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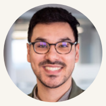

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# 2023 US Venture Capital Outlook: H1 Follow-Up

## Our analysts' outlook on the venture market in 2023

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## 2023 outlooks

## Introduction and market update

At the end of 2022, we published our forward-looking 2023 US VC Outlook. With nearly half of 2023 complete, this H1 update will provide an overview of how our outlooks are faring and what has changed since we last visited our key themes to look out for in US VC in 2023.

### *US VC's expected and unexpected half year*

It would be a bit facetious to declare that the first half of 2023 produced a venture market that many did not see coming. VC continues to experience doldrums that accompany a post-exuberance hangover. Financing options are relatively limited when compared with the exuberance of 2021 and early 2022. Investors are practicing extra caution and being patient with their capital. The market for public listings remains nonexistent, despite the public markets overall showing strong, positive returns year-to-date. Fundraising, too, has followed up an annual record for commitments with the lowest quarterly commitments in a decade. All of these were relatively foreseeable and continuations of trends that shaped 2022.

From a data perspective, these expectations have manifested in a relatively calm year so far. Deal sizes have slowed at the top of the market, leading to sagging deal value. Down rounds have yet to show up significantly in the data. In a lagged statistic from a data collection standpoint, down rounds have been pushed out by the high layoffs of 2022, an expanding debt market, and a general slowing of cash burn within the market. Capital efficiency is the current priority of the market. Growth is no longer priced at the premium seen in 2021.

*The* unexpected event of H1 2023, maybe even the past decade, was the fall of Silicon Valley Bank. Not just because of the failure—though that alone was an unthinkable event one year ago—but because of the speed at which it occurred. $40 billion-plus was withdrawn in a few hours, with many billions more stuck when the FDIC seized the bank. Silicon Valley Bank rose and fell with the venture market, becoming the sacrificial lamb for the industry as investors and startups rushed to pull money from the bank that they had relied upon for so long. While SVB remains a brand within the industry due to the acquisition from First Citizens Bank, it is no longer the monumental pillar of VC that it once was.

Such an unexpected event was an added pressure for the market. While the impacts of SVB's collapse and the broader banking crisis likely have not played into the data yet, we expect it to create a dynamic market moving forward. A further bifurcated market is likely, with winners more quickly jumping ahead of the competition, and those startups destined for failure likely failing faster—both a consequence of falling capital availability.

Still, venture continues forward at a faster pace than pre-COVID-19, but within a narrative of gloom. Seed-stage pre-money valuations are just as high as in 2021; the Unicorn Index has not yet turned negative; and megadeals are still happening, though on a muted pace. Deal counts and deal values have only now fallen below the long-term trendline, thus suggesting that there may not be much further to fall. The 3,500 funds closed in the last four years have kept the market above expectations, though that was a low hurdle.

## Outlook: The Morningstar-PitchBook US Unicorn Index will show a negative return from January 1, 2023, through December 31, 2023.

