 2014, average returns for IPOs had risen to 69.9%.

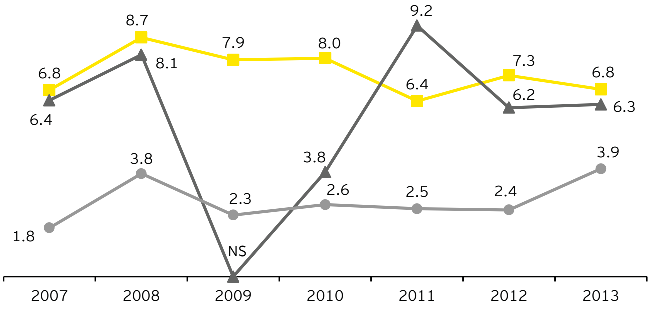
China saw a 523% rise in the median amount raised prior to IPO and a 77% rise in median pre-IPO valuation to US$398.6m, surpassing US levels for the first time since 2010. These increases are indicative of high levels of confidence in the Chinese companies that are mature enough to sustain foreign listing requirements.

In Europe, the number of venture-backed IPOs held steady compared to the prior year, and the amount raised increased slightly to US$0.6m. The median amount raised prior to IPO increased slightly to US$26.4b, but there was a three-fold increase in median pre-IPO valuations to US$85.6b.

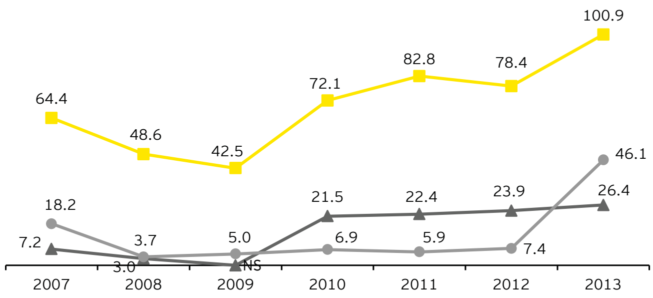
The Israeli IPO market performed strongly, with the volume of VC-backed listings restored to 2011 levels and, at US$0.2b, the highest amount raised for Israeli VC-backed companies at IPO since our records began in 2003. India saw a tailing off in the number and value of IPO VC exits, and Canada saw only one VC exit by IPO — which is comparable with activity in 2012 and 2011.

Median time to IPO exit was slightly accelerated in the US in 2013 to 6.8 years, broadly flat in Europe at 6.3 years and in China markedly up to 3.9 years, reflecting the 2013 market closure.

Median time from initial VC financing to IPO exit (in years)



Median amount raised prior to IPO (US$m)



Source: Dow Jones VentureSource, 2014

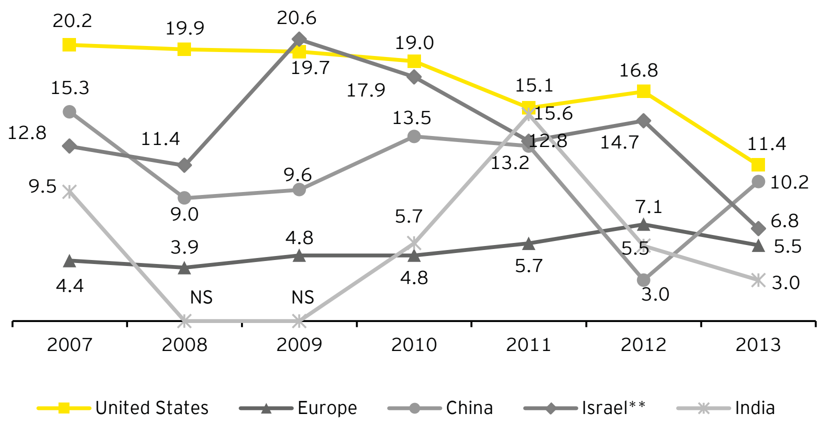
United States Europe China

M&A pre-money valuations on the rise

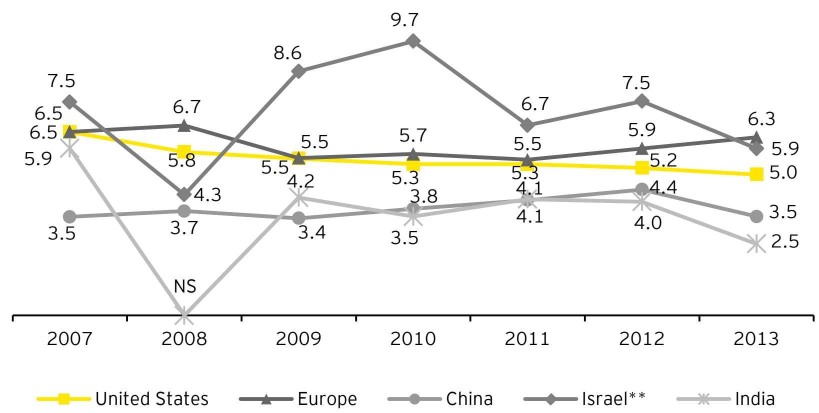
Globally, the value story in 2013 was much improved, with an uplift in median pre-money valuations in all hotbeds except the US, which saw a slight decline. In 2013, median valuations were the highest since 2007 in Europe, China, Israel and India, with developing markets outperforming mature markets by a considerable margin. This suggests that the VC investing outlook is broadly positive, particularly in emerging markets due to in part corporate acquirers accelerating growth through M&A.

However, despite some improvement in the global economic outlook, uncertainty continued to impact M&A exits as reflected by declining numbers across all markets except Canada, where numbers were flat, and China. In China, with M&A the only exit option barring a foreign listing, the volume of M&A almost doubled to 20 transactions and pre-money valuations almost tripled to US$87.5m.

Median amount raised prior to M&A (US$m)



Median time from initial VC financing to M&A exit (in years)



Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

Fundraising by VCs

In 2013, there were 325 VC funds raised, across all investing stages, for a total of US$28b. In contrast, 2012 saw 344 funds raised, totalling US$33.5b. The US accounted for 64% of the funds closed, with 207 funds in 2013 compared to 185 in 2012, a gain of 12%. There was a drop of 10% to US$19.7b raised. Europe and the Asia-Pacific regions continued to see a decrease in fundraising activity. Europe saw a 21% drop from 2012 with 58 funds closed in 2013, but raised US$4.7b, only a 5% decrease from 2012.

