INTRODUCTION
OUR TEAM

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INSEAD team to present findings including:

i. The case for and against expansion
ii. Potential for geographic expansion
iii. Potential for stage-based expansion
iv. Summary recommendations

Full group discussion of one or two strategic options
Highland Europe has been **singularly focused** on backing early-growth stage European technology companies (with early-growth defined as raises of €15–60M) and has raised steadily larger funds and built its team to do so.

As it contemplates the next decade, Highland must decide whether to retain this focus in strategy, or to expand its mandate?

Two industry trends form the backdrop to this decision:

1. **Ongoing explosive growth in the global technology landscape**, including the rapidly maturing European tech ecosystem.

2. In parallel, the considerable **growth in capital competing** for investments stemming from traditional institutions raising larger funds and expanding their mandates, as well as non-traditional players including corporates, sovereign wealth funds and LPs investing directly.

The guiding principle for Highland’s future strategy is that it:

- **Drives outstanding returns** for Highland’s LPs...
- **... by enabling Highland to find, win and help scale the best companies**...
- **... building on Highland’s competitive advantage** and aligning with its ethos.

**Process followed**

- Spoken to 10+ industry participants including competitors and LPs
- Benchmarked fund performance, market size and level of competition by stage and geography (where available)
- Canvassed the Highland team to gather thoughts and test hypotheses
SHOULD HIGHLAND EXPAND?
## The Case for Expansion

<table>
<thead>
<tr>
<th>Grow resources</th>
<th>Highland must continue to compete with companies raising considerably larger fund sizes and investing their increased resources in deal sourcing and portfolio support capabilities.</th>
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<tbody>
<tr>
<td>Support portfolio internationally</td>
<td>International expansion (US, Asia) is a key focus area for Highland backed companies. However, Highland’s credentials here are currently less compelling than those of its US and global rivals.</td>
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<tr>
<td>Develop our People</td>
<td>To recruit and retain the best talent, Highland must be able to offer a path to partnership for at least a portion of the young investors joining the firm. Ultimately this requires expansion in fund size.</td>
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<td>Seize the advantage</td>
<td>Leverage deals outside of Highland’s core strategy in which Highland has a competitive advantage including portfolio follow-ons, subsequent rounds in anti-portfolio companies, and either early, late or buyout deals in sectors in which Highland has expertise.</td>
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THE CASE AGAINST EXPANSION

Focus
Highland’s existing strategy underpins its success to date. There is benefit in staying focused.

Vocation
Highland team is motivated by building relationships with founders & helping grow their businesses (not by growing AUM)

Culture
Highland’s “family” culture will not scale indefinitely as team grows

Headroom
Highland has ample room to grow its fund size solely in its core market, which has doubled since 2017

Note: Series B & C used as a proxy for early-growth stage in the absence of more accurate data
GEOGRAPHIC EXPANSION
GLOBAL INDUSTRY DOMINATED BY US AND ASIA, BUT EUROPE GROWING FAST TO REACH C.$50B IN 2020

Source: Preqin, KPMG Venture Pulse Q4 2020

Global VC investment by region ($B)

<table>
<thead>
<tr>
<th>Region</th>
<th>2015</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>96</td>
<td>182</td>
</tr>
<tr>
<td>Asia</td>
<td>76</td>
<td>120</td>
</tr>
<tr>
<td>Europe</td>
<td>19</td>
<td>47</td>
</tr>
</tbody>
</table>

European VC investment ($B, 2020)

- UK: 15.3
- Germany: 7.1
- France: 6.3
- Nordics: 5.7
- Israel: 5
- Rest of Europe: 7.4
SINCE 2015, LOCAL AVAILABILITY OF DRY POWDER HAS DOUBLED IN ASIA RELATIVE TO THE US, NOW CLOSE TO PARITY

**Asian VC dry powder and investments as % US**

- 2015: 39% (Asia dry powder), 22% (Asia deals)
- 2020: 79% (Asia dry powder), 80% (Asia deals)

**European VC dry powder and investments as % US**

- 2015: 22% (Europe dry powder), 24% (Europe deals)
- 2020: 20% (Europe dry powder), 26% (Europe deals)

Source: Preqin
LEARNINGS FROM INTERVIEWS: MORE TO DO IN US AND ASIA

Highland team

The US

• “The US is the most obvious opportunity for us. Synergies around sourcing, network, brand. Should we be doing more with US funds?”

• “There’s appeal in being able to tell a strong US story. I could see us coming back together with HCP – they’re likeminded”

• “We need to be credible for our companies as a bridge to the US. Does that mean building out more there? And are we right to prioritize HCP as partners?”

• “We should keep nurturing strong relationships with US funds. The more we coinvest with strong American funds and have buddy relationships there, the less we need the distraction of a US based partnership”

Asia

• “We’re nascent when it comes to supporting our companies in China. The list of people we could call out there is short”

• “India and China would be tough to do ourselves, but could we be doing more with AlphaX?”

