



QUANTITATIVE PERSPECTIVES

US Venture Capital: Momentum Out of Uncertainty

Q3 2021



US Venture Capital: Momentum Out of Uncertainty

Introduction

Nearly overnight, the COVID-19 pandemic threw economies around the world into turmoil. Over one year after the onset of that disruption, an unexpectedly rapid recovery has taken place, as well as resilient private market activity.

Venture investors leaned in to the new reality and leveraged many of the industry-funded technologies to keep capital flowing. VCs have taken full advantage of institutional investors' hunt for yield by pouring capital into startups at all stages of the funding cycle. Despite the challenges posed by the pandemic, the pace of investment barely skipped a beat, with 2020 recording the highest total investment on record and 2021 on pace to set a new high-water mark.

The frenetic investment pace is poised to continue, with massive fundraising numbers posted in 2020 and H1 2021, as well as increasing participation from nontraditional investors. The prospect of liquidity has also been given a shot in the arm, with the emergence of new—albeit unproven—routes to the public markets via special purpose acquisition companies (SPACs) and direct listings.

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Key takeaways

- Venture capital investment and fundraising both reached record highs in 2020, as investors embraced virtual processes.
- Private market investors have benefited from a low interest rate environment, as institutional investors search for yield.
- Investors have concentrated their capital into fewer industries over the past 15 years, moving away from IT hardware.
- Venture funds, corporations, and nontraditional VC investors have record high levels of capital at their disposal, which should bolster activity moving forward.
- According to PitchBook's VC Dealmaking Indicator, the VC investing environment is as startup friendly as it's ever been—and across all stages.
- Exit activity was strong in 2020 and H1 2021, with public listings accounting for 86.6% of exit value.

