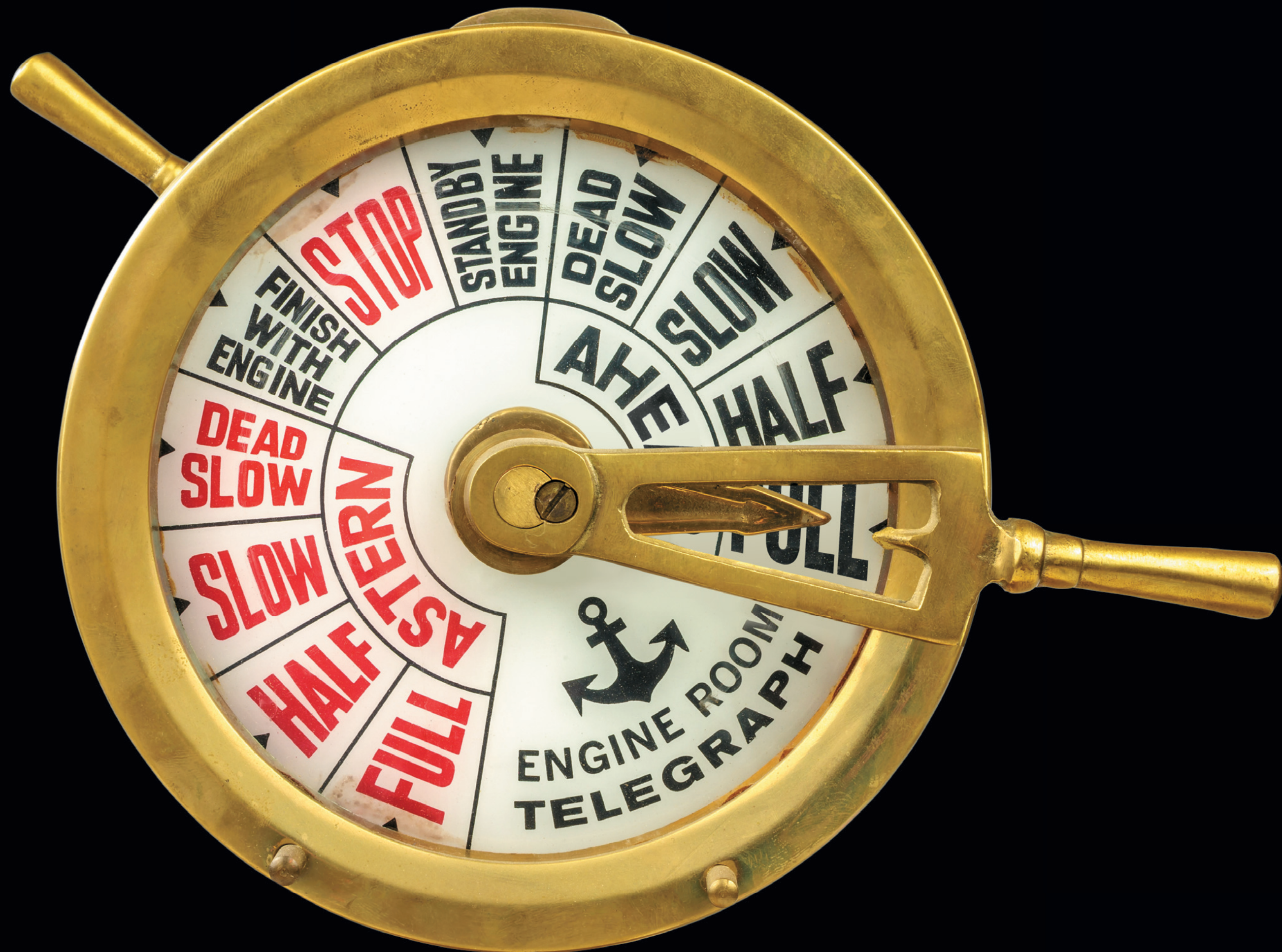
Sponsored by

VC Valuations

1Q 2018



Can an audit propel you toward an IPO?

Think an audit will slow your IPO down? Look again.™ A Deloitte audit is an opportunity for insight, one that can help leaders see further and deeper into their businesses and can help inform vital decisions. It can help prepare you for the seas ahead. See how at deloitte.com/us/egc.

PitchBook

Sponsored by Deloitte.

Contents

Credits & Contact

PitchBook Data, Inc.

John Gabbert Founder, CEO
Adley Bowden Vice President, Market Development & Analysis

Content

Joelle Sostheim Analyst
Cameron Stanfill Analyst
Darren Klees Data Analyst

Contact PitchBook

Research
reports@pitchbook.com

Editorial
editorial@pitchbook.com

Sales
sales@pitchbook.com

Cover design by Jennifer Sam

Click here for PitchBook's report methodologies.

Key takeaways from the analysts

• Venture capital valuations continue to move higher across all stages. The most significant increase was at the late stage, where the median pre-money valuation as of 1Q 2018 pushed to $75 million, a 19% increase from 2017.

• The median time between VC rounds remains extended, sitting at 1.4 years for angel & seed and early-stage rounds and 1.8 years for late-stage, compared to long-term averages of 1.2 and 1.5 years, respectively. Extended hold times have caused some apprehension in the VC community; however, VCs appear willing to continue funding companies for prolonged periods in private markets.

• While we continue to see valuation increases across all stages, this is not driven by an increase in investor protections. For example, the percentage of deals with cumulative dividends, as well as those with participation rights, fell steadily over the past decade and hover at or near prior lows so far in 2018.

