PitchBook

European VC Valuations Report

Q1 2020

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Introduction

In Q1 2020, pre-money valuations across the financing stages remained resilient amid the emergence of COVID-19. However, most VC deals were conducted prior to disruption, and valuations are expected to cool or fall as the year progresses. Valuations tied to new angel & seed and early-stage rounds could fall as managers shift their focus inwards towards existing portfolio companies. Rapid late-stage valuation growth is expected to taper during the recessionary environment.

Nontraditional investment is likely to decrease, adding to downward pressure on VC deal sizes and valuations. Valuations associated with rounds involving nontraditional investor participation will likely fall in the near term, in line with an overall depression in valuations across the board. Nontraditional investors may focus on their primary markets instead of VC during the looming downturn.

Aggregate unicorn value growth has been strong, but this may slow. Valuations of high-profile loss-making unicorns could come under scrutiny as avoiding funding gaps and resource management become imperative. Unicorn valuations are likely to flatten or fall as growth becomes harder to capture in the current environment.

Exit valuations continued to fall in Q1 2020, and COVID-19 will drastically reduce the number of exits. Mature startups will seek out follow-on and extension rounds to stretch runways rather than an exit. Exit opportunities will be further hindered by volatility in public equities and strategic acquirers facing financial problems.

Nalin Patel
Analyst, EMEA Private Capital

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Angel & seed

The median angel & seed pre-money valuation reached €4.4 million in Q1 2020 to begin the new decade, continuing the impressive momentum from the last five years. The top- and bottom-quartile valuations also recorded increases in Q1, as the effects of the pandemic have not yet cropped up in valuations. However, we believe impacts of the current crisis will emerge over the next two quarters as economic prospects worsen and valuations are recalculated.

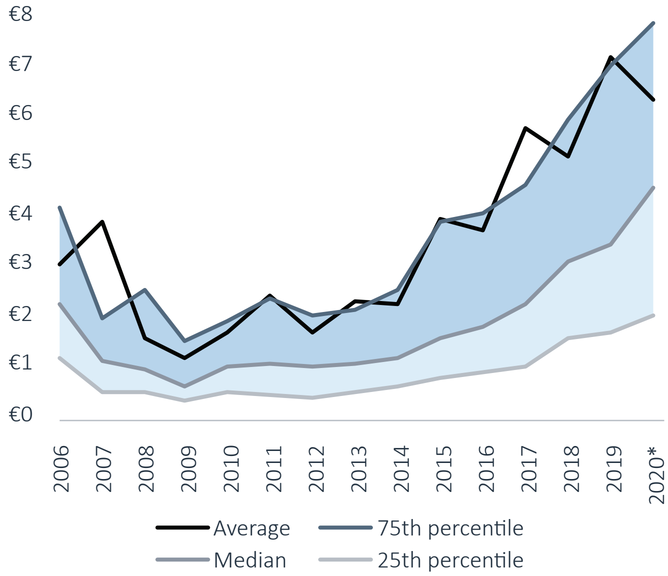
Angel & seed deal sizes across the lower, middle and upper quartiles all increased in Q1 2020, which follows a five-year trend in the European ecosystem of more capital being used across fewer deals at the stage. Deal count in the angel & seed bucket has fallen every year since 2015, and this is expected to continue in 2020. In addition, deal sizes will likely cool as recessions kick in and dampen investment appetite within the VC ecosystem.

The angel & seed stage has evolved as larger rounds have been utilised to develop more mature startups. As a result, startups have grown before their initial funding and have garnered bigger angel & seed rounds at higher valuations. The median time from founding until a completed angel & seed round has steadily risen in the last decade, reaching 2.8 years in 2019. The median time to financing could lengthen further in 2020 as growth opportunities slow, leading to fewer earlier angel & seed rounds for startups pursuing capital earlier in their lifecycle.

We believe angel & seed deals and subsequent valuations could see significant declines due to lockdowns in Europe. Deals can involve unfamiliar parties and in-person meetings occur to build relationships to understand the business priorities and vision shared between founders and investors. While strict measures are in place in the short term, we also expect looser restrictions and adjustments to long-term working practices until a vaccine is found. Despite the availability of videoconferencing, this will affect investors' and founders' ability to conduct new angel & seed deals more than extension or follow-on rounds between participants with an existing rapport.

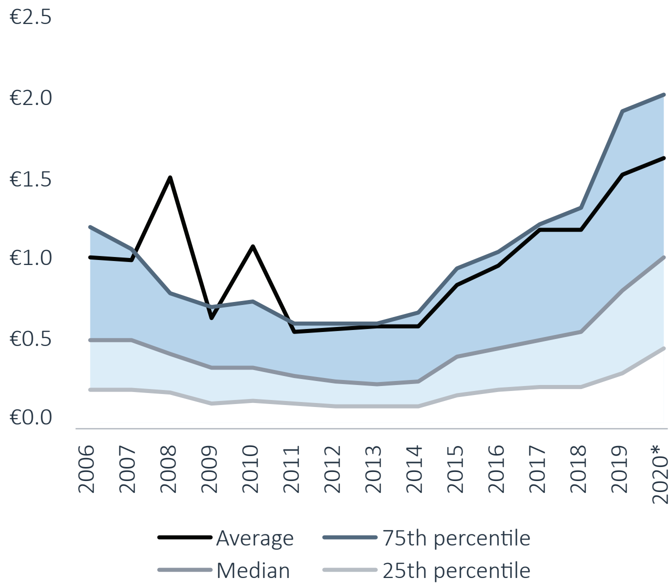
The abundance of capital in the VC ecosystem has allowed angel & seed valuations to flourish in recent years, often representing similarities with financial expectations at the early stage. Growth has been exceptional as investors and startups have raised record amounts at towering valuations, in fear of missing out on opportunities. However, as dealmaking decreases across the board and investors become more prudent, we believe angel & seed rounds will command lower valuations as startups lose the ability to represent rapid growth in a recession. Moreover, as risk-off tactics surface, investors will prioritise inward investments for their current portfolio instead of new angel & seed rounds for unproven startups.

Quartile distribution of angel & seed pre-money valuations (€M)



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Quartile distribution of angel & seed deal sizes (€M)



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Early-stage VC

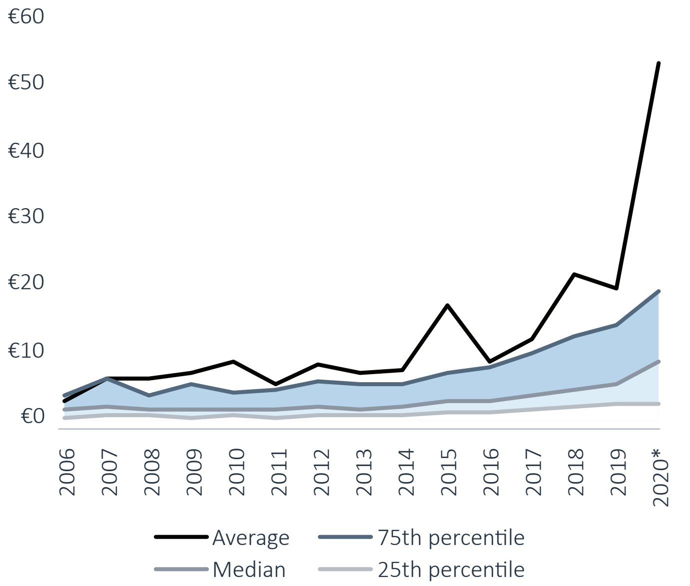
Early-stage pre-money valuations in Q1 2020 maintained growth across the bottom, middle and top quartiles after annual peaks in 2019. The gap between top- and bottom-quartile valuations has been pacing at around €16.1 million, widening further from the 2019 figure. The median early-stage pre-money valuation reached €8.8 million in Q1 2020, representative of a quarter that was largely business as usual until COVID-19 spread. We expect early-stage valuations for newly negotiated deals during the remainder of the year to carry significantly less heft as growth estimations are cut.