A significant trend to note is that early-stage fundraising is above last year, with 222 funds raised versus 214 in 2012. Those funds raised US$12.8b, which was only down 4% for the same time frame. However, in the US, early-stage funds closed was at a multiyear high, with the highest total of funds closed since 2009; 153 funds closed in 2013, which up 30% for a value of US$9.4b, a gain of 51% over the dollars raised in 2012.

What is important to note, with fundraising still below peak levels, VC funds are electing to execute fewer deals each year, which shows in the proportion of funds that invest in four or more deals. This has declined across all markets, except in India and the Bay area, which has the highest concentration of VC funds and investee companies in the world.

Dry powder slightly up

With fewer funds having the ability to successfully raise capital and close new funds, it is interesting that there is a rise in the amount of "dry powder" or "overhang" exists in the global VC industry. Dry powder is the excess capital held by VC funds, not yet committed to either their existing portfolio companies or to other potential investments.

Data supplied by PREQIN shows that at the close of 2013, there was a total of US$114.3b worth of dry powder. The data comes from 1,400 firms that offer a VC strategy, for both exclusive and expansive use. The dry powder is up roughly 3% from 2012, and is on par with 2011, 2012 saw a drop of US$3.2b from 2011.

North-American focused funds have less than 2 years (22 months) of investable assets based on the investing pace of 2013 while Europe has 26 months and Asia-Pacific has 74 months or more than 5 years' worth of capital based on the 2013 investing pace.

Dry powder in 2013

Regions	Amount of dry powder (US$b)	% of dry powder	% of VC investment	Estimated months of dry powder remaining
North America (Canada, United States, Israel**)	65.9	57.7%	74%	22
Europe	15.8	13.8%	15%	26
Asia-Pacific/other	32.6	28.5%	11%	74
Total	114.3b	100%	100%	28

Source: PREQIN, 2014
**All-site Israeli companies

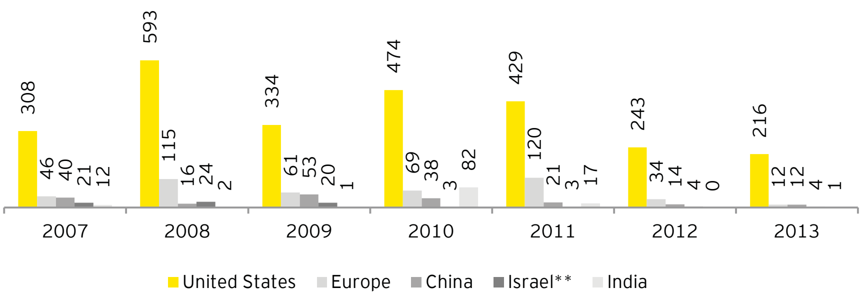
Later-stage VC investing dominates, but angel participation grows

Successful VCs will make "course corrections" in the investment strategy of their funds. They have many options, which can include stage of development, industry sector or geographic focus. Many factors influence their decisions depending upon which stage the fund is in its life cycle. Those funds nearing the end are more likely to invest in later stage deals that are closer to exit; to quickly gain a higher perceived return potential. The experience of the GPs etc., and amounts of investment required and time to a liquidity event, are other important factors that can change a fund's investment strategy. Entrepreneurs seeking to raise capital should bear all of these factors in mind when considering which VC funds to approach.

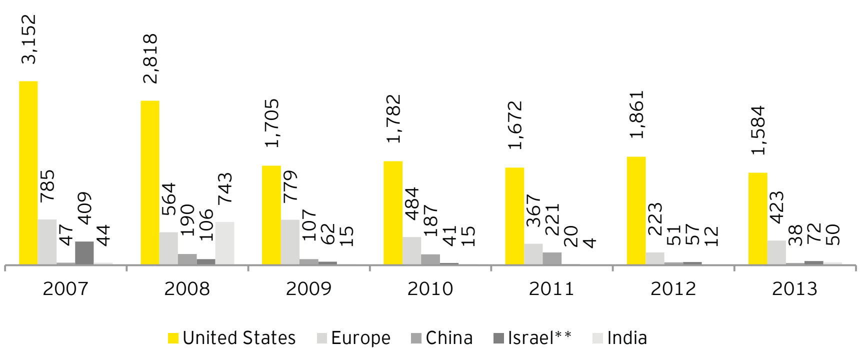
VC portfolio companies can be categorized by "stage of development" — typically referred to as start-up, product development, revenue generation and profitable — or by round — typically seed, first, second or later stage. As shown by median round size data, the later the round, the more money is likely to be invested in a round.

In 2013, VC investment in companies at the revenue-generation stage continued to dominate in terms of number of rounds and the proportion of VC investment.

Start-up (by amount invested in US$m)



Product development (by amount invested in US$m)



Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

This should not be surprising for two reasons:

1) Median time from initial VC financing to IPO exit remains at 6.8 years in the US (range of 3.9 to 6.8 in major VC markets), and at 5 years for an M&A (range of 3.5 to 6.3 for major VC markets).

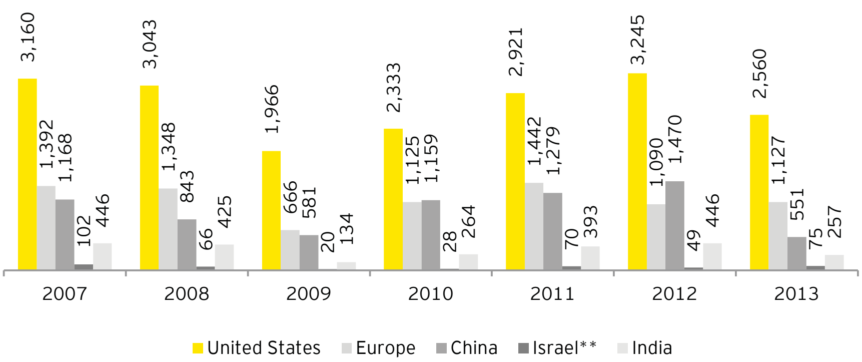
2) Many VC firms are relatively late in their fund life cycle; therefore, they are preferring investments that are further de-risked and closer to exit.

In most markets, the share of investment dollars directed to the revenue-generation stage was higher than 70%, but increased to more than 80% for both China and Israel in 2013. Conversely, India saw revenue-generation stage investment decline to 63% of total investment in 2013, down from 82% in 2012, although investments made at the profitable stage during the year were at 33%, up from 14% in 2012.