19% increase
in late-stage median pre-money valuations since 2017

1.4 & 1.8
years between rounds for angel & seed to early-stage & late-stage, respectively

5% of deals
in 1Q 2018 had cumulative dividends

Overview

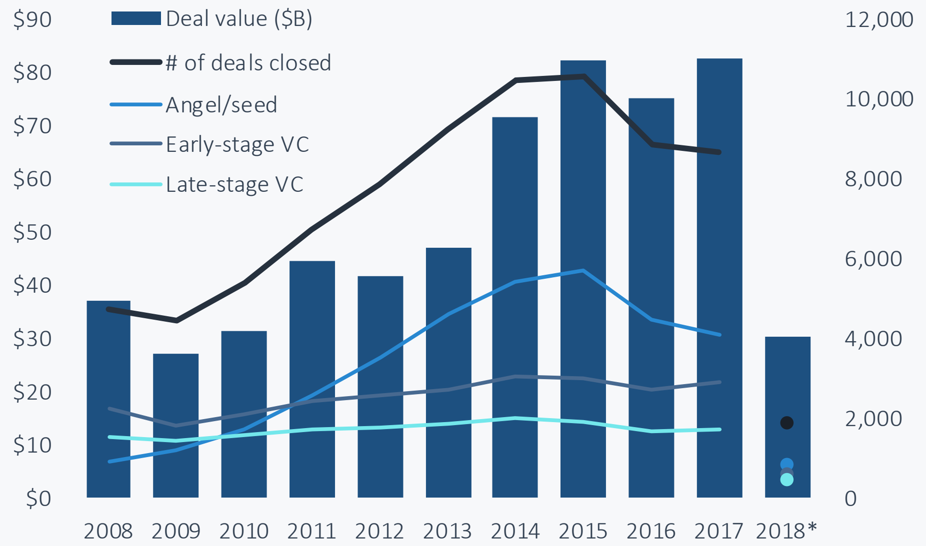
VC valuations trend higher in 2018

Following a decade high of VC invested in 2017—and on a record pace again in 2018—VC valuations continue to move higher across all stages. The most significant increase was at the late stage, where median pre-money valuations as of 1Q 2018 pushed to $75 million, a 19% increase from 2017. We believe much of this valuation expansion has been caused by the buildup of dry powder and general availability of capital to high-growth companies, which has given these companies pricing power in negotiations with investors.

This phenomenon is transforming the VC environment and contributed heavily to the solidification of support for mega-deals, which we categorize as deals over $100 million. Historically, companies seeking equity financing of this size would turn to the public markets to continue funding their growth, but the size and maturity

While valuations have risen in recent years, fears of declining capital invested haven't manifested

US VC activity



Source: PitchBook
*As of March 31, 2018

of the VC ecosystem now allows companies to scale with VC backing. Traditional VC firms raising $1 billion+ funds and increased activity by SoftBank's Vision Fund make these mega-deals possible.

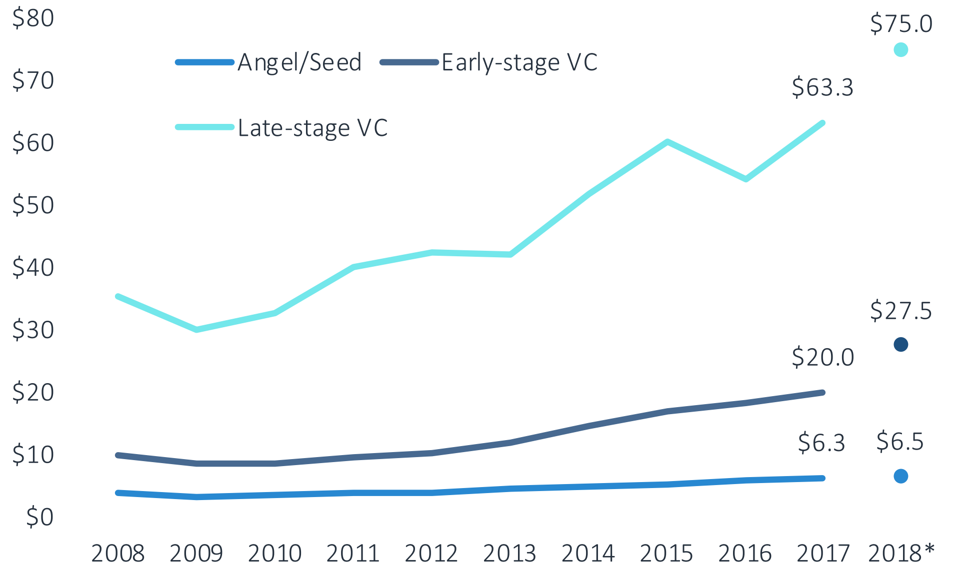
With older and more mature businesses raising a greater number of VC rounds, it is logical that valuations rose in tandem. This development also lengthened average hold times for venture investments, so not only is there more risk of a down exit from an elevated valuation, but time-weighted returns may also come under pressure as companies sit in fund portfolios longer.

The shift toward funding more mature companies was especially present in the angel & seed stage, where the median age for companies receiving financing pushed to three years—twice as old as a decade ago. This trend is explained by a multiplicity of alternative funding options, such as accelerators, equity or product crowdfunding and a greater ability to bootstrap thanks to tech-enabled, low-capital-intensity business models.

As valuations and deal sizes at the angel & seed stage steadily grew larger over the last 10 years, investors in these transactions consistently took a 20% ownership position. But so far in 2018, the median percentage acquired has spiked to a decade high of 26.7%. This is an intriguing change, as large seed financings now come with the trade-off of giving up more equity. We see this shift as evidence that companies are now being more fully valued at the angel & seed stage, with investors tempering their expectations for unchecked valuation growth going forward.