Early-stage VC deal sizes across the lower, middle and upper quartiles remained robust in Q1 2020, with the median reaching €2.7 million. Early-stage VC deal sizes across all quartiles recovered after dipping noticeably in the wake of the global financial crisis (GFC) and remaining comparatively flat until 2015. Early-stage deals have overtaken angel & seed deals as the most common type in the past two years, and this continued in Q1 2020. Furthermore, deals at the early stage accounted for 36.4% of overall VC deal value in Q1, as expanding nontraditional sources of capital entering at the stage have inflated deal sizes.

Early-stage valuations and deal sizes are tied to startups optimising product-market fit and total addressable market within their first few years of founding. In most instances, sustainable revenue generation may not be possible and investment rounds are used for long-term R&D efforts. However, early-stage VC rounds are also used to develop scale, whereby significant losses may be incurred, but recurring revenue growth drives valuation in the market. As the economic downturn continues, we believe flat and down early-stage VC rounds will occur more frequently, as launching new offerings becomes increasingly difficult while costs and unit economics become vital for survival. Valuations at this stage are likely to spread wider as startups with different business models—operating in different sectors with varied impacts—negotiate demand fluctuations affecting revenues in the near term.

Median early-stage VC valuation step-up multiples climbed to 1.6x in Q1 2020 after posting consistent YoY growth between 2017 and 2019. However, we expect this to fall as valuation haircuts become more common amid the downturn. Rounds closed in Q1 were likely negotiated prior to the spread of COVID-19 or pushed through in anticipation of it. New rounds closing over the next few quarters will reflect market sentiment and the effects of reduced revenues, rising unemployment and deflation. Early-stage VC valuations with limited revenue generation history will be heavily scrutinised. Forecasts for financial performance in the next six to 12 months will be predominantly based on revenues in 2020, rather than the last three years in which growth was easier to extract. Moreover, as investors familiarise themselves with new market conditions and identify potential dislocations between revenues, it will take longer for them to derive valuation estimates and close deals.

Quartile distribution of early-stage VC pre-money valuations (€M)



Source: PitchBook | **Geography:** Europe
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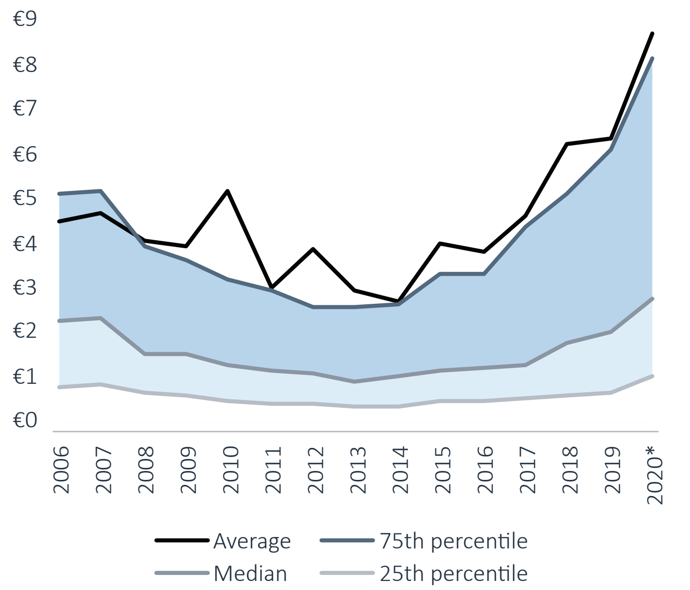
Quartile distribution of early-stage VC deal sizes (€M)



Source: PitchBook | **Geography:** Europe
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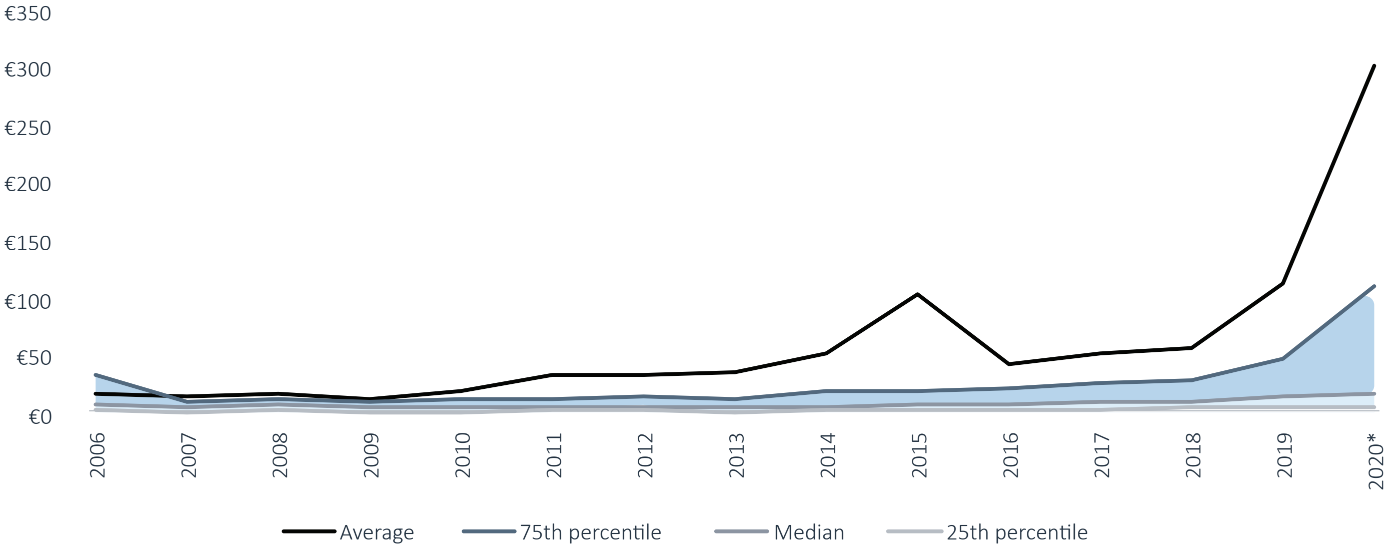
Late-stage VC

Quartile distribution of late-stage VC pre-money valuations (€M)



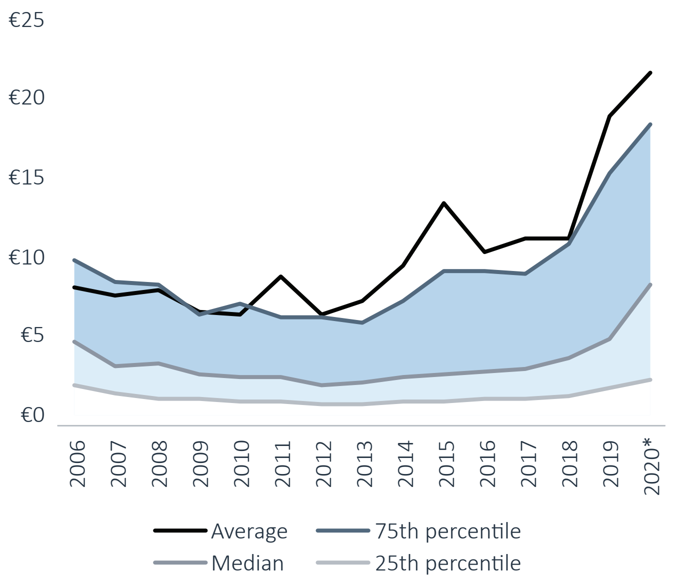
Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

In Q1 2020, median and top-quartile pre-money valuations ticked upwards, while the bottom quartile dropped in comparison to 2019 figures. The disparity between top- and bottom-quartile late-stage valuations reinforces the perception that prized late-stage startups have pulled away from the rest of the field and continue to attract the bulk of capital. The top quartile surged to €107.7 million in Q1 as multiple mature startups, such as multibillion-euro valued unicorns Klarna and Revolut, closed rounds. Late-stage VC has inflated valuations by extending funding runways before exits, leading to a maturation of late-stage valuations for companies that would have already exited the ecosystem a few years ago. We believe COVID-19 will drastically change valuations at the late-stage as the year progresses, leading to a bifurcation in the market. Investors will prioritise solid financials over chasing market share for many loss-making late-stage companies.

