

IN COOPERATION WITH



Russian Venture Capital Market Overview

1Q 2014

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Welcome

Dear friends!

We are pleased to present the latest issue of the Russian Venture Capital Market Overview by RMG Securities and East-West Digital News, offering a detailed analysis of Russia's VC market in 1Q 2014.

The year began very quietly, the market is still seeking new growth opportunities. The amount of venture capital invested fell sharply. Nevertheless, we point out several positive trends: the Russian government maintained its support for early-stage technology companies; new venture funds continued to appear (including the first venture funds in Russia to be set up under investment partnership agreements); and co-investment developed further.

However, difficulties in the Russian economy (exacerbated by international tensions over Crimea) postponed any cure for the market's chronic ills, which include absolute dominance of IT to the detriment of biotech and industrial tech, low number of corporate venture funds and lack of foreign involvement. The latter problem is now complicated by tensions between Russia and the west.

Our aim in this report, as in preceding reports, is to help make the Russian VC market more transparent and understandable, and thereby contribute to its growth



Arseniy Dabbakh

Director, Corporate Finance
Rye, Man & Gor Securities

About Rye, Man & Gor Securities

Rye, Man and Gor Securities (RMG) is an independent Russian investment company. RMG has been on the market for 20 years, in which time it has earned an excellent reputation among both clients and peers as a reliable partner.

RMG provides a wide range of services to Russian and foreign clients in the venture capital market, including:

- search for promising target assets;
- capital raising through public or private offerings;
- search for strategic investors and M&A deal support;
- venture project support, including strategy development and measures to increase capital-raising potential;
- advisory on deal structuring and financing, deal processing, negotiations, and due diligence of target companies.

Rye, Man & Gor Securities is a member of the National Alternative Investment Management Association (NAIMA). NAIMA is a non-profit partnership representing alternative investment firms and service providers committed to the growth of long-term capital in Russia. Its major targets are:

- raising awareness of the alternative investment sector among asset allocators, regulators and entrepreneurs;
- creating a more favorable legal environment for direct investments;
- promoting Russian private equity and venture capital in the global limited partner/general partner community and setting professional standards for further development of this market.



About East-West Digital News

Dear Readers,

When I arrived in Russia five years ago to work in a Western venture fund, the local venture capital market had only just been born. There were no more than 20 funds active, Russian and foreign. Skolkovo was still no more than a field on the outskirts of Moscow (the project was announced in late 2009), and I can remember just one startup incubator in Moscow.

Since then, with government encouragement, startups, funds, technoparks, incubators and accelerators of all kinds have sprung up like mushrooms after rain – not only in Moscow, but also in a range of other major cities such as Kazan, St. Petersburg, Nizhny Novgorod, Novosibirsk and in Russia's Far East.

To illustrate the progress: more than 1000 projects from all over Russia now compete every year at BIT, Russia's largest startup contest, compared with 70 when the contest was created in 2003 and 200 in 2009.

In 2010-2012, the volumes on Russia's venture market became significant, approaching one billion dollars – far behind China and India, but comparable to the US market in segments like e-commerce.

The recent decrease in total investment volumes can be seen as a step towards maturity, as investor interest in later-stage investments increases and exits multiply.

Meanwhile, this opportunity-rich market knows remarkably little about itself. Analytical reports on the Russian venture market are few in number and of varying quality, and international venture databases miss many of the transactions, which in fact occur. As a result, Russia remains terra incognita for most global investors.

We at East-West Digital News found RMG's coverage of this market to be the most complete and accurate among available sources. That is why we decided to lend our support to RMG's initiative, in line with our mission of informing the global business community objectively and reliably of developments in Russia's innovative industries.

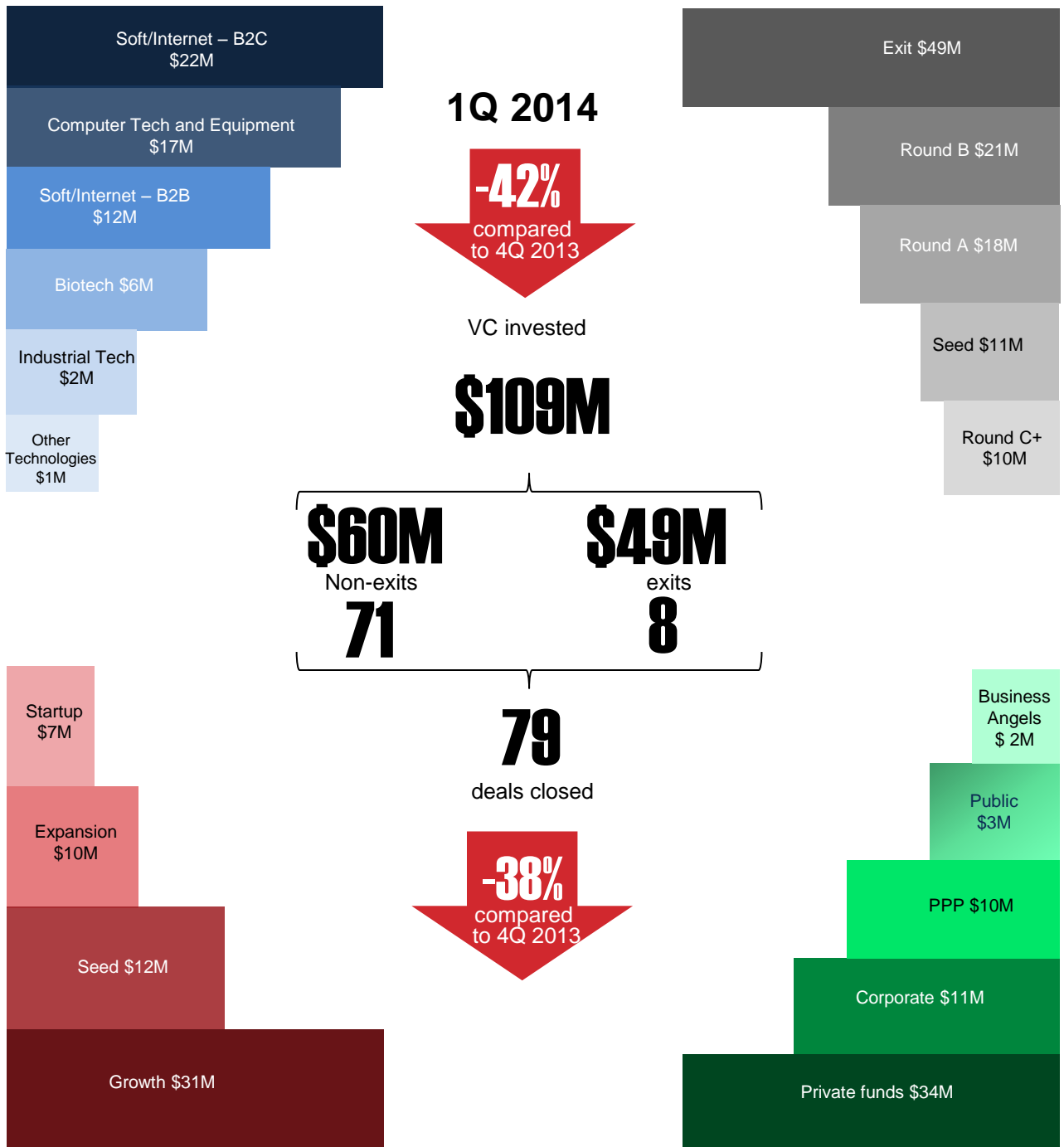
We will do all we can to ensure that this groundbreaking effort helps to increase investment efficiency, mutual trust and transparency for the global business community, as well as helping to develop business ties between two worlds that are sometimes tempted to turn away from each other.