Late-stage valuations continue to soar

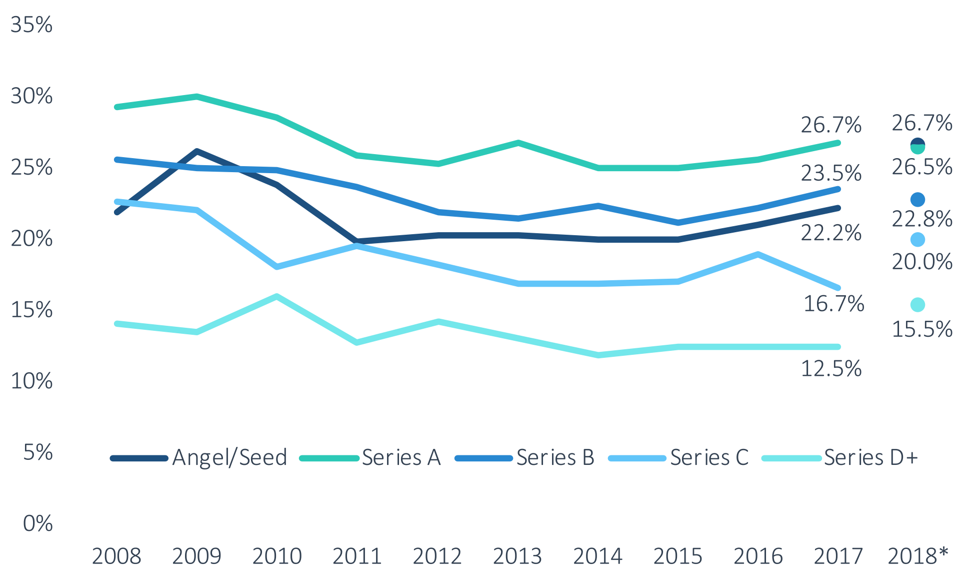
Median pre-money valuation ($M) by stage



Source: PitchBook
*As of March 31, 2018

Percentage acquired in angel & seed eclipses early-stage

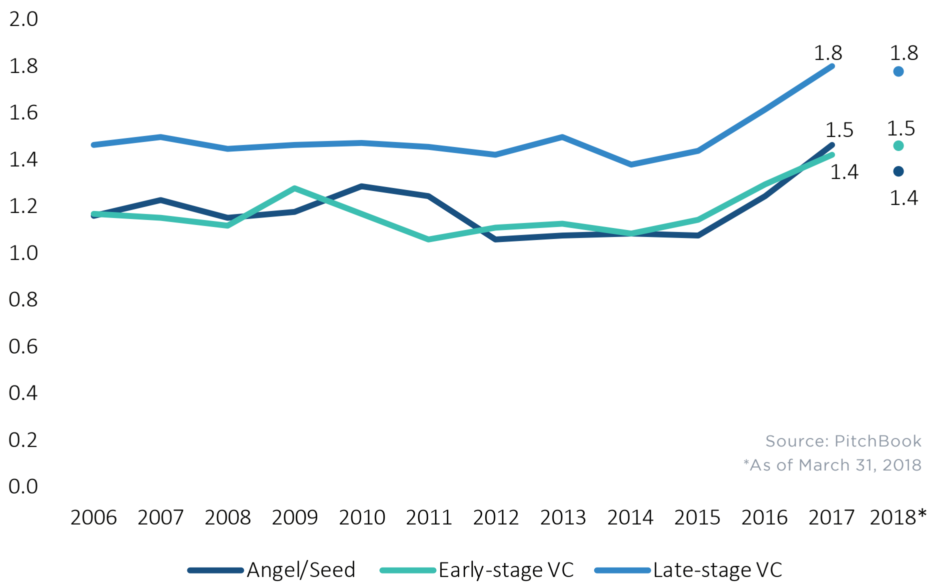
Median percentage acquired by series



Source: PitchBook
*As of March 31, 2018

Cash runways remain extended

Median time (years) between rounds



Source: PitchBook
*As of March 31, 2018

Growth at all costs?

In recent years, attractively priced companies with strong growth potential have been difficult to find—even in public equity markets—because quantitative easing raised valuations across almost all asset classes by decreasing the cost of leverage and injecting cash into the market.

While the backdrop is changing, growth remains highly sought-after, which was another force behind the extended climb in VC valuations. Over this decade-long bull market, VC investments offered the ability to back high-growth companies, attracting greater demand from capital allocators, as evidenced in our fundraising data. However, investors are also paying up for growth outside of the private markets, as forward price to earnings ratio of the S&P 500 growth versus value moved to 1.37x—the widest gap since 2008.

Driven by bigger deals at larger valuations, the median time between VC rounds remains extended, sitting at 1.4 years for angel & seed, 1.5 years for early stage and 1.8 years for late stage, compared to long-term averages of 1.2, 1.2 and 1.5 years, respectively. It is logical that cash runways extended following the run-up in valuations over the last five years and, more importantly, the parallel move in deal sizes. Extended hold times have caused some apprehension in the VC community, where the balance of power seems to have shifted to founders and startups. Nonetheless, VCs appear willing to continue funding companies for prolonged periods in private markets. Of course, GPs still operate funds with defined timelines and need to return capital to LPs. To that end, some large VCs are even raising separate vehicles to support follow-on rounds for successful portfolio companies, as the largest companies start to outgrow original funds.