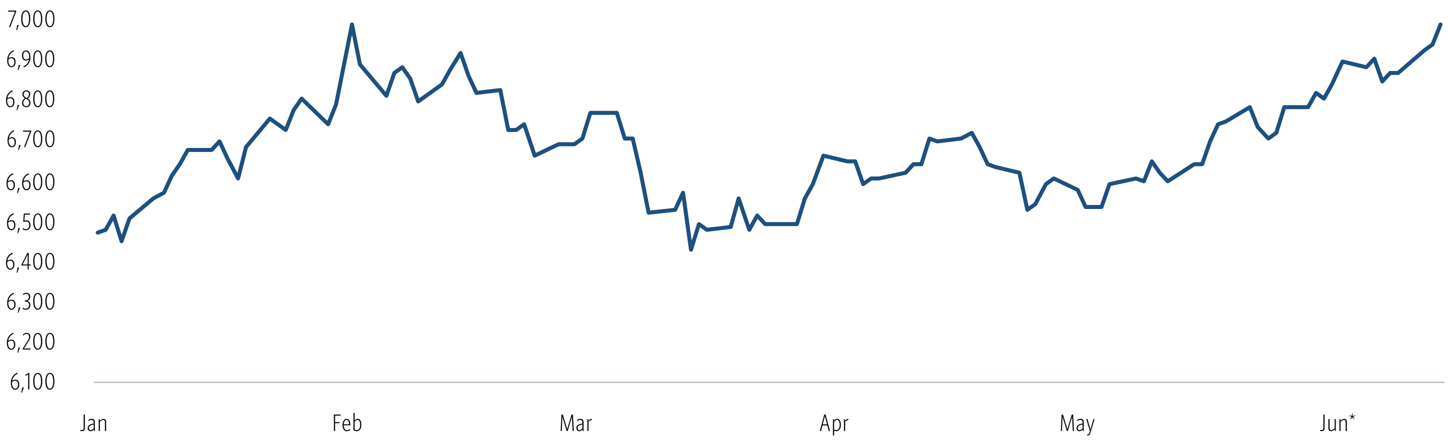
The cause of the Morningstar-PitchBook US Unicorn Index staying positive in 2022 (though just barely), was the lack of down rounds for unicorns. Nearly 95% of the companies that had held a $1 billion valuation prior to 2022 and then raised another round of financing raised that new funding at a valuation higher than their previous valuation. That was a stark contrast to the public markets—another pricing factor in the index—which dropped significantly. As examples, the S&P 500 returned -18.1%, while the NASDAQ fell 33.5%. Our VC-backed IPO Index was down more than 50% on the year.

In 2023, while down rounds have picked up, that increase has been slight. On the other side of the pricing model, public markets have been in the green. The S&P is up around 12%, NASDAQ more than 20%, and our VC-backed IPO Index is up 21.9%.

While the point here is not to add a caveat to the update of an outlook that is not looking strong through the first half of the year, the public markets have been somewhat of an unforeseen gem through H1, and continued strong economic figures from the US have been a boost to the idea that a soft landing is still in the cards. But interest rates, inflation, and recent China-US tensions are cause for a cautious approach going forward. Any of those could pressure the public markets downward, bringing the index down alongside.

From a venture funding perspective, only 34 companies have raised at a valuation of $1 billion or higher so far in 2023. Capital is not nearly as available as it was two years ago, but also, unicorns have raised around $200 billion since the beginning of 2021. There might not be a need for new funding and risking a down round. As companies stand pat on their valuations, the Unicorn Index will not feel the pressures needed for a decline.

