PitchBook

US VC Valuations Report

Q1 2020

PitchBook

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Credits & Contact

PitchBook Data, Inc.

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

Content

Cameron Stanfill, CFA Analyst II, VC
Kyle Stanford Analyst, VC
Joshua Chao, Ph.D. Analyst, VC
Van Le Senior Data Analyst

Contact PitchBook

Research
reports@pitchbook.com

Design by Julia Midkiff

Click here for PitchBook's report methodologies.

Introduction

Late-stage valuations come under pressure.
Even prior to the COVID-19 outbreak, late-stage valuations had been contracting. The median pre-money valuation for late-stage VC deals in Q1 2020 dropped yet again to $73 million after reaching its peak in Q2 of 2019. Our data indicates that 2019 marked an inflection point in the runup of late-stage pre-money valuations. The growth trajectory of valuations has been cooling off over the last several quarters, and we expect upcoming quarters to reflect this trend as deal terms begin to shift back in the favor of investors.

Preferential terms for investors finding their way back into term sheets.
While protections such as liquidation participation, cumulative dividends, pay-to-play clauses, and full ratchets have been steadily declining over the past decade, both the data and anecdotal evidence suggest they are returning. As of the end of Q1 2020, we have seen a relatively small uptick in the proportion of deals with these terms, and the levels are still sitting far below what was recorded before the previous crisis; however, the effects of the pandemic in the US only started in March, meaning the next few quarters' data will be more indicative of the magnitude of these changes.

Seed valuations have declined from 2019 highs.
For the first time since 2012, the median seed pre-money valuation fell 6.3% to $7.5 million. Over the past several years, the rising number of seed-stage investors, coupled with companies' ability to operate longer before needing institutional capital, have helped push up deal sizes and valuations. While this decline in valuations is noticeable, the formulaic nature of seed deals and valuations may preclude a deeper decline if investors determine the risk-return of the stage is worthy of continued investment.

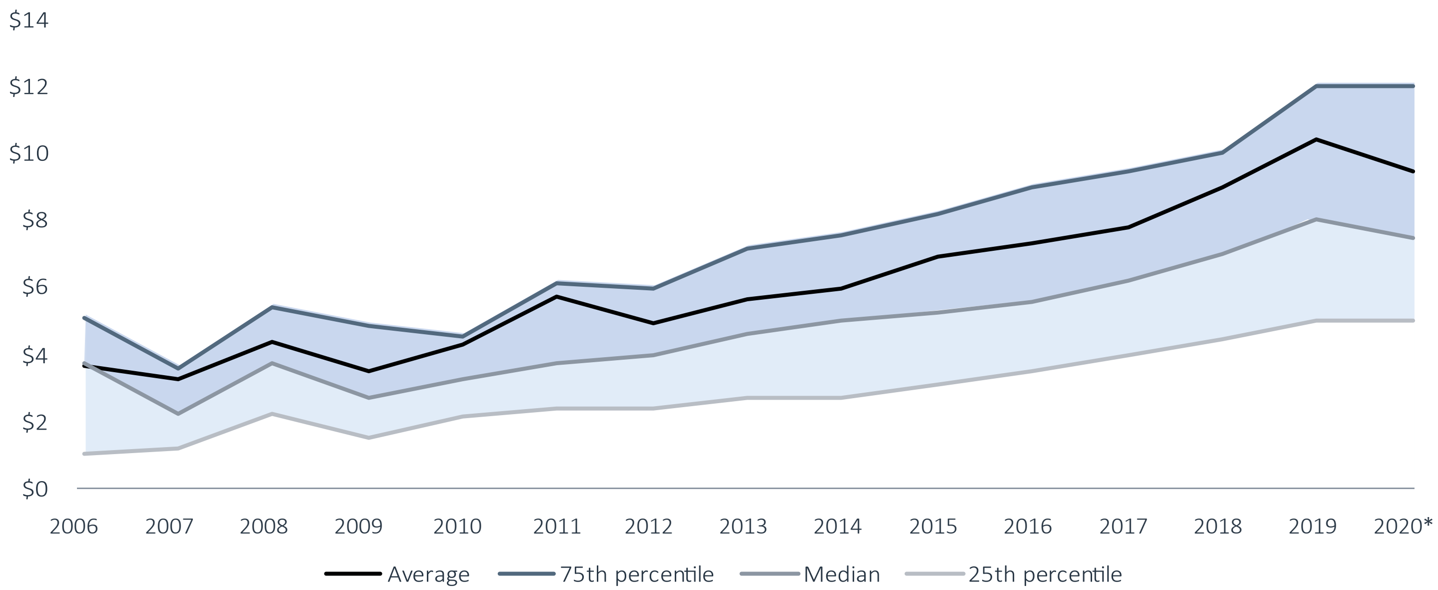
Cameron Stanfill, CFA
Analyst II, VC

Kyle Stanford
Analyst, VC

Joshua Chao, Ph.D.
Analyst, VC

Angel & seed

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

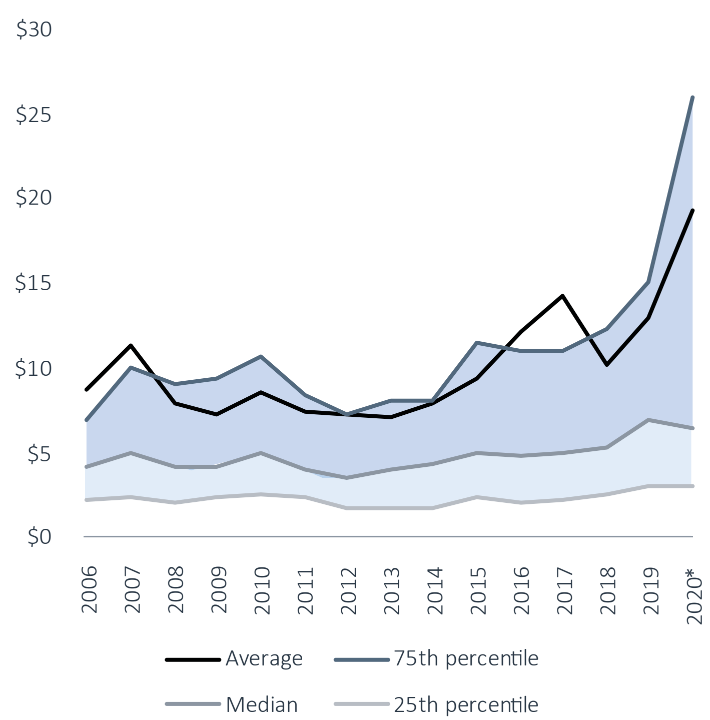


Source: PitchBook | **Geography:** US
*As of March 31, 2020

Through Q1 2020, angel and seed investments proved to be resilient, even increasing from the number of completed deals that had been tracked by this time in the previous quarter. This is in line with what we expected because COVID-related challenges and closures didn't truly hit the US until the end of Q1 2020, as well as the fact that VC data typically lags in reaction to macroeconomic events due to the illiquidity of the investments. This isn't to say the deals completed during Q1 weren't affected by the emerging threat of the virus or by factors contributing to growing uneasiness in the market beforehand. The median angel and seed valuations each dropped during Q1 from the highs recorded in 2019, with angel valuations slipping to a median of $6.5 million (-7.1%) and seed financings seeing a drop to $7.5 million (-6.3%).

A contraction of valuations will likely be seen across venture stages as the looming economic recession digs deeper and drags on further. However, at the angel and seed stages of financing, the rout will be determined more by how market investors react to the risks of these stages, rather than by the comparison of these companies to the public markets and near-term growth prospects, as will be the case with the later stages. Angel investors are likely to have their wealth affected by public market volatility, while seed-stage funds rely heavily on capital from family offices, which could balk at recommitting to new funds if they view VC as too risky

Quartile distribution of angel pre-money valuations ($M)



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

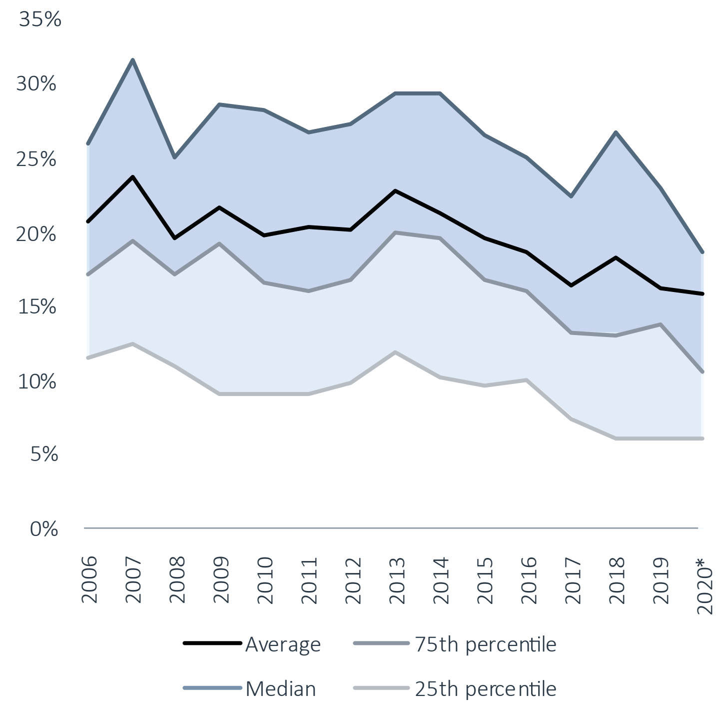
in companies that are almost fully reliant on VC for growth, with few to no revenues on which to rely.

