

Market Update:

The venture capital market continued the strong momentum we discussed in our prior quarter's report. The amount invested in VC deals during QIII 2018 was \$27.9 billion, up 15% versus a year ago and the third consecutive quarter exceeding all pre-2018 quarters in the past dozen years. YTD deal value totaled \$84.3 billion, up 37% versus a year ago and a record amount of capital raised for a year with one quarter yet to go.

The number of deals completed thus far YTD, at 6,583, is 7% below the same period in 2017. This continues a slowly declining trend in numbers of deals since 2015 along with an increase in average deal size.

The increase in deal size is primarily due to the rise of big deals, as rounds totaling \$50 million or more are becoming more prevalent; there were 263 such financings through September 30, 2018, compared to 206 in all of 2017. In addition, during the first nine months, there were 39 "unicorn" financings (deals with valuations of \$1 billion or more) totaling \$8.0 billion.

This increase in deal size has been present at every round of VC financings, resulting in rising pre-money valuations across the board, most notably for Series A financings. Median pre-money valuation of Series A financings has increased steadily, from \$6.2 million in 2010, to \$10.9 million in 2014, to \$20.0 million for YTD 2018.

While VCapital invests primarily in Series A rounds, we continue to take a disciplined approach to the price paid for our investments. Our strategic focus on the Midwest, versus the traditional investment hotbeds of northern California and the northeast, has helped our quest for good value, as pre-money valuations and deal sizes tend to be lower in the Midwest and ultimate exit multiples on invested capital higher.

On the exit side, we are encouraged by the reawakening of the IPO market. Through September 30, 2018, the number of venture-backed IPOs has already surpassed that of 2016 and 2017. In addition to the number of companies going public, we are encouraged by the strength and quality of companies once they complete their IPO.

Finally, on the legislative front, in July the JOBS and Investor Confidence Act of 2018, or "JOBS 3.0," was passed in the House of Representatives by a 406-4 vote. This proposed law, which needs to be passed by the Senate and signed by the President, includes several

provisions that encourage capital formation for startups and seeks to find solutions to some of the issues that small cap companies face in the public markets. ¹

Portfolio Update:

Below is a schedule of the investments made by VCapital and BVC during the second quarter and the investment amounts as of September 30, 2018:

<u>Portfolio Company</u>	<u>QIII 2018 Investment</u>	<u>Investment at 9/30/18</u>
Atlas Space Operations	\$0	\$505,000
Camras Vision	\$0	\$1,471,000
Intensity Therapeutics	\$0	\$2,351,667
Padcaster	\$0	\$735,000
simMachines	\$635,000	\$1,838,500
Synap (Imagineer)	\$0	\$559,984
Xaptum	\$252,500	\$1,082,500

Atlas Space Operations (Developing Innovative Products and Services for Satellite Communications)

In August, Atlas announced that it joined forces with Xenesis and Laser Light Communications to form the Empower Space Alliance, with the goal of providing a turnkey direct optical data distribution service from spacecrafts to customer locations worldwide. This is an \$18M contract for Atlas, with 10% received upfront and approximately \$250k per month thereafter. This contract will make the company EBITDA positive. Please see the link below for a press release announcing this transaction.

[Atlas/LaserLight Press Release](#)

We are also encouraged by the recent successful launch with commercial payload by Rocket Lab. Like Atlas, which has innovated through physical downsizing of satellite communication ground stations, driving down the cost of satellite communications (as well as increasing capacity through ability to receive signals from multiple satellites simultaneously), Rocket Lab has innovated in the launch of small satellites. This is similarly driving down the cost of satellite launches, which will increase the number of satellites launched and in turn demand for the services Atlas provides.

¹ Statistics in this section were obtained from Venture Monitor 3Q 2018 published by Pitchbook and the National Venture Capital Association.

On November 7, 2018, VCapital Atlas Space, LLC invested an additional \$1.8M in the Series A round of Atlas, bringing the total VCapital investment in Atlas up to \$2.3 million.

Camras Vision (*Developing a New Superior Device to Treat Glaucoma*)

The third quarter was characterized by important learning, as the company encountered hurdles inevitable for an innovative startup and, encouragingly, found ways to surmount them. This reflects Camras' strong executive team, led by CEO Ray Krauss, previously COO at the company that brought Lasik (laser vision correction) to the market.

For example, during the quarter, Camras completed and put into manufacturing filter design improvements to reduce clogging of the Camras Shunt. Positive rabbit and monkey tests have indicated that this will improve the lifetime of the filter by a factor of 5-10x for a minimum of five years. This improvement, plus issues relating to mucin formation, have extended the company's overall development schedule from 6 to 12 months, resulting in a projected FDA investigational device exemption (IDE) in early 2021.

The Manila trial continues, and the company has learned a great deal from this first trial, which provided insight on how to improve shunt performance. The company is in the early stage of recruiting doctors for a trial in Mexico, and also expects to start a trial in Spain/Poland in mid-2019.

The company was awarded a \$500k grant from the National Science Foundation, and currently has grant receivables of \$1.3 million. Based on its current burn rate, the company expects its cash to last until mid-2020.

Imagineer Technology Group (f/k/a Synap) (*Developing CRM Solutions for Customer Service Teams*)

Imagineer closed \$229K and \$107K in new software subscription revenue and professional service revenue, respectively, during the third quarter, less than the \$315K and \$138K budgeted for these two items. For the nine months ended 9/30/18, new software sales are \$87K less than target, and professional service revenue is \$77K less than target. Full year revenue targets for new software subscriptions and professional services are \$1.26M and \$570k, respectively. The company has 71 active sales opportunities worth \$920K ARR in its QIV pipeline, and while it certainly won't close all this business, the company believes it will be able to reduce the variances from budget with these opportunities.