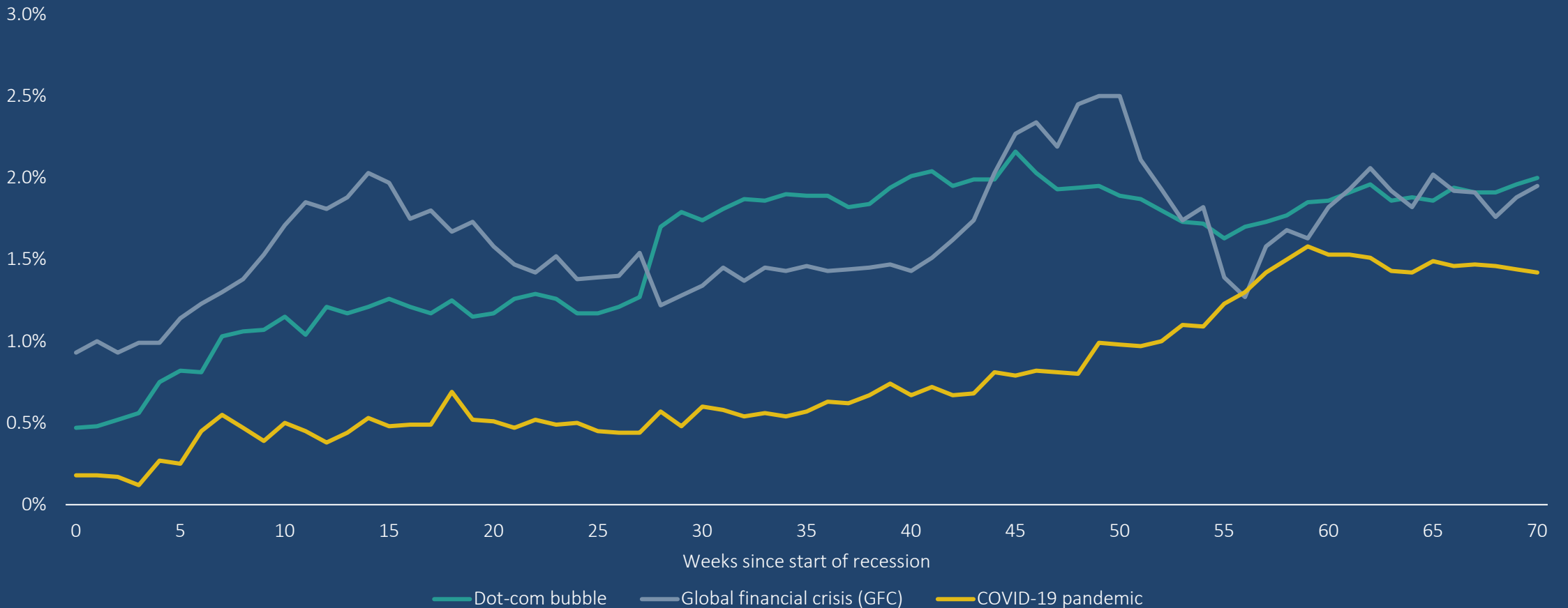


Venture investment during COVID-19



Yields remain historically low, particularly when compared with the recoveries from the prior two recessions...

10-2 yield curve spread since the start of each recession*

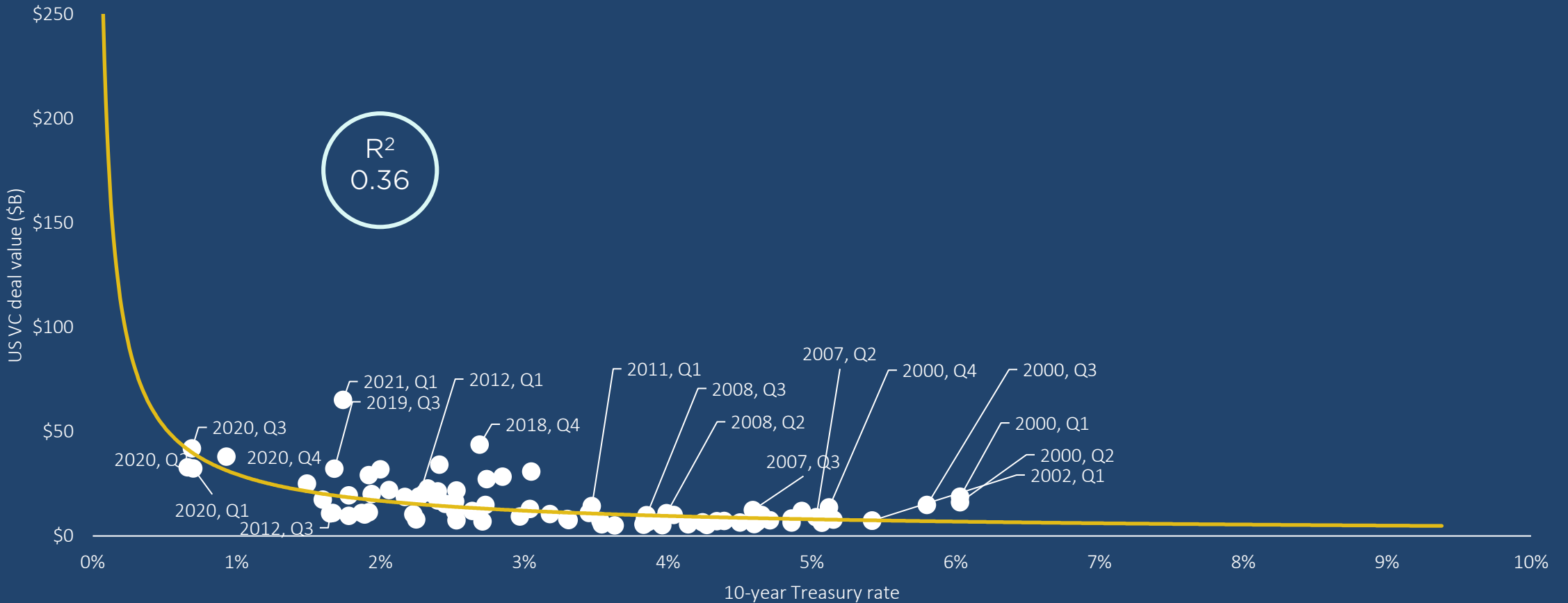


Source: The US Courts | Geography: US
*As of May 31, 2021



...making riskier assets more attractive as investors search for yield. This dynamic appears to affect VC, though other factors are at play.