The seed stage especially has gone through a distinct transformation over the past decade. Lower startup costs and an increased number of capital sources for pre-VC financing have enabled seed-stage companies to reach higher levels of maturity, enabling more complete due diligence and robust investment processes. This institutionalization of seed funding—which has drawn larger, multi-stage funds into the mix led to a competitiveness within the market, which has driven up deal prices. The $8 million median seed valuation realized in 2019 was nearly triple the median valuation of a decade ago, while the median percentage acquired in seed deals has grown to, and has remained steady at, 25% since 2018. That growth has stemmed from the decade low of 19.9% in 2011. While the top quartile figures of deal size and valuation in Q1 2020 continued at heightened levels, the declines at the median may be seen as a tempering of the overheating valuation growth across the stage rather than as a snap reaction to COVID-19.

That being said, we believe that fallout from the pandemic will have an overall mild effect on the angel and seed stage. Although many investors claim to be open for business and may well be making deals, the inability to conduct in-person meetings will undoubtedly impact seed investment, and the personal nature of seed investment presents the largest hurdle to the stage. Without robust financial performance metrics available for many of these young companies, conviction from investors that the founders and executive team are well-suited to grow the company and provide the end return will rely on a strong relationship between the two parties. Even when this is the case, seed and angel deals are more formulaic in nature than early and late-stage financings, which should keep valuations relatively stable with only a minor decline should deals continue to get done. For this to happen, however, the larger funds, which have provided seed capital for the larger deals seen over the past few years, will need to continue making investments.

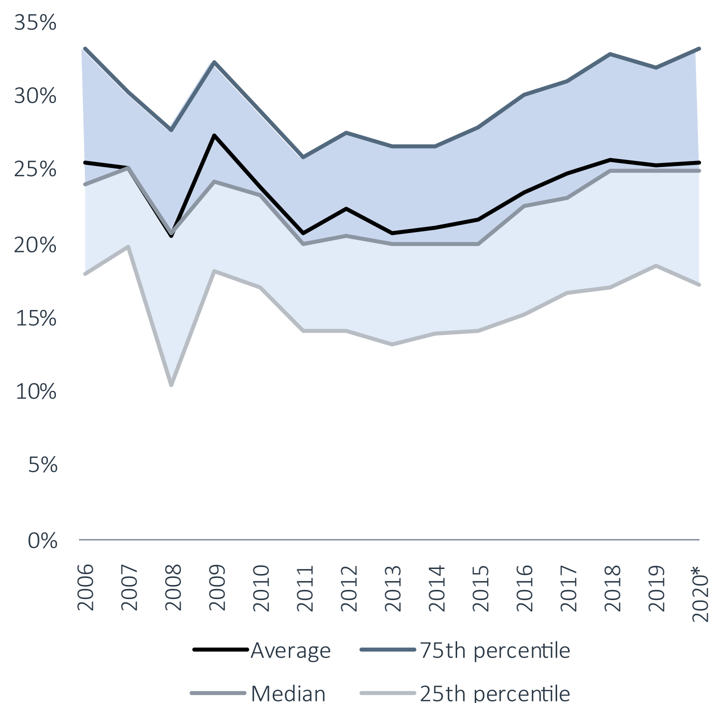
Angel and seed financings are very different now than they were during the global financial crisis (GFC). In 2009, fewer than 1,300 deals were completed while in 2019 more than 5,100 were closed. As we have noted in the past, seed and angel deals actually grew during the last crisis, although we believe this growth was more attributable to a longer-term growth trend in angel & seed investment rather than investors capitalizing on the crisis. Though similar growth during the COVID-19 crisis may not be attainable, the stage should remain a targeted investment space for those willing to bear the risk.

Quartile distribution of percentage stake acquired during angel rounds



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

Quartile distribution of percentage stake acquired during seed stage



Source: PitchBook | **Geography:** US
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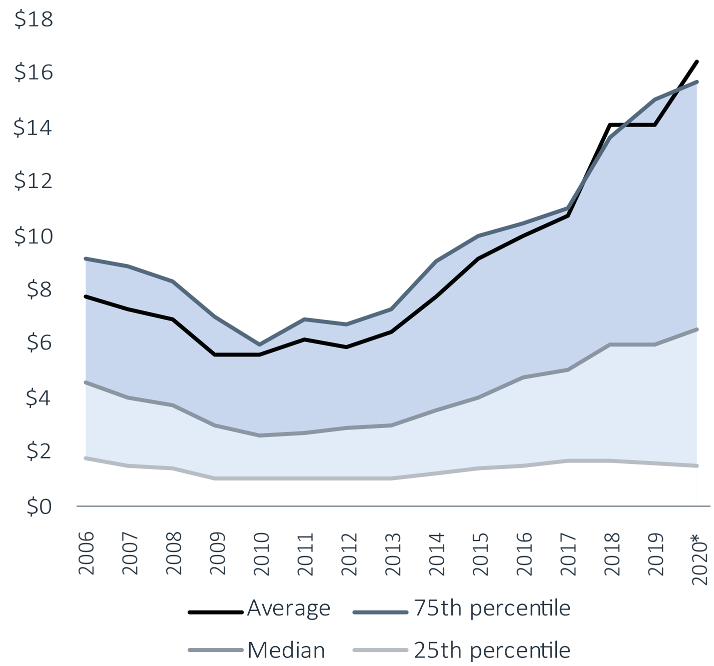
Early-stage VC

Early stage valuations continued to grow in Q1 2020, according to our data. While the median stayed at a decade high of $28 million, the lower quartile figure grew by nearly $3 million to $17 million, and the top quartile figure rose to $70 million, a jump of $11.5 million over the full-year 2019 figure. Compared to other stages, however, the count of completed early stage financings is much lower, falling below the number of completed late-stage deals for the first time in our dataset. This lower level of completed financings may be putting an upward bias on the valuation and deal size figures. A flight to quality deals, as we have noted in the past, will also affect the valuation figures within the dataset.

We predicted there could be a high number of companies looking for Series B and Series C rounds that might be left behind by investors unable to support the whole of their portfolio; companies unable to raise funding would not have a valuation in the dataset. The slowdown in early stage financings is noticeable, especially against the robust figures the stage saw in recent years. Those startups that were having trouble attracting investors in March may simply have had to push out round closing to Q2 2020, which will show up during next quarter's data. Investors need to audit their portfolios to survey the potential damage their companies may sustain, which takes time and may push out rounds into Q2 2020 or further. It seems plausible that investors' early reaction has been to put a higher emphasis on late-stage portfolio companies in order to protect their larger investments, as well as companies closer to exit.