Overall VC deal value reached €8.5 billion in Q1 2020, with late-stage deals contributing 59.2% of the total. Capital infusions at the late stage from a multitude of nontraditional and international investors have been the main driving force behind climbs in overall deal value and sizes in recent years. The late-stage median size was €8.1 million, with both bottom- and top-quartiles up in Q1.

Although most deals were closed prior to the pandemic, early indications from the start of the year illustrated new records were expected in 2020. During the downturn, we predict deal sizes will flatten and constrict as growth decelerates for late-stage companies and investors become more prudent. Late-stage VC rounds that occur in the near term will likely be closed to plug costs, manage demand-side falls and prevent funding gaps crippling mature startups that will have to taper cash burn rates.

Quartile distribution of late-stage VC deal sizes (€M)



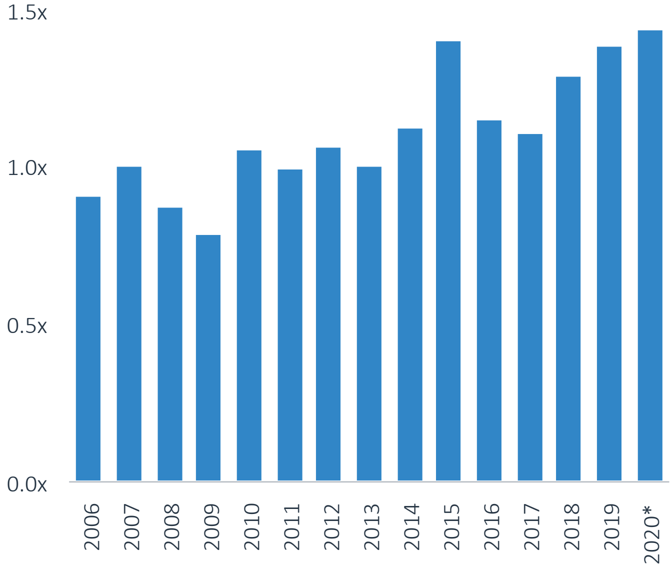
Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

The median age of late-stage companies hit 7.2 years in Q1 2020, following the general decline exhibited since 2016. Startups have closed larger late-stage rounds earlier in their lifecycle, sparking accelerated underlying financial revenue creation and subsequent valuation growth once they have moved through angel & seed and early-stage financing stages. Companies have also scaled faster as technological advances, capital availability and elevated economic confidence have promoted rapid late-stage growth. Value creation will become harder in the bear market and the transition between financing stages will slow. In the long term, we believe time between rounds will lengthen as rounds are used to fund current operations rather than aggressive new scaling efforts. As growth slows, time between rounds will also widen to reflect the alteration in overarching market dynamics and valuation expectations. Startups will find it challenging to gain traction in new markets, as businesses and consumers spend less during the looming recession.

The median late-stage valuation step-up multiple ticked up slightly to 1.4x in Q1 2020 as competition has driven up valuations in recent years. Rounds resulting in step-ups have been common and investor and startup confidence in valuation progression has grown. We believe the pandemic will hinder the ability to close rounds in the near term that result in significant step-ups in valuation. Immediate uncertainty has resulted in rounds being put on hold or renegotiated to ensure terms reflect the current market conditions. As a result, we believe round step-ups will decline over the next few quarters as flat or potentially down rounds occur more often. Deal terms will likely shift in favour of investors with term sheets including reduced valuations and larger equity stakes forming major parts of the negotiation process.

Follow-on financing is procured to sustain momentum. Strategies involving follow-ons have also contributed the majority of capital and count in recent years, as investors have continued to back leading startups. We believe this is where the bulk of activity will remain in the near term as investors tend to their existing portfolios. Mature startups have had to close frequent larger rounds to fund expansion and stay ahead of competition in crowded sectors. More mature startups have conducted late-stage follow-on rounds with relative ease, but with increased uncertainty, haircuts could spread across sectors as demand collapses and urgent capital needs surface. During the GFC, the European VC ecosystem was less heavily skewed towards the late stage. Funding requirements at the late stage have surged in the last decade and could dictate capital availability for the rest of the ecosystem during the crisis.

Median late-stage VC pre-money valuation step-up multiples



Source: PitchBook | **Geography:** Europe
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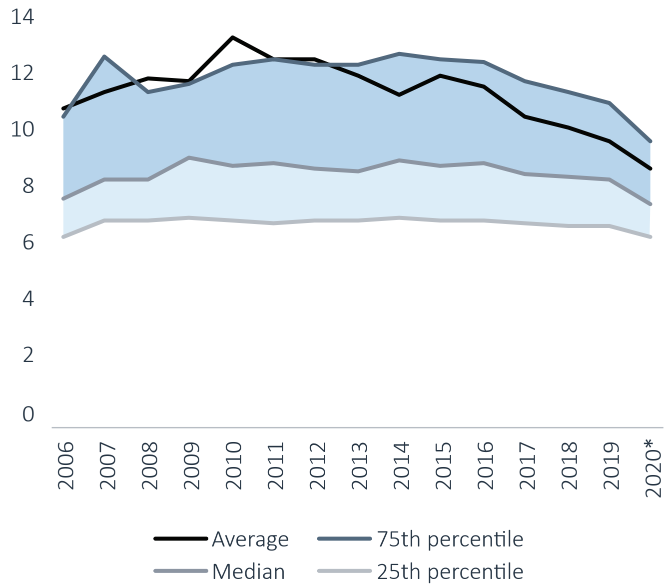
Quartile distribution of median age (years) of late-stage VC companies since founding



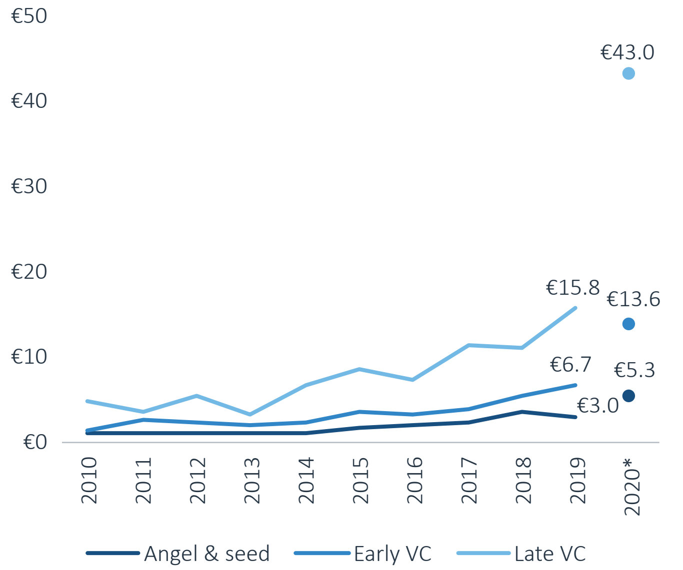
Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Sectors

Software valuations and VC deal sizes across the lower, middle and upper quartiles have all been pacing strongly through Q1 2020. Software deals have continued to dominate venture activity in Europe, and we expect this to continue despite dealmaking and valuations cooling due to COVID-19. Software VC deal sizes across the stages roughly doubled between 2016 and 2019—a testament to the amount of capital investors are pouring into the tech sector to disrupt and enhance traditional industries. While investment will continue, we doubt the recession will allow for growth akin to this in the near term.

