PitchBook

2020 Venture Capital Outlook: H1 Follow-Up

Assessing our VC predictions

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2020 predictions updates:

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Prediction: The median pre-money valuation for seed-stage companies will eclipse $8.5 million.

> ***Score:*** Fail
>
> ***Rationale:*** Median pre-money valuations for seed-stage companies have been on the rise over the past decade. Despite the emergence of alternative sources of capital for venture-backed companies and predictions of a VC slowdown, we expect pre-money valuations will continue to climb in 2020, with the median reaching a decade, if not all-time, high. A mix of increased investor competition, larger funds and a shift toward more mature startups are contributing to upward pressures on seed-stage valuations.
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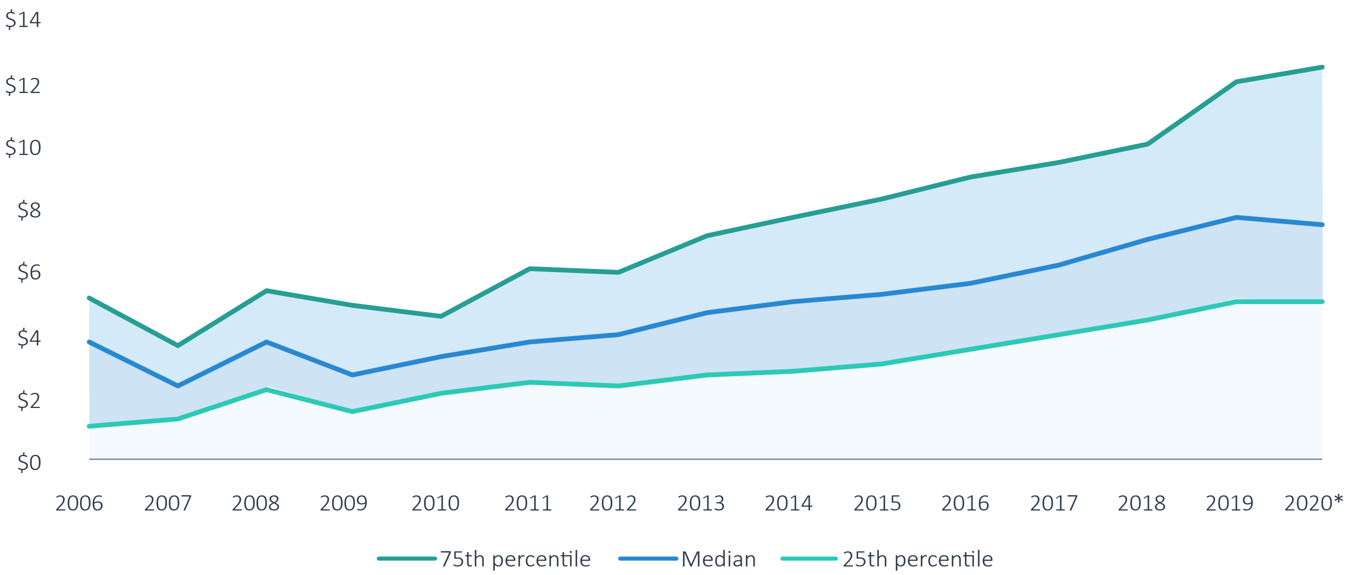
> ***Caveat:*** In the event of a downturn, certain seed investors—especially larger players that have moved upstream—may feel compelled to instead seek out late-stage opportunities with lower risk profiles, which would alleviate upward pressures on seed-stage valuations.

H1 2020 update: The median pre-money valuation for seed-stage companies in H1 2020 was $7.5 million, which was 11.8% off from our prediction. VC-backed companies have enjoyed a significant run-up in valuations over the last several years, fueled by record levels of VC fundraising and deal activity. In fact, median seed-stage pre-money valuations have nearly tripled in the last decade, rising from $2.7 million in 2009 to $7.7 million in 2019. However, the economic uncertainty caused by the COVID-19 pandemic and broader market volatility has compelled seed-stage startups to raise capital at lower pre-money valuations in H1 2020.