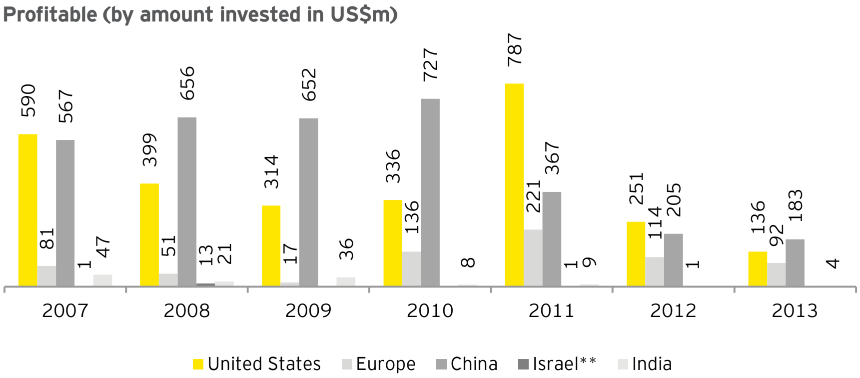
By number of rounds, companies at the revenue-generation stage continued to lead, but in China the percentage of deals entered at this stage fell from 82% in 2012 to 77% in 2013. This is because VC activity at the product-development stage recorded a significant improvement in the region during 2013 (accounting for 12% of total deals, compared to 7% in 2012).

Meanwhile, activity at the start-up stage dropped from 2012 for the two key VC hotbeds — US (from 199 deals to 87), Europe (from 45 deals to 40) and China was flat at 10 deals.

Revenue generation (by amount invested in US$m)



Profitable (by amount invested in US$m)



Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

Entrepreneurial ecosystem is strengthening

Angels on the rise

Since later-stage has dominated VC investing, angel and incubators are filling the gaps in the early-stage.

Angels and incubators have become more recognized and better understood as a capital source. They command larger pools of capital than ever before and are increasingly better organized, making it easier for businesses to locate them and converse with them in an effort to secure capital. Until recently, forging a deal with angel investors was often a challenge. Entrepreneurs had to work their personal networks to get meetings with the right financiers and then negotiate privately. There are signs, however, that this is starting to change. AngelList[1], for example, is an online forum where start-up founders post their ideas and meet investors who fund early-stage companies.

The rise of angels is not just a US development; for the last 2 years, the percentage of angel and incubator participation has been the highest in Canada, followed by India.

Angel and incubator investment 2013

Region	Rounds of angel investment		Rounds of incubator investment		Total		Total rounds
United States	213	6%	205	6%	418	12%	3,480
Europe	79	6%	67	5%	146	11%	1,395
China	14	4%	3	1%	17	5%	314
Canada	20	11%	16	9%	36	20%	176
Israel**	2	1%	3	2%	5	3%	166
India	19	9%	18	8%	37	17%	222

Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

"At Greylock Partners, we've succeeded over decades by really focusing on the consumer internet and enterprise software. Looking ahead, I'm particularly interested in how the convergence of cloud and mobile adoption is changing everything — from shopping to playing to learning to being well. We're at an incredibly interesting inflection point as the next 6 billion people around the world come online."

— John Lilly
Greylock Partners

[1] https://angel.co/

On a less positive note, Israel and China, the two countries with a growing preference for late-stage investment by VCs, are also the two countries that have the lowest angel and incubator participation in overall VC investment, although this is expected to increase in the coming years.

Globally, participation by angels and incubators is up overall, but there are currently geographic disparities in terms of activity. This suggests that some markets are better served at the early stages than others, and that some countries offer a much better environment for start-ups than others.

In 2013, there was a significant increase in the angel and incubator participation rate at the start-up stage in the US, which nearly doubled from 13.7% in 2007 to 25.5% in 2013. In Europe, the increased interest in start-ups was even more significant, up from 4.6% in 2007 to 26.8% in 2013.

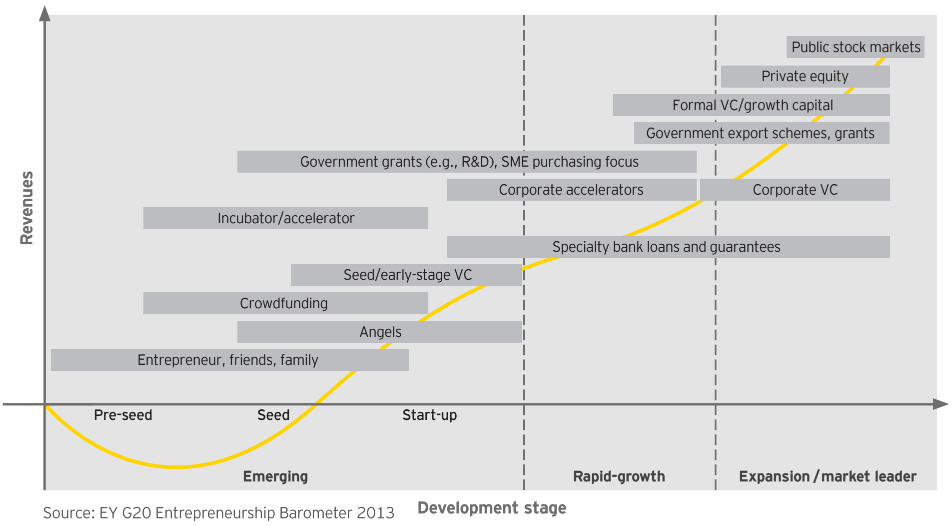
It is also interesting to note that in certain areas angels are participating throughout more of the life cycle of companies now than they previously did. The table below shows the differences in participation by angels and incubators at each stage between 2007 and 2013.

Total % of angel and incubator participation in rounds by stage — US

Stage	2007	2013
Start-up	13.7%	25.5%
Product development	3.3%	17.5%
Revenue generation	3.9%	9.9%
Profitable	3.0%	5.3%

Source: Dow Jones VentureSource, 2014

The EY guide to funding entrepreneurial businesses



Source: EY G20 Entrepreneurship Barometer 2013

Elsewhere, there is evidence that angels and incubators are staying in for follow-on investment rounds, which accounts for increased presence at the later stages. In Canada, angel and incubator participation was highest at the product development stage, while in China, there was a significant increase in angel and incubator participation at the revenue-generation stage (9 out of 244 rounds in 2013 compared to just 4 out of 213 rounds in 2012). Israel and India are attracting some interest from angel investors and incubators at the product development and revenue-generation stages, but have seen no reported participation at the start-up stage since 2010.

Angels and VCs are working together, crowdfunding is building

VC funds are increasingly recognizing the contribution of angels and, in some cases, are collaborating on early-stage investment with them. This is sometimes done on a personal or a fund basis, although this involvement is not well documented in terms of formal activity statistics. In another interesting development, at the very early stages of the company life cycle, where even angels are hesitant to join in, crowdfunding is increasingly filling the gap in markets such as the US and Europe, extending the choices and support open to entrepreneurs at the very early stages of development.