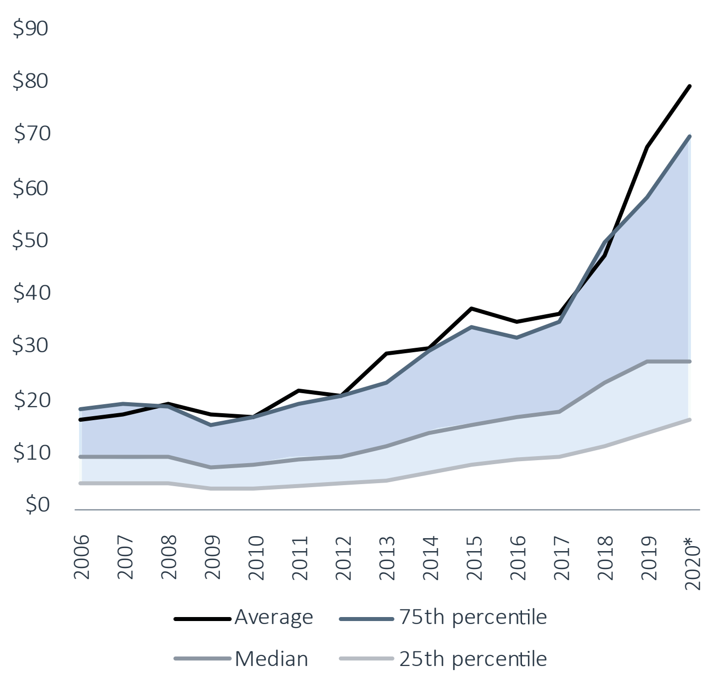
While early stage valuation figures remained largely unchanged or were growing, the step-ups between early stage companies and their previous rounds dropped at both the median and average. Together, this tells us that the companies raising new rounds are likely those companies that had already been considered to be strong prior to the crisis, and likely already had relatively high valuations. Despite the overall decline in valuation step-ups, the figures are still high relative to historical numbers. The median figure of 1.9x is still the second-highest figure we track in our dataset, and only 7% lower than the 2019 figure. At 2.3x, the average step-up continues to fall within trending values of the past five or so years. As with the overall valuations, we would expect these figures to further slide if a rush of companies that need rescue funding materializes.

Quartile distribution of early-stage VC deal sizes ($M)



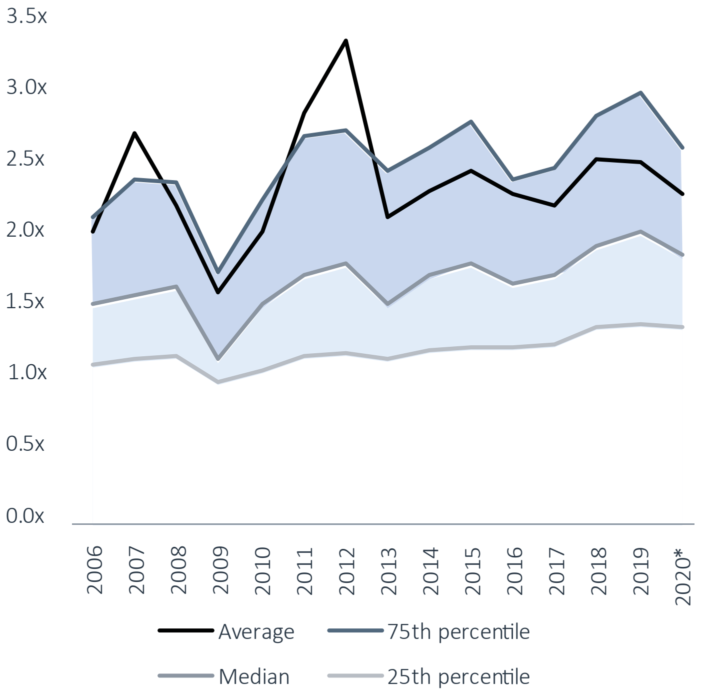
Source: PitchBook | **Geography:** US
*As of March 31, 2020

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



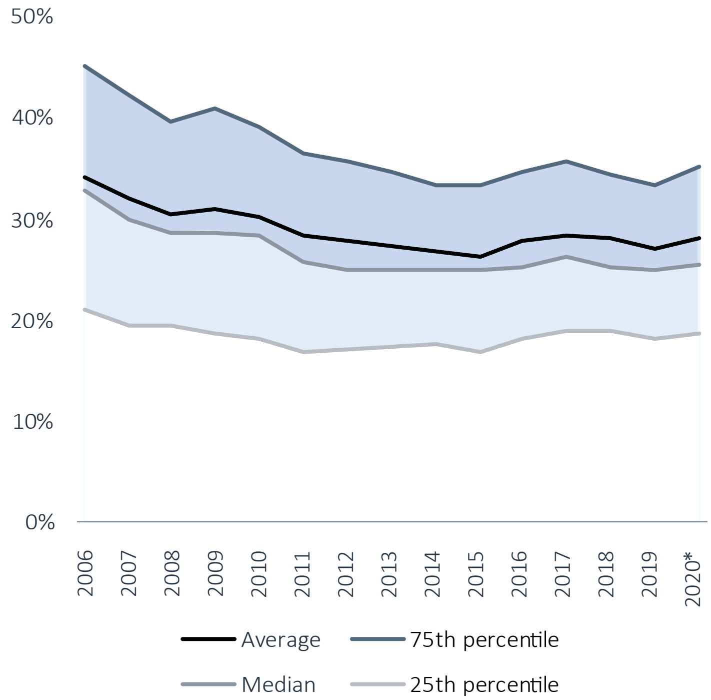
Source: PitchBook | **Geography:** US
*As of March 31, 2020

Quartile distribution of step-ups for early-stage VC pre-money valuations



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

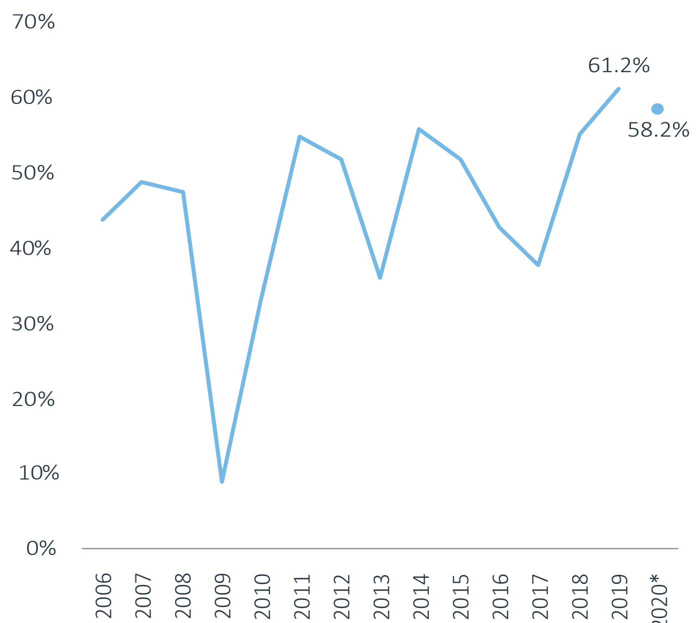
Quartile distribution of percentage stake acquired at early stage



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

The ability for early stage companies to cut burn and lengthen runway of existing capital will be necessary, but the large-scale layoffs that have plagued larger companies may not have as great an impact on runway because of their relative size. Many early stage startups likely qualified for paycheck loans from the PPP stimulus program, which could help avert the layoffs and allow these companies to simply delay raising new financings until late Q2 or early Q3 2020. There has been a backlash against VC-backed companies taking the stimulus money, which many people feel is better meant to aid companies without deep-pocketed investors. This will be a topic to watch over the next quarter as companies that return PPP loan amounts may need to seek emergency funding.

Median RVVC between early-stage VC deals

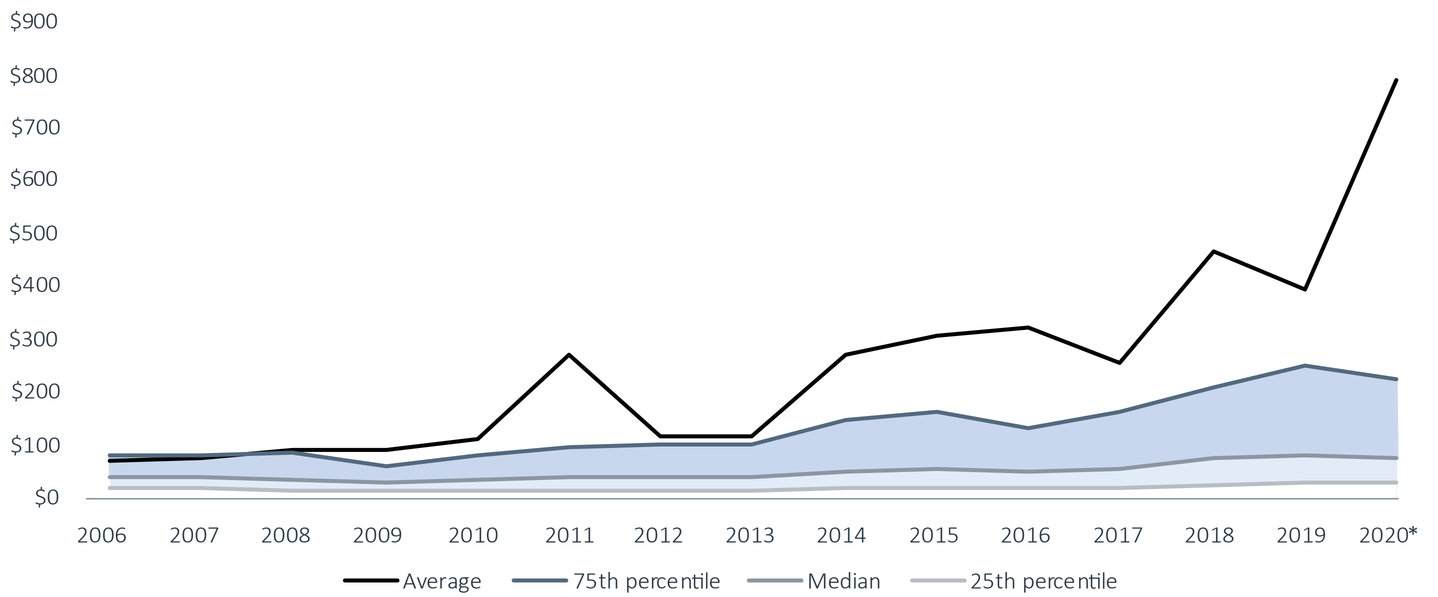


$$RVVC = \frac{\textit{\% growth in valuation between rounds}}{\textit{years between rounds}}$$