East-West Digital News is the first international information company dedicated to Russian digital industries. Its website EWDN.COM provides news, market data, business analysis and updates on the Internet, e-commerce, mobile and telecom markets, software and hardware innovation, as well as to related investment activity and the institutional environment. The company also provides in-depth industry reports on these topics. A consulting branch, East-West Digital Consulting, helps international players to develop their business in Russia and advises Russian companies on their international strategies.

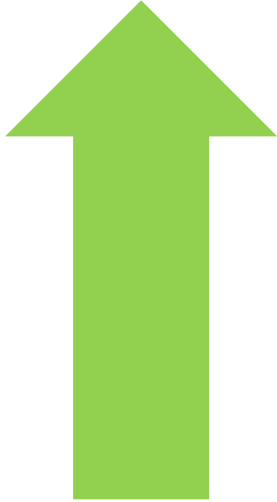


Adrien Henni
Editor-in-Chief
East-West Digital News

Russia's venture capital market: the 2-minute tour



Trends on the VC market



- Market decline was slowed down by investments made by the Internet Initiatives Development Fund (IIDF) in February 2014.
- The Russian venture market remains IT-oriented, but the share of technology has increased to 44% of total deal value.
- The Russian government continued to channel most of its financial assistance to early-stage technology projects, compensating lack of interest in this segment from other investors.
- Average deal value was almost unchanged despite decrease in the total number and volume of deals.

- Total venture capital decreased dramatically in the first quarter of 2014: the number of deals was down by 38% compared with the previous quarter (the drop affected all stages) and the total value of deals was down by 42% as the situation in the Russian economy worsened.
- The number of exits decreased sharply: there were just seven exits worth total \$49M, and most of the value was in one large transaction (Sergei Kalugin sold a large block of shares of WebMediaGroup holding for \$40M dollars). The negative development is explained by almost total lack of exit funding by private funds in 1Q.

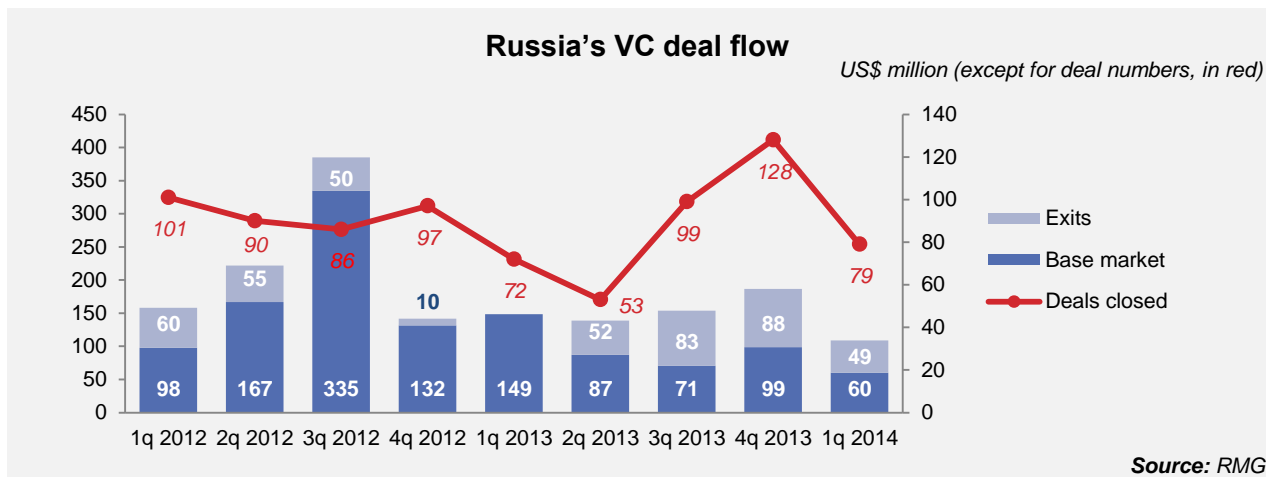


A few months after Crimea, the readiness of Western VCs to invest in Russia has been significantly affected, according to several sources. This is explained by current perception of the Russian market as highly risky and by specific concerns about co-investing with Russian funds, in case they are found to be linked in any way with persons or organizations targeted by the recent western sanctions.