10-year Treasury rate versus quarterly VC investment (adjusted for inflation)*



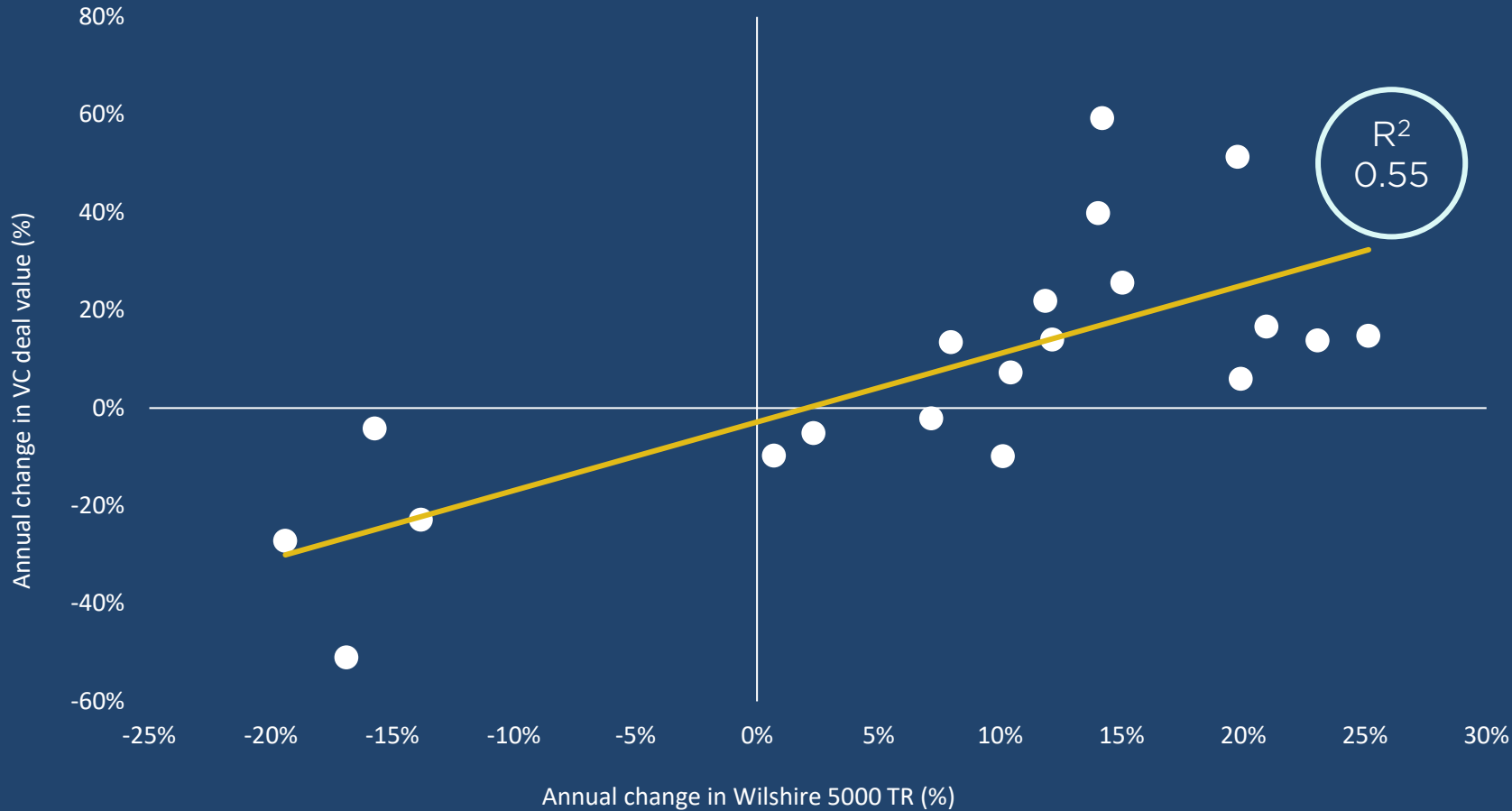
Note: The 10-year constant maturity Treasury rate at end of period is used compared with cumulative VC investment within the quarter indexed to 2012 dollars.