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

Late-stage VC

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

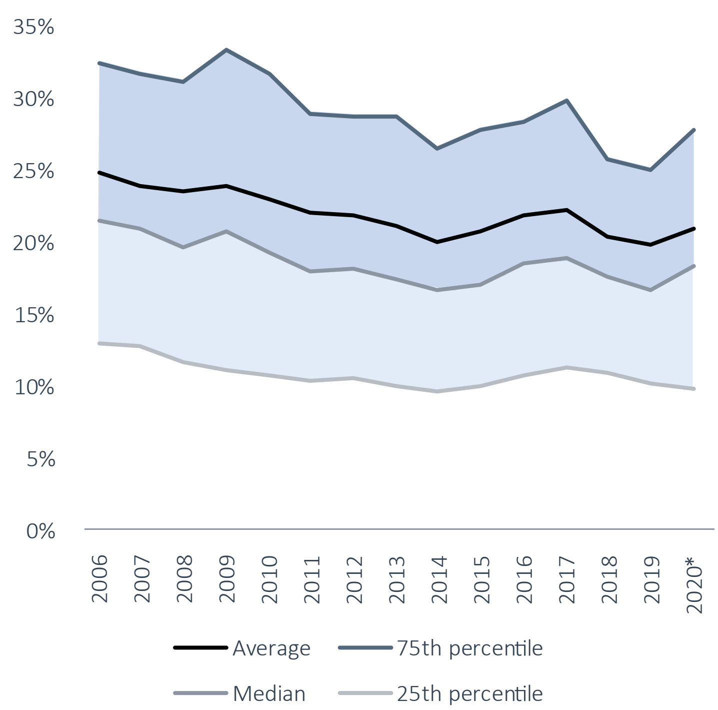


Source: PitchBook | **Geography:** US
*As of March 31, 2020

In recent years, capital infusions into late-stage deals have never been stronger, with 2018 and 2019 setting record highs for total deal value and total deal count, respectively. Late-stage VC activity in Q1 2020 started the year off strong, with 745 deals totaling $23.8 billion in deal value. This is an all-time quarterly high for late-stage deal count and means 2020 is on pace to be another record-setting year. However, we anticipate late-stage activity will curtail to some extent over the next several quarters.

Even prior to the COVID-19 outbreak, late-stage valuations had been contracting. The median pre-money valuation for late-stage VC deals in Q1 2020 dropped yet again to $73 million after reaching its peak in Q2 2019. Our data indicates that 2019 marked an inflection point in the runup of late-stage pre-money valuations. The growth trajectory of valuations has been cooling off over the last several quarters, and we expect upcoming quarters to reflect this trend as deal terms begin to shift back in the favor of investors. This could possibly be a result of the recent lowering of P/E ratios in growth stocks that late-stage VC-backed companies use for public comps analysis. While concerns around the overextension of valuations have been clouding the VC industry for several years, the contraction of public markets in Q1 2020 will be felt most heavily by late-stage VC-backed companies that often use public comps to gauge pricing for their rounds.

Quartile distribution of percentage stake acquired at late stage



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

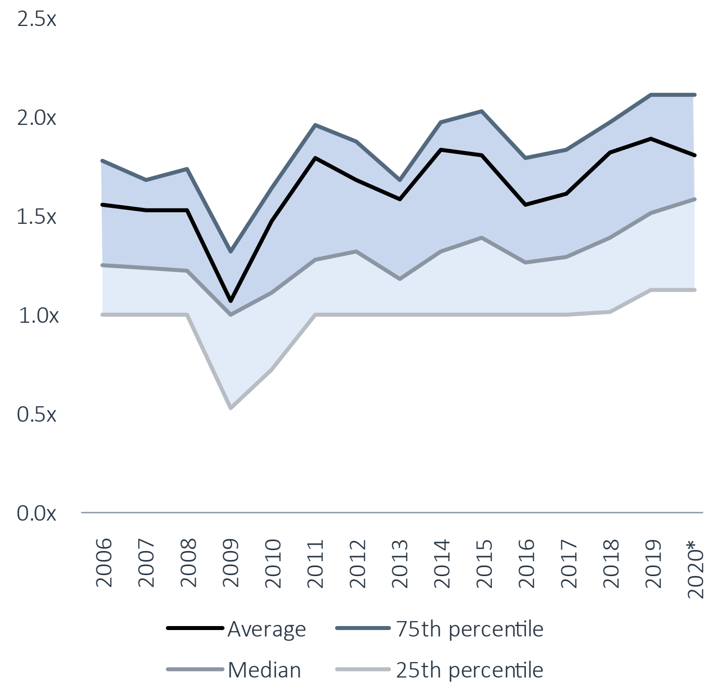
The spread of late-stage valuations has tightened in the last few quarters, but several outsized later-stage VC deals in Q1 2020 commanded pre-money valuations that were magnitudes higher than in previous quarters, skewing the average to be top-weighted when compared to the median. In a rare double fundraising in the same quarter, SpaceX raised $314 million and $221 million in two separate deals, commanding a $33.1 billion and $35.5 billion pre-money valuation, respectively. Furthermore, Alphabet's autonomous driving technology subsidiary Waymo announced its first external investment from Silver Lake, Canada Pension Plan Investment Board and Mubadala Investment Company, raising an initial $2.25 billion in Q1 2020 at a $27.75 billion pre-money valuation.

Median step-up multiples for late-stage valuations have continued to rise over the last five years, reaching 1.58x in Q1 2020. This has been fueled in part by the surplus of available capital along with a "growth at all costs" mentality. This is likely to subside as investors become more prudent and focus their efforts inward toward existing portfolio companies.

While current market conditions and funding environments are being stress-tested by COVID-19, many investors are turning to the great financial crisis (GFC) of 2007-2008 to determine what correlations are likely to be seen as they navigate the current period of uncertainty. The median step-up multiple for late-stage VC valuations in 2009 was 1.0x, indicating that half of all companies that raised a Series C round or later were forced to stomach valuations lower than their previous financing round. To note, median step-up multiples did not recover to pre-financial-crisis levels until 2011. As the median late-stage step-up sits at an all-time high, it remains to be seen if upcoming late-stage VC deals will dip down to the step-up multiples seen post-GFC in 2009 and 2010.

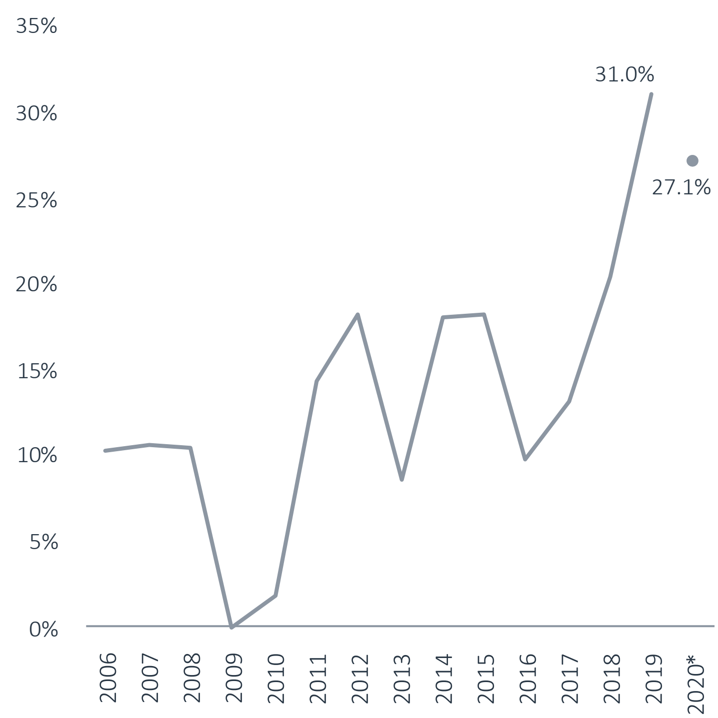
We anticipate this challenging fundraising environment will pressure many late-stage VC deals to close at lower post-money valuations than previously desired, as exit opportunities become hazier and the burden to sustain the large-scale growth often seen in late-stage VC-backed companies becomes heavier. While it is advantageous for investors to execute follow-on financings at markedly lower valuations, VCs are also facing difficult capital allocation decisions as they navigate the entirety of their portfolio through this challenging time.