Adrien Henni, Chief Editor, East-West Digital News

VC market overview

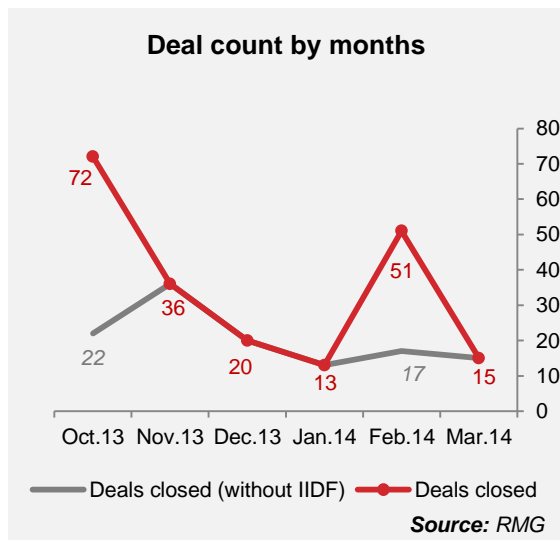
The market hasn't found new drivers yet



The first quarter of 2014 broke last year's positive trend: the number of deals decreased as did their total value. Russian venture projects raised \$60M dollars in 71 non-exit deals and \$49M dollars in 8 exit-deals, so the number of deals decreased by 38% and the volume of deals decreased by 42%. It is important to note that part of the deals (43%) were closed by the IIDF in February, slowing down the market decline (the fund makes investments at the seed stage).

Worried that a "made in Russia" label could harm their image among commercial partners amid recent international tension, some Russian startups have begun moving their headquarters to the West or even to Ukraine, or are considering doing so. They include Game Insight, which moved its headquarters to Vilnius, the capital of EU member state Lithuania. However, this phenomenon is not entirely new, considering the number of Russian startups and entrepreneurs that have established themselves in California over the past few years. It should also be noted that, even before the recent political tensions, Western and Russian investors favored Russian startups with global potential, worrying that the Russian market might be too small.

**Adrien Henni, Chief Editor,
East-West Digital News**



Exits and large deals

1Q 2014 results

Company name	Business description	Investor	Exiting stakeholder	Deal value, \$ million	Sector
Exits					
WebMediaGroup	Internet-holding	Gazprombank	Sergei Kalugin	40	Software/ Internet , B2C
KitLocate (Israel)	Developer of geolocation technology for mobile devices	Yandex		8	Software/ Internet , B2B
Large deals					
Aviasales	Flight search engine	iTech Capital		10	Software/ Internet , B2C
Mango Telecom	Cloud business applications supplier	Intel Capital		10	Computer Tech and Equipment

Source: RMG

There were two large exit deals in the first quarter of 2014. Yandex paid \$8M for the Israeli start-up KitLocate, which develops technology for geolocation by mobile devices with low consumption of battery power. Sergey Kalugin, the president of Rostelecom, sold his block of shares in WebMediaGroup holding, which includes the video service Zoomby.ru, internet-hypermarket Dostavka.ru and a number of other sites. The sale of 25% of shares was worth \$40M.

Other large deals in 1Q included the purchase of a minority stake in the flight search service Aviasales by venture fund iTech Capital for \$10M. The money will be used for business development, including expansion into new markets. There was also a \$10M investment by Intel Capital (the investment fund of Intel Corporation) in the leading Russian cloud business applications supplier Mango Telecom, to help it prepare for expansion into the European market.

New VC funds in 1Q



Softline Seed Fund (SSF) (the first venture fund in Russia to be set up under an investment partnership agreement)

Founders: RVC Seed Fund, Softline Venture Partners.

AUM: \$981,000

Sectors: cloud services, digital marketing and data protection technology, mobile applications

Fund manager: Softline Venture Partners.

Stages: preseed and seed.

Investment horizon: 3 years with recapitalization option.

Planned number of projects: 5-8.



High Technology Fund (the second venture fund in Russia to be set up under an investment partnership agreement).

Founders : RVC Seed Fund, TONAP-Venture.

AUM: \$964 000

Sectors: biotechnology, new materials, energy efficiency.

Stages: preseed and seed.

Investment horizon : five years with possibility of extension.

Planned number of projects: 5-8.