Corporate VC continues to lend weight in the later rounds and stages. Corporations are increasingly looking to VC-backed businesses to fill gaps in their innovation pipeline and enhance treasury returns.

As a general rule, corporate investors prefer the later funding rounds, when companies that have been somewhat de-risked are at the revenue-generation stage and where the product or service can be integrated in a short period of time to drive revenue growth or other synergies in their business. Historically, they have been most active in the business and financial services sector, information technology and health care where their presence ensures consistently higher pre-money valuations than those without such investment.

Not only do the leading US-based entities that include Intel Capital, Google Ventures and Qualcomm Ventures play a significant role in the domestic US economy, but they are also a presence on the global stage. The significant uptick in investment in Israel in the later investment stages in 2013 can, in some part, be attributed to these companies.

Against this backdrop, the indications are that the prospects for entrepreneurs seeking funding are stronger than they have been for some time at every stage of the funding ecosystem.

Ultimately, of course, despite the range of funding alternatives, investors will be attracted to those businesses that they perceive as having the right growth story and the right management team that comes to market at the right time.

VC prefers industries with a fast route to value

Raising money and making money for investors are at the core of the VC industry. Against this backdrop, making the right sector choice is vital to generating the best returns within the shortest possible timeframe.

Favorite sectors for investment globally are overwhelmingly consumer services and information technology. Consumer services has a direct and immediate connection with consumers that offers extremely rapid feedback on whether investments are likely to pay off, plus a rapid path to value realization compared to other sectors. This is particularly true of the consumer-facing subsectors such as e-commerce, internet gaming and web marketing and the mobile interfaces or cloud technologies that support them.

Information technology tops the charts in US, Canada and Israel

Information technology companies took the lion's share of investment in the US, Canada and Israel in 2013, both in terms of the highest number of deals (1,173) and the greatest dollar share. Software and consumer information services were the two subsectors that dominated in all markets; software accounted for 70% of total information technology deals in the three markets.

Consumer services is preferred in Europe, China and India

The consumer services sector continued to secure the bulk of VC investment in 2013 in Europe, China and India, indicating that venture investors in those markets still have a healthy appetite for consumer internet companies. The sector accounted for more than a 50% share in each of the two emerging market economies by amount invested and contributed 28% of total VC funding in Europe.

Health care particularly popular in mature markets

Another sector that consistently occupied third or fourth place in the sector preferences of the six global hotbeds by number and value of investments was health care – a category which covers a multitude of fast-growth sectors traditionally funded by VC including life science, biotech and medical device technology. Many recent IPOs have been in the biotech sector, adding to the appeal for VCs.

Aging and wealthy populations in mature markets are a clear source of future value, and the US and Europe both ranked health care second in terms of capital invested.

Highest VC investment by sector 2013

By number of rounds		
Consumer services		
390 Europe	123 China	79 India
Information technology		
1,034 United States	71 Israel**	68 Canada

VC investment (US$m)		
Consumer services		
2,056 Europe	1,902 China	890 India
Information technology		
8,673 United States	910 Israel**	454 Canada

Source: Dow Jones VentureSource, 2014
**All-site Israeli companies

Governments playing a crucial role

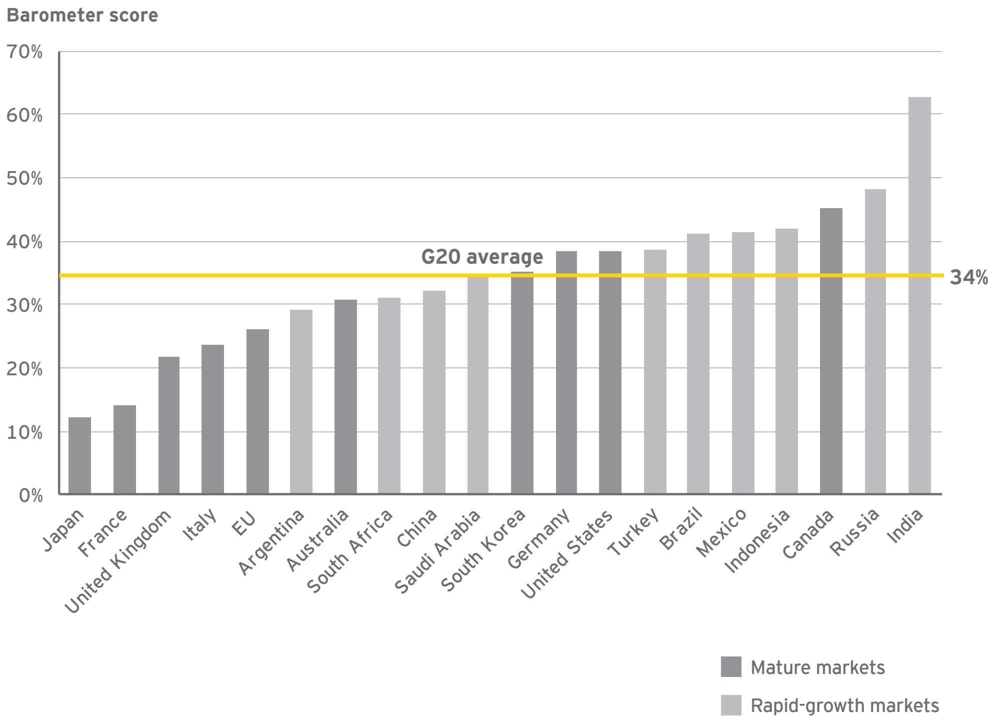
Governments play a crucial role both in creating the right funding ecosystem for entrepreneurial and start-up businesses and, in many cases, providing them with vital funding that complements private VC.

According to the *EY G20 Entrepreneurship Barometer 2013*, entrepreneurs say the second-most important funding source after bank credit for fueling entrepreneurship is public aid and government funding. Government start-up programs are also viewed as one of the most valuable sources of help. Public money can act as a powerful catalyst, especially when delivered in partnership with the private sector. Indeed, research by Brander, Du & Hellman concludes that commercial enterprises that obtain at least part of their funding from government-sponsored sources outperform those that received funding from only private VCs.

It's not hard to find evidence that the provision of government-sponsored funding improves a company's ability to access debt and other financing, creating a multiplier effect. Many of the most innovative young companies in the US were funded not by private VC, but by public programs such as the Small Business Innovation Research (SBIR) program. In the UK, molecular antibodies, which provided the foundation for biotechnology before VC moved into the sector, were discovered in public Medical Research Council laboratories. And, in perhaps the most striking example, it is a little known fact that the algorithm that led to Google's early success was funded by a public sector National Science Foundation grant.