Quartile distribution of step-ups for late-stage VC pre-money valuations



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

Median RVVC between late-stage VC deals



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

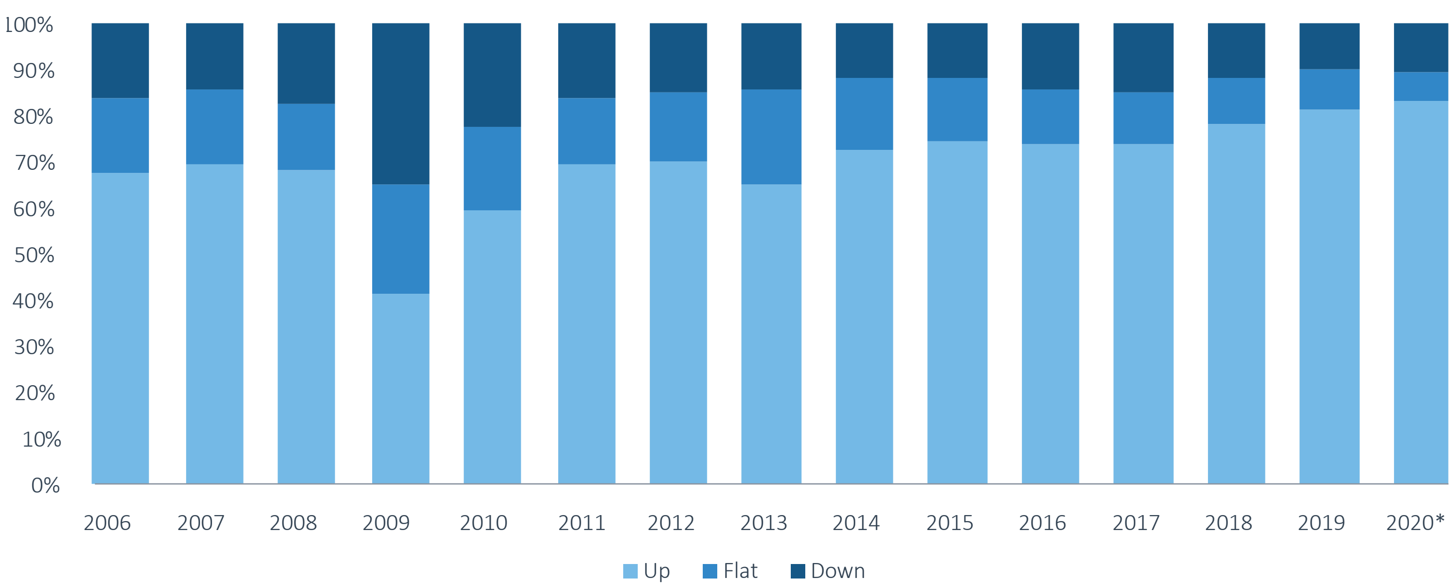
Late-stage VC

Given the proximity of late-stage VC to the public markets, late-stage companies are bound to be more affected by the current market volatility than early stage companies. At the late stage, many VC-backed companies have exit strategies on their horizon as investor pressure for liquidity begins to grow and, as such, the roadmap for IPO plans or M&A considerations becomes more tangible. However, Q1 2020 was mired with substantial public market volatility, dimming the prospect and timing of a public listing.

Several companies that had previously planned to IPO in Q1 2020—such as Postmates and Airbnb—saw their plans dashed as uncertainty in the public markets continued to grow, potentially forcing companies to return to the private markets for capital. Furthermore, many potential strategic acquirers are also taking more conservative approaches to their financial budgeting.

These compounding factors have been a catalyst for the implementation of creative financing structures as late-stage companies still require significant capital to see them through this uncertain market environment. Most notably, Airbnb received $1 billion of development capital and $1 billion of debt financing in April 2020 as a result of the devastating effect of COVID-19 on its business model, with investors getting warrants that can be converted into shares at a company valuation of $18 billion, which represents a 42% drop off from the post-money valuation of their Series F financing in 2017. Ultimately, while hiccups in financing plans have left some late-stage VC-backed companies strapped for cash and forced to accept unfavorable deal terms, it may just be enough to keep companies afloat until exit opportunities begin to materialize again.

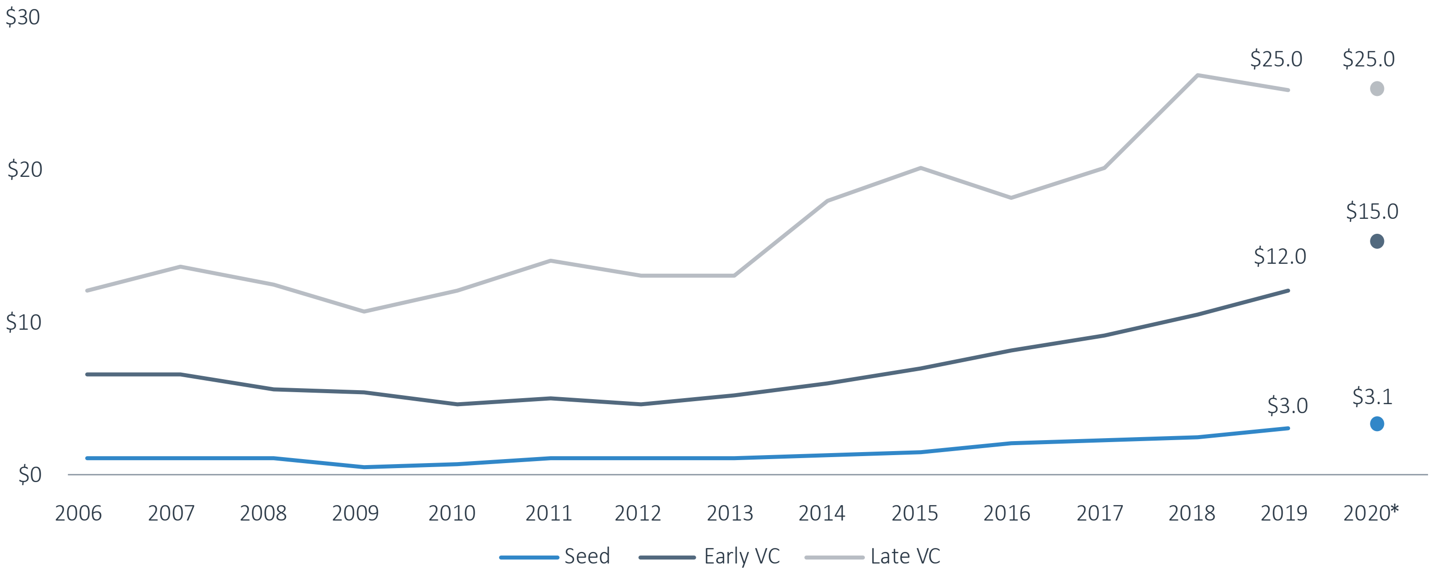
Direction of valuation change between rounds (all VC stages)