Spotlight: Pre-seed Valuations

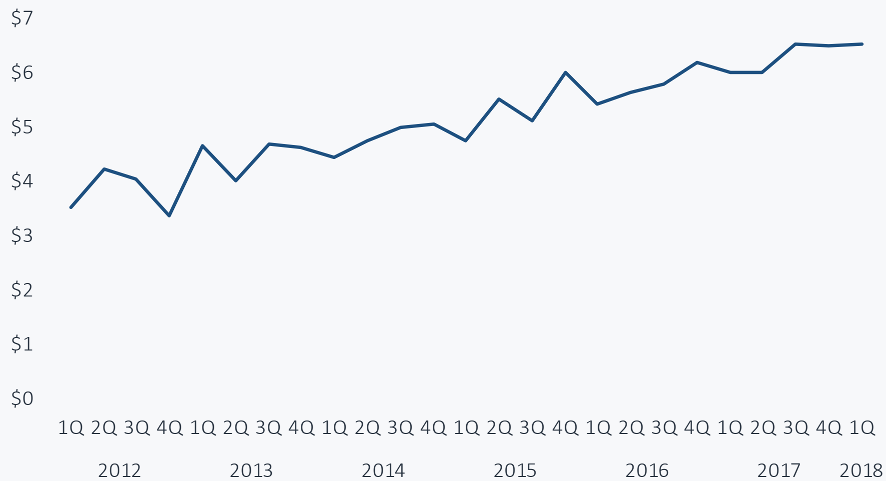
The origin of rising late-stage valuations is the sustained growth in both deal size and valuations of angel & seed rounds. Investors and founders have noted that the upward shift in the venture life cycle pushed angel & seed financings to more closely resemble historical early-stage financings, remarking that "seed is the new Series A." The data corroborates this sentiment. Median age at time of angel & seed rounds reached three years in 2018—surpassing the maturity level of companies securing early-stage rounds in 2012. Median seed-round size reached $2.0 million in 2018, edging closer to 2012's median Series A size of $2.7 million. Startups are also raising more rounds before their first early-stage VC round (Series A or B).

The phenomenon of seed rounds shifting to companies that in the recent past would have received early-stage financings appears to have led to a stage of funding that some investors are referring to as "pre-seed." As one might infer, pre-seed is the stage of funding that precedes angel & seed rounds. Some define this stage of financing as either the first institutional capital investment received by a startup or simply as investment rounds less than $1 million.

Using this working definition, we analyzed the subset of rounds less than $1 million to determine if they resemble size and valuation of historical seed rounds—or put simply, to see if "pre-seed is the new seed."

Angel & seed valuations steadily climb to record highs

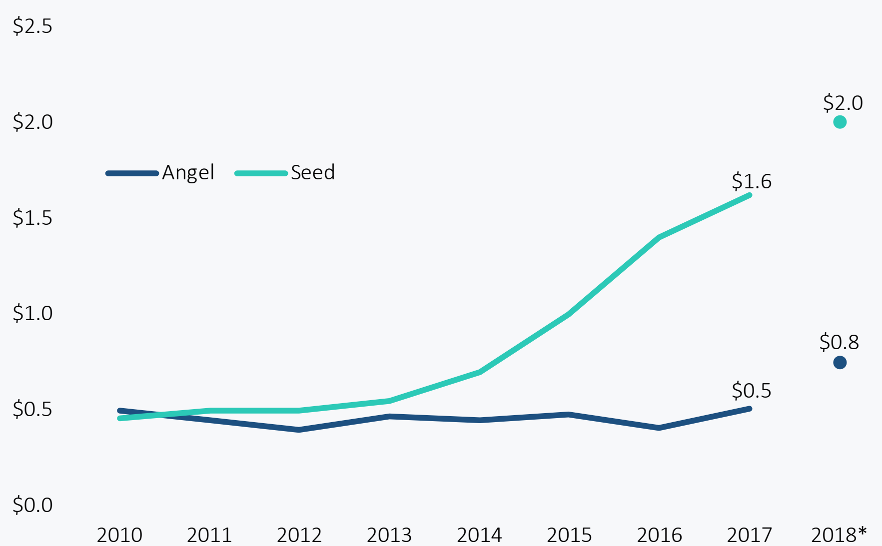
Median angel & seed pre-money valuation ($M)



Source: PitchBook

Median seed deal size edges closer to historical Series A

Median deal size ($M) by deal type



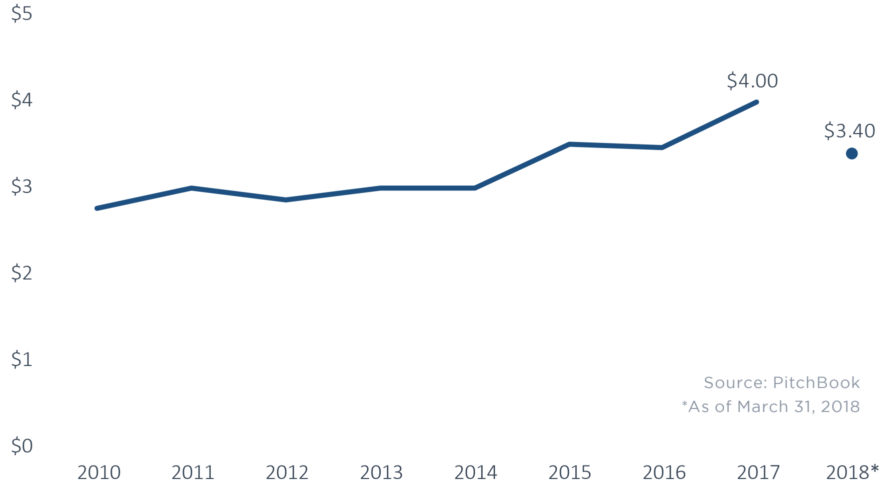
Source: PitchBook
*As of March 31, 2018

Indeed, pre-seed valuations at year-end of 2017 and 1Q 2018 were $4.0 million and $3.4 million, respectively. These metrics closely resemble angel & seed valuations from 2012 and 2013 ($4.0 million and $4.5 million, respectively). It appears that pre-seed rounds are more founder-friendly, with median equity acquired in 2017 sitting at just 12.4% compared to 22.2% in all angel & seed rounds.