### Morningstar-PitchBook US Unicorn Index in 2023

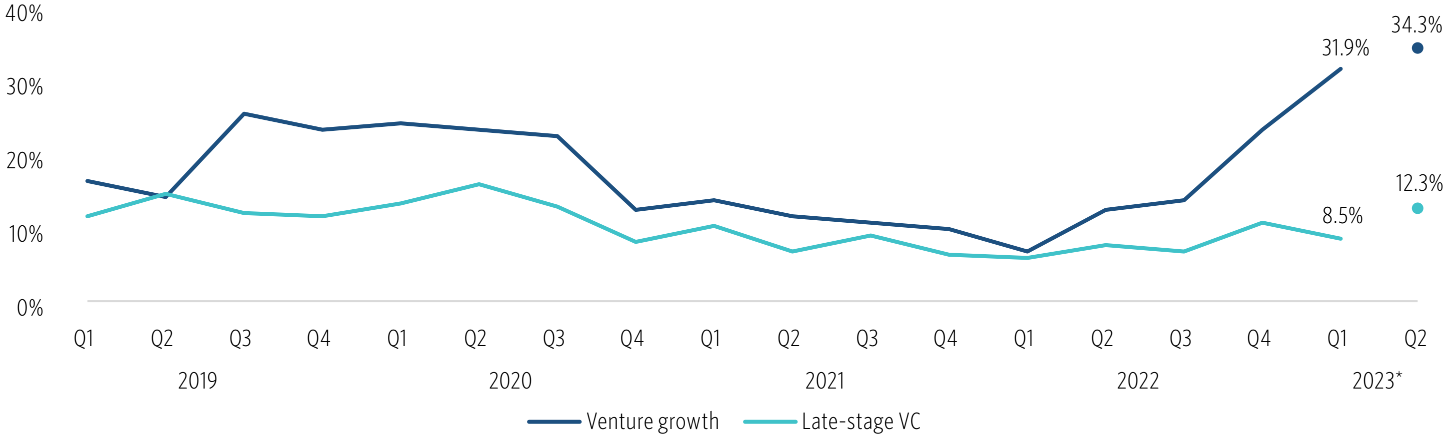



Sources: PitchBook, Morningstar • Geography: US
*As of June 14, 2023

## Outlook: Series C and D rounds will see the most down rounds, as these companies are currently the most starved for capital.

The capital landscape during H1 has not seen significant improvement for late-stage and venture-growth companies. The capital supply and demand dynamic is still skewed, with late-stage companies experiencing a particularly pronounced imbalance. Demand for capital in the late-stage sector is about 2.84x more than the available supply—a stark difference compared to the 1.29x overextension observed in the venture-growth stage. Our VC Dealmaking Indicator suggests that both stages are decidedly in investor-friendly territory. However, the venture-growth stage has seen a greater increase in down rounds than the late stage.

### Quarterly VC prevalence of down rounds by stage

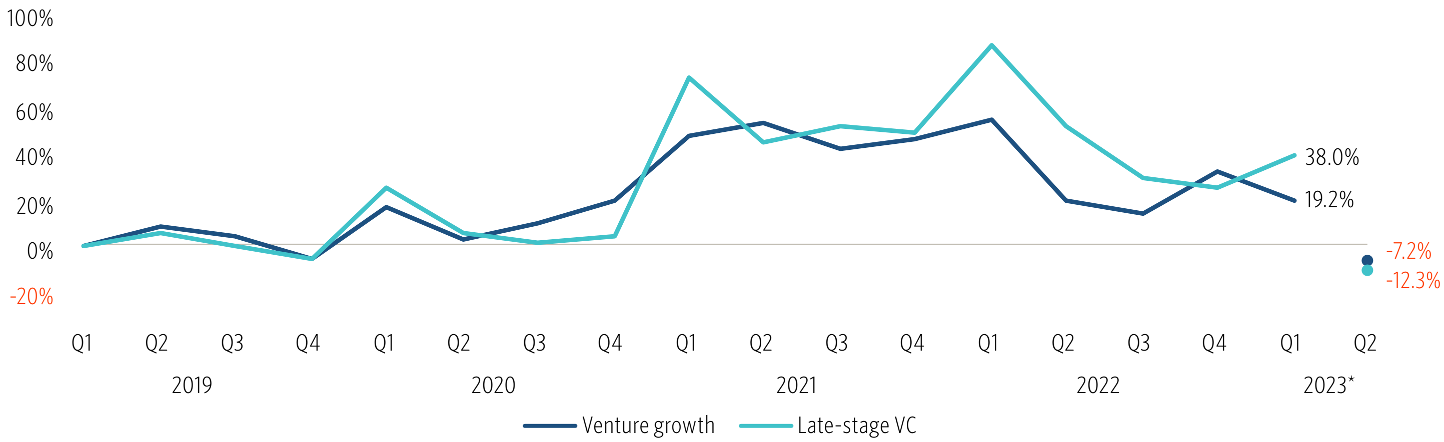



Source: PitchBook • Geography: US
*As of June 6, 2023

One might theorize that venture-growth companies have successfully secured funding while their late-stage counterparts have faced difficulties, which could skew our data toward a higher number of down rounds for venture-growth firms. However, upon closer inspection, this theory does not hold up.

