



White Paper
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The Path to Liquidity in Venture Capital

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Introduction

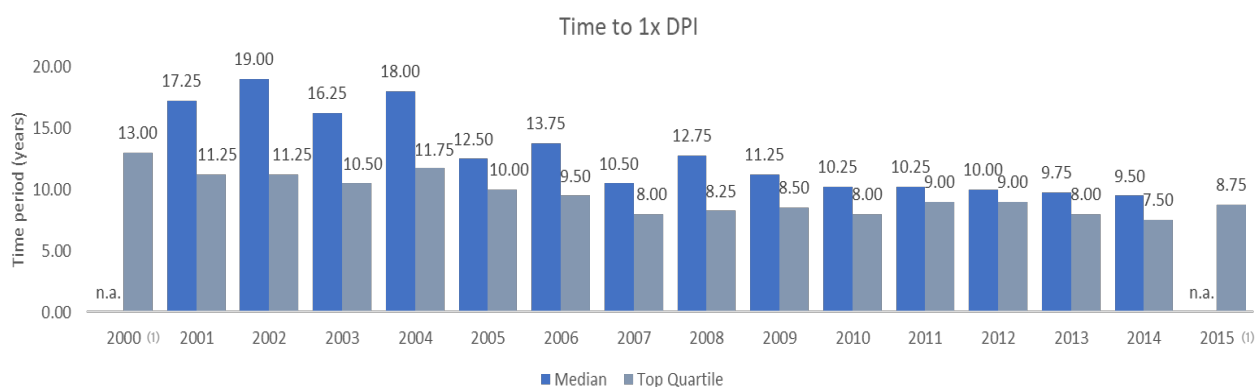
While the venture capital (VC) market saw a boom in deal making and valuations during 2020 and 2021, it saw a stark contrast in activity and exits in the two years which followed. The slowdown in deal activity was driven by a less favourable interest rate environment and a progressive shutting down of the IPO markets, which had a negative impact on overall exits. Given the resulting liquidity constraints, both Limited Partners (LPs) and General Partners (GPs) have been seeking alternative solutions to generate cash distributions across their portfolios, which is what has led to an increase in secondary activity between 2023 and now.

At AVP we have leveraged our proprietary data as well as fund performance data from Cambridge Associates to analyze the time to achieve 1.0x distributions-to-paid in capital (DPI) across both median and upper quartile US venture funds historically. We felt this analysis would aid existing and potential investors to form a realistic and clear understanding of the expected timing of distributions when investing in the venture capital asset class. We have focused on funds from 2000 until 2015 to cover a broad range of vintages. The funds of more recent vintages (2016 and later) are still early in their trajectories and have not yet reached 1.0x DPI, hence we did not include them as part of the analysis.

Further to the above, we have focused the second part of this paper on the VC fund secondaries market. As part of our analysis, we have explained the reasons behind the increase in secondaries deals, the dynamics and trends across LP-led and GP-led deals and have presented data pertaining to expected returns and discounts across VC secondaries.

Number of years taken to reach 1.0x DPI for historical vintages

To analyse the number of years taken to reach 1.0x of DPI for funds of vintages from 2000 until 2015, we used DPI data from Cambridge Associates. We assessed quarterly data from March 2000 until March 2024 to provide a more complete and granular view.



Based on historical data available, for fund vintages between 2000 and 2015, it has taken upper quartile funds at least 8 years to reach a DPI figure of 1.0x (the maximum being 13 years for 2000 vintages) and it has taken median quartile funds at least 9.5 years to achieve a DPI of 1.0x (the maximum being 19 years for 2002 vintages). Evidently, the time to 1.0x DPI for upper quartile funds is consistently shorter than for median quartile funds, but it is not insignificant. The data implies that achieving a meaningful level of distributions in the venture capital asset class takes time, and even more so depending on the quality of managers (i.e. where they rank compared to the benchmark) and the stage at which they invest. The timeline to 1.0x DPI will almost always be longer for a pre-seed manager investing in pre-product companies compared to a Series B focused manager investing in companies with significant traction, irrespective of their quality.