The data also suggests that larger angel & seed rounds ($1 million or greater) command a greater percentage of equity, with median percentage of equity acquired sitting at 25.0% in 2017, a value significantly higher than that of pre-seed rounds. Because recent angel & seed rounds more closely resemble historical early-stage rounds, it appears they are pulling the percentage of equity acquired upward. The key takeaway for startups is that, even though the bar has risen for companies seeking seed financings, some investors are still cutting checks at historically smaller seed sizes and valuations. Though the concept of pre-seed rounds is still being solidified, it provides us a glimpse of valuations in financing rounds of very early-stage startups and illustrates the emergence of a stage resembling what seed financings used to be historically.

'Pre-seed' valuations similar to 2013 angel & seed metrics

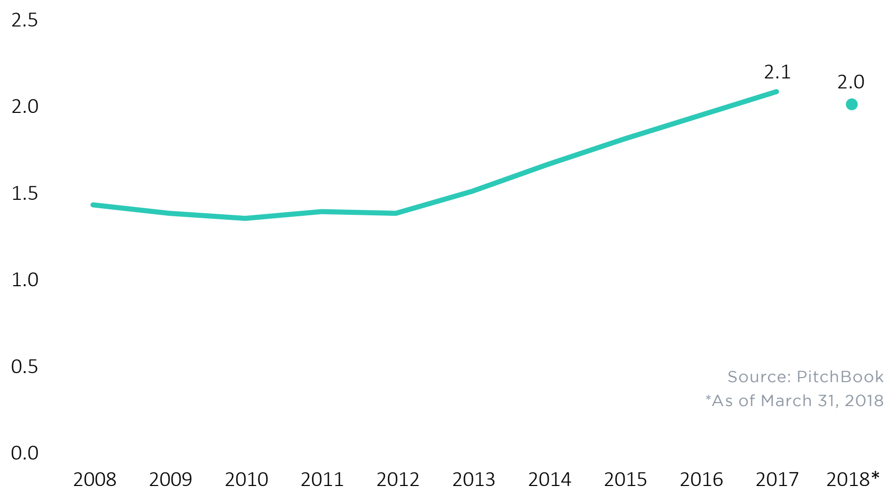
Median pre-money valuation ($M) for rounds less than $1M



Source: PitchBook
*As of March 31, 2018

Startups raising additional rounds before early-stage VC

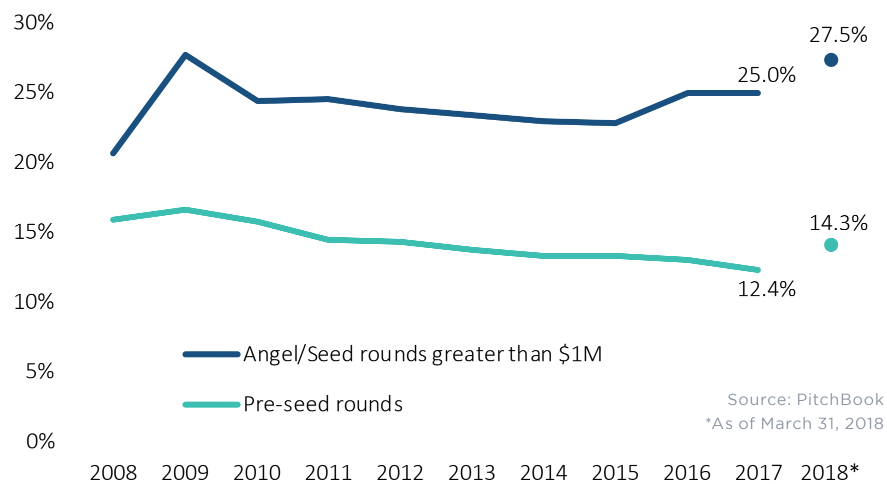
Average number of rounds raised prior to first early-stage deal



Source: PitchBook
*As of March 31, 2018

Larger rounds command greater percentages

Equity acquired (%) in pre-seed vs. larger angel & seed rounds



Source: PitchBook
*As of March 31, 2018

Valuation Step-ups

Data from the beginning of the year suggests that the median valuation step-up between VC rounds increased to 1.6x in the first quarter. This is the greatest increase we've seen in recent years by a significant margin, as median step-up over each of the last three years settled into the 1.4x to 1.5x range. Median valuation step-up of early-stage rounds reached a decade high of 1.9x in the first quarter of 2018.

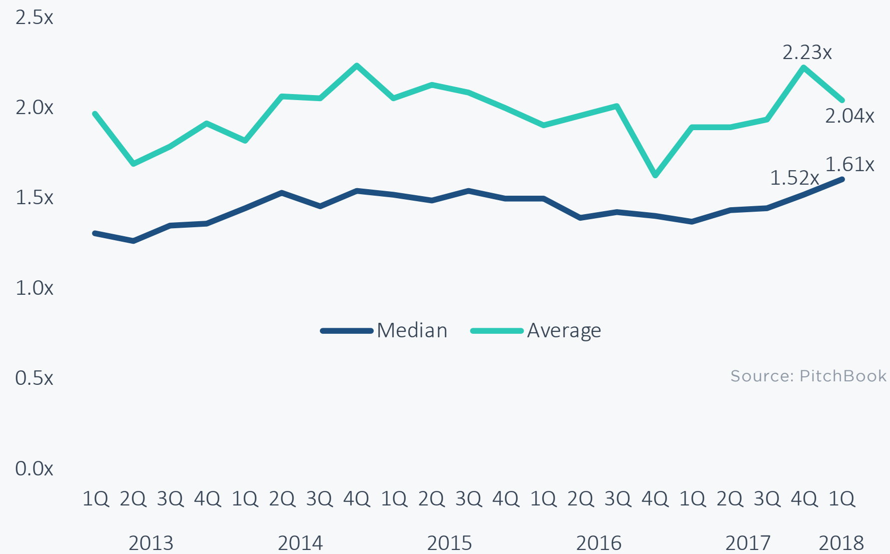
Given that equity acquired in early-stage financings remained relatively unchanged, it appears that founders were able to negotiate significantly larger financings and valuations without giving up more equity.