Healthcare VC deal sizes have also increased in the last decade after dipping in the wake of the GFC. We believe the current public health crisis could result in opportunities in the sector, as discussed in our Q1 2020 European Venture Report. Many sectors are facing extremely uncertain times, but healthcare startups could capitalise on growth opportunities to help against COVID-19. Consequently, we could see long-term implications for valuations in the sector as capital is put to work to help fight the current pandemic and develop preventative measures for future events.

Median pre-money valuations (€M) by stage for VC software companies



Source: PitchBook | **Geography:** Europe
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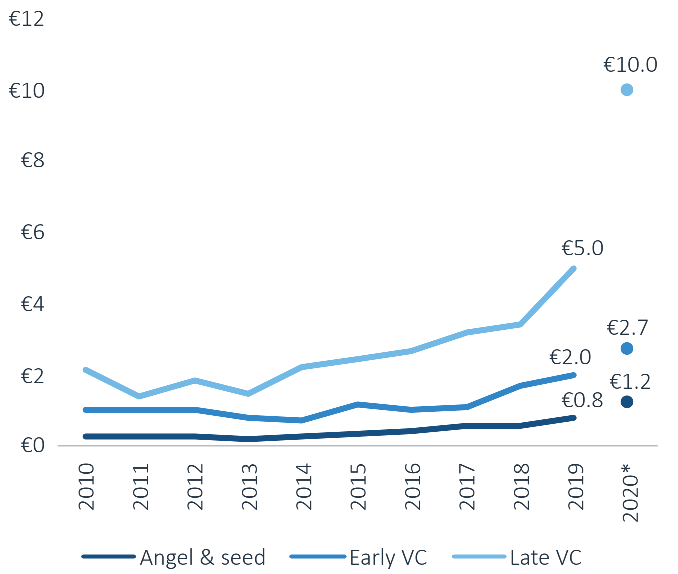
Median deal sizes (€M) by stage for VC software companies



Source: PitchBook | **Geography:** Europe
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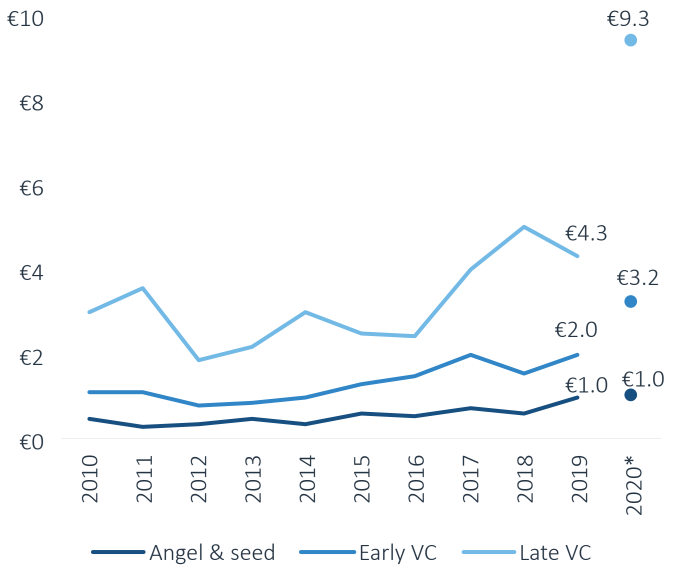
Median deal sizes (€M) by stage for VC healthcare companies



Source: PitchBook | **Geography:** Europe
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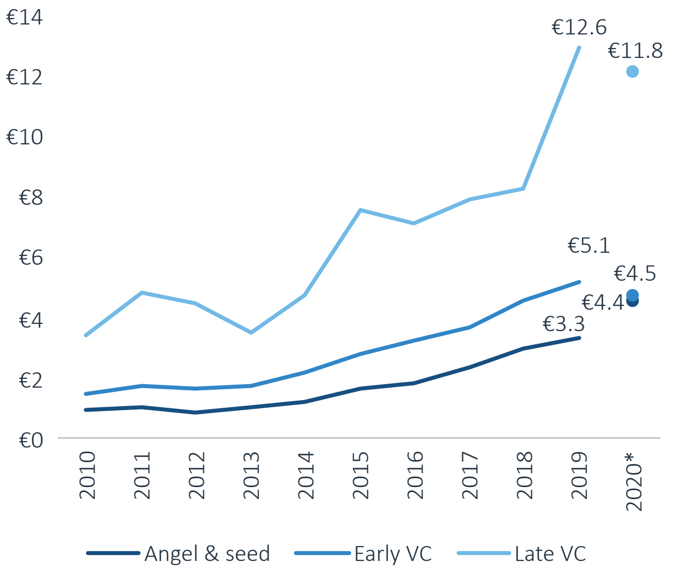
Regions

Median early- and late-stage valuations in the UK & Ireland cooled in Q1 2020 compared to 2019 figures. Prior to COVID-19, the depression in valuations could have been attributed to a short-term blip as overall valuation growth during the last decade has been immense across all stages. Nontraditional and international capital has increasingly helped fund late-stage startups, leading to maturation in the European VC ecosystem. However, we believe decreases in valuations will persist in 2020 and increase in occurrence across Europe. COVID-19 has affected the entire continent and no region appears unaffected despite widespread lockdowns and social-distancing measures.

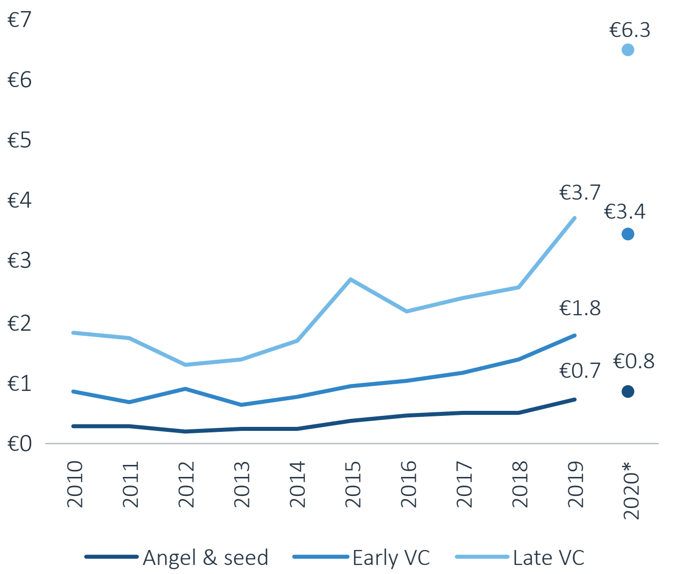
Median late-stage VC deal sizes in the UK & Ireland and France & Benelux regions have pulled away from other stages since 2018, with both pacing strongly in Q1 2020. Startups in these regions have been able to attract record round sizes and push overall regional VC deal value to new heights. As late-stage deal sizes are expected to shrink, deals that are closed could reflect a tapering in median late-stage VC deal sizes in more mature ecosystems. Nonetheless, decreases are likely to be felt across deal stages in all regional ecosystems.