OJSC Rostelecom Corporate Venture Fund

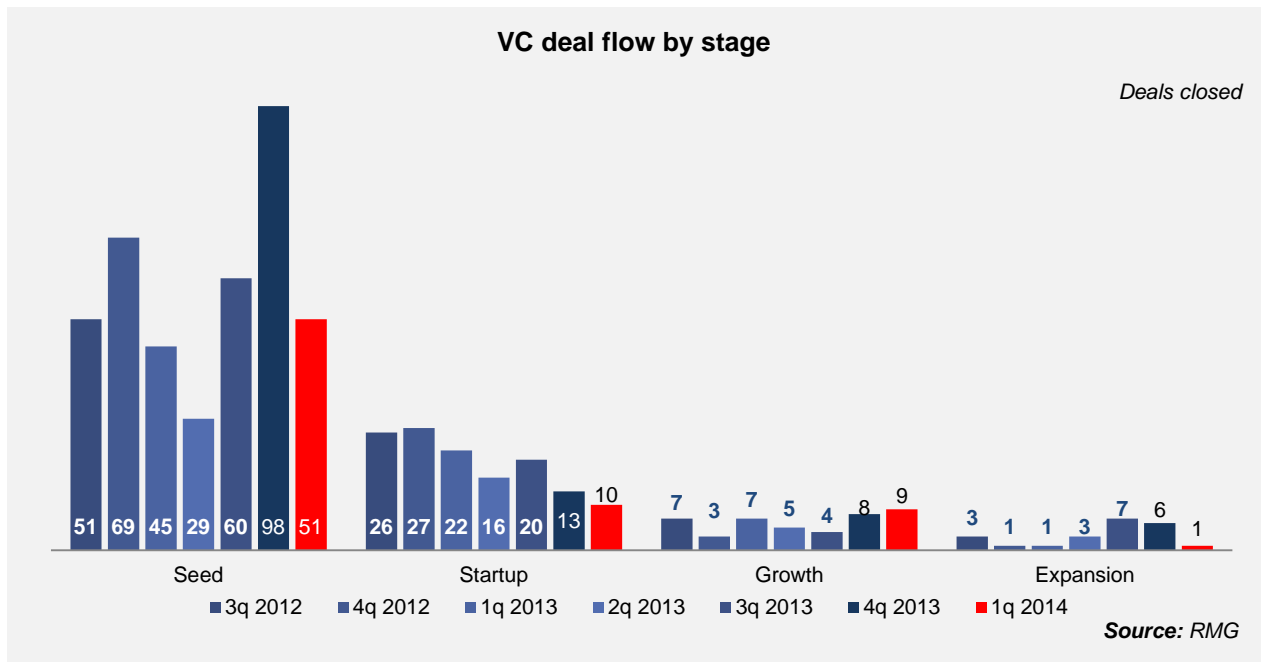
AUM: RUB 90-160m.

Sectors: electronic payment systems, internet advertising, content distribution, geolocation.

Stages: up-and-running businesses, startups.

VC market structure: stages

Deal numbers declined at all stages except the growth stage

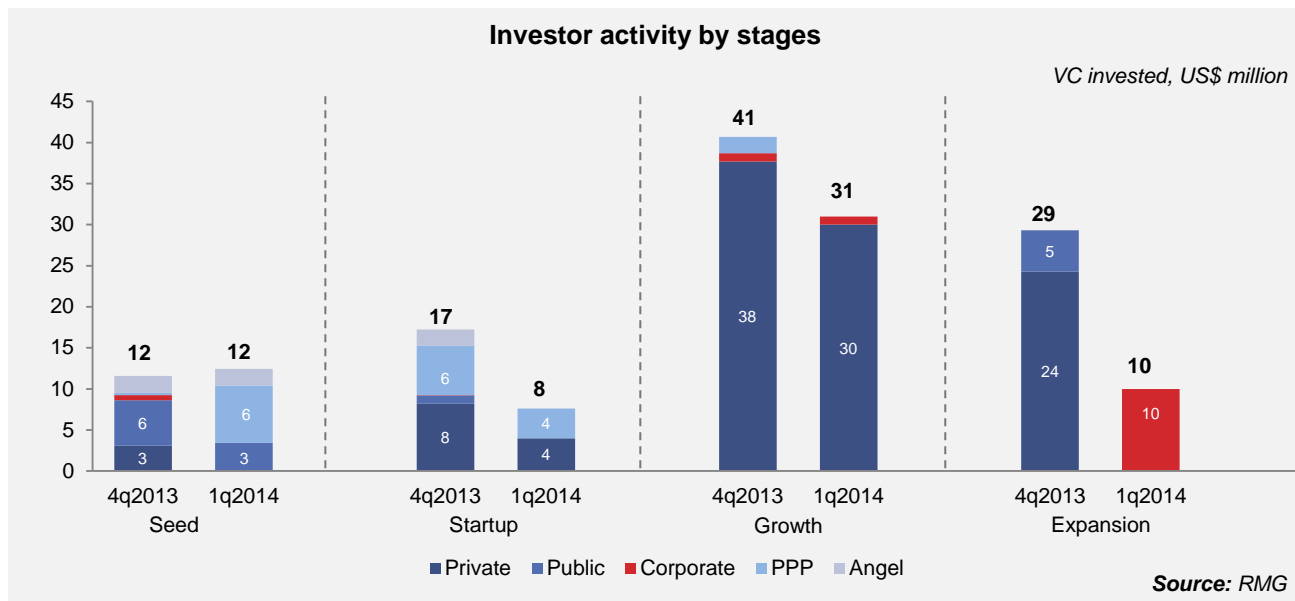


Investments in new projects suffered particularly badly from shrinkage of the venture market in the first quarter (the number of projects at the seed stage decreased by 52%), although investments at the expansion stage suffered even worse (reduction by 83%). The sharp decrease in seed stage investments is partly explained by negative sentiment in 1Q, but it also reflects greater pickiness on the part of investors, who have become more exacting in the requirements they make on projects.

The number of startup deals fell by only 23% and the number of deals at the growth stage actually increased (by 12.5%) in 1Q.

VC market structure: stages

Average deal value was unchanged

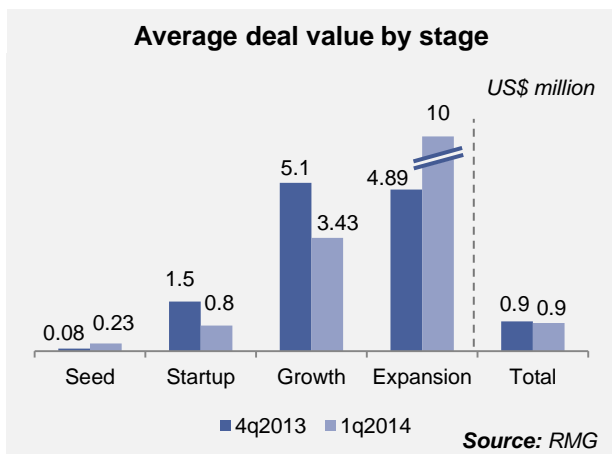


The total value of deals at the seed stage in 1Q was unchanged, despite the plunge in deal numbers, thanks to increase in average deal value (by 3x). So, while investors are being more selective at the seed stage, they are also ready to invest more money in each project.

