PitchBook

2019 Venture Capital Outlook: 1H Follow-Up

Assessing our VC predictions

PitchBook is a Morningstar company. Comprehensive, accurate and hard-to-find data for professionals doing business in the private markets.

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2019 predictions updates

2019 predictions scorecard

IPOs as a proportion of total VC exit value will hit another decade high.	PASS	IPOs as a proportion of total exit value sits at 82.9% on the back of a handful of massive exits, significantly topping the 73.0% record set in 2012.
New participants in VC will continue to proliferate.	PASS	Tourist investors have participated in nearly $40 billion of US VC deals in 2019, on pace to fall just shy of 2018's record, while participation in late-stage deals crested 40% for the first time.
Median early-stage valuation step-ups will hit 2.0x in 2019.	PASS	The forces pulling VC metrics upward have persisted through the first half of 2019, with the median startup raising an early-stage round now fully doubling their valuation from the previous financing.
Median angel & seed deal size will continue to climb.	SPLIT	The median deal size has increased for both angel and seed in isolation; however, angel & seed deal sizes in aggregate have plateaued due to higher relative activity from angels.
Growth in median fund size will decelerate.	PASS	Median fund size in 2019 sits at $81.0 million through the first six months of the year, only an 8.0% increase over 2018, after growing 50% the year prior.
Banks will back more institutional blockchain solutions.	SPLIT	Traditional banks have not been as active as anticipated; however, prominent financial institutions outside of banking, such as Fidelity and NASDAQ, have been more active.

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PASS

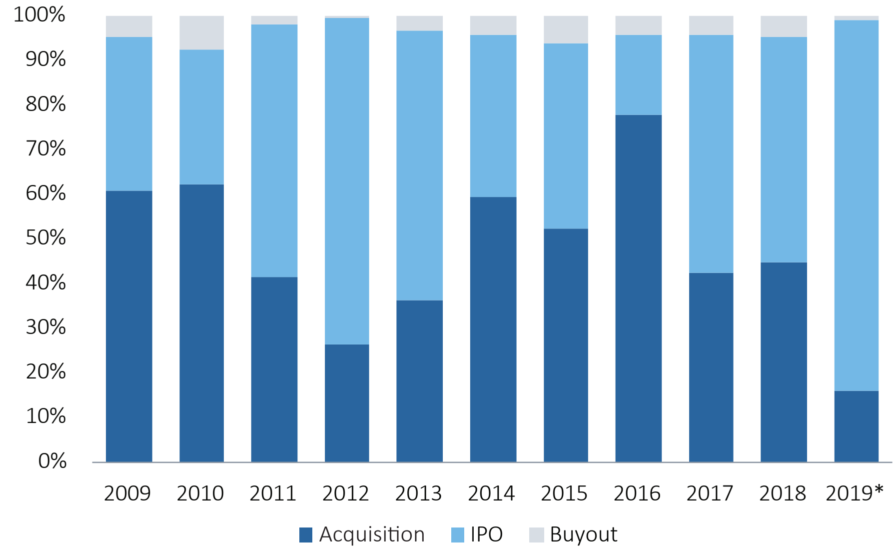
Prediction: IPOs as a proportion of total VC exit value will hit another decade high.

Rationale: The number of companies valued at over $1 billion (or even $10 billion) continues to swell—as does their age—driving a need for liquidity. Recent public announcements of IPO plans from many notable VC-backed companies indicate that IPOs will make up a greater percentage of 2019 exits. We expect the outsized valuations of companies that have filed or are expected to go public in 2019 will be enough to drive the proportion to a new decade high, regardless of activity of other exit types.

Caveat: Poor public equity performance or extended volatility in 2019 would likely cause a significant slowdown in IPO activity as companies could choose to postpone listing in a less-than-ideal market. An increasingly robust secondary market for direct stakes in VC-backed companies could relieve some of the liquidity pressure faced by aging startups. Furthermore, a pick-up in acquisitions in the days before a scheduled IPO (e.g. Qualtrics and AppDynamics) could siphon some exit value away from IPOs.