Median pre-money VC valuations (€M) by stage for the UK & Ireland region



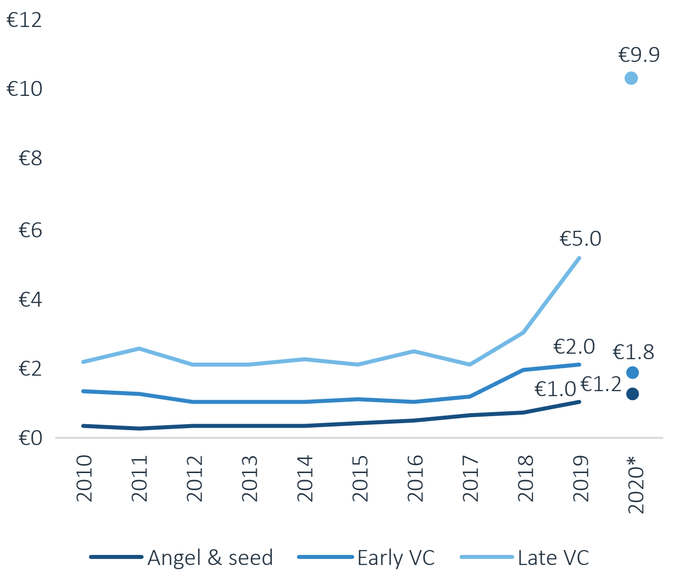
Source: PitchBook | **Geography:** UK & Ireland
*As of March 31, 2020

Median deal sizes (€M) by stage for the UK & Ireland region



Source: PitchBook | **Geography:** UK & Ireland
*As of March 31, 2020

Median deal sizes (€M) by stage for the France & Benelux region



Source: PitchBook | **Geography:** France & Benelux
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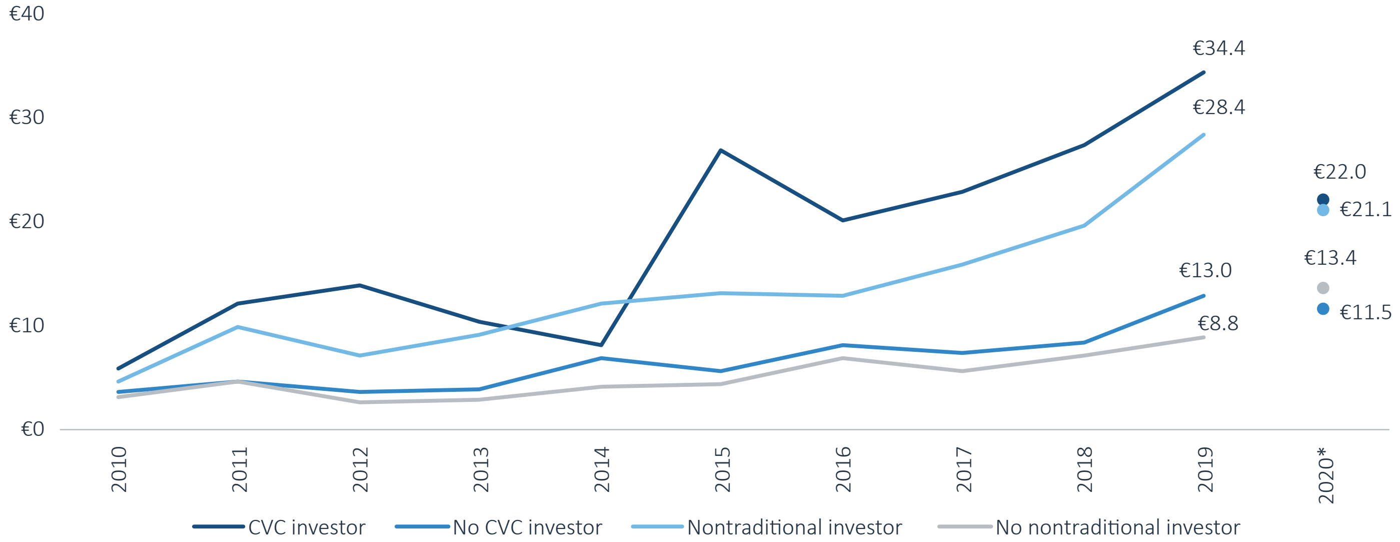
Nontraditional investors

Median late-stage VC pre-money valuations (€M) with nontraditional investor participation



Source: PitchBook | **Geography:** Europe
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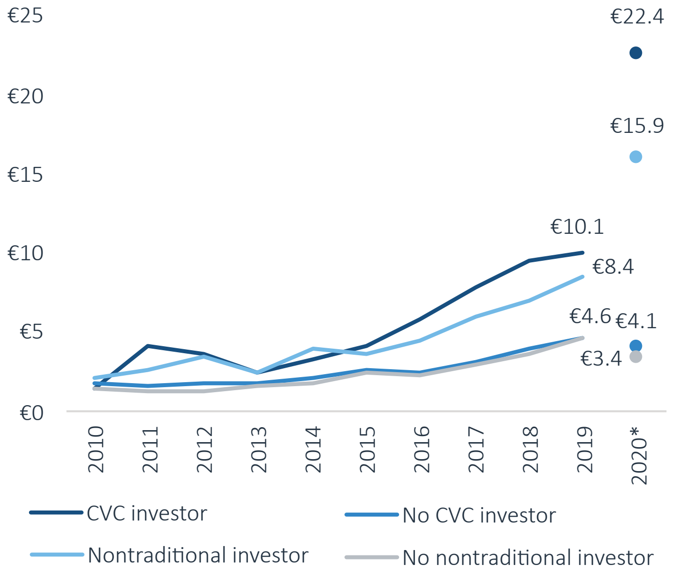
Nontraditional investors have become a driving force behind increased round sizes and valuations across the VC ecosystem. Many nontraditional investors have directly invested in startups or committed capital to venture funds to complement their investment portfolios. However, under current economic conditions, venture investment from nontraditional sources will likely decrease, adding to downward pressure on VC deal sizes and valuations.

Median early- and late-stage pre-money valuations have climbed in the last four years and remained healthy in Q1 2020, as nontraditional investors, including CVCs, have continued to participate in rounds. We believe falls in valuations will be reflected over the next few quarters, as COVID-19 swept through Europe towards the end of Q1 and therefore did not manifest in the quarter's valuation numbers. Valuations with nontraditional investors will likely drop down towards figures without nontraditional investor participation. However, we expect an overall depression in valuations across the board is likely.

Median early- and late-stage deal sizes with nontraditional investor participation paced higher in Q1 2020 from the record annual highs set in 2019, while the angel & seed median dipped slightly. Development of the late-stage median VC deal size with nontraditional investor participation has been staggering since 2014, effectively doubling in size. Prior to COVID-19, growth was expected to continue with capital from expanding nontraditional sources funding larger deals and sustaining the increase in overall deal activity witnessed over the last decade.

Median early-stage VC pre-money valuations (€M) with nontraditional investor participation



Source: PitchBook | **Geography:** Europe
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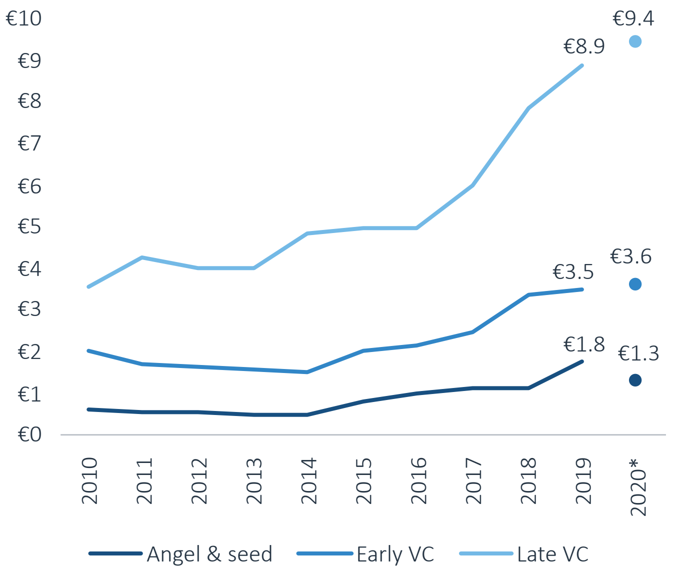
Venture investment is illiquid and potential returns are generated in the long term, making it a high-risk strategy only available to investors with high levels of disposable capital. Numerous nontraditional investors have primary markets they operate in, and venture can be a secondary or tertiary strategy to put capital to work and diversify. For example, many sovereign wealth funds (SWFs) primarily invest in natural resources and can be highly exposed to volatility concerning oil prices. Lack of demand due to COVID-19 has led to crashes in primary sectors for nontraditional investors across the globe. Therefore, these types of investors may be less inclined to invest directly or commit to a venture fund that locks capital away for several years if critical near-term cash requirements surface.