An interesting observation can be made regarding the delta between median and upper quartile funds. For older vintages (2001 to 2004), the delta is much greater than for newer vintages, in particular those from 2010 to 2014. It took an average of 6 more years for median quartile funds to reach 1.0x DPI compared to upper quartile funds for 2001 to 2004 vintages, whilst it only took an average of 2 more years for the 2010 to 2014 vintages. As such, the variance pertaining to the mean in terms of time to distributions has narrowed as exit markets for the venture industry have matured over time.

One of the contributing factors for the acceleration and normalisation of timelines to distributions is the growing prominence of VC fund secondaries. Given that VC fund secondaries allow LPs and GPs to unlock liquidity before the end of a fund's term, the time to reach 1.0x DPI in venture capital is likely to reduce for the more recent vintages and it will therefore be unlikely to see another fund vintage which takes 19+ years to reach 1.0x DPI. Hence, while it has historically taken a long time to unlock distributions when investing into the VC asset class, the ongoing trend in terms of timelines to distributions decreasing is likely to persist.

Increase in secondary deals and secondaries funds raised in the recent years as the result of liquidity constraints⁽²⁾

While the market has seen liquidity constraints and a delay in exits over the last 12-18 months, it also saw an uptick in secondary transactions during the same period. Venture fund secondaries, in particular, hit a record increase in volume of 151.3% (\$2.7bn in H1 2024 vs \$1.1bn in H1 2023), which was largely driven by Lexington Partners purchasing a \$1bn venture portfolio earlier this year⁽³⁾. We have observed a similar increase in activity and quality of opportunities within our own secondary pipeline: AVP has executed three times the number of VC fund secondary transactions in H1 2024 compared to each of the last three years.

In terms of fundraising activity, the number of secondaries funds dedicated to VC and their size have grown over time. StepStone recently raised the largest ever fund dedicated to VC secondaries, which closed at \$3.3bn, a significant uptick from its 2022 predecessor, which closed at \$2.6bn (a ~20% increase). Similarly, Industry Ventures closed its tenth flagship vehicle at \$1.45bn (~ 70% larger than its predecessor), which will focus on direct secondaries, secondary LP investments and continuation funds, among other deal structures. Large players such as Lexington Partners as well as Hamilton Lane have also raised large funds in the recent years. Lexington Partners held the final close for its latest flagship secondaries fund at \$2.7bn (~ 60% increase in size from its predecessor). Hamilton Lane also held the largest ever close for its secondaries flagship fund at \$5.6bn (~ 40% increase in size from its predecessor). Overall, the fact that investors have been raising large secondaries funds, both those dedicated to venture secondaries as well as those with a broader mandate (i.e. covering VC, Private Equity (PE) and other asset classes), is testament to the fact that the VC secondaries market is maturing. The increase in demand has been driven by a multitude of factors, namely (a) liquidity constrains, (b) investors wanting to access the venture asset class with less risk and via a path which would yield distributions at a faster pace, (c) the proliferation of different types of LPs who are active in VC, beyond endowments and foundations, who might need to access liquidity and distributions more quickly and (d) stronger pricing alignment between buyers and sellers as well as GPs finally allowing those transfers to happen.

LP-led and GP-led transactions in venture secondaries

In recent years, we have observed a steady volume of both LP-led and GP-led transactions within VC fund secondaries. In H1 2024, the LP-led market remained active as LPs continued to bring forward portfolio sales to generate liquidity following two years of reduced distributions. GP-led transactions, and in particular continuation funds, have become an increasingly popular channel for executing secondary transactions given their flexibility and negotiability on terms (i.e. fund terms are reset given the assets are moved into a new vehicle) and LP participation (i.e. LPs can choose to sell, hold, or re-invest), as well as the relative abundance of pricing information compared to LP-led transactions. Continuation funds also enable GPs to hold assets for longer and give them the ability to invest more capital into companies which have additional room for growth.