Source: PitchBook | Geography: US
*As of May 31, 2021



Venture investment activity moves with public markets, likely driven in part by the denominator effect.

Annual change in Wilshire 5000 Index versus annual change in US VC deal value*



Venture investment tends to move with public markets, as institutional investors must rebalance their portfolios in accordance with their allocation targets. However, the slower nature of private markets tends to dampen the magnitude of changes in VC activity.

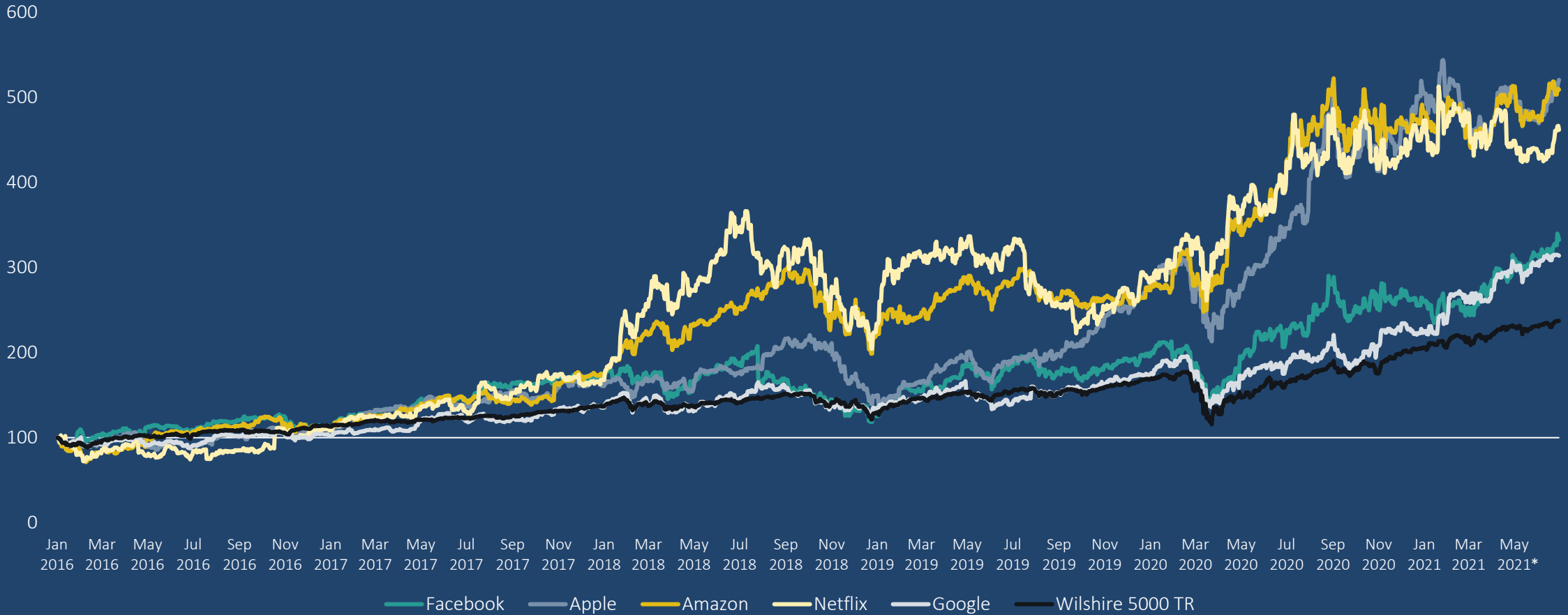
The overall correlation between the index change and VC investment is low, but it increases during large directional movements. This helps explain why VC dealmaking has exploded over the past few quarters, as public market performance has been impressive since the pandemic-induced low in March 2020.