Nontraditional investment from CVCs is encountering heightened uncertainty as parent corporations face extensive issues due to closures, collapses in demand and plummeting revenues. We believe CVC participation will reduce drastically in the near term in sectors such as mobility, which have seen planes grounded and car manufacturing stopped. This will lead to a decrease in investment activity from CVC arms in the sectors hit hardest. Furthermore, it will be difficult for startups to justify and demonstrate increased valuations in sectors seeing larger corporate investors struggle.

Median VC deal size (€M) with nontraditional investor participation by stage



Source: PitchBook | **Geography:** Europe
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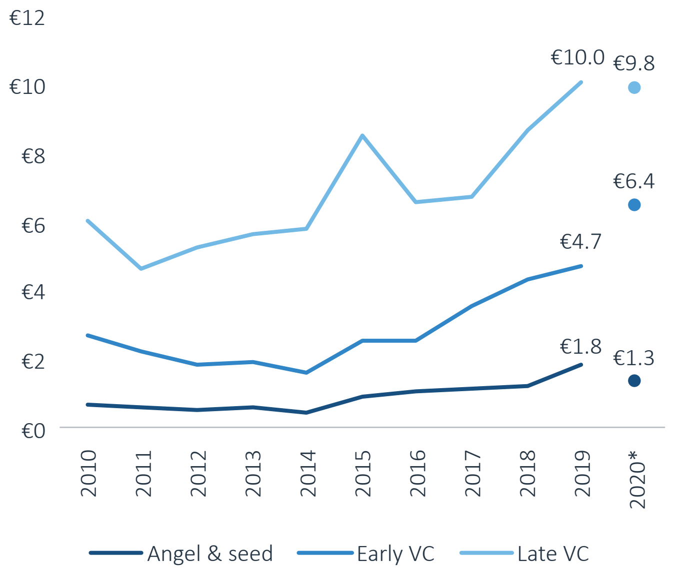
Median VC deal size (€M) with CVC participation by stage



Source: PitchBook | **Geography:** Europe
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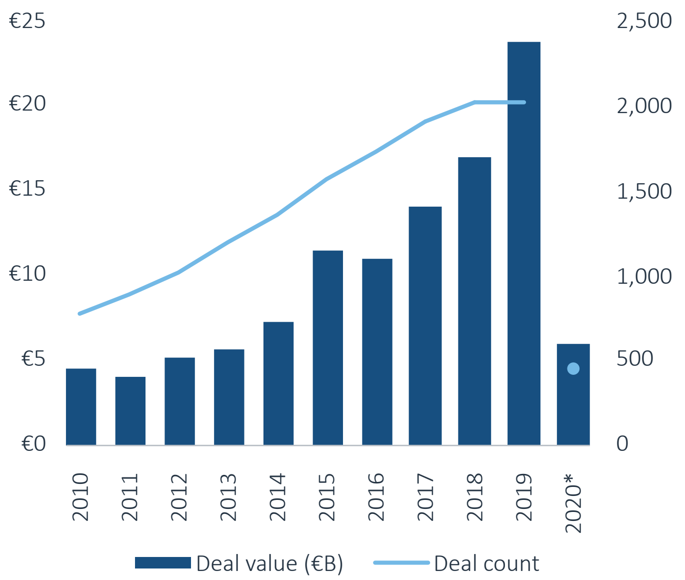
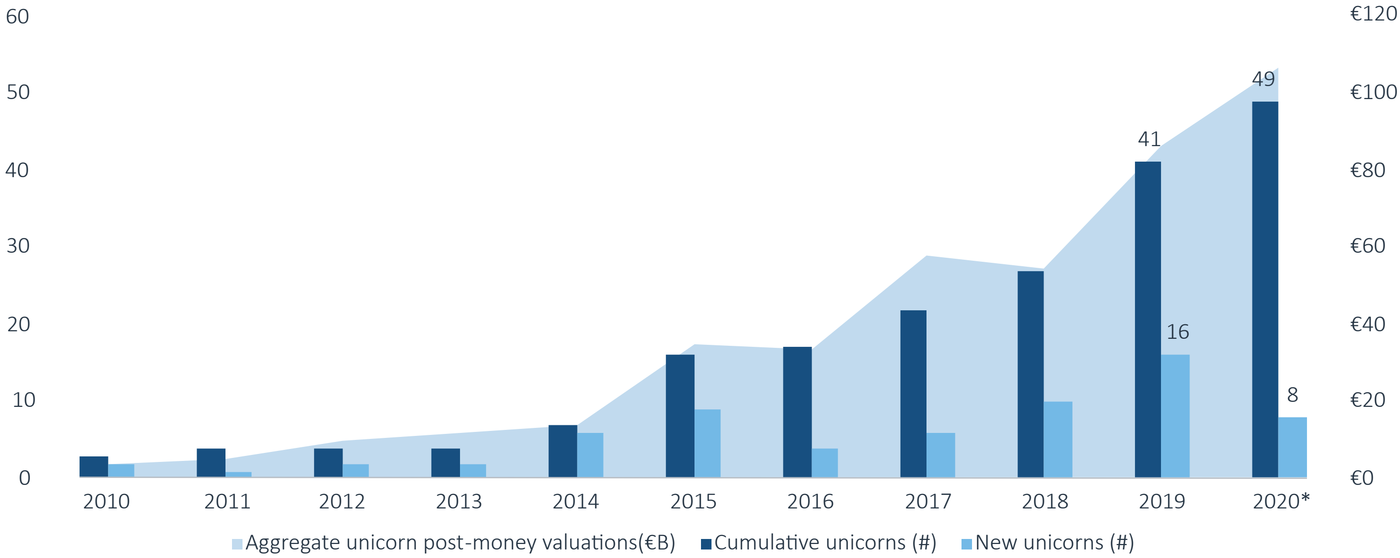
VC deal activity with nontraditional investor participation



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Unicorns

Unicorn count and aggregate post-money valuation

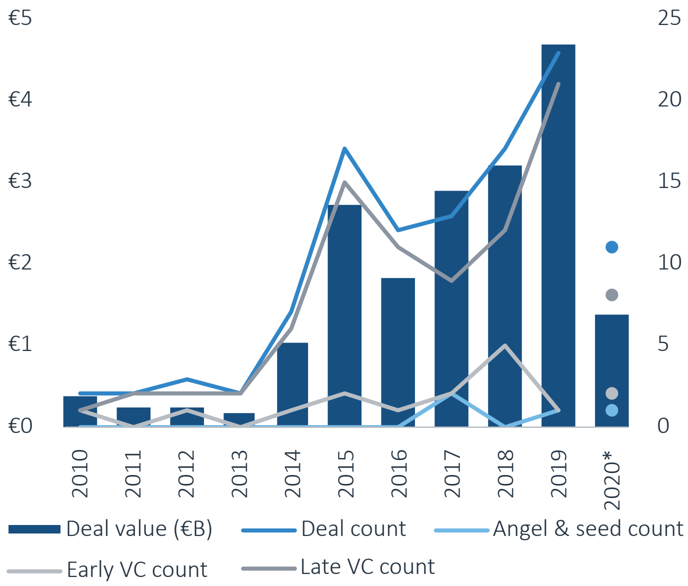


Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Value generated from unicorns in the European VC ecosystem has progressively improved during the last decade and continued in Q1 2020. There are currently 49 unicorns in the ecosystem and eight have been minted since the start of 2020. The development of unicorns has been a major factor in the maturation of the European VC ecosystem, which has cultivated larger valuations and VC deal sizes in the last five years. Unicorns have been able to develop fairly unscathed during the European VC bull run. But as we enter a downturn, swelling unicorn valuations are expected to face fresh challenges and could see some of the largest drops. Furthermore, valuations of high-profile loss-making unicorns could come under examination as cash squeezes ensue and resource management becomes imperative.