The previous trajectory of increased valuations and deal activity for seed-stage companies has stalled in the last six months, as startups no longer have the leverage to command the frothy valuations they previously enjoyed. Seed-stage investors have also been focusing their efforts internally toward current portfolio companies, leaving less time for sourcing deals and performing due diligence. While seed-stage investors are more insulated from public markets than late-stage investors, many prefer more risk-averse investing under current conditions and are less likely to fund higher-risk, seed-stage investments.

Furthermore, given the pullback in capital allocation, VCs looking to make seed-stage investments may not be willing to pay as high a price as before. As a result, many startups seeking seed-stage funding will be unable to sustain themselves through this crisis given their dependency on capital. The top quartile of seed-stage pre-money valuations has continued to grow in H1 2020, indicating that elevated valuations have persisted for a subset of seed-stage companies. Even though economic recovery is beginning to occur in other sectors, it is unlikely that seed-stage companies will experience a similar rebound in pre-money valuations and deal activity in H2 2020.

Quartile distribution of US VC seed-stage pre-money valuations ($M)



Source: PitchBook | **Geography:** US
*As of June 18, 2020

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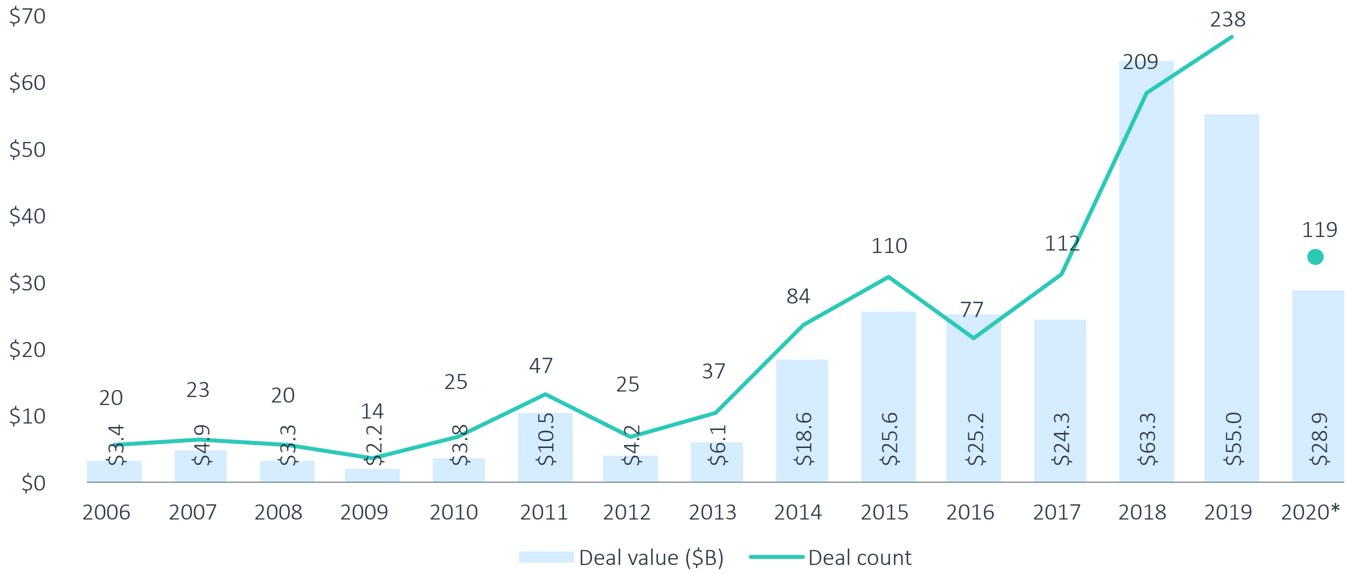
Prediction: 2020 will mark a new annual record for US mega-deals.

