VIEW

The Seed Investment Landscape

The Rise of Seed Investment Activity

Seed investment activity has increased dramatically over the last three years due to fundamental changes in the dynamics of the venture capital industry. Entrepreneurs in the information technology sector require less capital to form and support companies than ever before, driven by declining infrastructure expenses, the rise of cloud-based software and service providers, and "pay as you grow" cost structures. According to NVCA data, for example, internet focused companies raised an average of $8.0 million in their initial rounds of financing in 2000. By 2005, that number had dropped to $4.8 million, and by 2013 internet focused companies were raising only $3.0 million in their initial financing rounds. This capital efficiency is positive for the industry, as companies can generate revenue, become cash flow breakeven and achieve attractive exits on smaller amounts of investor capital. Venture capital investors have recognized these trends, and the industry has seen both increased seed investment activity by traditional venture capital funds, as well as the rise of dedicated seed funds to meet the changing needs of informational technology entrepreneurs. For the purposes of this analysis, seed investments are defined as early stage investments (typically less than $1.5 million) that specifically include the participation of a venture capital and/or corporate venture capital investor. Note that angel rounds are excluded from this analysis.

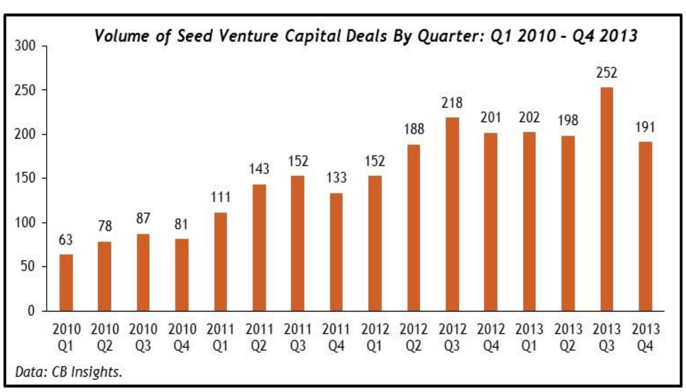
Over the last three years, seed investment volume has demonstrated significant growth. According to CB Insights, approximately $900 million was invested across more than 840 seed deals in 2013. By number of deals, this represented an 11% increase from 2012 levels, and an over 170% increase from 2010.

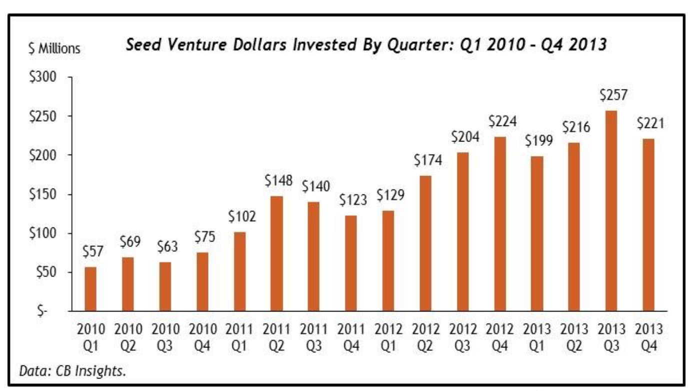
The dollar volume of seed investments also hit a four-year high in 2013, increasing 22% and 74% over 2012 and 2011 respectively. Of note, in the third quarter of 2013, $257 million was invested into 252 unique seed deals, which represented the most quarterly seed investment activity over the last four years.

Anatomy of a Seed Deal

Seed investments occur at, or shortly after, the birth of companies, participating in the highest risk, but also the highest reward, stages of their development. Compared to traditional venture capital rounds, seed rounds deploy smaller amounts of capital, typically between $500,000 and $1.5 million, into pre-Series A financings. Seed round financings frequently take the form of convertible debt that converts into shares of preferred stock upon the closing of the underlying company's subsequent Series A round of financing.

Structurally, the seed round convertible debt instrument contains three major elements: an





Typical Seed Investment Profile

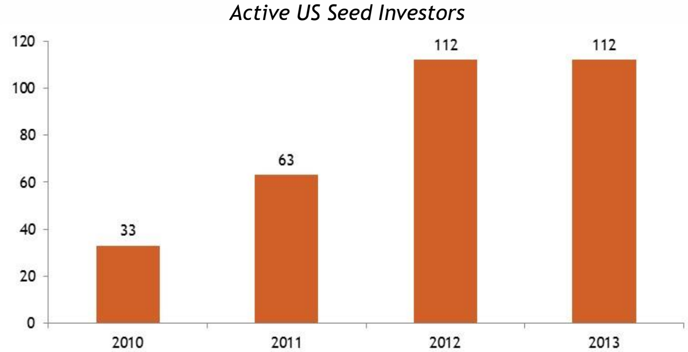
Size	Range From $500,000 to $1.5 Million
Stage of Development	Concept to Product Development
Structure	Convertible Debt
Important Terms	Interest Rate Conversion Discount to Series A Valuation Cap

interest rate, a conversion discount to the subsequent financing round, and a conversion valuation cap. The convertible note's interest rate is historically in the range of 5% to 10%, and accrues until the conversion of the note into the Series A round. The conversion discount grants the seed round investors the right to convert their debt, plus interest, into Series A stock at a reduced price to the Series A share price. The conversion discount is quoted in percentage terms, and can range from 10% to 35%. The conversion valuation cap defines an upper limit on the value of the company at the time of the Series A financing for the purposes of determining the conversion price for the convertible debt. If a Series A financing occurs at a valuation higher than the valuation cap, the seed round investors are permitted to convert their loan, plus interest, at a lower price than the Series A price. This lower price is set at a level that corresponds to the price the seed investor would have paid if the Series A valuation occurred at the valuation cap. This feature allows seed investors to participate in any significant increase in the company's value between the seed and Series A rounds through a mechanism that limits their dilution.