We've seen a similar story in late-stage financings, but to a lesser degree. While late-stage rounds are also larger than ever, a minor uptick in equity acquired suggests mature startups may be giving up slightly more in exchange for higher valuations.

Upward movement in valuations of late-stage rounds is widespread so far in 2018, with only 4% of late-stage down rounds recorded in the first quarter, compared to 10% in the two preceding years.

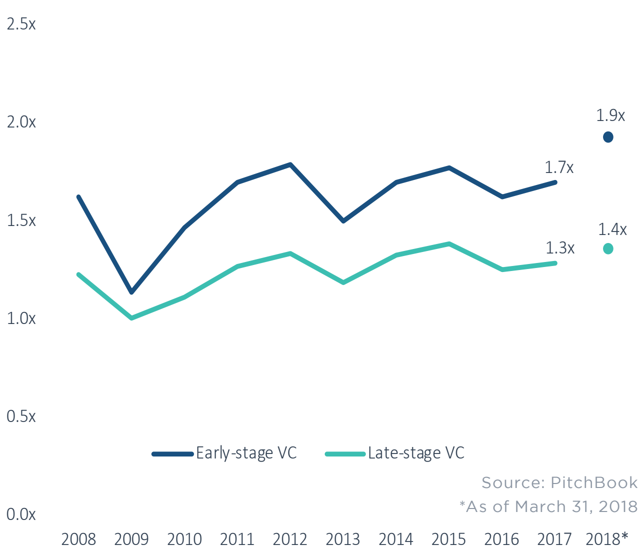
Valuations continue upward momentum

Valuation step-ups between pre-money & post-money across all rounds



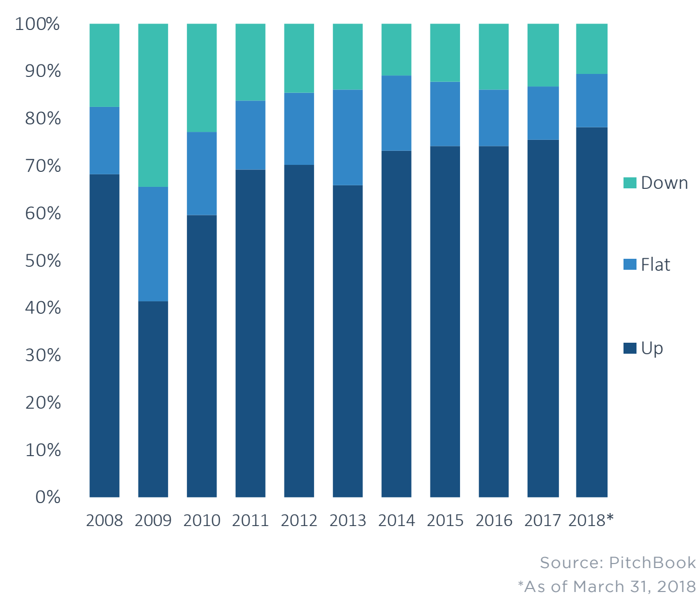
Early-stage step-ups reach record high

Median valuation step-ups



Down rounds remain scarce

Up, flat & down rounds



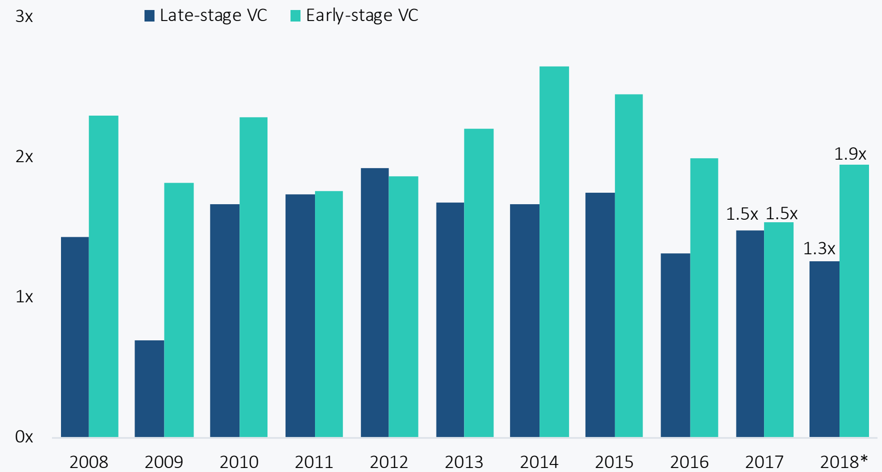
Spotlight: Exit Valuation Step-ups

The significant valuation expansion over the past few years has surfaced worries that companies won't be able to maintain these lofty private valuations at exit. This is most critical at the top end of the VC market where we've seen the greatest percentage rise in median valuations. The data has started to show signs of late-stage valuations becoming inflated relative to the public markets, as the median late-stage valuation step-up at exit fell to 1.3x through 1Q 2018—the lowest value we've recorded since 2009. So, while most late-stage companies are exiting above their last private valuation, the number failing to meet that benchmark is growing.