> ***Score:*** Undetermined
>
> ***Rationale:*** VC remains an alternative investment strategy wherein investors have successfully sought high growth on both an absolute and relative basis, which has led to rising allocations. Additionally, the positive momentum of returns over the past few years has led to strong distributions from VC funds back to LPs. With these large sums recycling back into new VC funds and rising VC allocations from LPs, fundraising totals were pushed to historically elevated levels in 2019. The flood of committed capital and increased participation from nontraditional investors provide a compelling backdrop for late-stage dealmaking. While there have been some hiccups for large VC-backed exits toward the end of 2019, we believe that the long-term factors driving this historic shift of capital to the late stage remain in place and can continue to support elevated VC mega-deal ($100 million+) activity.
>
> ***Caveat:*** Materially negative shifts in the broader economic landscape or tangential asset classes would have a significant effect on the number of startups that can successfully raise outsized financings. A likely substantial decrease in the capital availability for large private companies—especially from non-fund investors (for example, mutual funds, corporations, LP direct investment) that are highly active in the VC mega-deal arena—would be detrimental to overall mega-deal volume. If large VC funds or new vehicles such as SoftBank's Vision Fund 2 have difficulty fundraising due to economic shifts or other exogenous factors, this could also hinder sustained levels of mega-deal activity over the next few years.

H1 2020 update: The economic climate has undoubtedly taken a turn for the worse since the start of the year, yet VC mega-deal activity seems to be proceeding as usual. With over 119 completed VC deals of over $100 million as of this writing, investors seem to see some resiliency in the largest VC-backed businesses and their prospects of making it out of the pandemic-related crisis relatively unscathed. At the current pace, we are tracking close to 2019's trajectory, where we recorded 240 VC mega-deals through the year's end. Even without an exogenous economic shock, we saw this as a lofty prediction given the growth in VC mega-deal volume over the past five years, so this result through H1 2020 is quite surprising.

We noted two long-term trends in the original VC outlook note that we believed would buoy VC mega-deal activity: zero interest rate policy and the JOBS Act. These are still very much in effect. The long-term committed capital in the venture ecosystem and the number of players that now have a VC strategy are contributing heavily to sustained deal activity. Furthermore, the pandemic has brought some more capital scarcity to the VC environment for the first time in many years, forcing some GPs' hands in terms of which portfolio companies they are able to continue supporting. This has potentially buoyed late-stage deal activity, and particularly mega-deal activity, as investors see these companies as their “winners” that they need to return the fund. The sharp slowdown in the exit market, especially for unicorns, has driven some startups to return to private investors and raise VC mega-deals when they would have pursued an exit event under normal conditions.

VC mega-deal activity



Source: PitchBook | **Geography:** US
*As of June 18, 2020

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Prediction: CVC activity will reach a new record in 2020.

> ***Score:*** Undetermined
>
> ***Rationale:*** Deal activity with CVC participation has increased sharply in recent years, with many large incumbents utilizing the strategy to identify emerging trends and gain access to innovative technologies. CVC arms are becoming more entrenched within the VC industry, having raised more funds dedicated to venture pursuits in 2019 than in any previous year in our dataset, which should underpin activity in the years ahead.
>
> ***Caveat:*** If deal activity falls across the VC industry—whether due to an economic downturn or other developments—deal activity with CVC participation will inevitably follow suit. While some CVC teams can source and lead their own deals, many corporations opt to invest in venture-backed companies on an ad hoc basis and participate only in rounds that are already in process. Falling corporate revenues in a broad downturn would also deter corporations that see startup partnerships as nonessential to business growth.

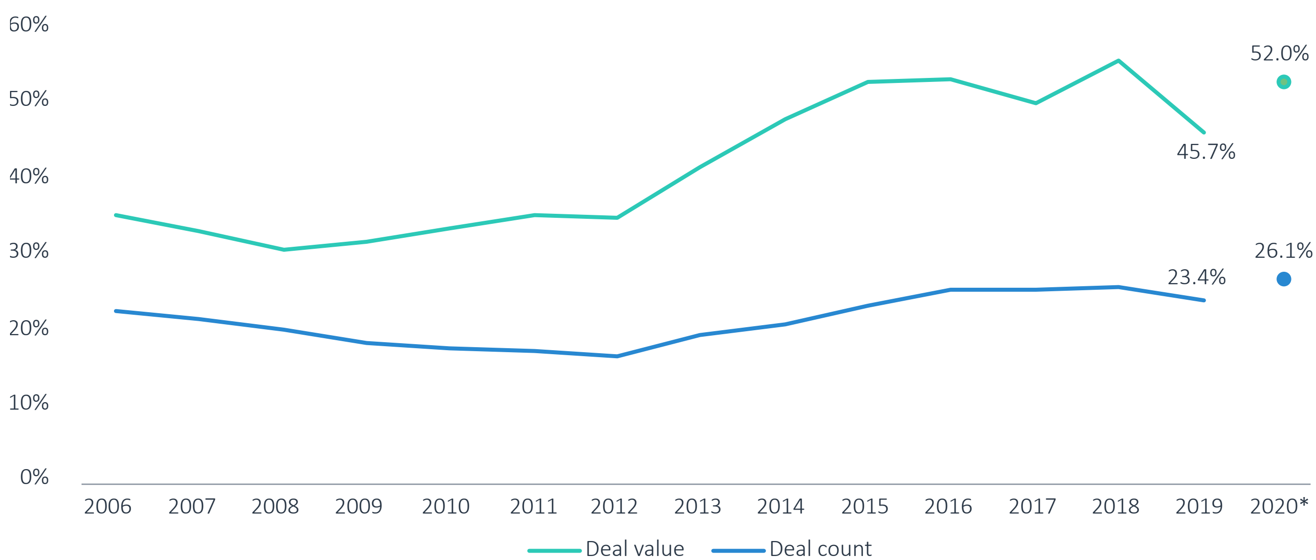
H1 2020 update: CVC activity is currently pacing slower than 2018 and 2019, but strong participation levels illustrate corporate VC is here to stay.