Source: PitchBook | Geography: US
* January 1, 2001 to December 31, 2020



With large tech stocks driving the market run upward, investors will seek value in the next crop of tech companies—thus making an allocation to VC more enticing to institutional investors.

FAANG and Wilshire 5000 stock indexes (based to 100 on January 1, 2016)

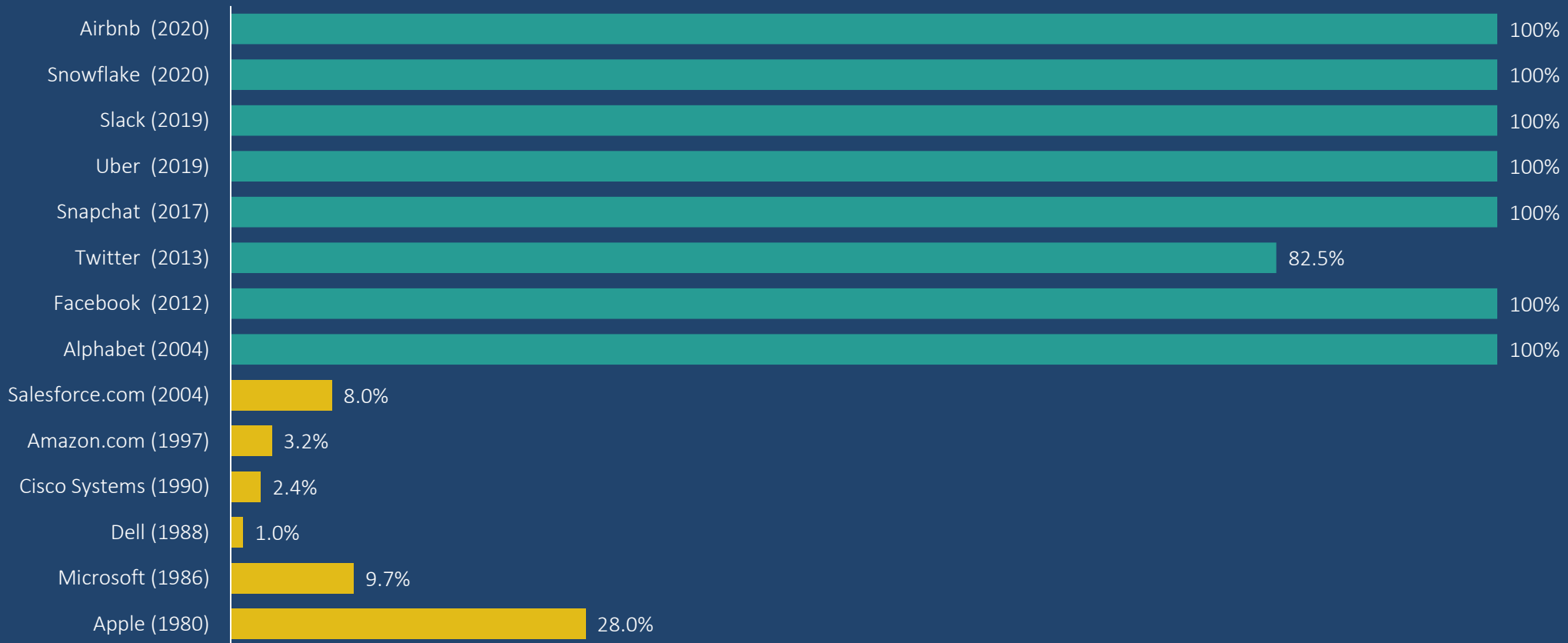


Source: PitchBook | Geography: US
*As of June 30, 2021



Companies are garnering loftier valuations while private, thus accruing more gains to pre-IPO shareholders and making private investments more attractive to investors...