Update: The first half of 2019 resoundingly confirmed this prediction, as a multitude of outsized VC-backed companies finally made their expected transition to the public markets. Headlining this group were Uber and Lyft, the ridesharing giants that scaled massively under VC backing, with these two deals making up 47.4% of total exit value in the first half of 2019. Outside of those two IPOs, a plethora of other large public debuts from Slack, Pinterest, Zoom and many others drove IPOs' proportion of total 2019 exit value to 82.9%. This value will have to remain above the 73.0% set in 2012 to fully corroborate our prediction, but we believe this is well within reach given the current momentum of the IPO market. The total of 48 IPOs through the first half of the year has also cultivated optimism about this pathway to liquidity for VC-backed companies, demonstrating that the exit route is open to startups outside of the unicorn population.

VC exits ($) by type



Source: PitchBook | **Geography:** US
*As of June 30, 2019

Aftermarket price performance has been the one soft spot for a few of the unicorn IPOs with some flat to down performance, most notably from Uber and Lyft, which both broke their offering price during the first day of trading. There are myriad potential reasons why these massive companies stumbled out of the gate, but some of the most compelling arguments center on margin pressure, loss-making and the companies' full pricing in the private markets. However, many other 2019 IPOs have exploded out of the gate, tempering many fears around pricing. A significant public equity market downturn remains a potential headwind for IPOs gaining share of exit value, although this would also likely slow corporate acquisition activity.

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PASS

Prediction: Growth in median fund size will decelerate.

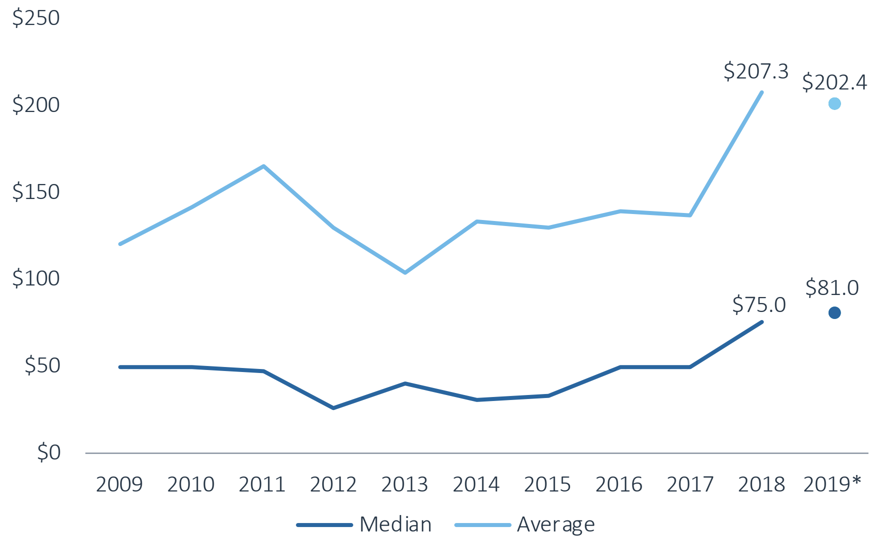
Rationale: For the last five years, the median venture fund size hovered between $40 million and $50 million. In 2018, however, median fund size skyrocketed to $75.0 million. GPs increasingly express the need for more capital to adequately compete in a world with SoftBank, while LPs still appear willing to make commitments to larger funds. However, we expect fund sizes will hit a ceiling as GPs refrain from raising excess capital to maintain venture-like returns. Subsequently, we believe fund sizes will begin to plateau.

Caveat: PitchBook's 2018 Annual US Institutional Investors Survey suggests that LPs maintain a considerable appetite for private market fund investments. This positive LP sentiment could be further fueled by the multiple unicorn exits expected in 2019, which could help GPs secure outsized fundraises for multiple years to come.

Update: US VC fundraising is on pace for a much lower total than the massive haul in 2018. One factor is that our prediction of slower growth in fund sizes is playing out, with the average fund size declining from 2018. The median fund size is up, but the growth rate has slowed considerably. After a 50% jump between 2017 and 2018, the median fund size through the first six months of 2019 is sitting at $81.0 million, only 8% higher than the 2018 data point. This weakness in fund sizes parallels the tepid growth trends we recorded in both deal sizes and valuations, potentially signaling a cooling of the unchecked expansion in the past five years.