Improvement in access to VC

% of entrepreneurs selecting "greatly" or "somewhat" improved



Source: EY G20 Entrepreneurship Barometer 2013

Increasing support

The good news is that governments are doing more to support VC. Across the G20 as a whole, an average of 34% of entrepreneurs believe access to VC to be either greatly or somewhat improved. This figure rose to 38% of respondents who believe that access to angel funding is improving. In some countries, such as Brazil, Indonesia and Germany, that trend is particularly positive.

Examples of steps being taken to encourage greater VC investment include efforts by regulators to create a "passport system" that makes it easier for VC firms to offer partnership interests in funds throughout the European Union (EU), rather than needing to register them in every country where they want to operate.

Some governments are taking more direct action by creating government-sponsored VC funds to make direct investments in new enterprises. Others are considering changing regulations to allow government or pension funds to invest in VC assets or adapting the tax and regulatory environment to encourage investment from overseas VC firms.

Capital gains taxes are another important consideration for governments. Many countries, including Canada, Australia, Japan and the UK, have recognized this and put in place capital gains tax deductions to ensure that entrepreneurs are not excessively penalized on the sale or exit of their business.

In India, VC investment more than doubled from US$600m to US$1.4b between 2006 and 2012, principally driven by regulatory changes, including the elimination of tax on capital gains and the relaxation of rules preventing foreign investment.

Other supportive government actions include the green light from the U.S. Securities and Exchange Commission (SEC) to support the provisions of the 2012 Jumpstart Our Business Startups (JOBS) Act that, allows VC firms to publicly talk about fundraising, even for vehicles that are open only to accredited investors.

At the other end of the scale, the anticipated completion of regulations under the JOBS Act will permit crowdfunding, subject to meeting certain disclosure and other requirements, enabling more investors to make small investments in private companies.

In the EU, there are also moves afoot to make crowdfunding more effective. Following a period of EU-wide consultation which closed at the end of 2013, the European Commission is evaluating what "soft-law" measures could be taken to promote crowdfunding across Europe, and is investigating how government funding could be aligned to support crowdfunding platforms and investment opportunities that attract significant popular support.

Global VC hotbeds

US

VC trends

Key US VC statistics

	2010	2011	2012	2013
Invested capital (US$b)	29.2	36.2	32.8	33.1
Invested rounds	3,161	3,600	3,649	3,480
Median round size (US$m)	4.16	4.86	4.12	4.20
Number of VC-backed IPOs	47	46	50	74
Dollars raised (US$b)	3.2	5.3	11.2	8.2
Median time to exit (years)	8.0	6.4	7.4	6.8
Number of VC-backed M&As	593	562	490	436
Median M&A valuations (US$m)	37.8	60.0	60.0	57.5
Median time to M&A (years)	5.3	5.3	5.2	5.0

Source: Dow Jones VentureSource, 2014

Slide in activity halted

- VC investment activity in 2013 reversed the steep decline seen in 2012, achieving marginal (1%) growth on the prior year to US$33.1b. However, although the dollars steadied, the number of investment rounds fell by 5% to 3,480.
- Trends in the Bay Area, the largest global VC hotbed by some margin, reflected the national picture with a fall of 11% in deal numbers, but New York, a hotbed which has been growing in importance, was more buoyant.

Flat figures mask vibrant mood

- US VC-backed companies have raised more than US$100b in finance in the last 3 years, showing a healthy consistency of appetite without the wild enthusiasm that leads to dangerous bubbles in which investment discipline can suffer.
- Flat high-level figures mask a fresh vibrancy in the industry, following a number of successful fund closings toward the end of 2013. This, plus continued improvement in the economic picture and rapidly improving IPO exit environment, have buoyed confidence, opening the way for fresh fundraising in 2014.
- Against this backdrop, category leaders are having little difficulty in raising large sums of capital at favorable valuations.

Moore's law tearing up the rulebook for information technology investments

- Information technology continues to be the sector that attracts greatest VC interest in the US, accounting for a greater proportion of dollars and deals than any other.
- Changes in information technology funding requirements in part explain long-term shifts in VC investment patterns.
- As costs of entry have plummeted due to innovations such as cloud technology, which enable global businesses to be built faster with less cash, so demand for start-up funding has eased. VC investors in information technology are responding by shifting its focus to later stage, less risky, investments as businesses scale up.
- Conversely, larger scale, longer term funding will continue to be required for more capital-intensive sectors including information technology hardware, life science and health care, where the larger sums involved mean VC is more likely to retain its interest to benefit from the longer-term value story post exit.

Angels need to mind the gap

- While the VC pipeline has remained broadly stable in the past 5 years, both the quantum of angel and incubator funding and its proportion of overall investment have increased.
- Although angels and incubators have grown in importance particularly in the start-up phase, where participation has risen to 25.5% from 13.7% in 2007, their involvement in the revenue generation and profitable stages has remained in the single digits.
- As angels continue to build a presence within the VC ecosystem their challenge will be to ensure returns remain adequate once VC cash arrives to help build scale in the later stages and liquidation preferences dilute their shareholdings.

Strong prospects for 2014

- The open IPO window has created a strong tailwind for 2014, and it is hoped the improving economic picture will reverse the gradual deterioration seen in M&A exits since 2010, helping buyers and sellers to achieve better price consensus, close more deals and liberate cash for fresh investments.
- The double platform shift in information technology to smartphones and PCs to tablets, combined with the general move to mobility is expected to be an ongoing driver of investment opportunity.
- More generally, advances in mobile technology will drive significant change in sectors, ranging from health to automotive, generating further opportunities for investors who can read the changes in the landscape.
- Corporate venturing will continue to increase in importance — anecdotal evidence suggests a high degree of interest at every stage, from incubation through product development and profitable stages.
- Changes introduced by the JOBS Act continue to positively impact the market, with life sciences in particular benefiting from the confidential filing option available under the JOBS Act.