At the growth stage, conversely, increase in the number of deals (+12.5%) did not entail increase in the total value of deals, due to decrease in average deal value (-33%).

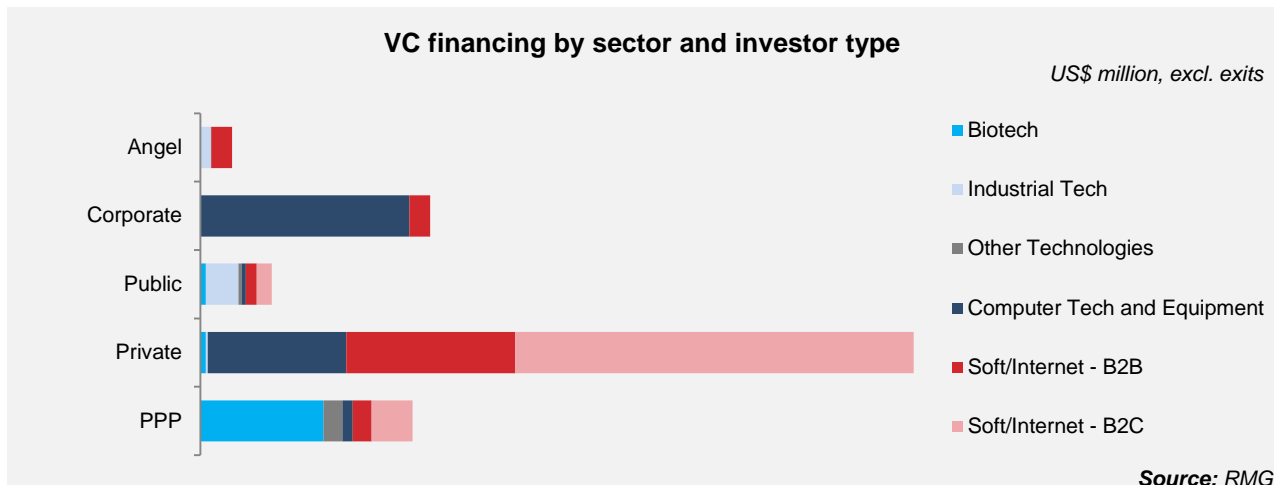
At the startup stage a decline in total deal value (-53%) was accompanied by decline in the number of deals (-23%) and average deal value (-47%). At the expansion stage there were also declines in total deal value and the number of deals, but average deal value increased. This is simply explained: there was only one deal at the expansion stage in 1Q!

Average deal value at all stages was unchanged q-o-q.



VC market structure: investors

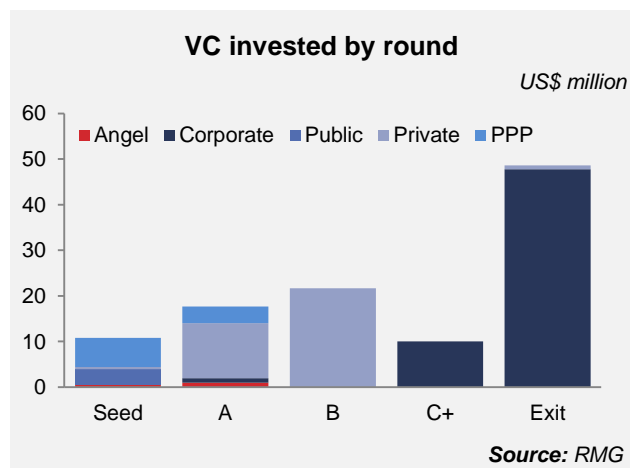
Corporate investors drawn to computer technology



One major change evident in 1Q was reorientation by corporate investors from Soft and Internet (about 90% of corporate investments in 4Q 2013) to Computer Technologies and Equipment (about 90% of corporate investments in 1Q 2014). Private funds also began to invest more in Computer Technologies and (to a lesser extent) in Biotechnology. Business angels ventured beyond the Soft and Internet sector to try the water in Industrial Technologies.