The median pre-money unicorn valuation has increased for the last three years and reached €2.6 billion in Q1 2020. While this figure may fall as the year progresses, it does indicate that unicorns have carried larger valuations when closing rounds. This is a consequence of late-stage capital put into follow-on rounds, extending runways for unicorns to mature in the VC ecosystem instead of exiting. We believe unicorn valuations will flatten in 2020 as rounds are completed to prevent funding gaps rather than support scaling plans. Uncertainty tied to cost-benefit analyses of operations accustomed to growth and

Unicorn VC deal activity by stage



Source: PitchBook | **Geography:** Europe
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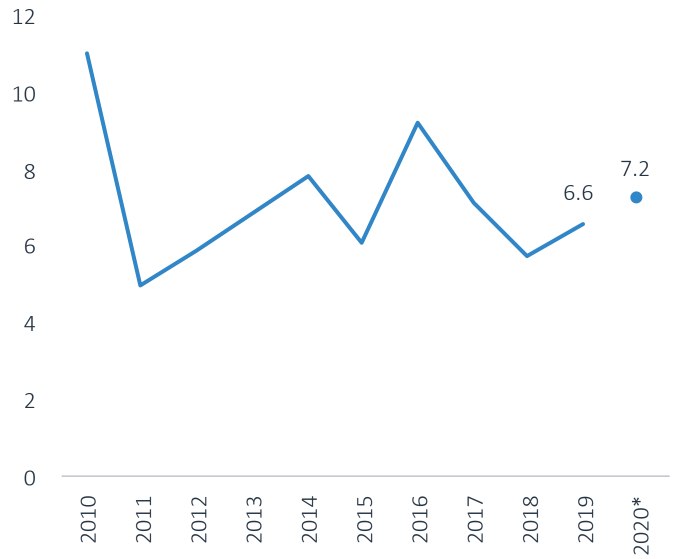
trimmed forecasts will reduce overall valuation growth within the European unicorn cohort and could result in the loss of considerable chunks of value. In the near term, some rounds will also be conducted at significantly lower pre-money valuations than those seen in recent years as revenues decline amid recessions.

Newly crowned unicorns have been achieving their status at a comparatively shorter time from founding. Startups such as Bristol-based processing unit developer Graphcore have experienced rapid valuation growth, achieving unicorn status less than five years after founding. Graphcore's valuation has been nurtured through multiple rounds in a short time that have totalled more than €400 million. While this is possible in today's environment, we believe similar velocity of growth will be hard to come by as we enter a new economic cycle. In the short term, we anticipate newly crowned unicorns will be scarce in 2020, and in the long term we believe the median time from founding will extend relative to the last three years. Time between rounds could lengthen too, as revenues plateau and growth expectations for valuations dampen.

Unit economics and streamlining strategies will be crucial in managing the downturn for established unicorns with significant recurring costs. However, impacts on sectors will be varied and valuation growth will be possible. Europe-based unicorns have mostly been established in the software sector. Lockdowns have forced commercial, educational and social interactions to move online, generating opportunities for unicorns who are already equipped to disrupt sectors to act as catalysts for embracing and ensuring subsequent stickiness with new remote services in the long term.

Median time (years) for VC-backed companies to achieve unicorn status



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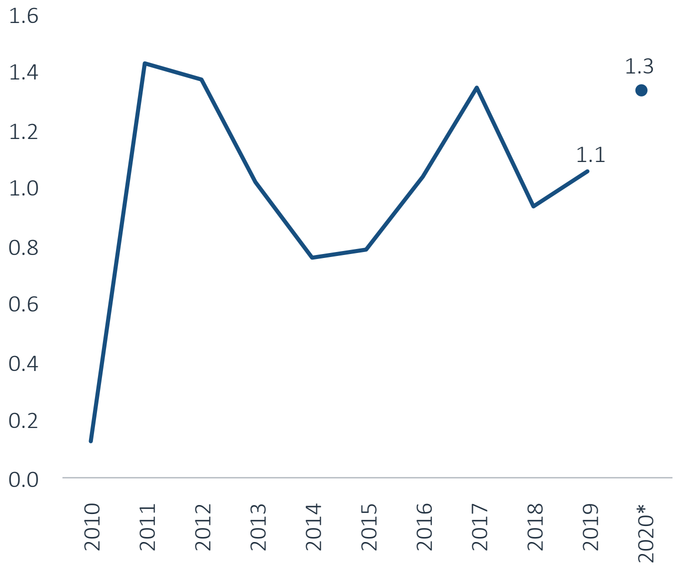
Median time (years) between rounds for unicorns



Source: PitchBook | **Geography:** Europe
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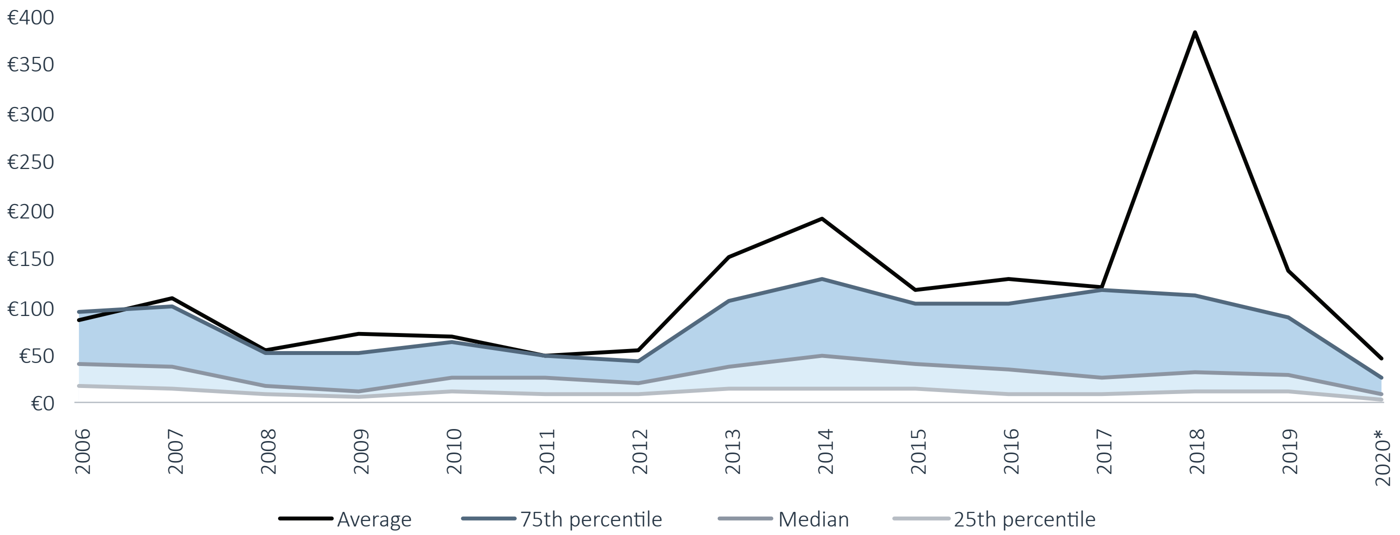
Liquidity