Europe

VC trends

Key Europe VC statistics

	2010	2011	2012	2013
Invested capital (US$b)	7.1	7.3	6.2	7.4
Invested rounds	1,411	1,322	1,320	1,395
Median round size (US$m)	2.45	2.14	1.96	1.98
Number of VC-backed IPOs	18	15	16	15
Dollars raised (US$b)	0.6	1.0	0.5	0.6
Median time to exit (years)	3.8	9.2	6.2	6.3
Number of VC-backed M&As	217	216	162	157
Median M&A valuations (US$m)	23.0	40.5	26.7	63.8
Median time to M&A (years)	5.7	5.5	5.9	6.3

Source: Dow Jones VentureSource, 2014

Europe is back

- 2013 was a watershed year for the European VC industry. The number of investment rounds was up by more than 5% on the prior year and the value of investments rose by 19% to US$7.4b. This high growth demonstrates Europe is very much back in the game.
- On the back of an improving economic picture, the UK was the dominant hotbed for the region, with investments up 21% to US$2.2b, accounting for around 30% of regional activity. Germany also performed strongly, but growth in France was less strong, reflecting the country's weaker economic fundamentals.
- Although European VCs conform to the global norm, with the majority of investments made at the revenue-generation or later stages, 2013 saw a definite shift in investment pattern. VC funds increased their participation at the product development stage in terms of round size, number of rounds and amount invested.

Early-stage pipeline looking strong

- In the post recession years, entrepreneurs have been in something of a "death valley" in terms of access to funding, with a lack of opportunity at the sub US$1m level and very little formal VC interest in the pre-seed or seed stages.
- On the back of greater success in 2013, four of the larger European funds set up angel structures in 2013 in order to tap into early stage opportunities more effectively.
- In 2013, more than a quarter (27%) of start-up rounds by VC saw participation by an angel or incubator — six times more than in 2007. The rates of participation in the product development stage are also strong with more than one fifth (23%) of rounds seeing angel involvement.

Governments are supportive

- Governments across Europe are keen to support new business and innovation in a bid to boost employment, particularly among the young.
- In Europe, crowdfunding platforms collected €446 million in 2011, €735 million in 2012 and allowed for the financing of 470,000 projects, according to the European Commission, which intends to introduce new legislation in 2014 to harmonize regulation.
- In France, the government made a significant vote of confidence in crowdfunding in 2013 by raising the threshold for regulatory oversight, enabling entrepreneurs to access up to €1m before external supervision kicks in. It also invested €2m in the incubator and angel infrastructure and launched the "France tech" brand to encourage more start-ups.

Corporates are coming

- In the past, limited partners in VC funds were generally financial services businesses — typically banks and insurance companies. As these investors have scaled back due to tougher regulation and higher capital requirements post Solvency II and Basel III, corporate venturing firms from a variety of other sectors have stepped into the breach. Although corporate venturing does not happen on the same scale as in the US, it is a trend we expect to continue in 2014.

Exit environment transforms VC confidence and expands routes to value

- Rising confidence has seen European VCs expand their geographic horizons, with specialist tech and life sciences investors making investments around the region.
- This cross-border investment trend was given further impetus with the successful IPO of French online advertising specialist Critéo on the US NASDAQ in October, which exceeded price expectations.
- The uplift in VC confidence overall meant that in 2013, European entrepreneurs were able to source significant, late-stage investment from within the region, rather than looking to US VCs as in 2012.

Outlook for 2014

- The funding environment for entrepreneurs in Europe is more positive and better balanced than it has been for many years. There are more funds available from a greater variety of sources for early-stage ventures. There is a higher level of confidence to invest in the later stages and more creativity in terms of geographic routes to value realization. This augurs well for fundraising and investment in 2014.

Israel

VC trends

Key Israel VC statistics**

	2010	2011	2012	2013
Invested capital (US$b)	1.9	1.9	1.1	1.7
Invested rounds	160	173	141	166
Median round size (US$m)	4.60	5.00	3.50	4.43
Number of VC-backed IPOs	2	2	0	2
Dollars raised (US$m)	42.4	24.2	N/S	156.0
Median time to exit (years)	N/S	N/S	N/S	N/S
Number of VC-backed M&As	19	18	19	10
Median M&A valuations (US$m)	35.0	30.0	24.9	143.1
Median time to M&A (years)	9.7	6.7	7.5	5.9

Source: Dow Jones VentureSource, 2014

Israel VC activity rebounds in 2013

- After a comparatively flat 2012, VC activity in Israel rebounded in 2013, as we predicted in last year's report. The value of investment was up 55% to US$1.7b, and the number of rounds increased by 18% to 166, from 141 in 2012.
- This spike in activity has been driven by the seemingly endless supply of innovative Israeli companies with a competitive advantage in the hot VC sectors that are attracting a wave of more and more new foreign investors, predominantly from the US but increasingly from other locations, principally in Asia.
- The fact that in recent years Israeli fundraising has been higher than the average amounts invested points to the potential for further significant growth.
- VC investment will likely continue to take place at the later stages as angels, micro VCs and incubators begin to lead funding at the start-up stages.

A dynamic funding ecosystem

- An interesting development that is likely to accelerate angel involvement, is that groups of super angels have created their own investment funds tasked with training people to search for and identify companies in which to invest on their behalf.
- Although crowdfunding has yet to take off in Israel, it does appear to be gaining momentum. The government is currently reviewing legislation that would provide for its regulation as a viable funding mechanism.
- Although local corporate venturing (CV) activity is currently limited, some companies are looking to establish CV units. We expect this to increase in the future. In the meantime, multinational CV funds will continue to be active in the Israeli market. In addition, we are also seeing large multinational corporations becoming increasingly involved in the governmental incubators program as incubator concessionaires.

Positive exit environment

- One of the drivers for this increased level of acquisitions has been cash-rich corporates, hungry for innovation, that have been snapping up Israeli companies.
- IPO activity has also picked up. With no VC-backed listings taking place in 2012, there were two in 2013 — both in the life sciences sector — raising a combined total of US$156.0m.
- Looking ahead, the outlook for IPO exits is extremely positive. There is a robust pipeline of good companies waiting to go public, and we anticipate there will be between 8 and 15 IPOs in 2014-2015.

Technology sector continues to lead

- In 2013, Israel saw strong levels of VC activity in the life sciences and banking and financial services, but information technology was once again the leading sector, accounting for 55% of total investment.
- Cyber security in particular was a stand-out market, and is likely to remain active in 2014 especially as the Israeli Government is promoting the sector as part of its broader strategy to promote VC going forward, which also includes a focus on life sciences and renewable energy.
- In addition, enterprise software information technology, big data and social networking are expected to be sectors to watch in the coming year.