Q1 2020 data suggested corporate VCs were here to stay at the outset of the COVID-19 pandemic and the ensuing economic downturn and slowdown in VC dealmaking in the US. This was contrary to what many around the industry felt would happen to corporate venture after a broader group of investors pulled back from the asset class during the GFC, leaving some companies out to dry. Though Q1 data only contained around a month of COVID-19-era financings (the pandemic was largely relegated to March from a Q1 data perspective), CVCs were tracked to be participants in roughly 30% of US VC deals at the time. This not only suggested that CVCs were still active within the industry, but that figure was also the highest percentage we have tracked. Over the past decade, traditional internal R&D programs have given way, slightly, to the addition of corporate venture programs, which, when used adjacent to internal programs, can provide actionable data and insights for large corporations. With this in mind, we weren't surprised by the continued activity of CVC arms within the US market.

With Q2 2020 data arriving, we now have a better view into CVC and its standing within the broader venture landscape. The caveat to the original outlook opined that if overall dealmaking activity fell, so would corporate VC. So far through Q2, venture activity within the US is down, and not by an insignificant margin. However, corporate participation has shown resiliency. To date, CVCs have participated in 26.1% of US VC financings, a figure significantly higher than past years in our dataset, and even an increase over last year's record of 23%. We believe one major reason for this resiliency is that while overall VC activity has slowed, late-stage dealmaking is largely tracking at 2019's pace, while early-stage and seed financings have recorded a much sharper decline. Late-stage VC deals have received high support from CVCs because companies at this stage provide corporates the opportunity for significant partnership and synergistic efficiencies. Late-stage companies also generally have more developed technologies than younger companies that can be integrated in existing platforms and products of large corporations, a benefit to both investor and target. Participation in late-stage VC deals also figures into why CVC deal value has also remained high in 2020. Through mid-June, deals with CVC participation have already raised nearly $29 billion, more than half the total amount raised by such deals in 2019. The US VC ecosystem has continued to see strong investment in VC mega-deals and other large late-stage financings as investors protect the relationships where they already have the most skin in the game.

The second half of 2020 will determine whether CVC activity will approach the levels seen in the past two years and make a play for a new record high. Though the current pace is lower than years past, corporates have illustrated staying power when the industry assumed they would retract. This may prove venture platforms have become integrated and relied-upon pieces to the R&D programs for corporations. In addition, recent announcements that Amazon will be introducing a $2 billion venture fund targeting cleantech and that Facebook is launching a venture arm further bolster our belief that CVC will continue its growth within the venture ecosystem.

Deal activity with CVC participation as a proportion of overall VC deal activity



Source: PitchBook | **Geography:** US
*As of June 18, 2020

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Prediction: The median US VC fund size will top $110 million, reaching a decade high.