When we look at the number of deals conducted at each stage and compare it to the activity in Q1 2019, we find that both stages are underperforming. Moreover, the ability to garner funding does not appear to favor one stage over the other. In fact, both venture-growth and late-stage companies seem to have had similar success in securing investment. Thus, our data does not support the initial theory, thereby indicating a more uniform funding environment across both stages.

## Quarterly VC round count by stage as a share of all rounds (rebased to Q1 2019)




Source: PitchBook • Geography: US
*As of June 6, 2023

One possible explanation could be that venture-growth companies, which missed their IPO window in 2020 and 2021 and likely raised funds at soaring valuations, found themselves particularly exposed to the market downturn. Their failure to initiate an IPO could signify a lack of the fundamental strength necessary to attract public markets, while the median pre-money valuation for such companies more than doubled between 2020 and 2021 from $172.5 million to $355.0 million, the period during which these companies likely secured funding. This placed them in a precarious position ahead of the coming downturn.

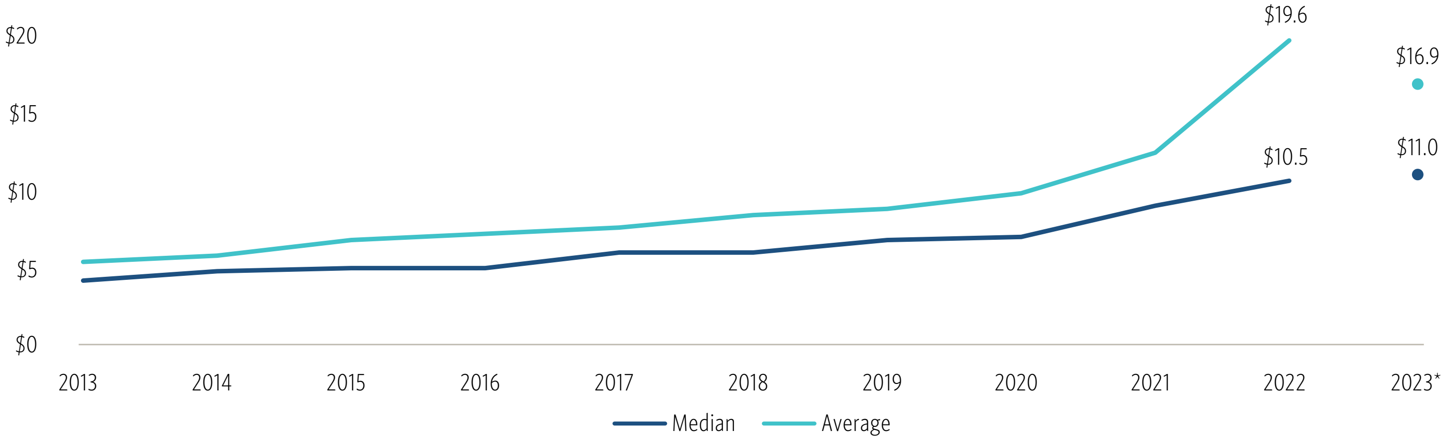
In contrast, firms that recently transitioned to the late stage, propelled by the previous market euphoria's funding surge, might still require time to mature into entities worthy of public markets. Despite additional funding rounds, their business models and fundamentals appear to be more resilient compared to the average startup. This suggests that the market downturn's impact may have been less severe for these late-stage firms.

## Outlook: Seed-stage startup valuations and deal sizes will continue their ascent, reaching new annual highs despite a slowdown in total deal value and count.

The insulated nature of the seed stage has remained steadfast in the face of increasing market volatility. In our Q1 2023 US VC Valuations Report, we saw the median seed pre-money valuation and deal size continue their upward trajectory, setting record highs of $12.9 million and $3.0 million, respectively. Not only has the more formulaic nature of dealmaking at the seed stage prevented the valuation compressions seen in later stages, but the elevated participation of corporate VCs (CVCs) and larger investors at this stage has helped boost deal metrics. Examining the seed-stage deal activity of CVCs and VCs managing funds with commitments of $500.0 million or more, of which more than 150 VCs fit this criterion, shows that deal sizes have continued to climb past the broader market's median as they look to put their large coffers to work.