Pricing across all VC fund secondaries has shifted from high 70s and low 80s percentage points of Net Asset Value (NAV) to high 60s and low 70s percentage points of NAV post-market correction. Despite pricing becoming more favourable towards buyers, the volume of completed VC fund secondary transactions has continued to rise during this period as buyer and seller expectations have grown increasingly aligned due to (a) GPs having proactively adjusted portfolio valuations over the last five to six quarters and (b) LPs increasingly seeking creative liquidity solutions to rebalance their portfolios and to continue making new fund commitments. While the IPO market has seen signs of recovery, venture secondaries are expected to remain a relevant exit channel. Particularly in VC, a recovery of the IPO market is highly beneficial for the secondaries landscape as it creates more certainty around exits and therefore allows buyers and sellers to underwrite portfolios with greater confidence.

Expected returns and discounts on venture secondary deals (as of H1 2024)

	Venture Capital	Private Equity ⁽⁴⁾
Expected IRR on secondary deals	~ 20% - 25%	~ 15% - 20%
Expected multiples on secondary deals	~ 2.0x - 2.5x	~ 1.5x - 2.0x
Expected discounts on secondary deals ⁽⁵⁾	~ 29% - 45% discount (55% - 71% of NAV)	~ 6% - 10% discount (90% - 94% of NAV)

The data shown in the table above suggests that VC fund-focused secondaries deals are, on average, expected to generate a higher multiple and Internal Rate of Return (IRR) compared to PE-fund secondaries. This is due to the fact that there is often more risk involved in investing into a VC portfolio compared to a PE portfolio given the nature of the assets (i.e. these are often higher growth, unprofitable businesses) and the relative scarcity of pricing information made available to stakeholders. As such, the expected returns are often greater for VC secondary deals in comparison to PE secondary deals. Furthermore, given the risk associated with VC fund secondaries, the discounts on such deals are usually higher than those on PE secondary deals. Despite the associated risk, the discounts on VC secondaries have remained attractive over the years and have adjusted to be more buyer-friendly. Hence, while VC secondaries are riskier in comparison to PE secondaries, the combination of higher discounts and stronger expected returns offers buyers an appealing opportunity to access high quality venture portfolios at attractive entry prices.

Conclusion

Overall, following our assessment of time to 1.0x DPI for VC funds of older and more recent vintages (from 2000 until 2015), it is evident that irrespective of what quartile these funds sit in, it takes a long time to even return one's cost; investing in VC is a game of patience, which if done correctly can reap strong rewards. In more recent years, particularly following 2022, it has been more difficult for GPs and LPs to generate DPI due to a multitude of factors. This, in turn, has driven an increase in VC fund secondaries deals being executed and VC-focused secondaries funds being raised. While secondaries have offered an attractive avenue for generating DPI during a time when exits have been scarce and have acted as a means through which GPs can hold their strongest assets for longer, the question of what the overall return profile of the venture asset class will look like going forward continues to be pertinent, as LPs and GPs trade TVPI and potential future upside for DPI. Nonetheless, an increase in venture-focused secondaries deals indicates that despite a slowdown in overall activity, LPs remain interested in venture and are looking for creative ways to yield faster results with a reduced level of risk.

Sources and Notes

1 - For funds which were of the 2000 vintage, the median level DPI has not reached 1.0x, hence the number of years to reach median DPI for this vintage has been marked as "n.a.". For the 2015 vintage funds, the years to median DPI is shown as "n.a." due to funds of that vintage having not yet hit 1.0x DPI

2- Data pertaining to fund sizes which have been noted in this section of the paper has been gathered from various sources comprising Secondaries Investor, TechCrunch and relevant Press Releases

3 - Setter Capital Volume Report H1 2024

4 - The returns on PE secondaries vary and depend on whether they are LP-led or GP-led deals as well as whether the transaction is a single-asset secondary transaction or a multi-asset secondary transaction. The data presented refers to average figures gathered from a range of sources

5 - The pricing and discount data has been sourced from AVP's proprietary dataset pertaining to secondary transactions as well as information available online

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