We see this as a healthy tapering of this explosion that shifted the definition of what can constitute a VC investment and vastly increased the capital available to startups. Unbridled growth in VC fund sizes can lead to an environment that makes it more difficult and inefficient to deploy capital into VC deals, despite the current frequency of mega-deals. Because of this, further massive growth in median fund sizes would add increased risk of irrational behavior and worse outcomes in the event of an economic downturn.

Median and average VC fund sizes ($M)



Source: PitchBook | **Geography:** US
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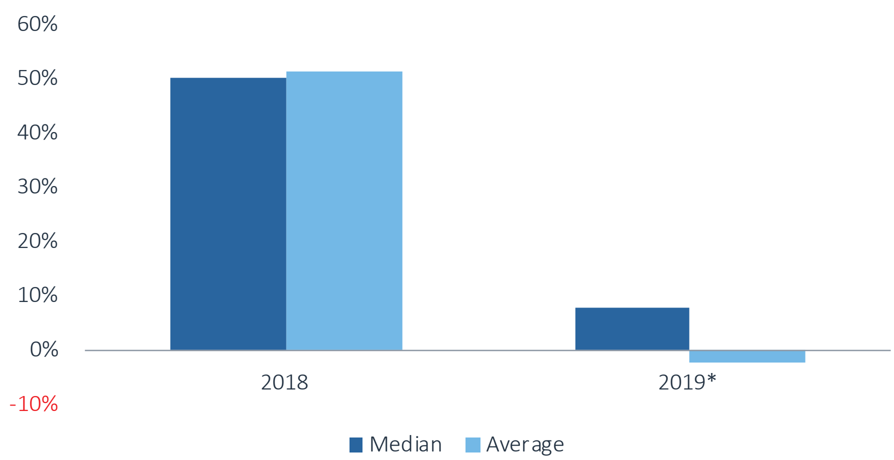
YoY change in median and average VC fund sizes



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PASS

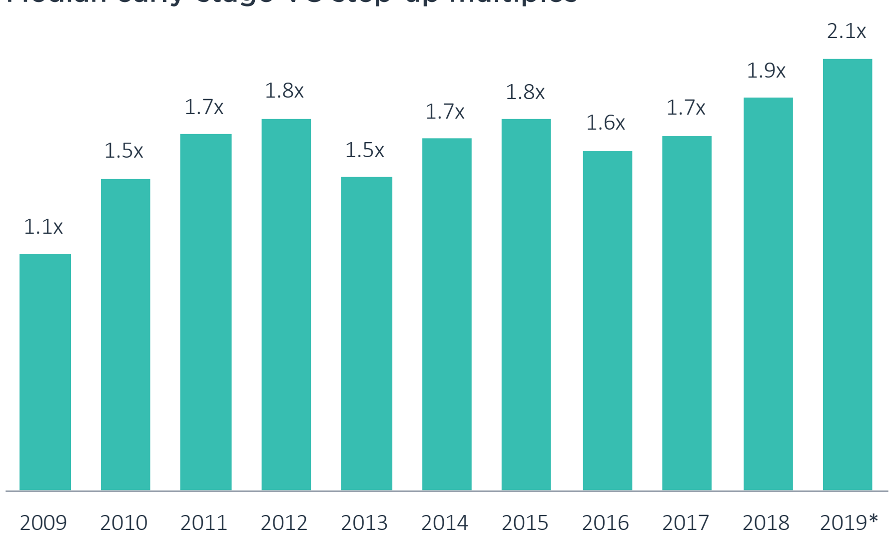
Median early-stage valuation step-ups will hit 2.0x in 2019.

Rationale: An increase in the age of firms at first fundraise and increased investor competition are putting upward pressure on valuations, especially at the early stage when firms begin to accelerate growth.

Caveat: Despite the trend toward growing valuation step-ups at the early stage, macroeconomic headwinds or pessimistic change in expectations will lead to risk aversion and more conservative valuations. Additionally, a continued shift toward larger funds and late-stage deals may result in some traditionally early-stage investors turning their focus to later stages, thereby easing upward pressure on early-stage valuations. Conversely, an increase in the velocity of new investors at the seed and pre-seed stages could raise valuations, making it more difficult to achieve large early-stage valuation step-ups.