Quartile distribution of VC post-money valuations (€M) at exit

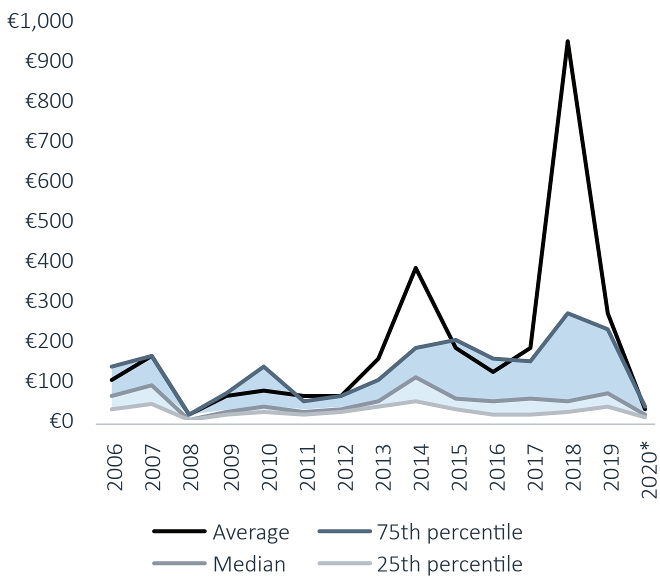


Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

European VC-backed company post-money valuations upon exit across the lower, middle and upper quartiles all fell further in Q1 2020, as exits remained muted. Less than €1 billion was exited across the ecosystem in Q1, the worst quarterly showing in seven years. Confidence was knocked globally in 2019, and this has continued in 2020, and will get worse as COVID-19 stifles economies. The fallout from major VC-backed listings such as Uber and WeWork's cancelled IPO caused more scrutiny around valuations of VC-backed companies. Volatility in public equities and uncertainty posed by Brexit, along with US-China trade wars, helped to hinder exits in the last 12 months. We expect great caution surrounding exits amid COVID-19 and valuations may not recover until a vaccine is found and economies rebound.

As valuations are recalibrated over the next few quarters to reflect the recessionary environment, we believe there will be a pause in European unicorn exits in 2020. Mature startups will instead focus on ensuring financing can be arranged to avoid funding gaps and prevent disruptive restructuring within companies. From an investor perspective, exiting an investment now when prices are set to fall could result in a considerable reduction in returns. Nonetheless, large exits could be triggered by management teams in the near term to cut losses and mitigate long-term impacts from the forecasted downturn, which could be the worst since the Great Depression.

Quartile distribution of VC post-money valuations (€M) at exit via IPO



Source: PitchBook | **Geography:** Europe
*As of March 31, 2020

Valuations derived from these exits will carry a significant reduction, but could release capital for investors to reallocate with better terms in new investments demonstrating promise amid COVID-19.

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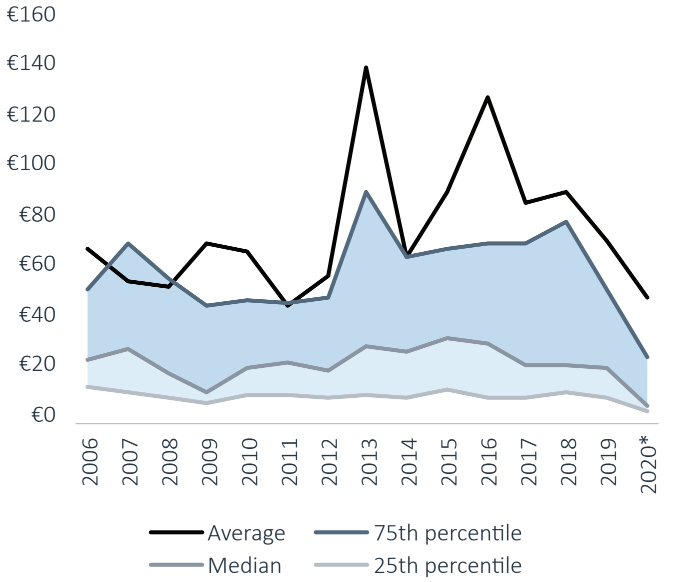
Interest in VC-backed IPOs has been prevalent during the last two years, as record listings have taken place in the US and Europe. Only three listings occurred in Europe in Q1 2020, and this figure is not likely to increase substantially in the next three quarters. Risks associated with volatility in public equity markets will deter IPOs in the short term as VC investors and operators attempt to preserve valuations instead of seeking out liquidity. Furthermore, investment bankers mandated for such transactions would advise against pushing ahead in the near term as investor appetite has weakened and valuations are dislocated.

In Q1 2020, post-money valuations for acquisitions across the lower, middle and upper quartiles all fell further from 2019 figures. As the financial burden of a recession affects balance sheets, a lack of desire or capability from strategic acquirers or could result in fewer acquisitions taking place. Demand will fall from acquisitive corporates that have sought out inorganic growth via acquisitions, which has led to synergy and efficiency gains, along with underlying expansion opportunities. As core industry revenues are hit, costly capital outlays will be put on hold to ensure businesses remain financially viable in the long term. Valuations of corporates have already been hit across sectors and capital may need to be utilised to alleviate financial problems instead of acquiring startups.

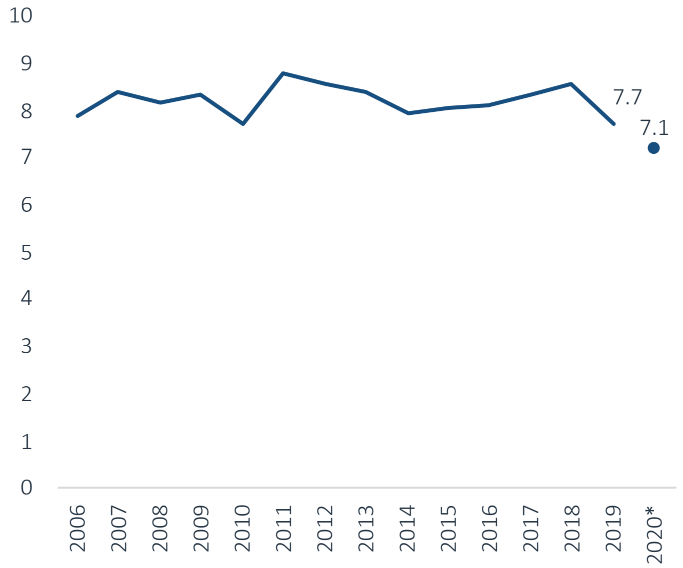
Although median time from founding continued its decline in Q1 2020 prior to COVID-19 disruption, slashes in the velocity of value creation will lead to this extending in the long term. Existing companies in the VC ecosystem will have to manage impacts from COVID-19 rather than maximise valuations in the near term. They will then need to evaluate how the business has coped in the aftermath and adjust valuation estimates ahead of a potential exit. As the length and depth of this recession is still unknown, this recovery process could take several years for startups resulting in delayed exits and prolonged holding periods.

Quartile distribution of VC post-money valuations (€M) at exit via acquisition



Source: PitchBook | Geography: Europe
*As of March 31, 2020

Median time (years) between founding and exit for VC-backed companies



Source: PitchBook | Geography: Europe
*As of March 31, 2020

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