*Proportion of first \$20 billion in value (in 2020 dollars) captured as of IPO**

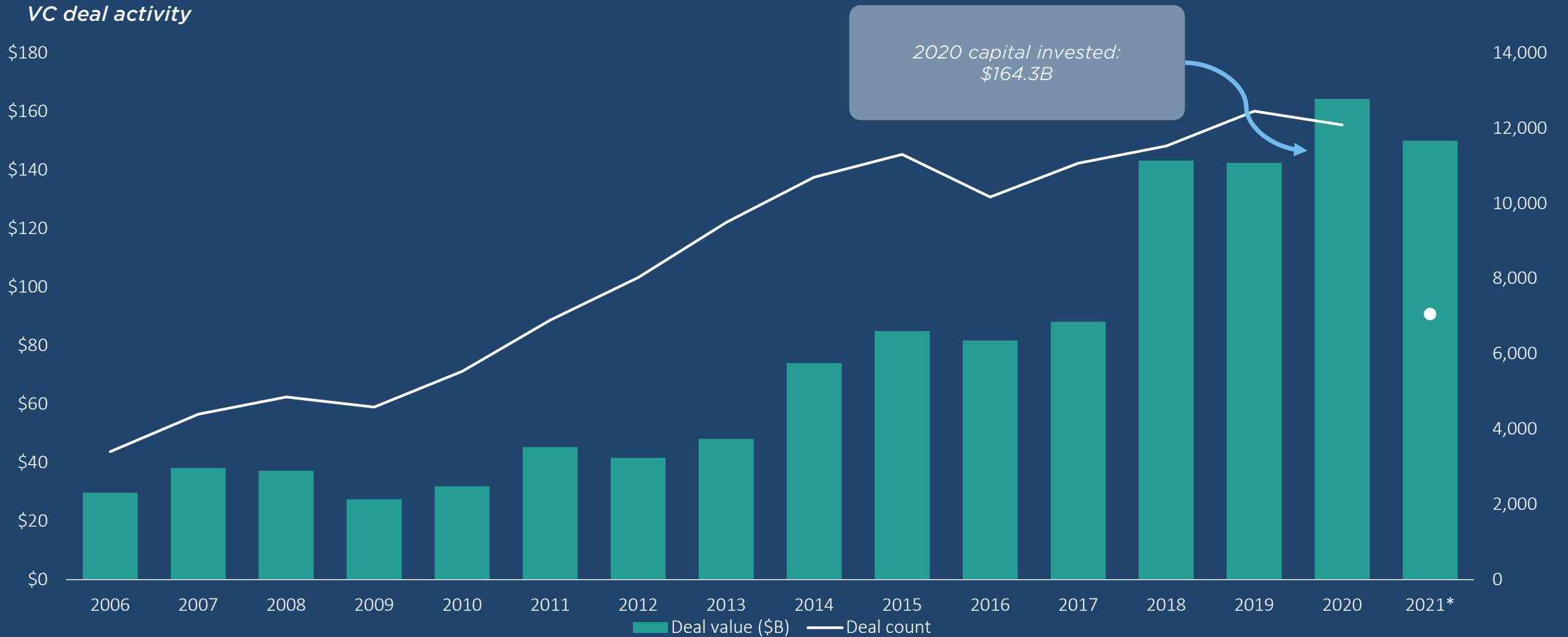


Source: PitchBook | Geography: US
*As of June 30, 2021



...which has translated into massive VC funding numbers, despite negative headwinds caused by the global pandemic, with 2020 recording the highest VC funding to date...