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

Nontraditional investors

Median size for deals ($M) with nontraditional investor participation by stage

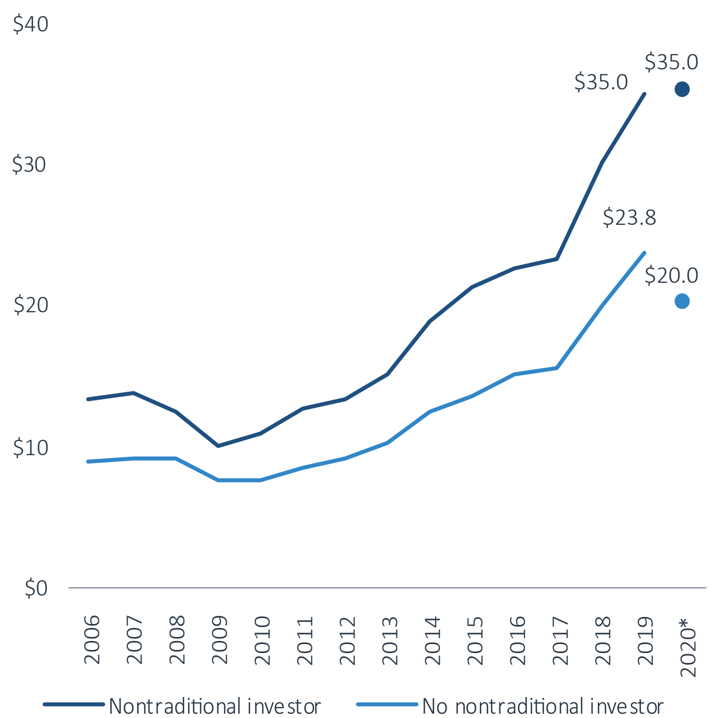


Source: PitchBook | **Geography:** US
*As of March 31, 2020

Valuations contained in deals with nontraditional investor participation largely follow trends seen across the wider industry. In many ways, nontraditional investor activity is tethered to the broader VC market. Fewer of these investors are willing, nimble or sophisticated enough to lead deals and drive pricing. At the same time, the size of these investors limits the number of opportunities available, pushing much of the nontraditional activity into larger, late-stage deals. Nontraditionals have been considered to be likely candidates to pull back investment during times of stress, retracting to their core strategies. Although data for participation during the current crisis is light, there has yet to be an indication that nontraditional investors have reined in their VC activity in a material way. For one, 63 mega-deals ($100M+), which are heavy investment targets for nontraditionals, were completed in Q1 2020, an uptick from Q4 2019; 59 of those Q1 deals received nontraditional investment.

The various types of nontraditional investors will likely react differently to the crisis and seek opportunities that align with their distinctive risk-return profiles. Hedge funds and mutual funds, for example, may find opportunities to take pre-IPO stakes in companies that have postponed their initial offerings to raise further private capital. While private equity funds will likely find many distressed opportunities for late-stage companies that have taken major hits to revenues due

Median pre-money valuations ($M) for early-stage deals by investor participation



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

to the crisis. Silver Lake, for one, has been aggressive in its approach to investment, helping provide a $1 billion lifeline to Airbnb in April.

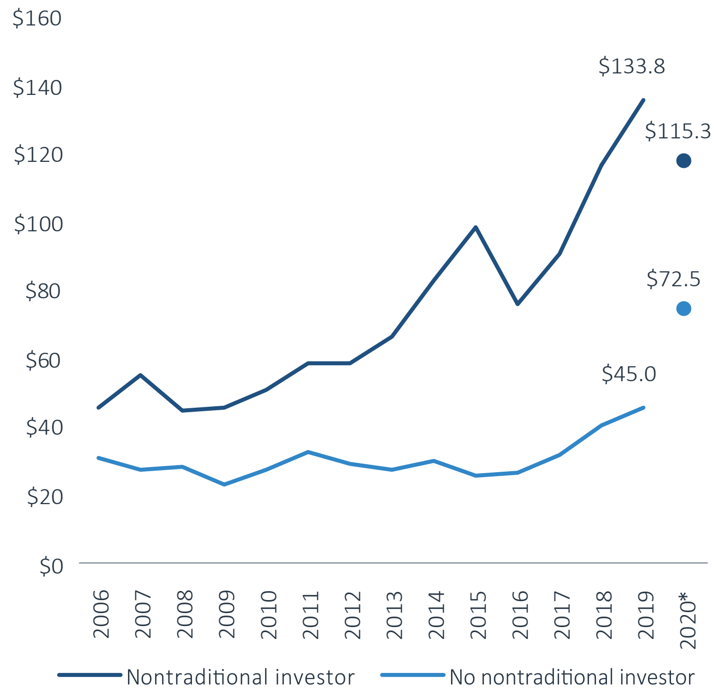
For nontraditional investment, especially at the late stage, the overall participation levels will rely heavily on the need for these deals to get done. With the IPO market stalled for the foreseeable future, many ultra-late-stage companies that would look toward an IPO exit for their next round now find themselves in trouble. This could become an opportunity for nontraditionals to invest in distressed companies that are still seen as viable businesses on the other side of the pandemic. The crisis may also provide increased secondary opportunities in companies that have pushed back IPOs, giving existing investors liquidity and public market investors a stake in the future public companies.

Late-stage valuations with nontraditional participation fell nearly 14% in Q1 2020, even as much of the economic fallout was only seen in the latter half of the quarter. While the public markets have recovered strongly from the selloff seen in mid-March, the uneasiness around the decline in comparable public companies used to help price late-stage deals has had an overall negative effect on late-stage valuations. This will likely carry over through the next couple of quarters as companies assess the damage to their business.

While many nontraditional investors focus on late-stage deals, corporate VC participates in more early stage deals annually than late-stage financings. For early stage deals with CVC participation, the median valuation stayed level from 2019 at $35 million, while the median value of deals without nontraditional participation came in $10 million less. This difference cannot be fully pinned on corporations driving up the valuation, but is more suggestive that CVCs are willing to participate in these rounds because they receive more in return than simple cash-on-cash realizations.

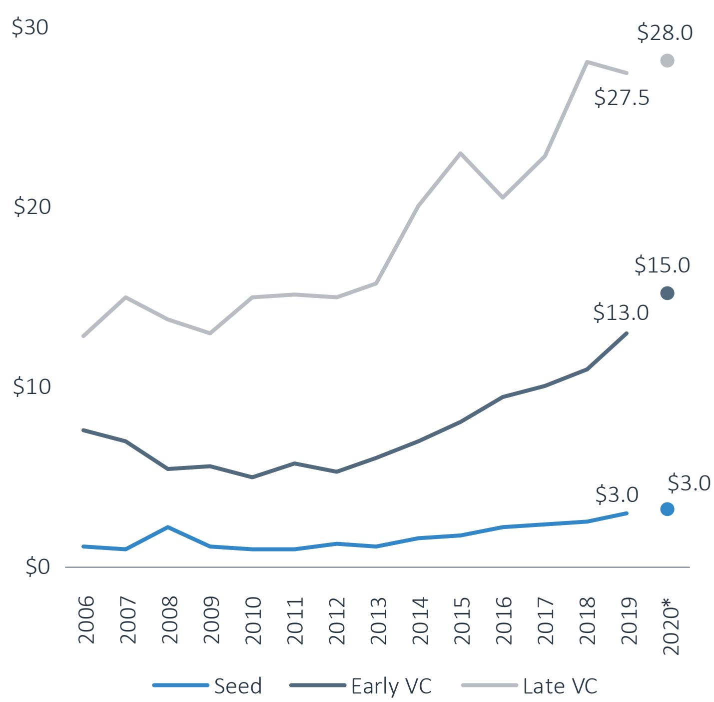
As CVC has grown as an effective use of R&D and partnerships, corporations' participation in VC has grown extensively. Nearly 2,000 US VC deals were completed by corporate VCs in both 2018 and 2019. Those highs will be tested by the pandemic and looming recession, but corporations are not seen as likely to turn off the spigot. Corporations have been sitting on hordes of cash considerably greater than those of a decade ago. At the same time, startup investment has been a workhorse for growth, giving incumbents access to new technologies and data on emerging tech markets that can help drive programs moving forward.