**All-site Israeli companies

China

VC trends

Key China VC statistics

	2010	2011	2012	2013
Invested capital (US$b)	6.1	6.5	5.0	3.5
Invested rounds	388	404	261	314
Median round size (US$m)	7.47	10.00	8.00	7.00
Number of VC-backed IPOs	141	99	46	15
Dollars raised (US$b)	22.0	15.6	4.4	2.0
Median time to exit (years)	2.6	2.5	2.4	3.9
Number of VC-backed M&As	18	11	11	20
Median M&A valuations (US$m)	61.4	80.0	33.0	87.5
Median time to M&A (years)	3.8	4.1	4.4	3.5

Source: Dow Jones VentureSource, 2014

Significant fundraising activity

- Chinese companies raised a total of US$3.5b in 2013, the lowest yearly total since 2009. Despite a 20% increase in the number of VC rounds, the dollar amount raised declined by 30%, compared to 2012.
- However, the moratorium on new listings through 2013 on Mainland Chinese exchanges stifled exit activity and the eventual reopening of markets will give a boost to VC investment activity going forward.
- Historically, VC activity — an important funding source for Chinese companies whose access to bank lending can be difficult — has been aligned with levels of economic growth. The current GDP forecasts point to good times ahead for the VC industry.
- The recent introduction by the Chinese Government of policies designed to stimulate growth among SMEs is also expected to translate into new opportunities for VCs.

Consumer services and information technology booming

- Consumer services, with US$1.9b raised in 123 rounds, led the way in 2013, followed by information technology with 101 deals raising US$762m.
- This trend is set to continue driven by China's on-going love affair with smartphones. The Chinese population is one of the world's largest users, and this is driving demand for companies in three areas: location-based services (which provide a new direct route to traditional businesses in fields such as entertainment, tourism and catering), mobile online gaming and personal finance.

M&A leads the way

- The number of VC-backed M&A exits almost doubled to 20 in 2013, compared to 11 in the prior year. Significantly, in the same period, median M&A valuations rose from US$33.0m to US$87.5m.
- In the past, quality VC-backed companies coming to market have, in general, preferred the IPO route rather than exiting via M&A. However, with the IPO markets in Mainland China closed in 2013, exit options have been limited. As a result, the number and quality of companies looking toward M&A have increased, with subsequent upward impact on valuations.
- The Chinese Government has introduced policies to encourage greater levels of M&A, as it looks to strengthen a number of strategic industries, including electronics and rare earths. These policies simplify the investment and regulatory review processes and should benefit the VC industry by helping to further bolster the exit environment.

The return of the IPO

- With no new listings on Mainland Chinese exchanges last year, VC-backed companies have been exploring other avenues.
- Some Chinese companies have turned their attention to the Hong Kong Stock Exchange, although market capitalization requirements are higher compared to some other markets.
- Elsewhere, after a period of decline in Chinese companies listing in the US, provisions enabled under the JOBS Act have led around 30 companies to take advantage of the new confidential filing process, according to estimates.

VCs moving earlier as angels rise

- With more competition between a range of investors interested in middle and later stage companies driving valuations up, Chinese VCs are looking toward earlier stage investments, in an interesting reversal of the trend in other markets, such as Europe and the US.
- In 2013, while the percentage of dollars invested at the revenue-generation stage remained high at 81% the percentage of VC deals fell to 78%, from 82% in 2012. At the same time, VC activity at the product-development stage recorded a significant improvement during 2013, accounting for 12% of total deals compared to 7% in 2012.
- Meanwhile, investment by angels and incubators has taken off in the last couple of years. From no representation in 2009, the following year the percentage of rounds accounted for by angels and incubators sat at just 1%. However, by 2013 this had risen by 67% to 5%.

A thriving ecosystem

- With CV also starting to take hold in China, the range of funding alternatives for emerging enterprises has never been broader.
- Ten years ago, this was a space occupied purely by multinationals specifically focused on the technology sector. Today, there is a growing number of wealthy Chinese companies with their own venture funds, primarily focusing on consumer- and internet-related enterprises.

India

VC trends

Key India VC statistics

	2010	2011	2012	2013
Invested capital (US$b)	0.9	1.5	1.6	1.8
Invested rounds	116	180	227	222
Median round size (US$m)	7.25	5.15	3.97	4.00
Number of VC-backed IPOs	6	2	2	1
Dollars raised (US$m)	532.5	46.4	19.5	10.9
Median time to exit (years)	4.3	N/S	N/S	N/S
Number of VC-backed M&As	16	6	16	13
Median M&A valuations (US$m)	27.0	N/S	18.4	46.5
Median time to M&A (years)	3.5	4.1	4.0	2.6

Source: Dow Jones VentureSource, 2014

Activity holds steady in India

- VC activity in India was largely in line with 2012 levels in terms of deal value and volume. While the number of deals fell marginally by 2% compared to 2012, the amount invested increased by 13%.
- India saw revenue-generation stage investment decline to 63% of total investment in 2013, down from 82% in 2012. However, investment made at the profitable stage during the year represented a third of total investment — more than double the proportion in 2012. This indicates both that investors continue to be cautious about the early stage, and are increasingly confident in making late-stage investments in companies as they scale.
- A slowdown in economic growth — to less than 5% at the end of 2013 — is, to some extent, impacting investor confidence and the impending Federal Election in mid-2014 is having a similar effect, as investors take a cautious approach ahead of a potential change in administration.

Solid fundamentals

- These short-term horizon risks are offset by solid fundamentals, not least a population that is rapidly becoming better educated and wealthier than ever before, which is reflected in the sectors which are witnessing most VC activity.
- India is a market primarily driven by services rather than products and the consumer services sector continues to secure the bulk of VC investment, accounting for more than a 50% share of the total.
- Technology — principally social, mobile, analytics and cloud — remains attractive, while health care investment in India has almost doubled. With the growing acceptance of the need to make affordable health care available to all, VC money is being channelled into budget initiatives such as specialist providers and innovative health care models.
- Financial services is another growth area. The existing banking infrastructure in India is unable to reach many of the country's more remote areas and innovative companies in areas such as micro credit, payments, etc. are actively addressing this need.

Challenging exit environment

- The very low level of IPO exits continued in 2013, despite the launch of a new exchange platform for VC-backed companies to list and generate capital from institutional investors. So far, this has not gained much traction.
- M&A activity has also slowed, down to 13 deals from 16 in 2012. A large part of India's transactions has historically been led by foreign investors who may be sitting back until after the general election. We expect that at that time, the outlook for the market will become clearer and levels of M&A will pick up again.
- Another factor that will strengthen the exit environment in India should be sustained economic recovery in Europe and the US, which has already started to take hold and is expected to accelerate through 2014.