Warburg Pincus China, Peele Investment, Starquest Capital, 5Y Capital India, JI Capital Singapore

• “The Chinese market is super competitive there’s a ton of dry powder”

• “To win in Asia, it is critical to empower and trust the local team: decisions must be made locally even if the regional leader is appointed from abroad”

• “Sequoia, Hillhouse and Matrix Partners are the top funds in China and were early entrants. The teams are localized and make the decisions independently from HQ”

• “China’s VC industry has matured. In 2005-10 it was mostly managers from top tier foreign funds, but more recently managers with local experience including entrepreneurial experience are emerging”

• “There is less competition in India compared to China helped by Indian government regulations which banned Chinese and Pakistani funds investing in India”

• “Singapore is a key hub but the real activities (almost 95%) happen in-country (in Indonesia, Philippines, Vietnam, Malaysia, Thailand)”

• “The uncertain political environment makes it difficult for a foreign fund to enter S.E. Asia. It is also important to maintain good relationships with the main wealthy families, which requires rich localized network and knowledge”
## US Expansion

### Pros
- Huge focus area for Highland’s active and prospective portfolio companies for commercial expansion, follow-on investment and exit
- Highland experienced in supporting European companies with US expansion
- Highland has invested opportunistically in the US alone (Oro, Maropost) and alongside HCP (Malwarebytes, Domino)
- Highland has strong ties in the US including to HCP and associated spinouts

### Cons
- Highland’s lack of material US presence a disadvantage when competing with US funds for European deals
- No internal appetite to set up a US-focused fund and enter fiercely competitive local market
- Highland has very limited sourcing coverage in the US and somewhat limited local market knowledge

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### Determine preferred partner(s) for US, and expand activity level

- Decide whether HCP to remain our preferred partner for US deals or whether other firms should be considered alongside them?
- Depending on the above, deepen ties with US partners including:
  - Sourcing collaboration
  - More co-investment activity (e.g., to fill out large European rounds of >€60M)
  - More social interaction
  - Encourage Highland investors to spend time on rotation in the US
  - Hire US-based talent manager?
  - Eventually, consider portion of shared carry across the US and European funds
ASIA EXPANSION

Pros

• Rapidly growing and maturing market across every stage and sector of the ecosystem
• Asia likely to become increasingly relevant to European tech companies from commercial expansion (e.g., Huel), follow-on funding and eventually exit perspective
• Highland relationship with AlphaX Partners

Cons

• Immature markets with significant regulation, political intervention, capital restrictions etc.,
• Highly local and relationship driven
• Fierce competition from local funds: local dry powder nearing parity to the US. Early foreign funds entered the market 20 years ago and are now well established
• Highland nascent in Asia

Deepen Asia ties to enhance European portfolio support

• Expand network & increase activity to better advise EU portfolio companies wanting to expand in Asia & to benefit from Asian tech ecosystem learnings
• New investor hire into EU team with Asian network & work experience
• EU team to spend more time building out network in Asia
• Hire China-based business development associate
• Target co-investment with AlphaX in Fund IV/V
NEW EUROPEAN MARKETS EXPANSION

Pros

- Europe is Highland’s core market: clear fit with existing strategy and value proposition
- Easy markets to serve from existing offices
- Highland has proven track record of building presence in new markets following an initial “launch” investment (e.g., Smartly in Finland)
- Each country is its own market with local nuances and competition
- Amount of time, effort and focus required to truly penetrate the local market including building network, reputation, understanding and sourcing coverage should not be underestimated
- With some exceptions (e.g., Israel), new European markets are small and immature in the growth stage making desirable deals sporadic

Cons

- Set internal targets regarding new geographic entry per fund. For example, in Fund IV: investment #2 in Israel and investment #1 in Norway or Sweden
- Ensure coverage of new geographies by allocating responsibility or encouraging focus of individual associates
- Temporarily place Principal/Partners in strategic but underdeveloped locations in Europe
- Eventually enter new geographies adjacent to Europe (e.g., MENA) in the same manner
STAGE EXPANSION
EARLY GROWTH NOW C.$15B MARKET IN EUROPE, DOUBLE THE SIZE OF THE EARLY AND LATER STAGE SEGMENTS

![European investments by series ($B)](chart)

- **Series A**: 2018 - 5.8, 2020 - 8.0
- **Series B & C**: 2018 - 8.4, 2020 - 15.5
- **Series D +**: 2020 - 2.8, 2020 - 7.0

Note: Series B & C used as a proxy for early-growth stage in the absence of more accurate data

Source: KPMG Venture Pulse Q4 2020
LARGE FUNDS HAVE OUTPERFORMED SMALLER FUNDS OVER THE PAST DECADE

Net IRR 2000–19 for global venture capital vintages, 2000–16 (%)

Implications

- Later-stage and multi-stage focused funds tend to be larger. Implication that they outperform?
- Most successful managers raising larger funds likely to impact data as well