Median pre-money valuations ($M) for late-stage deals by investor participation



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

Median size of VC deals ($M) with CVC participation by stage



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

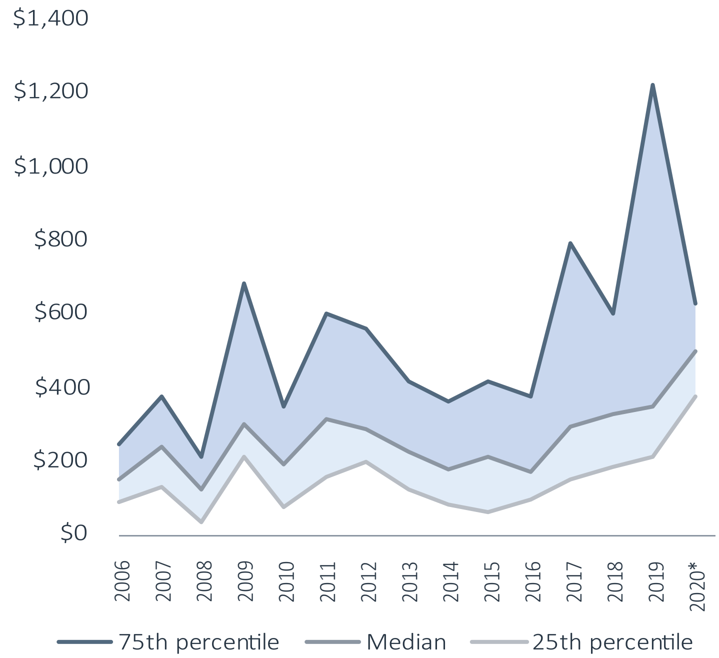
Liquidity

Exits are the ultimate mechanism that returns capital back into the VC ecosystem, where private market valuations meet real world expectations. Those expectations have shifted markedly in 2020, wreaking havoc on the exit market. Public market volatility has essentially closed the IPO window, while many corporations focus on liquidity rather than external investments as revenues evaporate across a large variety of industries. These factors will undoubtedly put downward pressure on startups' valuations at exit as the buyside demand diminishes, leading to some fire sales or valuation haircuts at IPO.

While we may have predicted a slight slowdown in exit value and count after 2019 cemented itself as a banner year for exits, the decline has been accelerated by the effects of the pandemic. The exits that did reach the finish line in Q1 2020 did so at broadly lower valuations from the 2019 stats. While the low volume of IPOs ticked the median and bottom quartiles higher, the continued downward move from the top quartile and average tells the story of the current struggles of large IPOs. These outsized public listings were a key driver of aggregate capital exited during the last couple of years. In the current environment, however, it doesn't seem as if many, if any, IPOs of VC-backed companies valued over $1 billion will close during the rest of the year, severely depressing the potential capital return this year. There still does seem to be demand from public market investors for biotech IPOs, unlike essentially every other business model, which has helped those companies buck the broader trend and actually see growth of the median valuation at IPO for biotech startups, which moved to a new decade high of $463.3 million.

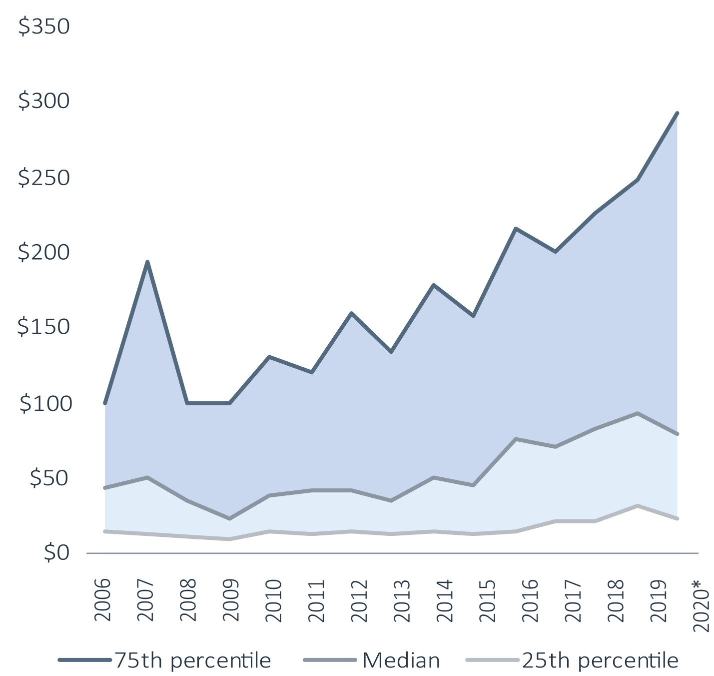
Acquisitions are in a slightly stronger position than IPOs as we look forward through 2020, although there are still quite a few headwinds. The number of active purchasers will likely shrink significantly as corporations turn most of their focus inward as they attempt to maintain operations. This shift toward being more defensive will likely discourage corporations from paying up for growth in an acquisition; rather, they may shift toward looking for assets at discounted prices. Furthermore, outside of the cash shortage, public companies have likely seen stock price declines, which may reduce their options for funding new acquisitions.

Quartile distribution for VC valuations ($M) at exit via IPO



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

Quartile distribution for VC valuations ($M) at exit via acquisition



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

Rolling four-quarter median step-up at exit by exit type

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

Looking back at the first quarter we can see these struggles starting to show with quarter-over-quarter decreases from Q4 2019. The exception was the top quartile valuation of acquisitions during the quarter, which jumped to a new decade high of $292.5 million. This is due to the high proportion of massive exits, given the slightly slumped volumes, as five acquisitions over $1 billion closed during the quarter, headlined by the $5.3 billion acquisition of Plaid by Visa. These outliers helped to stretch out the average this quarter, highlighting the dichotomy in the market, but as we get deeper into the year, we expect that statistic to follow the median line downward as new discussions on mega-mergers are canceled or postponed until there is more certainty in the economic outlook.

For private market investors the step-up at exit is a critical measure to watch, as it determines the eventual return—especially for the investors in the last round. Step-ups have trended downward over the past two quarters as valuations have come down, paralleling the slowdown in exit activity. The median IPO step-ups have been particularly lackluster, hovering right around the 1.0x mark, which implies that about half of all IPOs are going public at below their last private market valuation. Private market valuations have swelled over the past decade, and capital availability has expanded, making it more difficult to achieve a high step-up over the elevated valuations. These factors have encouraged more value creation while companies are VC-backed rather than in the public markets since companies can enjoy more operational freedom while remaining private.

Step-ups for acquisitions have trended higher than IPOs' metric over the past decade, as the acquisition premium seems to be a more constant factor along with this category's inclusion of more early stage businesses, which have lower existing valuations to compare to the exit value. Furthermore, in the past, corporations were willing to pay premium multiples for high-growth businesses to fuel inorganic growth strategies, a behavior we expect to drop off at least through the duration of this downturn. Given these expected struggles in the exit market throughout the rest of 2020, we believe the downward trend in step-ups for both acquisitions and IPOs will continue as demand from willing buyers dries up. IPOs will come under more pressure, likely moving the median back under 1.0x.

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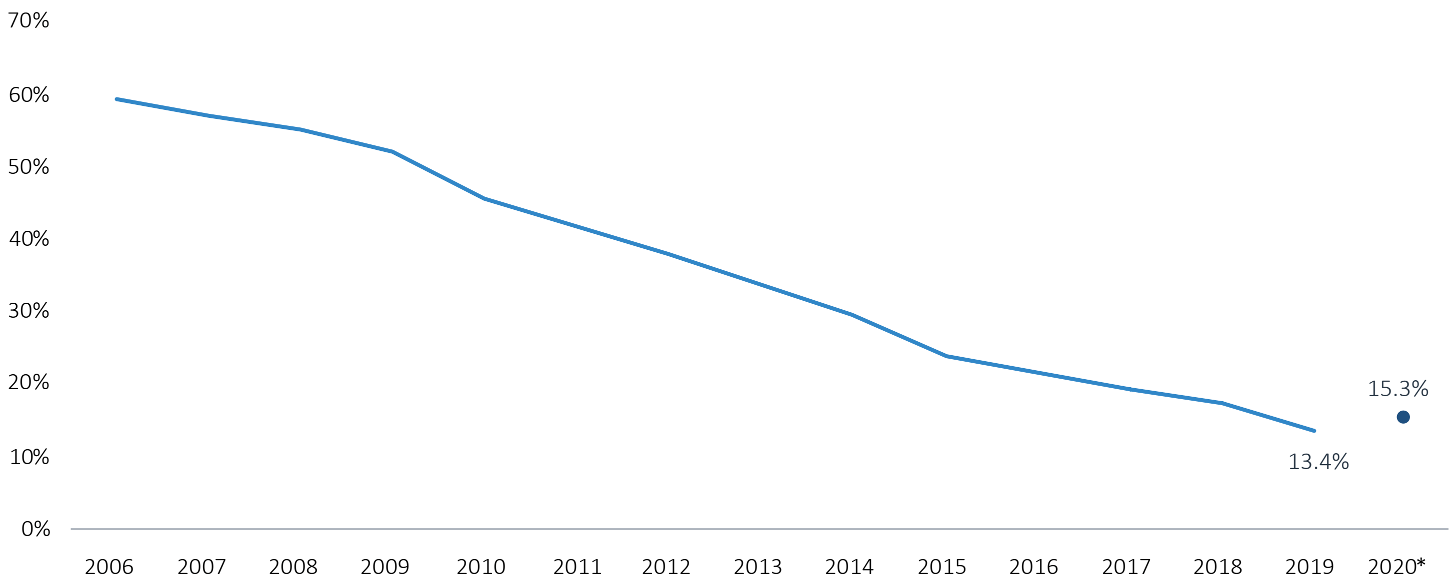
Deal terms