VC deal activity



Source: PitchBook | Geography: US
*As of June 30, 2021



...with only one month in 2020 (April) recording a capital invested total lower than the monthly average since 2017.

VC invested (\$B) by month

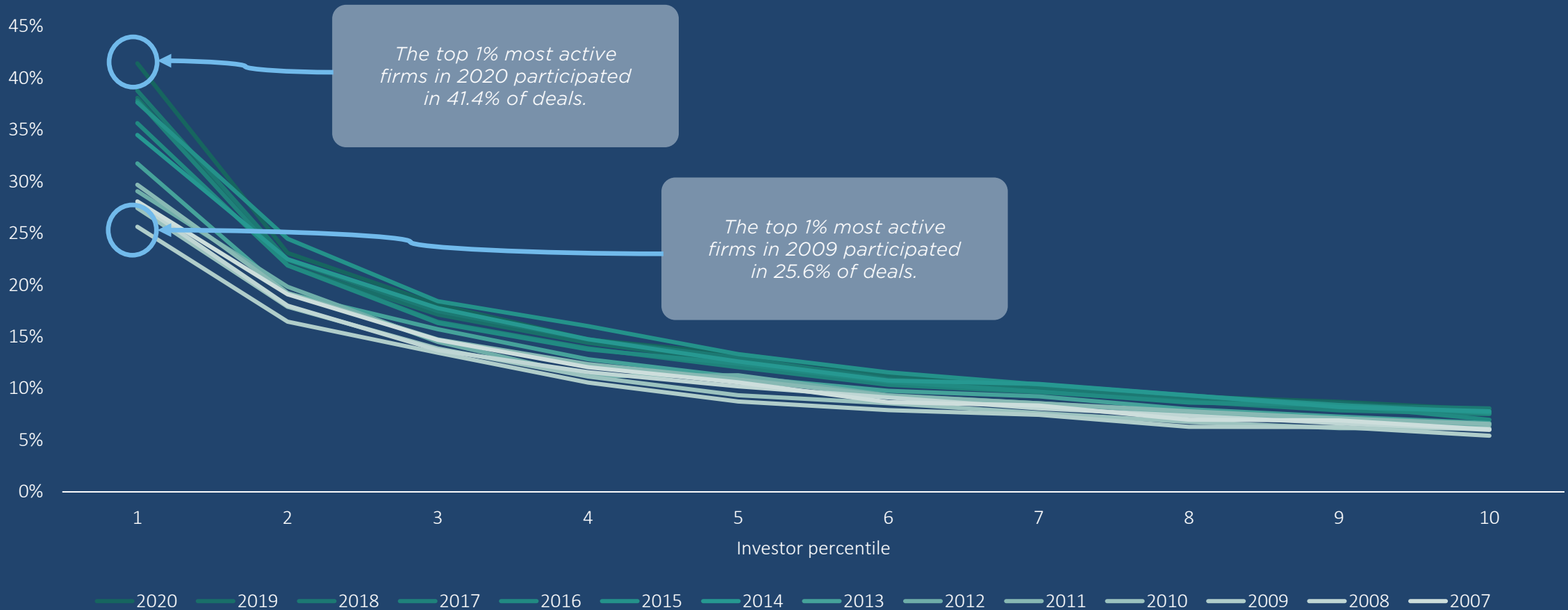


Source: The US Courts | Geography: US
*As of June 30, 2021



Driving this frenzy of activity, the most active firms are increasing their share of the total number of deals done...