## LEARNINGS FROM INTERVIEWS: MOST GROWTH FUNDS HAVE EXPANDED

### Going early

- “We’re tightly focused on one sector (B2B SaaS) and so need to be ready to go broad on stage. We don’t want to leave money on the table for other investors to claim at other stages”
- “We went early because we already had the capability. Passing on early rounds just because they were too early didn’t feel like a good reason”
- “A handful of our early deals will succeed and for those we’ll be able to lead future rounds and wind up deploying a good chunk of capital. For the rest, a few 10m bets don’t impact a multi-billion fund”
- “Enabling younger team members to lead earlier deals and take board seats protects senior bandwidth”
- “It’s early days but returns are looking quite encouraging”

### Growth & buyout

- “Are we AUM driven? There’s always that, but ultimately it’s not our motivation. It’s more about raising appropriate funds for the deals we’re trying to do – to drive top quartile performance”
- “Strategy evolved iteratively. Fund size grew in the US and eventually lost touch with $20-60m growth deals so we raised the early fund”
- “Europe fund is a mishmash of the US strategies but sweet spot is $30-60m cheque. Above that we bring in the flagship fund alongside”
- “The whole team is jack of all trades. There’s some gravitation of senior investors to particular strategies but everyone is equally incentivized across the funds”
- “Growth entrepreneurs don’t care that we do buyout. The difference it makes to them is the resources we have, the value enhancement team”

### Going late

- “Later stage is pretty much the same job; we didn’t see big challenges. You need bigger teams, more advisors, more rigorous financial analysis, but the core is the same”
- “The more time you spend in the industry, you understand that the economics support later stage investing. Management is stronger, processes are in place, helping the companies takes less of the fund’s time”
- “You get to do more of the fun stuff: strategy, how to scale globally”
- “In Highland’s position you can scale easily; the question is about lifestyle and culture”
EARLY-STAGE EXPANSION

Pros
- Huge potential upside thanks to low entry valuation
- Strong focus on people, aligned with Highland culture
- Early stage is "fun" – building a company, shaping culture etc. Very participatory and creative.

Cons
- Higher risk – minority of early-stage investments show positive returns
- Large number of investments required to diversify risk
- Longer timeframe to liquidity
- Different skillset required therefore additional human capital needed
- Highly localized
- No less time consuming than later stage deals but harder to move the needle on a large fund

No recommended expansion in early-stage

- Highland should avoid being drawn into early-stage investing
- Highland should at most continue to treat such investments as once-a-fund "wildcards"
LATE-STAGE EXPANSION

Pros

• Attractive risk-reward profile with product-market fit well established, strong management teams, clearer exit trajectory
• Can deploy more capital per deal
• Similar skillset to early-growth investing
• Allows growth in fund size and therefore in resources
• Makes Highland more appealing to some early growth stage entrepreneurs who care about the size of their backers’ balance sheet
• Highland already has the dealflow

Cons

• More competitive than early growth
• High absolute valuations and more valuation risk
• Less personal/fun: companies are well-established, likely to have had prior institutional backers, more bank-led deals. Less aligned with Highland differentiation
• Lends itself to scaled AUM and institutionalization. Not aligned with Highland culture
• Signalling risk where we do not lead later rounds of earlier investments

Actively track late-stage cos and streamline LP co-invest process to take advantage of later stage opportunities

• Continue to track promising companies as they move beyond Highland’s typical stage of investment (especially when meaningful time has been spent on DD previously)

• Establish a compelling way to fill out rounds that exceed Highland’s maximum cheque size:
  • LP co-invest via SPV is amenable to LPs but will only work for competitive new deals if process is smooth
  • “Club deals” with friendly funds is another option. Particularly compelling where other fund brings value add (e.g., US or sector expertise)

• Be more aggressive in leading or participating in portfolio follow-ons
SUMMARY

RECOMMENDATIONS
HIGHLAND SHOULDN'T AUGMENT CURRENT STRATEGY BY DEEPENING US & ASIA TIES, AND CREATE OPTIONALITY IN LATE STAGE EU MARKET

1. Stay focused

Existing core strategy:
- Underpins Highland’s exceptional returns to date
- Enables & is reinforced by Highland’s culture and ethos
- Aligns with Highland partner interest in building relationships with founders & helping grow their businesses
- Places Highland in a large, growing market with ample room for AUM growth

2. More to do internationally

- Determine preferred partner(s) for US, and deepen ties: sourcing collaboration, co-investment activity, US-based hire?
- Deepen Asia ties to enhance European portfolio support: new hires with Asia network? Asia-based hire?
- Expand into new European markets more deliberately

3. Create optionality in later stage EU market

- Continue to track promising companies as they move beyond Highland’s typical stage
- Establish a compelling way to fill out large rounds: LP co-invest or club deals
- Resist being drawn deeper into early stage investing