Update: The forces pulling early-stage VC metrics upward have persisted through the first half of 2019, resulting in ever-higher valuations. Startups raising an early-stage round are now fully doubling their valuation from the previous financing on a median basis. This is even more remarkable considering that median time between rounds has fallen to 1.2 years—the shortest timeframe since 2015.

Median early-stage VC step-up multiples



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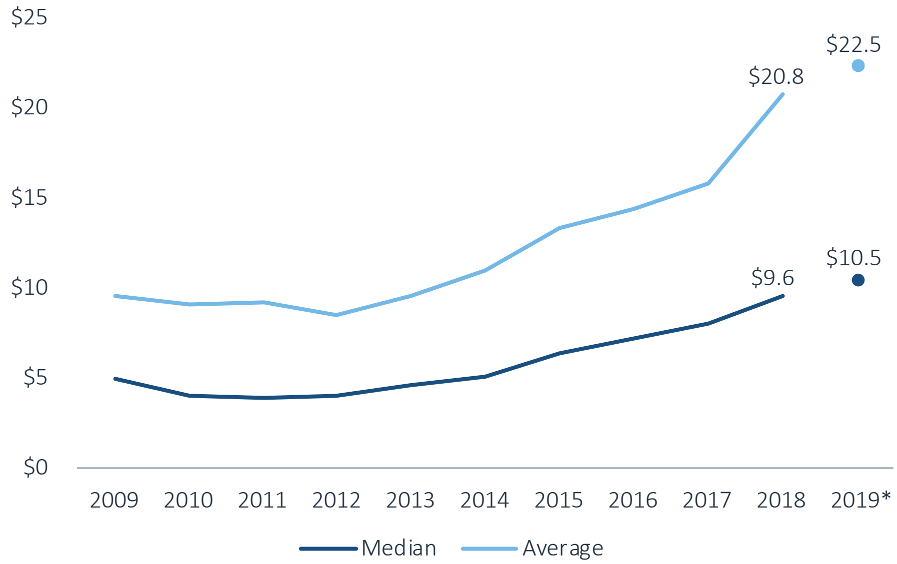
We believe valuation step-ups are likely reaching their upper bounds, but the absolute level of valuations will presumably remain elevated. One major factor is how much capital the company has raised, with the median level now above $10 million for the first time ever. With larger VC funds that need to be deployed and deep-pocketed tourist investors continuing to enter the space, larger deals and valuations are likely to persist—even if the magnitude of valuation step-ups cools.

Median and average capital raised at time of early-stage VC round ($M)



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SPLIT

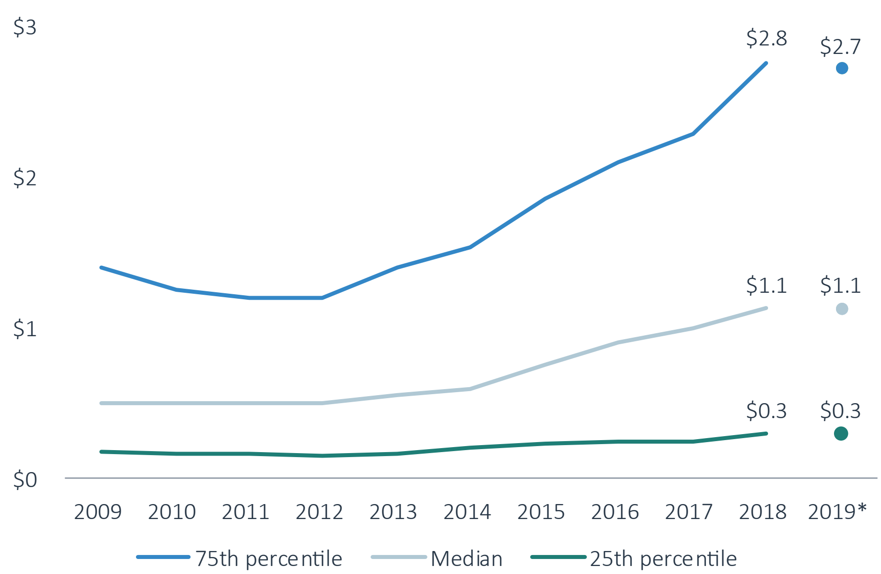
Median angel & seed deal size will continue to climb.