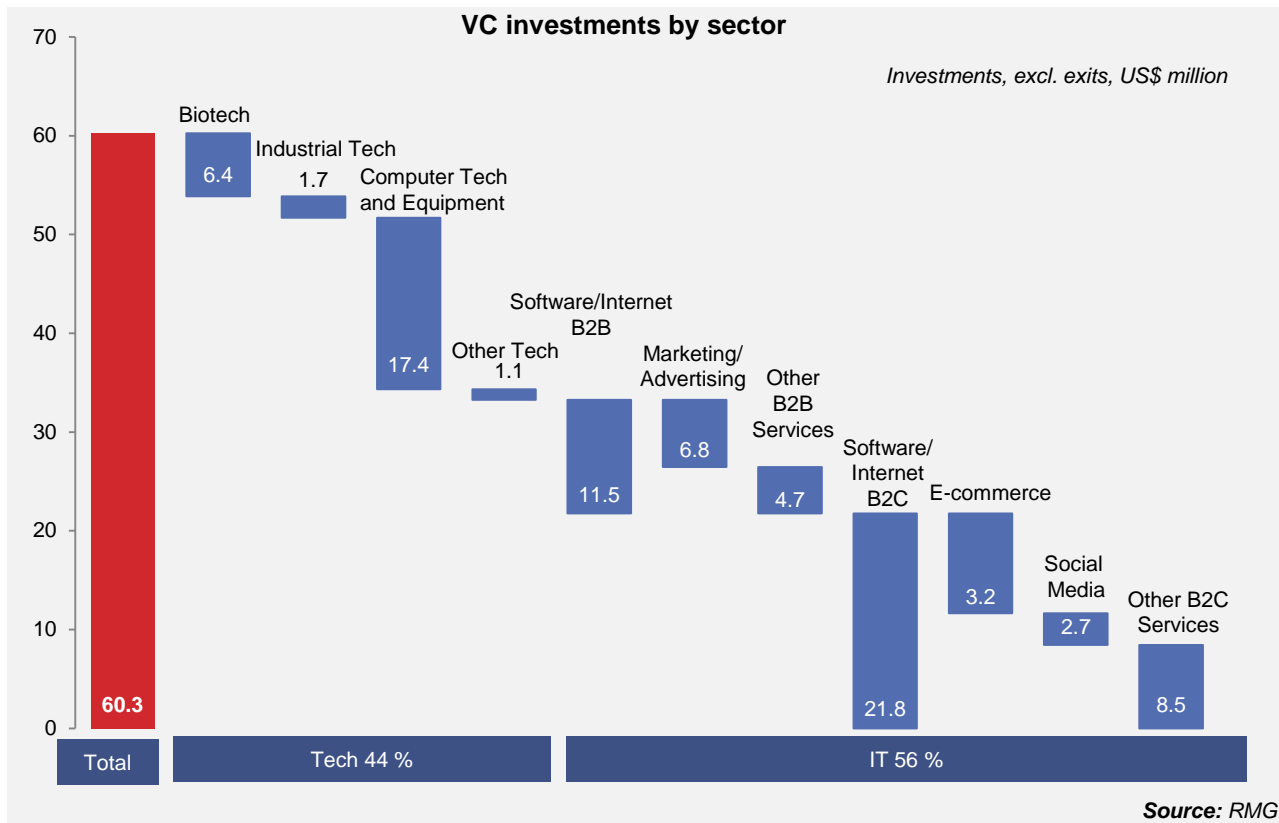
The Russian government (public funds or public-private partnerships) invested in practically all sectors, but in varying amounts: 46% in Industrial Technology, 36% in Soft and Internet, 7% in Biotechnology, 6% in Computer Technology and 5% in Other Technology. It should be noted that nearly all investments in Biotechnology were government-backed (either public funds or public-private partnerships).

There are also clear distinctions between investors by their preferred investment round. Corporate funds mainly invest at stages C+ and exits. Business angels tend to invest no later than the A stage. The Russian government invests at early stages (seed and A) to compensate for lack of early stage financing by other investors. Private funds concentrate on financing at rounds A and B.



VC market structure: sectors

Technology continues to catch up with IT

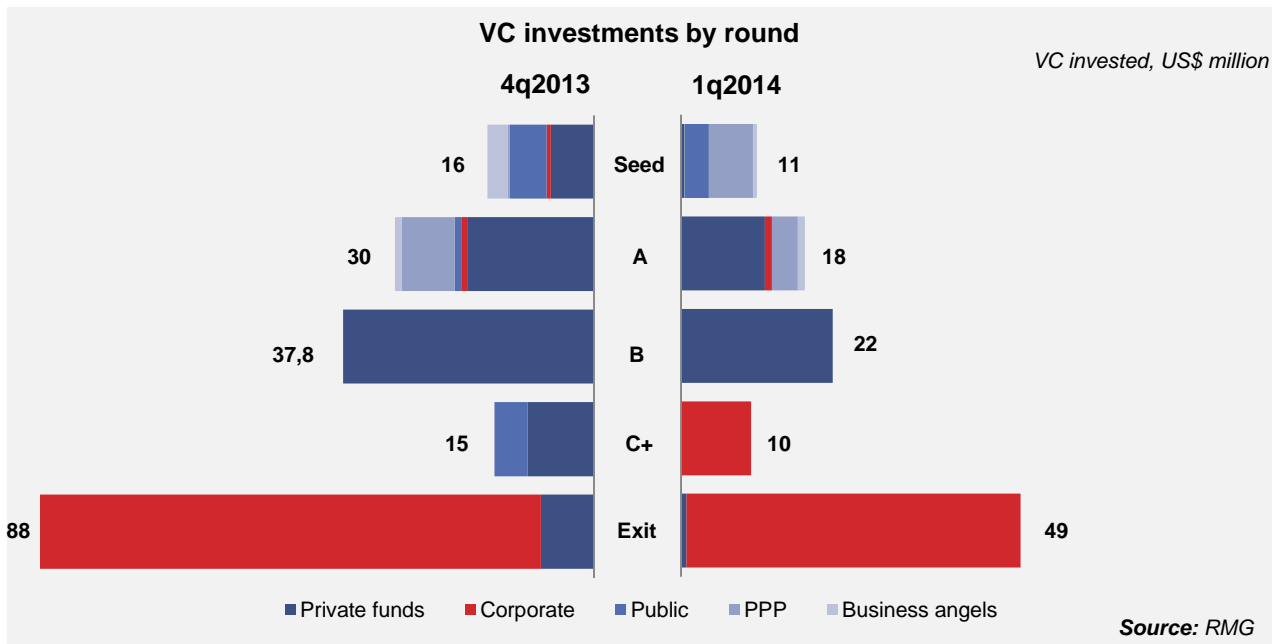


In a major change from the last two years, when the share of the IT sector was about 80%, the Technology sector took nearly half of investments in the first quarter (44%) while IT fell back to 56%. Computer Technology and Equipment (classed in “Technology” and not “IT”, which is software) and Botechnology accounted for 66% and 24% of total technology investments, respectively.

The B2C segment still dominates the IT sector (66%), and E-commerce and Social Media are the biggest B2C components (15% and 12%, respectively). B2B is led by Marketing and Advertising (59%). Investor interest in education and finance projects has declined.