YTD revenue through September 30 was \$4.3M, a small increase of 1.8% from the same period in 2017. The company, however, had targeted YTD revenue growth of 14.5% relative to 2017. The above-mentioned underperformance in new sales and higher than expected churn are the main contributors to this variance.

The company has been hurt by the rough year for the hedge fund industry, one of its largest customer segments. Many hedge fund managers have exited the business due to their

inability to raise money, retain assets, or generate acceptable returns, and Imagineer is looking to increase their sales to traditional asset managers and wealth management firms to offset the loss from the hedge fund industry.

Intensity Therapeutics (*Developing a New Approach to Fight Cancer*)

In the third quarter, Intensity recruited and dosed seven new patients in a higher dose, every two-week dosing test. Thus far there has been only one minor drug related adverse event (temporary pain at the injection site). Importantly, there have been no drug related systemic adverse events, no procedure related adverse events, and no dose limiting toxicities.

Moreover, this test demonstrated encouraging efficacy. One treated patient with a rare spinal cancer had previously undergone surgery, chemotherapy, and radiation with no success. Prior to receiving Intensity's drug, the patient's tumors always showed growth. After receiving Intensity's drug, the tumor decreased 58% after four months.

In order to gain understanding of the company's product and its potential value, it is important to increase awareness within the medical community. To this end, in the fourth quarter the company will be presenting at the European Society of Medical Oncology and the Society of Immunotherapy in Cancer conferences.

The company recently completed the sale of \$6.5 million in Series B Preferred Stock at a \$58.4 million pre-money valuation, of which VCapital's share was \$1.7 million. The use of these funds includes product development, increasing the number of hospitals in the study, filing regulatory documents in Europe, and production of additional clinical supplies. The company believes this latest round of financing provides them with adequate funds through 2020.

Below are links to various reports about Intensity which we believe you will find interesting.

[Intensity Q3 2018 Report](#)

[Press Release Announcing Series B Financing](#)

[Article About New Investor in Intensity](#)

Padcaster (*Products to turn Tablets and Smartphones into Video Recording Studios*)

Padcaster's QIII revenue was \$974k. While basically unchanged from the QII 2018 revenue of \$970K, we are encouraged by the current quarter's revenue, as QIII is typically a slow quarter, with spending in Padcaster's largest revenue source, the education market, very low during the summer period. Please note that due to an accounting error, the company mistakenly reported revenue of \$2.0M for QII 2018 (which we included in our quarterly report), rather than the correct amount of \$970k. The company has since replaced the part-time controller with a full-time CFO.

Year-to-date revenue through QIII 2018 was \$2.8M, as compared to \$1.9M for the same period in 2017. Gross margins remained consistent in the low to mid 70% range. The company added 318 new customers during QIII and is also now the number one selling

brand in the mobile video production category at B&H, America's largest photo and video retail store and distributor. Operating expenses increased to \$716K in QIII primarily due to increased headcount and increases in advertising and marketing costs.

The company believes there is a great opportunity for global growth within the DIY professional mobile video production market. This growth includes increased sales from the Padcaster flagship products and branded accessories for tablets and the Padcaster VERSE line for mobile phones, which was recently introduced to the market. The company expects to soon rollout its software and app which will also spur growth of its existing products.

SimMachines (Developing Explainable Artificial Intelligence Software)

simMachines continues to gain traction with major customers and prospects with their AI-enabled explainable predictions and by demonstrating their ability to deliver measurable customer value to such companies by increasing their revenue and cost savings.

There is a growing need in the business community for such explainable predictions, as the Wall Street Journal noted in its September 26, 2018 edition: "About 60% of 5,000 executives polled in a recent study by IBM's Institute of Business Value said they were concerned about being able to explain how AI is using data and marketing decisions in order to meet regulatory and compliance standards. That's up from 29% in 2016." simMachines is recognized by industry analysts as a leader in Explainable AI.

Sales activity is increasing, and the company is now managing 32 strong-interest, qualified opportunities in addition to 29 late stage opportunities. simMachines is working to close seven contracts, including with Starbucks (through simMachines' partnership with Accertify), Citigroup, Comcast, and TransUnion. Contracted revenue for 2018 is \$707k and annual recurring revenue is \$785k.

Xaptum (Developing Security for the Internet of Things (IoT))

Xaptum continues to reach out to various sales channel partners to increase its commercial reach. The company entered into a partnership with Inferon, a world leader in semiconductor solutions, to join their exclusive Security Provider Network. This relationship should give Xaptum access to global enterprise customers like Boeing and Ericsson as well as providing the company with co-branding and co-marketing opportunities.

The company has also entered into a Manager Security Service Provider agreement to join Palo Alto Networks' NextWave Channel Partner Program. Palo Alto Networks is a multinational cybersecurity leader that specializes in advanced security solutions across clouds, networks and mobile devices. Xaptum should benefit from this relationship in a similar manner to that of the relationship with Inferon.

On the compliance front, the company completed testing to secure the FCC Declaration of Conformity, certifying FCC-required conformity of the Xaptum ENF Router Card. The company's products also now meet various ISO standards as well.

Companies in Due Diligence:

Deal flow continues to be strong. We are seeing a large number of high potential investment opportunities. Two of the more promising are a company developing a biosimilar for Multiple Sclerosis, with applications for numerous other diseases, and another company developing a device to help with the safety of the mother and unborn child in the last trimester of pregnancy. We will let you know if/when we commit to make investments in these or other companies.

Below is a link to a recent article by Ken Freeman, our Strategic Marketing Officer and member of our Board of Advisors, posted to our website discussing the future of venture capital which we hope you find interesting.

[Article About Future of Venture Capital](#)

We appreciate your continued support of VCapital, and please feel free to reach out to either one of us should you have any questions.

Sincerely,

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