Extended hold times brought on by capital availability and the JOBS Act's elimination of the "500 Investor Rule" have changed investor economics at the late stage. Smaller valuation step-ups at exit put more pressure on the investors writing checks at the latest rounds and who are already taking on the risk of larger deal sizes. We expect to see buyers of VC-backed companies (strategic acquirers, PE firms and public market investors) become more selective or stringent in regard to operating benchmarks as the current business cycle matures, which should drive further compression of the step-up multiple.

Late-stage valuation step-ups at exit fall to lowest level since 2009

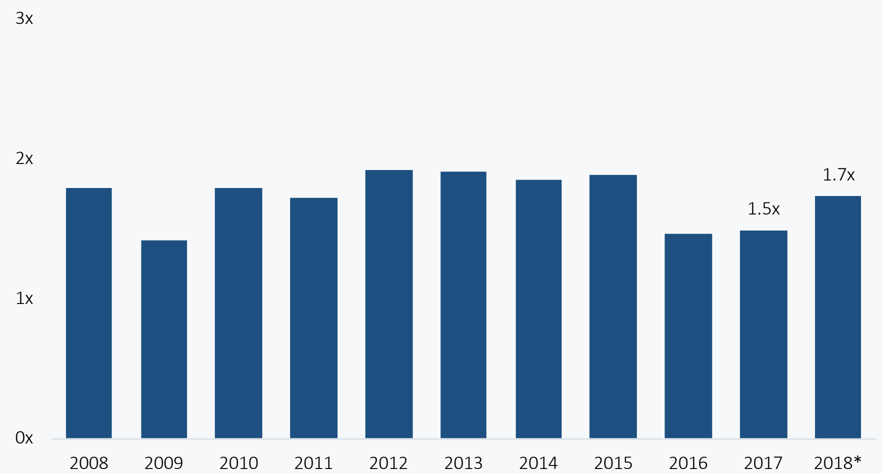
Median step-up from last VC round valuation to exit by stage



Source: PitchBook
*As of March 31, 2018

Median valuation step-up at exit climbs in 2018 to date

Median step-up from last VC round valuation to exit



Source: PitchBook
*As of March 31, 2018

Corporate VC Valuations

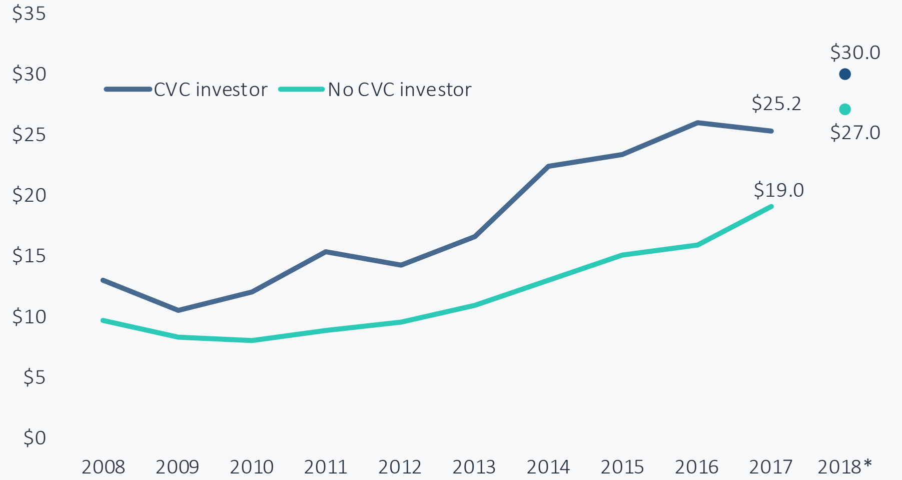
Rounds with CVC participation have consistently carried higher valuations than those without. But as valuations of early-stage rounds reached new highs in 1Q 2018, the difference between the two appears to be converging. With CVC-backed round valuations only 11% greater than those without CVC backing, this is the smallest spread we've seen since 2009. The surplus of dry powder has provided non-CVC investors with ample resources to compete for higher valued companies at the early stage, providing larger checks that result in larger valuations.

Early-stage CVC investments in the first quarter continued to tap into emerging technologies, such as robotics, VR and blockchain. The trend toward larger early-stage round sizes and subsequently larger valuations may be an indication that these strategic investors are willing to provide ample funding at premium prices to further develop desirable technologies that will advance their businesses. Blackmore Sensors and Analytics, for instance, received an $18 million financing (at a $68 million valuation) to advance its LiDAR sensor technology. Strategic funders in the deal included BMW i Ventures and Toyota AI Ventures, whose autonomous vehicle efforts could benefit from the production of cost-effective LiDAR sensors.

Conversely, the median pre-money valuation of late-stage rounds with CVC investors pulled dramatically ahead of those without CVC funding. In 1Q, 38% of deals with CVC participation were larger than $25 million, compared to a five-year average of just 24%. Given this statistic, it follows that late-stage valuations reached a record high of $135 million in the first quarter.

Early-stage CVC & non-CVC valuations converge in 2018

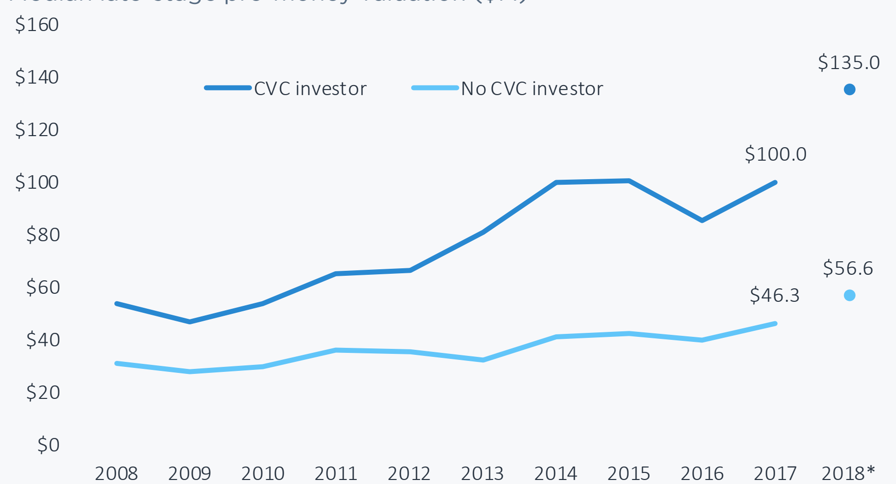
Median pre-money valuation ($M)



