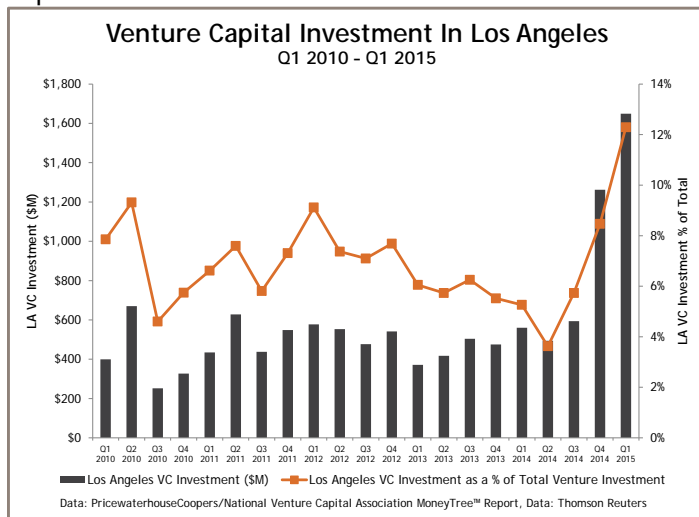


VIEW

Showtime for Venture Capital An Analysis of the Evolving Los Angeles Ecosystem

Fairview Capital seeks to be early in identifying and evaluating trends impacting the venture capital market to better inform our investment decisions for the benefit of our investors. Historically we have been at the forefront of major trends such as the emergence of the New York City startup and venture capital ecosystem, the rise of institutional seed funds and technology-specific trends such as the internet of things, the real-time web, and cloud computing. Of late, our investment team has been intrigued by nascent but growing activity in the Los Angeles region.¹

Los Angeles has long claimed the title of "Entertainment Capital of the World," with the region serving as a global hub for media and entertainment since the early days of the film industry. Today, the region continues to embrace its media and entertainment roots but is also home to leading companies across a diverse range of industries. Recently, many promising stars in digital media and technology have emerged from the region, including Snapchat, SpaceX, Nasty Gal and TrueCar. These successes have occurred against a backdrop of rising startup activity and the development of a robust ecosystem which has garnered the attention of venture capitalists.



¹The US Census Bureau's Los Angeles Combined Statistical Area consists of the entirety of the counties of Los Angeles, Orange, Ventura, San Bernardino, and Riverside. For the purposes of this analysis, the term "Los Angeles" will be used to refer to the entire Combined Statistical Area.

According to the National Venture Capital Association, venture capitalists invested \$2.9 billion across 290 Los Angeles companies in 2014, a 180% increase since 2009 and the highest dollar amount in over a decade. The total dollars invested represented 6% of all venture investment in the year and trailed only Silicon Valley, the New York Metro area and New England. In the first quarter of 2015, venture investment in the Los Angeles area accelerated to 12% of total venture dollars invested, vaulting the region ahead of the New York Metro area and New England.²

Venture investors have increasingly been deploying capital into Los Angeles area companies, fueling the maturation of the local startup environment. Our research indicates that there are multiple, long-term drivers supporting growth in the region and contributing to the emergence of the startup and venture ecosystem including demographics, the talent pool, industry trends and accelerator and incubator programs.

Demographics
First, Los Angeles is host to a large and diverse demographic. With a population of over 18 million, the Los Angeles Metro Area is the second largest in the country, behind only New York.³ The large population presents a natural advantage in the form of a larger talent pool and local market for goods and services. In terms of diversity, the region is the third-most ethnically diverse large metro area in the United States.⁴ Diversity has often been linked to numerous economic benefits such as enhanced innovation and creativity, reduced turnover and more effective marketing.⁵ In addition to diversity, Los Angeles also boasts a relatively young population. The region's median age of 34.6 years is 8% below the national median, which brings additional economic benefits.⁶ Specific to venture capital, benefits of a more youthful population include a more energetic underpinning with respect to talent for

²Q1 2015 PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters

³US Census Bureau


⁴Rice University Ethinc Diversity Study, Data -US Census Bureau

⁵Harvard Business Review (Hewlett, Marshall and Sherbin), December 2013, Harvard Business School Research (Chua), May 2011 and US Labor Department Research November 2014.

⁶CIA World Factbook, US Census Bureau

portfolio companies and a local market more receptive to new products and services.

Talent Pool

 Complementing Los Angeles' attractive demographic foundation are features that have proven to be critical for the development of a successful startup and venture capital ecosystem - technical talent and a large installed base of technology companies. The Los Angeles area is home to a number of universities with top engineering programs such as the California Institute of Technology, Harvey Mudd College, the University of California Los Angeles, and the University of Southern California. As a result, the region graduates approximately 3,000 engineers each year, more than any other area in the United States, including Boston and the Bay Area. Historically much of this engineering talent, up to 70% according to some estimates, had left the area to find employment⁷. Recently, however, more of this talent has chosen to remain in the area as the aforementioned digital media successes combined with local Fortune 500 companies in related fields have helped retain, and even attract, and train talent. Examples of local Fortune 500 companies based in the area include Amgen, Disney, DirectTV, Health Net, Jacobs Engineering and Live Nation. These companies have nurtured the local technology ecosystem while providing balance and diversity to the region's economy.