> ***Score:*** Fail
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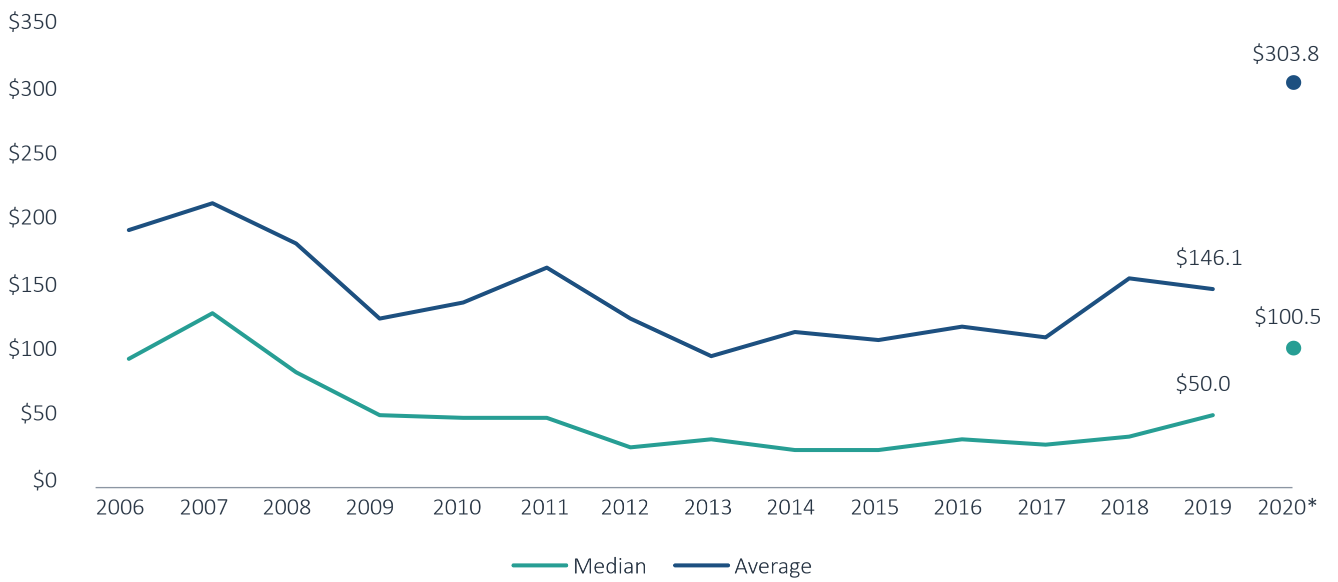
> ***Rationale:*** Although the median US VC fund size in 2019 has leveled off, we expect to see a significant increase in 2020 for a variety of reasons, including rising allocations to the strategy and decade-high VC fund distributions back to LPs. This has enabled GPs to raise ever-larger funds as they fuel blitzscaling strategies and strive to keep pace with rising deal sizes.
>
> ***Caveat:*** The recent WeWork calamity and the poor post-IPO performance of multiple prominent tech companies have renewed skepticism around investment into unprofitable startups, which could temper the strong venture fundraising environment of recent years. Furthermore, the healthy exit environment over the past several years is likely to contribute to a rise in first-time funds, a byproduct of the success of early team members. Historically, over half of first-time funds have been micro-funds (sized under $50 million), so naturally a surge in first-time funds would drive down the median fund size. Lastly, if fundraising activity continues to dip from 2018's stellar posting, it could signal investor reticence about the VC asset class, perhaps related to uncertainty regarding global public equities.

H1 2020 update: The median US VC fund size in H1 2020 reached $100.5 million, just $9.5 million shy of our prediction. While this prediction was relatively lofty, it was one that was supported by the broader trends seen in the VC asset class. Despite market uncertainty, fundraising in the last six months has been robust, with $41.3 billion raised across 142 funds. If fundraising continues to occur at this rate throughout the second half of the year, we will see 2020 break the record of $65.4 billion raised just two years ago.

Fundraising has been buoyed by top-tier investors who are able to ride the coattails of their firm's name and track record to raise new funds during the COVID-19 pandemic. Tiger Global Management raised a $3.75 billion fund in January 2020 and New Enterprise Associates (NEA) raised a $3.6 billion fund in March 2020. Notably, Lightspeed Venture Partners raised three funds in April 2020—a $890 million fund for seed- and early-stage investments, a $1.8 billion fund to accelerate existing portfolio companies, and a new $1.5 billion fund vehicle to back breakout companies across their global territories. In fact, the top 10 funds raised in H1 2020 totaled $18.6 billion, making up nearly half of all VC fundraising in the first half of this year.