While it is unlikely that seed-stage deal metrics will continue to grow in the long term as the market looks to find its new equilibrium, low costs to start businesses and growth of VC overall have caused seed-stage startups to mature. Through Q1 2023, the median time from founding for seed-stage startups dramatically increased to 3.0 years from 2.4 the year prior. The elongated time between founding and when these startups look to raise their first round of institutional capital has meant that their products and market traction are more developed than ever before. What's more, this maturation has dovetailed with the growth of the pre-seed market, wherein more accelerators and micro VCs are staking their claim and helping develop promising startups. We are optimistic about the further growth of seed-stage deal metrics but expect quarterly fluctuations in accordance with market headwinds and a resurgence of the IPO market.

### Median and average US seed pre-money valuation ($M)




Source: PitchBook • Geography: US
*As of June 6, 2023

## Outlook: SPAC IPOs and mergers will continue to decline while liquidations will continue to increase in 2023.

The decline in SPAC IPOs and reverse mergers of US VC-backed companies, along with the overall decrease in exit activity, has persisted during the first half of 2023. After a record-breaking 2021, during which we observed 115 reverse mergers, just 53 have occurred over the succeeding six quarters. This slowdown comes as no surprise during the persistence of the economic downturn, as indicated by the S&P 500 1 Year Return of 1.15%, which is below the long-term average of 6.29%.[1] Moreover, a mere 15% of CEOs anticipate an improvement in economic conditions over the next six months, while a substantial 93% are preparing for a US recession within the next 12 to 18 months, according to a survey by The Conference Board.[2] Adding to these challenges is the lackluster performance in public markets of companies that completed a de-SPAC event; PitchBook's DeSPAC Index shows a one-year return of -27.9%, while roughly 90% of companies that completed a de-SPAC event that then went public between 2019 and Q1 2023 were trading below their IPO price.[3]

As expected, poor de-SPAC company performance, declining economic conditions, and recessionary fears have also contributed to the surge in SPAC liquidations. In the first quarter of the year alone, 71 SPAC vehicles were dissolved—nearly half of the 145 vehicles that dissolved in 2022.[4] This is further exacerbated by ongoing legal and regulatory obstacles, exemplified by the recent legal case in which the Delaware Court of Chancery refused to dismiss a plaintiff's claims against a SPAC sponsor and its directors for breaching their fiduciary duty in a de-SPAC transaction.[5] Cumulatively, these factors have diminished the attractiveness and feasibility of pursuing SPAC transactions, and looking ahead, we anticipate a continued slowdown in SPAC activity throughout the remainder of the year.

1: "S&P 500 1 Year Return (I:SP5001YR)," YCharts, May 2023.
2: "US CEO Confidence," The Conference Board, May 4, 2023.
3: "Special Purpose Acquisition Companies Continue to Face Headwinds," Mayer Brown, John R. Ablan, Ryan H. Ferris, and Andrew J. Noreuil, May 5, 2023.
4: Ibid.
5: "Delman v. GigAcquisitions3, LLC," Justia US Law, Court of Chancery of the US State of Delaware, September 23, 2022.