Proportion of deals with liquidation participation



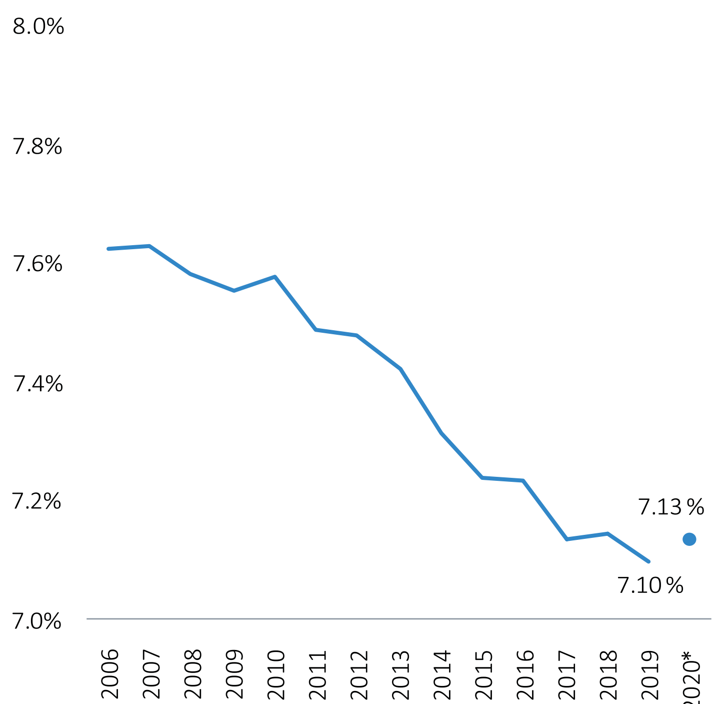
Source: PitchBook | **Geography:** US
*As of March 31, 2020

The last decade has coincided with a drive to simplify term sheets, which significantly cut down the number of deals that included complicated deal terms and heavy investor protections. As the scarcity of capital dissipated with growing allocations and the massive influx of new investors, founders were met with increased levels of demand, giving them leverage to push back on stringent terms.

However, the current environment, characterized by the economic uncertainty brought on by COVID-19, is starting to look much different. Many companies have had their revenue completely disappear overnight or are staring insolvency in the face, reminding us all how quickly things can change and how outlier events must be considered when making investment decisions. This uncertainty has caused some investors to return to the terms and protections of earlier years in order to protect their capital.

For example, we're seeing some upticks in investors' preferential terms, which had been steadily declining over the past decade, including liquidation participation and cumulative dividends as well as the average dividend percentage. As of the end of Q1 2020, these are relatively small percentage moves and are still sitting far below what we recorded before the previous economic crisis, although the effects of the pandemic in the US only started in March, meaning the next few quarters' data will be better indicators of the magnitude of these changes. We will have to watch

Average dividend %



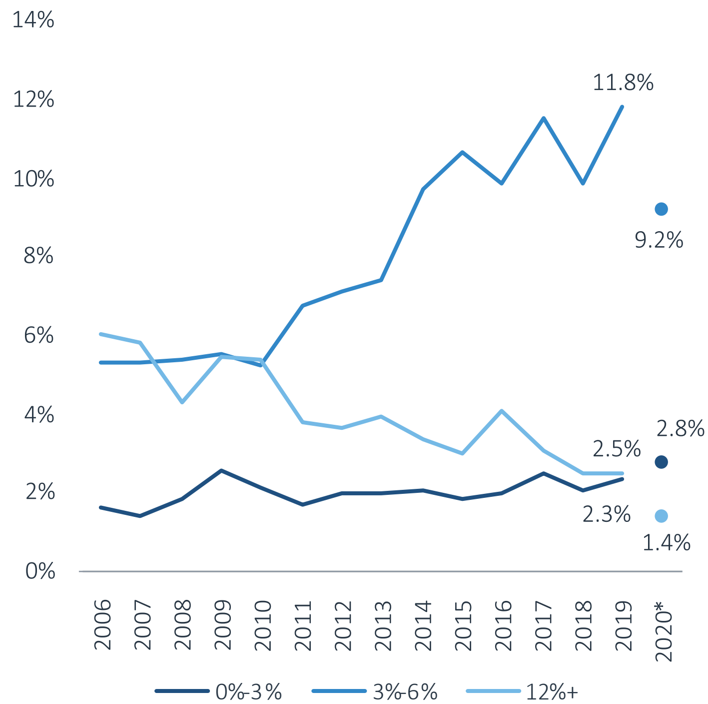
Source: PitchBook | **Geography:** US
*As of March 31, 2020

going forward to see whether the inclusion of these terms really spikes during the current downturn or if they just slightly increase.

While not fully captured in our dataset, especially as of the end of Q1 2020, there is also some anecdotal evidence that even lesser-used terms such as full ratchets and pay-to-play provisions are making their way back into term sheets or even being applied retroactively. These are likely more edge cases than the norm and are mostly from companies that are struggling or drastically reducing growth expectations. The proliferation of these more severe terms will depend greatly on the length and depth of the COVID-19 crisis, as a quick recovery may allow investors to have a little more surety in the future and feel secure with a more simple term sheet.

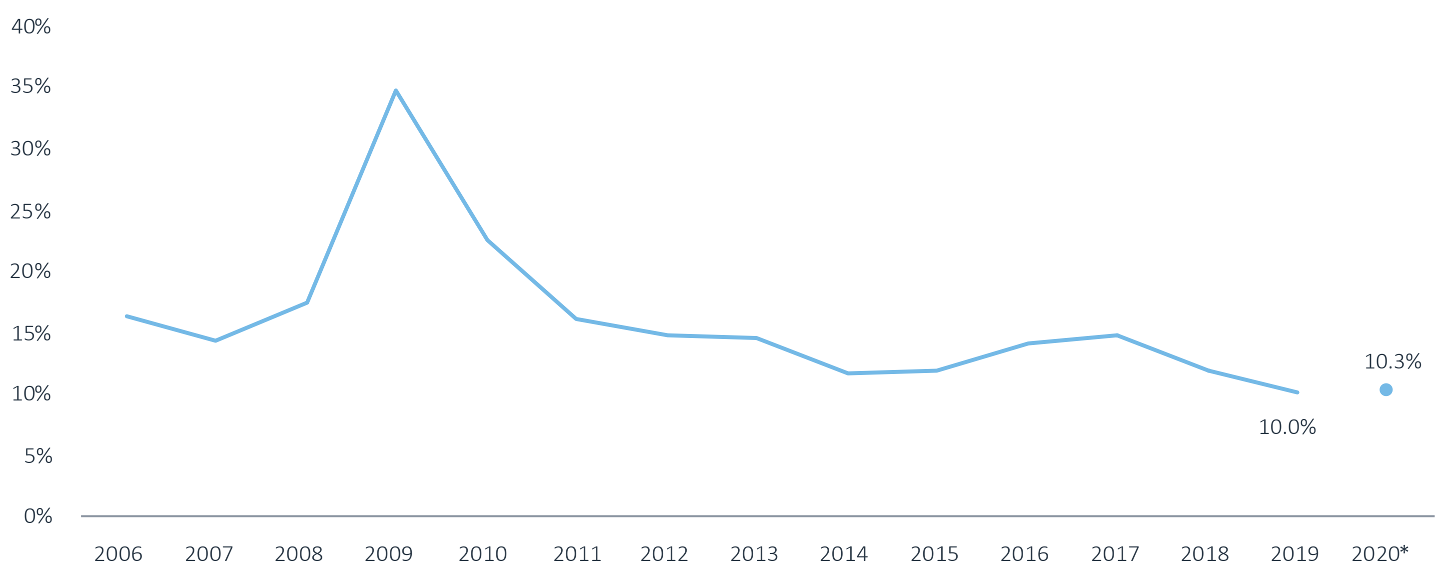
Really, most of these terms only come into play for investors in suboptimal scenarios such as down rounds or exits, so now that those situations have suddenly become a serious possibility for many portfolio companies, it follows that VCs will start considering these terms. However, we expect that the longer-term dynamics will remain in place and still support the simpler, more founder-friendly environment of the last few years once the economy has stabilized, and any short-term spikes in protectionist deal terms will subside.

Proportion of deals with dividends, by interest bucket (excluding 6-9%)



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

% of down rounds



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