Dedicated Seed Funds

While investors across the venture capital spectrum, from angel investors to traditional venture capital firms, may engage in seed investments, the industry has recently witnessed a proliferation of dedicated seed funds and firms. According to Pitchbook, 49% of all venture capital funds closed in 2012 and 2013 were capitalized at $50 million or less, and these funds are often focused on seed stage investing.

Active US Seed Investors



Data: CB Insights. Active Investors defined as those making more than four seed investments per year.

While seed funds can pursue a wide range of investment strategies, they tend to demonstrate some common characteristics. Seed funds are typically capitalized at under $75 million, and in many cases under $50 million. They are most often managed by one to three person investment teams that consist of former entrepreneurs, angel investors, and/or professional investors that have had prior careers at traditional venture capital firms. Seed fund portfolios are typically large and diversified with over 30 underlying investments per fund. Deal sourcing activity at most seed funds is focused on cultivating and nurturing relationships with new and repeat entrepreneurs. This activity is often hyper-localized, and managers heavily leverage personal networks to access and compete for deals. Seed funds are structured similarly to traditional venture funds in that they are limited partnerships.

To date, the majority of investors in seed funds appear to be high net worth individuals and family offices. However, interest in the category among larger institutional investors has increased significantly as the return dynamics of seed funds have fueled their increasing popularity. Investing early in companies at relatively low valuations means that a few, or even one, high performing investments can result in very strong fund performance. Fairview's proprietary database has tracked several seed fund managers who have generated investment returns that compare very favorably against the best venture funds in their vintage year. In addition, Fairview has observed the emergence of a class of "institutional quality" seed funds that are of scale, have multiple investing partners, have raised several prior funds, have built robust infrastructure and processes, and have begun to attract a small percentage of institutional investors into their mix of limited partners. These institutional quality seed funds' have also demonstrated their ability to deliver outsized returns, further increasing their appeal amongst institutional investors who are increasingly looking to access this new sub asset class within the venture capital industry.

Accessing Seed Funds Can Be Challenging

Despite the increased interest, however, accessing this category can be challenging for limited partners, including those who have been active venture capital investors. The seed fund landscape is large, diverse and growing, with active managers in all the major startup ecosystems, including Silicon Valley, Boston and New York. Many are first time funds that lack the investment history of traditional venture capital firms, and diligence can be resource intensive and time consuming. Beyond a seed fund manager's strategy, investment acumen and track record, many other factors must be assessed such as the firm's network, organizational infrastructure and its finance and accounting capabilities.

Another significant challenge for some institutional investors is that individual seed funds typically have limited ability to absorb large volumes of capital from limited partners since their investment models necessitate small fund sizes. In addition, returns in the seed fund sub-asset class can be volatile, and in order to build prudent levels of diversification, limited partners should spread their exposure to seed funds across several managers.

Typical Seed Fund Profile

Fund Size	Less Than $75 Million
Portfolio	Over 30 companies
Sourcing	Network-Based, Hyper-Local
Structure	Limited Partnership
Terms	Traditional Venture Capital Fund Terms

Fairview Activity

Fairview manages several venture capital investment programs on behalf of institutional clients focused on achieving top tier returns in the venture capital asset class. The firm identifies the most attractive strategies and markets for venture investment on an ongoing basis, and Fairview believes that seed funds can be an integral component of a sophisticated venture capital investment program. The firm is well positioned to help institutional investors prudently access seed fund opportunities through a customized solution – applying the same intelligent and innovative investment approaches that have allowed the firm to be a successful leading venture capital investment manager for nearly 20 years. For all of its customized investment programs, Fairview works closely with clients to determine the optimal approach in order to reach the client's goals. In the seed fund category, this will likely involve an assessment of the clients' return objectives, risk appetite and the fit of the program within a broader portfolio. Fairview can tailor a program to provide access to the most compelling seed fund managers, while building appropriate levels of diversification by investment strategy, industry sector, geography, vintage year, etc. As seed funds continue to institutionalize and mature, an opportunity may exist for direct participation by Fairview clients in subsequent fund offerings. Fairview has a long history of actively fostering direct investment relationships to the benefit of both its clients and the fund sponsors. Through proprietary research, professional insights and deep industry relationships developed through the firm's long tenure and experience in the private markets, Fairview has the capabilities in place to successfully prosecute a seed investment strategy on behalf of institutional clients.

About Fairview Capital

Fairview Capital Partners is a leading private equity investment management firm specializing in demanding segments of the market. Founded in 1994, Fairview provides innovative, intelligent, investment solutions and services to institutional investors. Fairview manages $3.5 billion through funds-of-funds, customized separate accounts and other innovative structures. The firm's areas of focus include venture capital / growth equity, small to mid-market buyout, emerging managers and frontier markets.

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