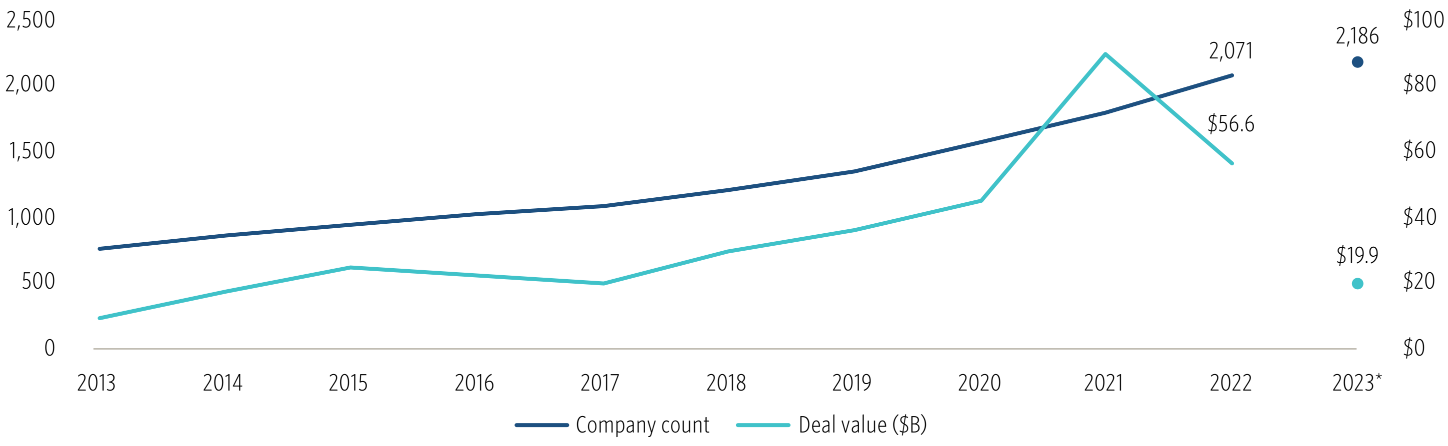
## Outlook: Venture-growth deal value will fall below $50 billion in the US.

In 2023 YTD, venture-growth companies raised $19.9 billion (almost $40 billion annualized). $6.9 billion of that came from a single deal, however. Stripe raised that much for its unique situation of paying taxes for employees exercising options, as well as using the money for a tender offer to purchase options from employees. Though it remains a VC investment (the company took a large hit to its valuation and added investors to its cap table), the investment drove more than half of the venture-growth deal value YTD. That itself should be a red flag for the market.

The venture-growth market has binged on non-VC capital for several years. In 2021, more than 90% of the capital invested in the stage was tied to a deal with a nontraditional firm. Crossover investors have pushed into the venture-growth stage because companies were not only exiting relatively quickly (in 2019, 1.3 years from the first venture-growth deal), but were also seeing large step-ups at exit, generating strong returns in a short timeline.

The $50 billion threshold for venture-growth deal value has been surpassed only twice, once in 2021 and once in 2022. While this hurdle miss might seem unimportant, there have never been more companies in need of venture-growth or pre-IPO capital. There are now more than 2,000 venture-growth companies. Outright failure of venture-growth companies is an uncommon event, but for those companies that may need to accept a low exit value because of current conditions and the lack of venture-growth capital, it may feel like one.

### Venture-growth company count (smoothed) and capital invested




Source: PitchBook • Geography: US
*As of June 13, 2023

## Outlook: US VC mega-round activity will fall below 400 deals, hitting a three-year low.

In the first half of 2023, mega-round activity has continued its descent, with a lackluster 108 deals completed. Not only has mega-round count dropped to a pace not seen since 2018, a year that culminated in 214 mega-rounds, but deal value associated with rounds is tanking as well. Mega-round deal value through YTD 2023 currently sits at $38.2 billion, with two startups, OpenAI and Stripe, accounting for 44.9%, or $17.2 billion, of the total mega-round deal value. Excluding the deals from these startups, the average mega-round deal size has fallen from $223.5 million in 2021 to $189.5 million at time of writing. Pullback from nontraditional investors, prioritization of lean operations, and limiting the compression of valuations amid an increasingly investor-friendly dealmaking environment has led startups to supplement capital raises with debt, raise smaller amounts of capital, or forgo fundraising altogether.