Source: PitchBook
*As of March 31, 2018

Late-stage CVC rounds pull dramatically ahead of non-CVC rounds

Median late-stage pre-money valuation ($M)



Source: PitchBook
*As of March 31, 2018

The strategy of CVC participation in late-stage deals appears to focus on investments in more mature companies (that may not fit as strongly into strategic objectives) with lower risk profiles, such as Lyft and DoorDash. SoftBank Group also plays a role here, single-handedly elevating valuations with large allocations to seven late-stage companies in 1Q alone.

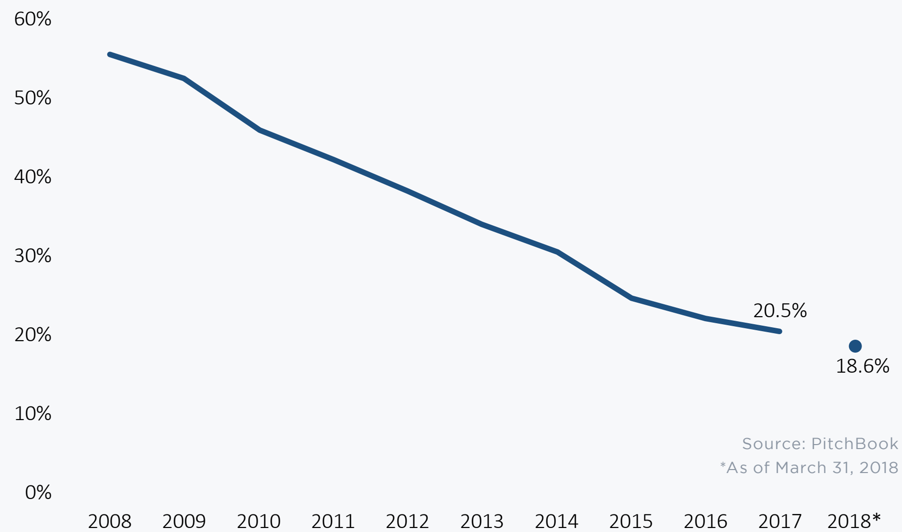
Deal Terms

Negotiated deal terms and investor rights play a key role in the ultimate valuation figure. By increasing the number of investor rights or sweetening the payout, investors are more willing to accept a higher valuation. Both the stigma and the economic reality of raising a down round remain strong deterrents for VC-backed companies, and adding investor-friendly terms can sometimes prevent this outcome. The adage that "you can pick the valuation you want, but I'll pick the terms" still holds true, but it seems this has become less of an issue with company growth potential justifying high valuations without excessive protections.

Looking at the data, it seems that the more "founder-friendly" sentiment commonly mentioned in the media seems to hold true. Inclusion of liquidation participation continued its steady decline, reaching 18.6% of deals in 1Q 2018, a far cry from the 55.5% levels we recorded a decade ago. A similar linear downtrend is evident in the percentage of deals with a cumulative dividend provision, which is a way for VCs to secure returns not linked purely to equity valuation growth. Overall, it seems the confidence in the portfolio companies and bargaining power for founders remains high, as investors have not had to resort to increased rights or protections thus far in 2018.

Deals with participation rights continue to decline

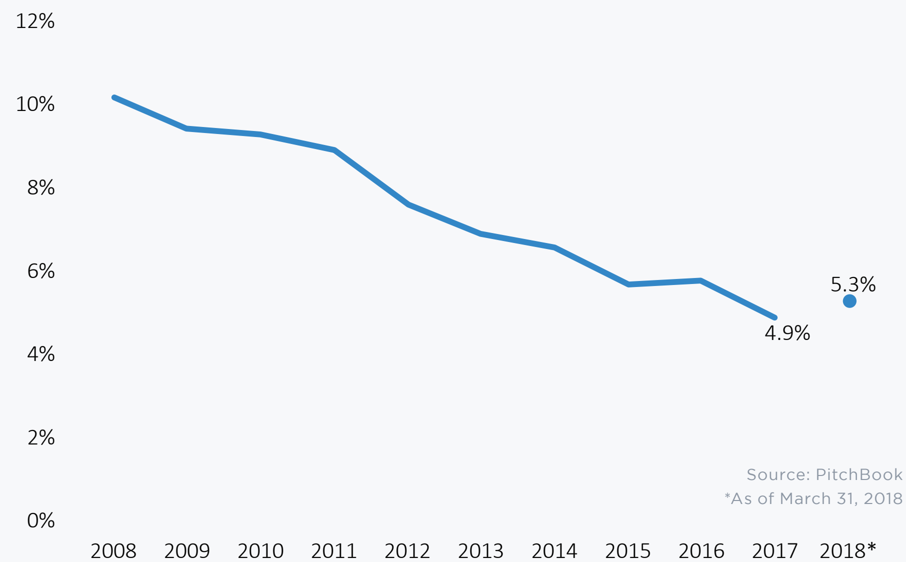
Percentage of deals with participation rights



Source: PitchBook
*As of March 31, 2018

Cumulative dividends provisions included in only 5% of deals

Percentage of deals with cumulative dividends



Source: PitchBook
*As of March 31, 2018