Angel activity gathers pace

- India's funding ecosystem is evolving at pace. As the number of people with high levels of disposable income increases, crowdfunding is expected to generate more interest and angel funding is clearly becoming more established.
- Over the last 2 years, the percentage of angel and incubator participation in India — at 16% in 2013, up from 3% in 2011 — has been bettered in just one other hotbed: Canada, with 19% in 2013.
- Significantly, in India, product development and revenue generation are the only two development stages that are attracting significant interest from angel investors and incubators, in contrast to other markets where the focus tends to be mainly on start-ups.
- The rise in angel funding has been recognized by the government. It has produced new regulations that will help to lay the foundations needed to formalize this form of investment and help to ensure its future growth.

Range of funding options

- There were no other significant nationwide regulatory developments to support the VC industry, but at a state level certain regional governments have been putting money into VC funding for a while and are expected to continue to do so.
- While a number of large Indian business houses such as Tata and Reliance have established their own asset management arms, CV is yet to take off. Those that have established a presence tend to focus on later stage businesses in India. At the start-up stage they will look to buy in products from the West (US, Europe and Israel, etc.) and apply them to developing solutions to the needs of the market.
- Conversely, multinational players, such as Google and Intel, are playing a role in early-stage investing in India.

Emerging VC hotbeds to watch

Russia

The VC market in Russia has grown very rapidly and is now believed to be the second largest in Europe and the fifth largest in the world. 2012 estimates put VC investments in Russian companies at US$1.2b, up from US$0.1b in 2007. With the relatively recent establishment of a formal VC industry, the landscape is currently dominated by a growing number of small funds, incubators, angel investors, angel clubs, start-ups and early-stage deals.

Growth in investing is driven primarily by the information technology and consumer services sectors, both of which have proved fertile ground for innovation and offer relatively rapid returns, although exit opportunities are few and far between. Russian corporations have not actively pursued M&A, and international exits are infrequent — to a certain extent investors are playing a long game, confident that they will see healthy returns in the medium- to long-term (over the next 4 to 8 years).

The Russian Government played a significant role underpinning the entrepreneurial infrastructure, but now the majority of investments on the market are made by private Russian and foreign investors. Access to information on investors, their portfolio companies and their investment strategies and exits is fragmented, because the market is not transparent. The situation is starting to improve, as funds have used social networks to promote portfolio companies, sponsor subject-related events and seek publicity in their own right. Independent blogs and websites are also starting to develop around the industry, which may ultimately result in increased market transparency.

Brazil

VC is still in its infancy in Brazil. However, there is a thriving entrepreneurial community and no lack of private investment. There are many different sources of capital, including a well-established private equity industry, a strong and well-networked angel community and a good number of wealthy individuals who, though not angels in the traditional sense, have money to invest. The Angels Association in Brazil announced that angel investment grew 25% in 2013, reaching US$262m.

According to the latest available public data, at least 50 firms made approximately 80 investments in start-ups in 2012, a sharp increase over previous years. Additionally, at least two Brazil-focused funds were formed, representing around US$250m of assets under management. Participants include both global-scale VCs, opportunistically making investments out of global funds, as well as a handful of US and European VCs who have committed resources and/or dedicated funds on the ground.

Recent trends suggest the number of Brazilian VCs and super angels is growing — and that these local investors are often sought out as "river guides" by foreign VCs to help navigate the local investment landscape and manage day-to-day contact with portfolio companies in syndicated deals. Typically, investors favor early-stage opportunities and primary sectors for investment are information technology — particularly web-based enterprises and sustainability projects. Currently, the preferred exit route is via M&A, but the IPO environment is improving and the government is planning to introduce regulatory changes to improve the IPO process and specifically to place fewer demands on smaller companies seeking to list.

Mexico

Although the VC industry in Mexico is at an earlier stage of development compared to some of its Latin American neighbors such as Brazil and Chile, over the last 3 or 4 years it has become increasingly active and dynamic, witnessing rapid growth, albeit from a low base, from four funds in 2009 to 15 funds in 2013. In the same period, the number of rounds increased almost six-fold, from six to 35.

Figures released in February 2014 by the Latin American Private Equity and Venture Capital Association revealed that private equity and VC firms committed US$8.9b through 233 investments in Latin America in 2013, representing a six-year high and a 13% increase over 2012.

Across the region investments in the oil and gas, especially in infrastructure, dominated in 2013. This sector is likely to see an uptick in VC activity in Mexico in the near future on the back of government reforms specifically designed to increase the level of private investment in the energy industry. At present, around a third of VC-backed investments are in software and e-commerce, but there is also a wide spread of interest in companies across a range of industries including health care, transportation and education.

VC exits have historically been via M&A — often a private sale to the original owner or to another VC or private equity fund — but with the Mexican IPO showing promising signs of growth, this will likely provide a genuinely viable alternative in the medium term.

With a strong economic outlook, a relatively youthful population and a rapidly growing middle class, the outlook is bright for Mexico and its VC industry.

Visit the EY Venture Capital Center of Excellence

The Center is the primary online destination for VC-backed companies that are looking to drive growth — and the funds that invest in them. The Center contains information, resources and advice to specifically guide and help companies and their investors through every stage of the growth cycle.

Visit **ey.com/vccenter** for more information.

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

The views of third parties set out in this publication are not necessarily the views of the global EY organization or its member firms. Moreover, they should be seen in the context of the time they were made.

About EY's Strategic Growth Markets Network

EY's worldwide Strategic Growth Markets Network is dedicated to serving the changing needs of high-growth companies. For more than 30 years, we've helped many of the world's most dynamic and ambitious companies grow into market leaders. Whether working with international mid-cap companies or early-stage venture-backed businesses, our professionals draw upon their extensive experience, insight and global resources to help your business succeed.

© 2014 EYGM Limited.
All Rights Reserved.

EYG no. CY0735
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

www.ey.com/sgm

VC contacts

Global Strategic Growth Markets

Maria Pinelli
+44 20 7980 0960
maria.pinelli@ey.com

Global VC Leader

Bryan Pearce
+1 617 585 0499
bryan.pearce@ey.com

Regional VC Leaders

United States, West
Jeff Grabow
+1 408 947 5607
jeffrey.grabow@ey.com

Israel
Oren Bar-On
+97 2 3568 7102
oren.bar-on@il.ey.com

EMEIA
Andrea Vogel
+31 8 8407 4070
andrea.vogel@nl.ey.com

France and Luxembourg
Franck Sebag
+33 1 4693 7374
franck.sebag@fr.ey.com

India
Mayank Rastogi
+91 22 6192 0850
mayank.rastogi@in.ey.com

Asia-Pacific
Ringo Choi
+86 755 2502 8298
ringo.choi@cn.ey.com

Greater China
Lawrence Lau
+86 21 2228 2816
lawrence.lau@cn.ey.com