This has also resulted in a noticeable drop in first-time funds, which raised only $1.5 billion across 14 funds in H1. Given the healthy fundraising activity exhibited by experienced VC investors so far this year, it is no surprise that the percentage of micro-funds raised in 2020 is on track to dip below 40% for the first time since 2008, as these tend to be more indicative of younger VC firms and less experienced investors. Rising allocations to the VC asset class and fund distributions back to LPs have allowed GPs to raise larger funds in recent years. Even though this prediction did not pan out in H1 2020, VC fundraising has been robust and the median fund size for the last six months is already a substantial jump when compared to 2019's median fund size of $50.0 million.

Median and average VC fund sizes ($M)



Source: PitchBook | **Geography:** US
*As of June 18, 2020

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Prediction: SoftBank's second Vision Fund will not close at its target of $108.0 billion.

> ***Score:*** Pass
>
> ***Rationale:*** The failure of the WeWork IPO—and the subsequent handling of its fallout—has called into question SoftBank's Vision Fund strategy, with skepticism coming both from LPs and the firm's public shareholders. Besides WeWork, several other mega-investments in the Vision Fund's portfolio have suffered significant write-downs in recent months
>
> ***Caveat:*** The broader industry of LPs is awash with capital and often has trouble obtaining sufficient allocations to VC. SWFs, which were big backers in the first Vision Fund, are continuing to diversify their holdings away from natural resources and seek alternative strategies for growth. If even a handful of large LPs are willing to look past SoftBank's recent losses and double down on their commitments to the GP's strategy, it could push Vision Fund 2 to its target.

H1 2020 update: Unsurprisingly, all data points point to SoftBank not reaching its goal of $108.0 billion for Vision Fund 2. SoftBank reported its first quarterly loss in 15 years after Q1 2020, realizing a loss of $18.0 billion largely due to some poor investments in its first Vision Fund. Masayoshi Son himself even noted that now is not the time to be asking SoftBank's partners for cash at the moment: "If the performance is not very good then of course the money for Vision Fund 2 cannot be asked for." The media scrutiny on SoftBank has surfaced other struggles beyond investment practices within SoftBank that don't paint a great picture of the internal mechanics of the conglomerate. SoftBank is also reportedly set to lay off 80 people working for the Vision Fund, another sign that now is not a time to expect Vision Fund 2 to surpass fundraising expectations.

The caveat to the outlook centered around the available capital within large LPs, specifically SWFs, of which two (Saudi PIF and Mubadala) participated in the initial Vision Fund to the tune of $60.0 billion. Despite concerns surrounding the recent volatility in oil prices, these investors still do have that capital availability, though plenty of other opportunities are available for them to put capital to work. Mubadala has been busy, participating in the $3.0 billion investment in autonomous vehicle company Waymo, investing $1.2 billion in India's Jio and making several other smaller investments during 2020. PIF used the market downturn to buy or increase its existing stakes in Live Nation and Carnival, along with its own $1 billion+ stake in Jio.

Vision Fund 2 currently has a reported $38.0 billion to invest—not a sum to scoff at. That capital has come from Masayoshi Son himself, along with SoftBank Group and executives. Because of the lack of major exits from Vision Fund 1, gains and losses on the fund are relegated to mark-to-market valuations rather than true realizations, and with around eight years left on the fund lifetime, a turnaround is always possible. Investments such as Didi, Paytm, Grab and DoorDash could still provide returns that turn the tide in favor of solid returns for the fund. However, we expect these fundraising struggles for SoftBank to hold true for at least 2020.

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Prediction: At least three direct listings of companies valued over $1 billion will close in 2020.

> ***Score:*** Undetermined
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> ***Rationale:*** Momentum behind direct listings has continued to accumulate following Slack's public debut in April 2019. In October 2019, investment bankers, VC investors and entrepreneurs held an invitation-only meeting to discuss alternatives to the traditional IPO process, which reportedly featured extensive discussion on direct listings. With its seeming emergence as the preferred alternative IPO for technology startups, and with Airbnb announcing that it might opt for this route in its reported 2020 offering, we see direct listings becoming a standard consideration for companies pursuing a transition to the public markets.
>
> ***Caveat:*** Given recent IPO struggles from many of the high-profile public listings in 2019, continued negative receptions to new listings or poor broad stock market performance would materially reduce the number of companies that choose to pursue a public listing of any kind. If investor sentiment around public equities or new listings becomes significantly negative, smaller unicorns may delay any type of offering or instead proceed down the well-worn traditional IPO path to avoid any unwanted volatility or raise money to insulate from the uncertainty.