VC market structure: rounds

Fewer exits



Investment volumes decreased at all rounds in the first quarter, including 32% at the seed round and 44% at the exit round. The latter took the biggest hit, falling from \$88M to \$49M. Specific factors explaining the shrinkage of exits (in addition to overall market contraction) include cessation of exit financing from private funds and some reorientation of corporate investors (the main investor at the exit stage) to C+ deals.

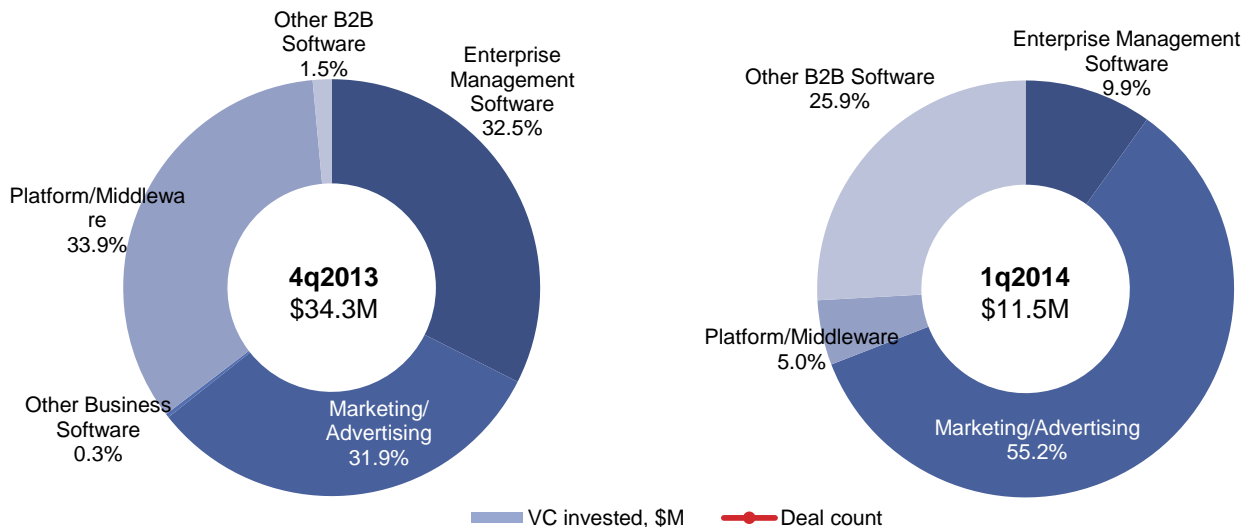
The biggest changes in investment structure were at the C+ round, where corporate investors have largely replaced private and public funds.

Stories that Western funds are skeptical about investing in Russia because of Crimea aren't accurate. In the past few weeks, I spoke directly with managing partners at five well-known western funds. Only one of them has put Russia investments on hold. The others said that they are "still in the game".

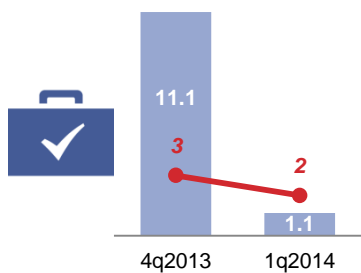
Maxim Faldin, co-founder of Wikimart.ru
(on the search for fourth-round investors)

Software / Internet – B2B

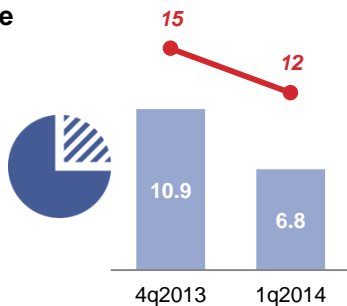
Marketing and advertising are prevalent on the B2B segment