Rationale: The influx of capital into VC in conjunction with increasing median age of firms when raising capital means that firms are looking to raise larger rounds at the angel & seed stage.

Caveat: A sizable negative economic event would likely lead to a plateau or reversal of median angel & seed deal sizes unfolding over the course of several years.

Update: One factor that we failed to consider when making our prediction is the breakdown between angel rounds and seed rounds. Early in 2019, we've seen angel deals increase on both an absolute and relative basis. Since the median deal size for angel rounds is about $600,000, compared to more than $2 million for seed deals, the change in composition has a meaningful impact on median deal size and valuation. In fact, when we separate angel & seed deals, we see that the median deal size has increased for each cohort.

Range of angel & seed deal sizes ($M)



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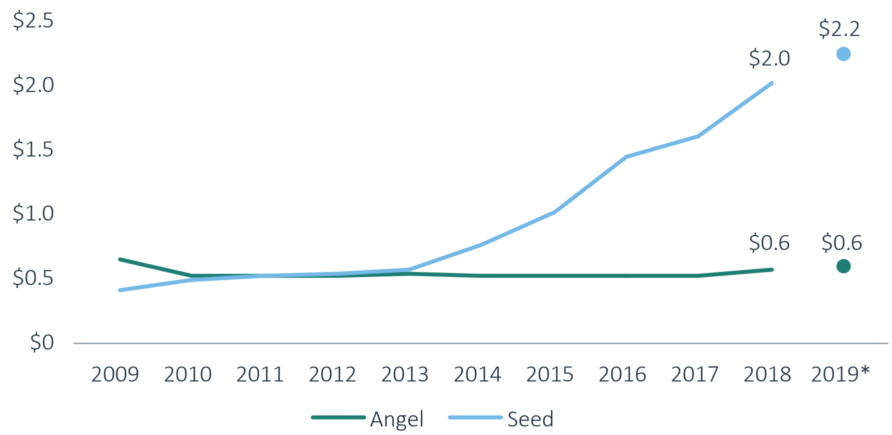
Median angel & seed deal sizes ($M)



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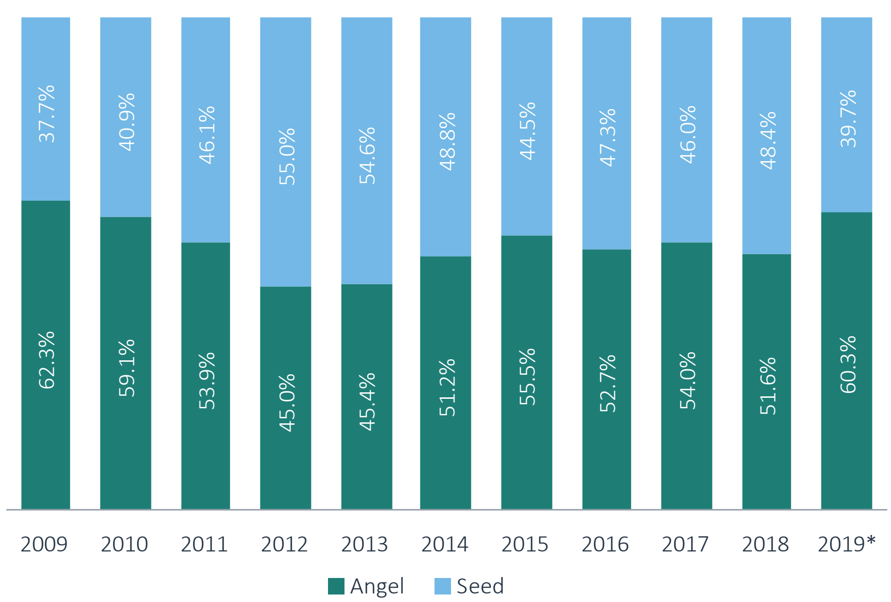
Considering this significant shift in the makeup of deals, we are somewhat surprised that deal sizes have largely maintained the record levels seen in 2018. Through the rest of 2019, we think it is highly likely that the composition of angel & seed deals reverts to historic levels, which should lead to higher deal sizes in aggregate.

Angel and seed deals ($) by year



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