Industry Trends

 The cost to launch most technology products and services has dropped significantly as internet infrastructure becomes commoditized. In fact, the cost to develop and launch an internet-based company's first product has dropped by a factor of 10 or more in the past decade.⁸ A primary industry that stands to benefit from this trend is content creation, as value steadily shifts away from infrastructure-related innovation towards content. Los Angeles has always been a content creation hub and its digital media and advertising industries have also benefited from this trend. Some of the most important new business models at the intersection of digital media and advertising have been conceived in Los Angeles, such as MySpace in social media and Overture in digital advertising. More recent Los Angeles based successes that have leveraged the region's natural strengths include Maker Studios in content creation, Oculus in virtual reality, Riot Games in online gaming, and

⁷PandoDaily Research and TechLA
⁸Startup Weekend: How to Take a Company From Concept to Creation in 54 Hours, Marc Nager

HauteLook in fashion e-commerce. Recent successes have been particularly valuable to the region as they have spurred additional startup successes and investment. They have also aided in talent retention while making it easier for companies to recruit talent from outside the region.

Accelerators and Incubators

 A burgeoning cluster of local startup accelerators and incubators has accompanied recent startup successes to help nurture and develop the growing local talent base. Los Angeles is now home to nearly a dozen accelerators and approximately 30 incubators.⁹ Accelerators, which typically fund externally developed ideas and provide mentorship, have, in most cases, been formed or backed by venture capital firms with an interest in the region or successful local founders and CEOs. Incubators, which typically help bring in external advisors and team members to an internally developed product (sometimes including a small investment), have a range of sponsors, including universities, economic development programs, local companies, as well as successful local founders and CEOs. The majority of accelerators and incubators in Los Angeles are local, but the group includes national programs as well. Examples include: Amplify LA, Launchpad LA, MuckerLab, K5 Launch, idealab, and Science.


Venture Capital in Los Angeles

Despite the recent rise in startup formation, Los Angeles is still a relatively new market in terms of local venture capital investors. A bulk of the current investment activity has been led by smaller seed funds, angel investors and angel groups. Examples include Baroda Ventures, Double M Partners, CrossCut Ventures, Wavemaker Partners and Mucker Capital. This group of investors, often characterized as tight-knit, has served young area startups very well and



⁹Vator News and Barbera Corporate Law

represents a strong foundation for the overall ecosystem. An element unique to Los Angeles is the involvement of celebrities as participants, generally as angel investors. In addition to financial support, celebrities have also been able to add creative and marketing value to startups. A prime example is Jessica Alba's The Honest Company.

 Company Profile: The Honest Company	
Location:	Santa Monica, CA
Founded:	2011
About:	The Honest Company is a multi-channel retailer of environmentally friendly, non-toxic consumer products targeted at households. The company's product offering consists of a selection of privately-branded diapers, baby products, cleaning products, and other consumer household staples.
Founders:	The Honest Company was co-founded by: <ul style="list-style-type: none"> • Jessica Alba - actress and advocate for environmentally friendly and safe children's products • Brian Lee (CEO) - serial entrepreneur, co-founder of LA-based companies LegalZoom.com and ShoeDazzle.com • Sean Kane (COO) - operational expertise including various roles at LA-based Pricegrabber.com • Christopher Gavigan (CPO) - former CEO of Healthy Child Healthy World, an nonprofit empowering parents to protect children from toxic risks
Investors:	BAM Ventures, General Catalyst Partners, Lightspeed Venture Partners, Institutional Venture Partners, Pritzker Group Venture Capital and Wellington Management
Status:	The Honest Company has raised over \$120 million in venture capital financing with the most recent round valuing the company near \$1 billion. In 2014 the company was reported to generate approximately \$150 million in revenue. An IPO is likely in the near future.
Data: Pitchbook Data and Fairview Capital Research	

Beyond the very early stage, the list of traditional Series A and B investors based locally is still small. Of the top investors in Los Angeles-based technology companies, only two, Upfront Ventures and Greycroft Partners, are based locally and serve companies raising traditional Series A and B rounds of financing.



Increasingly, the area has been drawing the attention of Bay Area venture capital firms, many of whom have established a satellite presence in the area. The dynamism of the region's startup ecosystem is expected to attract more attention as it continues to evolve. We are likely to continue to see increased

interest from outside venture capital investors, along with the emergence of new local venture firms - both through the maturation of local firms currently focused on the seed stage as well as the formation of new firms.

At Fairview, we maintain a geographically diverse portfolio. Our exposure to companies based in the Los Angeles region has gradually increased to over 7% of our entire portfolio's value and we have participated in many of the successes that have emerged from the region in recent years.¹⁰ The activity in Fairview's portfolio has reinforced our observations and analysis of the trends impacting venture capital investment in Los Angeles - in terms of the sectors and technologies that have been successful as well as the financing trends for new companies. Our exposure to Los Angeles-based companies has traditionally been developed through Bay Area venture capital firms that have been placing an increased emphasis on the region but in recent years we are beginning to see more of our exposure to the region being driven by local firms.



In covering the development of the local ecosystem, Fairview has engaged with an increasing number of managers based in and focused on the region. The Firm maintains relationships with both local and outside venture firms who have successfully invested and established a presence in the market and are well positioned to capitalize on future opportunities.

In summary, Los Angeles is quickly becoming a significant startup and venture capital hub and features many of the types of companies and business models that are attractive to venture capitalists. We are excited about the investments that we have in the Los Angeles area and the future of investing in the region.

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¹⁰ Fairview Capital portfolio as of 9/30/2014