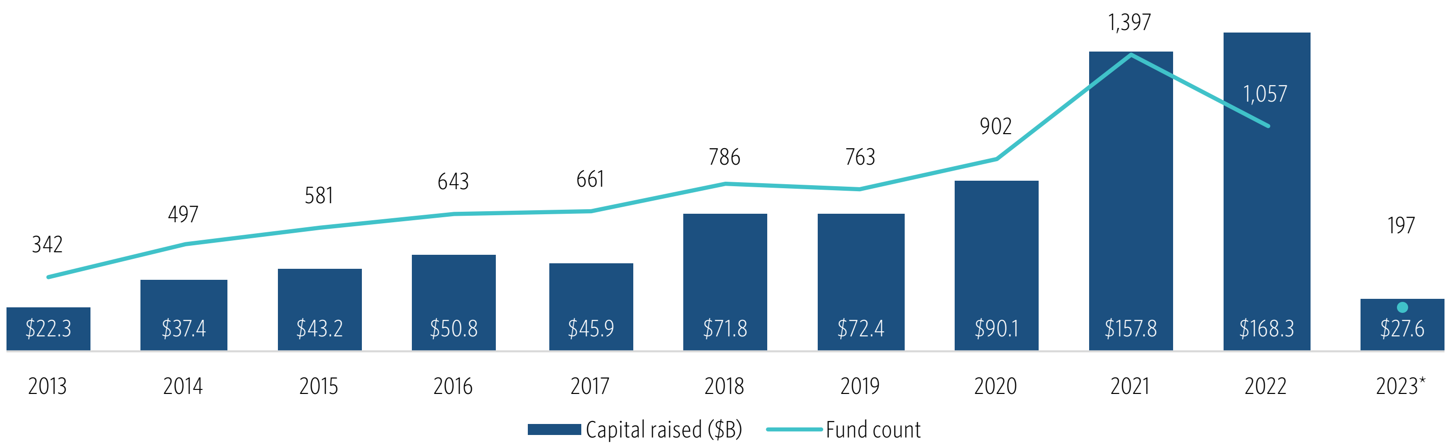
With no sign of the IPO market reopening in the near term, many startups remain in liquidity limbo, and the need for capital to supplement unprofitable operations remains. In our initial outlook, we highlighted that 104 startups that had raised mega-rounds in 2021 returned to market to raise. Since the report published in December 2022, this figure has increased to 162, thus reinforcing the notion that depleting cash runways will force more of these startups to raise in the harsher dealmaking environment. Despite the need for capital likely leading to an uptick in mega-rounds as the year progresses, discussions of the IPO market reopening in the back half of this year or in early 2024 may have sparked some optimism for startups hoping to hold out until then. As a result, this outlook will likely come to fruition, with mega-round activity falling below 400 and possibly even 300 by year's end.

## Outlook: US VC fundraising will fall between $120 billion and $130 billion in 2023.

Following two years of exceptional US fundraising activity, with $157.8 billion and $168.3 billion raised in 2021 and 2022, respectively, the first half of 2023 has witnessed a significant reversal. Though our outlook predicted a YoY decline in fundraising, considering the slowdown observed within the venture ecosystem during H2 2022 and the substantial amount of dry powder available, the collapse of Silicon Valley bank and other unforeseen events have had a profound impact on investor sentiment—and consequently, the fundraising environment thus far into the year. Just $27.6 billion has been raised by 197 US-based venture funds through YTD 2023, less than 16.4% of the total capital raised in 2022.

As pointed out in our Q1 2023 PitchBook-NVCA Venture Monitor, 85.0% of the capital raised thus far in 2023 has gone to established fund managers, thus demonstrating the notable advantage held by funds with a proven history of successfully raising investment vehicles and a track record of delivering favorable returns to LPs. Indeed, the sluggish exit environment has severely limited investors' ability to generate returns, which is crucial for venture firms to attract capital from LPs. Considering the ongoing freeze in exits that is expected to persist at least until the end of the year, we anticipate fundraising to fall well below the $100 billion mark for the year. In fact, if we were to extrapolate the current fundraising trends, fundraising could even drop below $55 billion, marking the first time since 2017 that such levels have been reached.

### VC fundraising activity




Source: PitchBook • Geography: US
*As of June 13, 2023