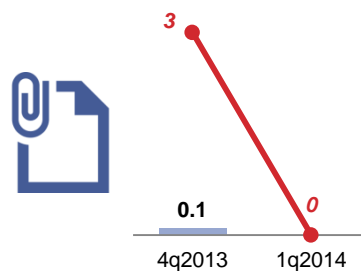
Enterprise Management Software



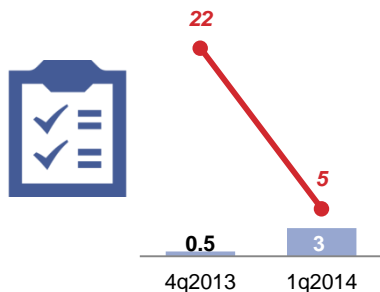
Marketing / Advertising



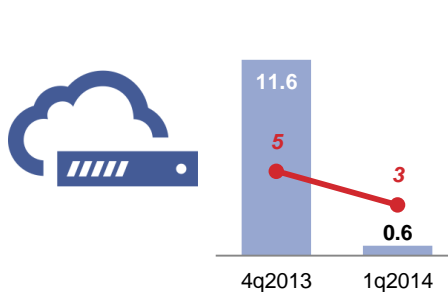
Other Business Software



Other B2B Software

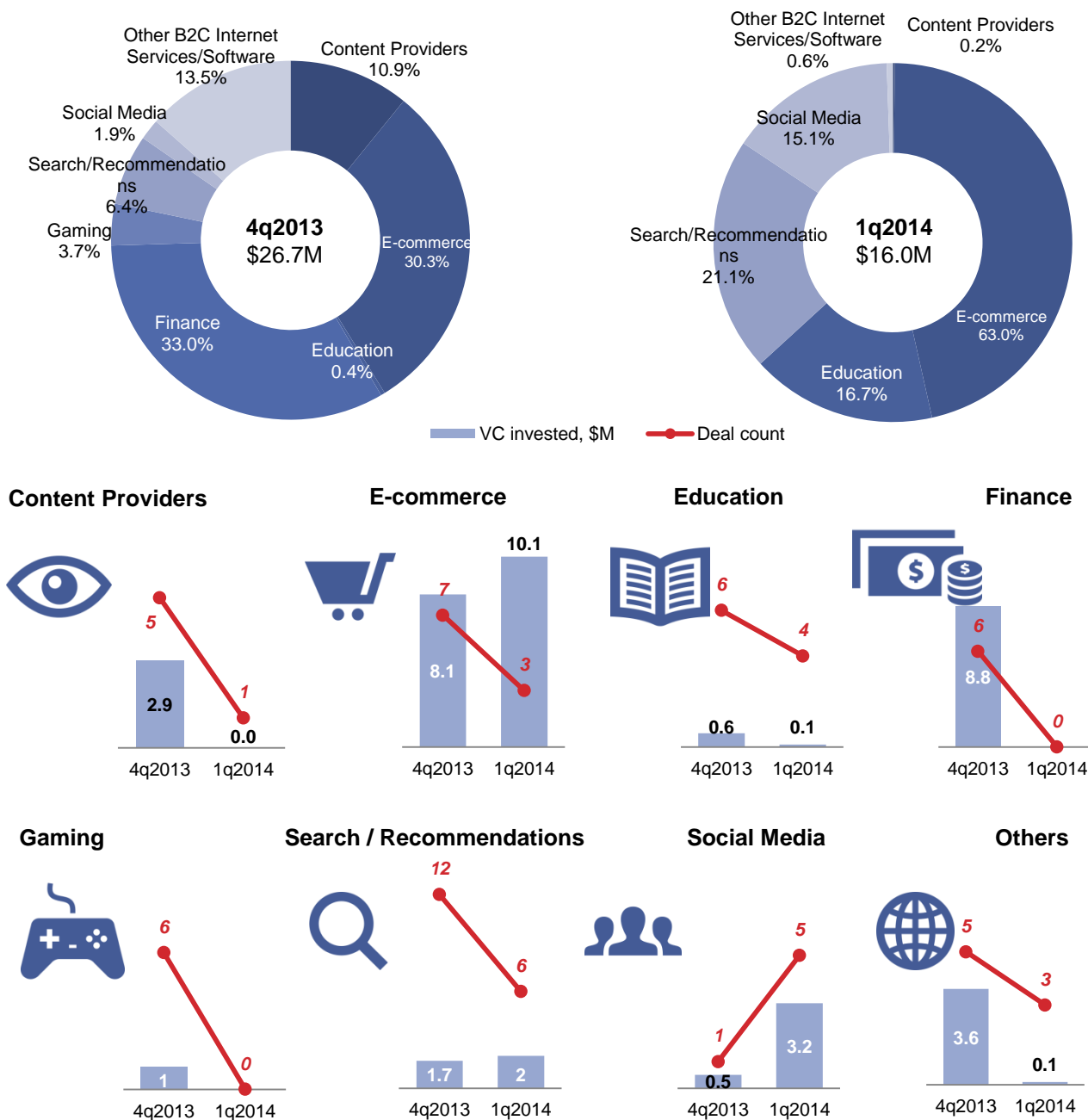


Platform / Middleware



Software / Internet – B2C

E-commerce and social media mitigate B2C decline



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Methodology

For the purposes of this report, 'venture capital investments' stand for investments of up to \$100M in high-risk and potentially highly profitable technological projects. Only VC investments in companies whose operations are focused on the Russian market were included in calculation of the market size. Companies financed by Russia-based investors, but oriented to foreign markets are not included in the analysis.

In this report corporate or corporate investors shall be understood to mean corporate funds.

We don't consider investments in infrastructure and exits in total value of venture market. By investments in infrastructure we mean investments in venture funds, business incubators, business accelerators, technopolises and other institutions that work on the venture market but which are not venture companies.

Grant financing was included in the calculation of market size as, although grants are non-repayable, they are used to finance commercial VC projects and thus represent an inflow to the VC economy.

Seed is the first round of investments, in which financing is arranged for the flotation of a company. Rounds A, B, C, etc. are subsequent rounds when additional financing is arranged. The letter represents the ordinal number of the round: the first is A, the second is B, etc. After round C, we use name C+. Exit is a deal in which no additional financing is arranged, but one or two current shareholders sell their stakes to a strategic investor or via an IPO.

For the purposes of this report, four stages of a VC project development are distinguished:

1. Seed: the project exists only as an idea or laboratory research.
2. Startup: a company is in the process of organization or has conducted operations for some time but sales have been minimal or zero.
3. Growth: launch of marketing and regular sales of a new product..
4. Expansion: a company increases its sales, market share, output etc.

We distinguish seven sectors: Biotech; Industrial Tech; Computer Tech and Equipment; Other Tech; Software/Internet B2B; Software/Internet B2C; Other IT. The first four sectors comprise the Tech macrosector and the rest comprise the IT macrosector.

Biotech: healthcare, pharmaceuticals, diagnostics and medical equipment development.

Industrial tech: laser, energy, green, aerospace technologies, robotics and other technologies designed for industrial use.

Computer tech and equipment: telecommunications, data storage, mobile technologies and computer equipment.

Software/Internet B2B: applications and web services whose clients are mostly businesses. The sector includes enterprise management, marketing, product development solutions etc.

Software/Internet B2C: applications and web services whose clients are mostly individual consumers, including e-commerce, content providers, search and recommendation engines, consumer finance solutions, educational services, games, social networks etc.

Contacts

We are very interested in the opinion of our readers, so if you are an investor, a venture entrepreneur or otherwise interested in Russia's venture capital market, we will be most glad to receive your feedback and suggestions to help us improve our reports.

Please send your feedback and suggestions to **vc@rmg.ru**

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