H1 2020 update: The outlook for direct listings looks much bleaker than many of the other expectations we had for the VC ecosystem in 2020. The pandemic all but shut down the IPO market for a significant portion of the year with only 21 VC-backed IPOs closing through June 2020, most of which have been biotech startups. This broader volatility that played out in public equity prices has discouraged many companies from proceeding with plans to go public either by an IPO or a direct listing. This is especially true for many of the large, high-profile businesses that were the best candidates for the direct listing route as they had the name recognition, market interest and enough capital raised to go without the new capital from the IPO. Airbnb is a prime example of a startup that chose to change their trajectory, as COVID-19's effect on travel deteriorated their business. Forgoing a direct listing, Airbnb instead raised $2.0 billion in a mix of debt and warrants to fund the business through this downturn. On the other hand, companies that need liquidity to fund operations during the ongoing COVID-19 crisis may face pushback or stringent terms from private investors, which may encourage some companies to go forward with an IPO to access the public market.

The twist here is that the public markets have largely recovered to the highs that the indices were hitting before the pandemic sell-off, something we had not expected to happen until much later in 2020. This early recovery in pricing, which may be unsubstantiated by the persistently uncertain economic conditions, has allowed businesses to reconsider their plans to transition to the public markets. For instance, Airbnb has reversed course and publicly left the door open for a public listing by the end of 2020. Palantir—which has put off an IPO for years—is reportedly filing now in time to go public in H2 2020, and Asana filed for a direct listing early in 2020 that could still go forward. Special purpose acquisition companies (SPACs) have also seen an uptick in volume so far in 2020, representing another potential way for a handful of businesses to reach the public market. Although these transactions are more of a hybrid between an acquisition and an IPO, and don't typically target technology companies, it again displays the current innovation in the public listing market.

While the prediction of three direct listings closing in the last six months of the year is quite unlikely to come to fruition, the fact that there may be at least one after how the year started is impressive. While the public market performance and the number of VC-backed IPOs through the rest of the year are still unclear, it seems we may see a few high-profile and highly valued startups choose to list publicly.

2020 predictions scorecard

Below we summarize our predictions for 2020 and how they fared thus far.

The median pre-money valuation for seed-stage companies will eclipse $8.5 million.	Fail	The median pre-money valuation for seed-stage companies in H1 2020 was $7.5 million. As VCs re-evaluate their current portfolio, sourcing new seed-stage deals has slowed and investors are less willing to pay as high as price as before.
2020 will mark a new annual record for US VC mega-deals.	Undetermined	With 119 mega-deals closed through six months of the year despite the struggles related to the pandemic, the data is well on its way to fulfilling this expectation.
CVC activity will reach a new record in 2020.	Undetermined	VC activity with CVC participation has declined at a lesser rate than that of the broader US venture industry, notching a 26.1% deal participation rate, the highest level we have tracked in our dataset.
The median US VC fund size will top $110 million, reaching a decade high.	Fail	The median US VC fund size in H1 2020 reached $100.5 million, just $9.5 million shy of our prediction. Fundraising has been robust, with many top firms raising oversized funds. The percentage of micro-funds raised in 2020 is tracking to dip below 40% for the first time since 2008.
SoftBank's second Vision Fund will not close at its target of $108.0 billion.	Pass	All signs point to SoftBank not realizing its $108 billion target for Vision Fund 2. The firm's original Vision Fund has not been able to keep up with its initial hype, dragging the Japanese conglomerate to its first quarterly loss in 15 years during Q1.
At least three direct listings of VC-backed companies valued over $1 billion will close in 2020.	Undetermined	IPOs have been hit hard by the current uncertainty in the economy which also makes the outlook on direct listings much more negative. There is still a possibility that one will close in 2020, but likely not the three we predicted.