Share of annual VC deals with participation in each percentile*

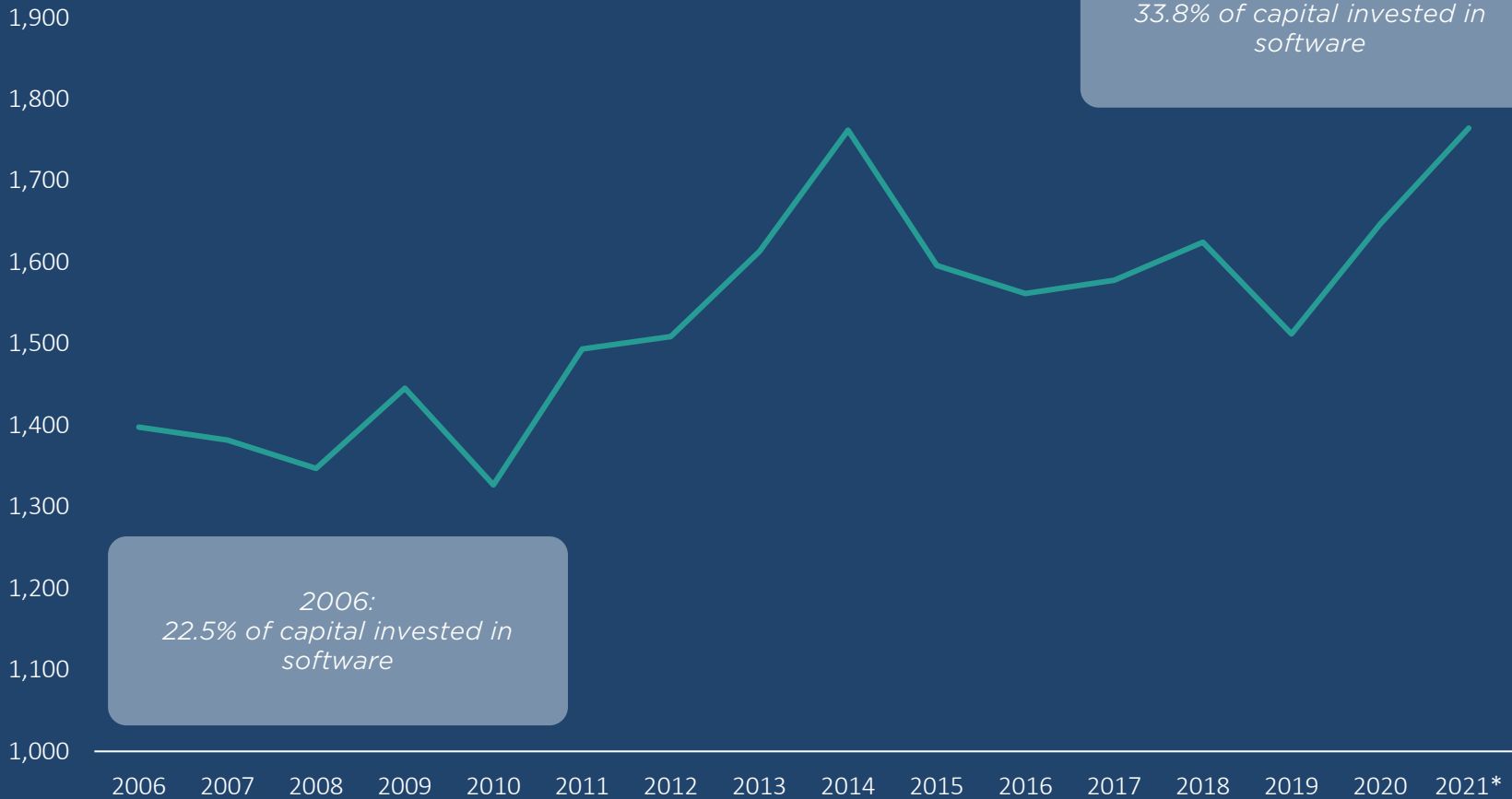


Source: PitchBook | Geography: US
*As of June 30, 2021



...and putting more capital into fewer industries over the past 15 years...

VC invested HHI score



The Herfindahl-Hirschman Index (HHI) is a measure of market concentration. This framework is commonly used in matters concerning competitiveness in certain industries, and often in antitrust cases.

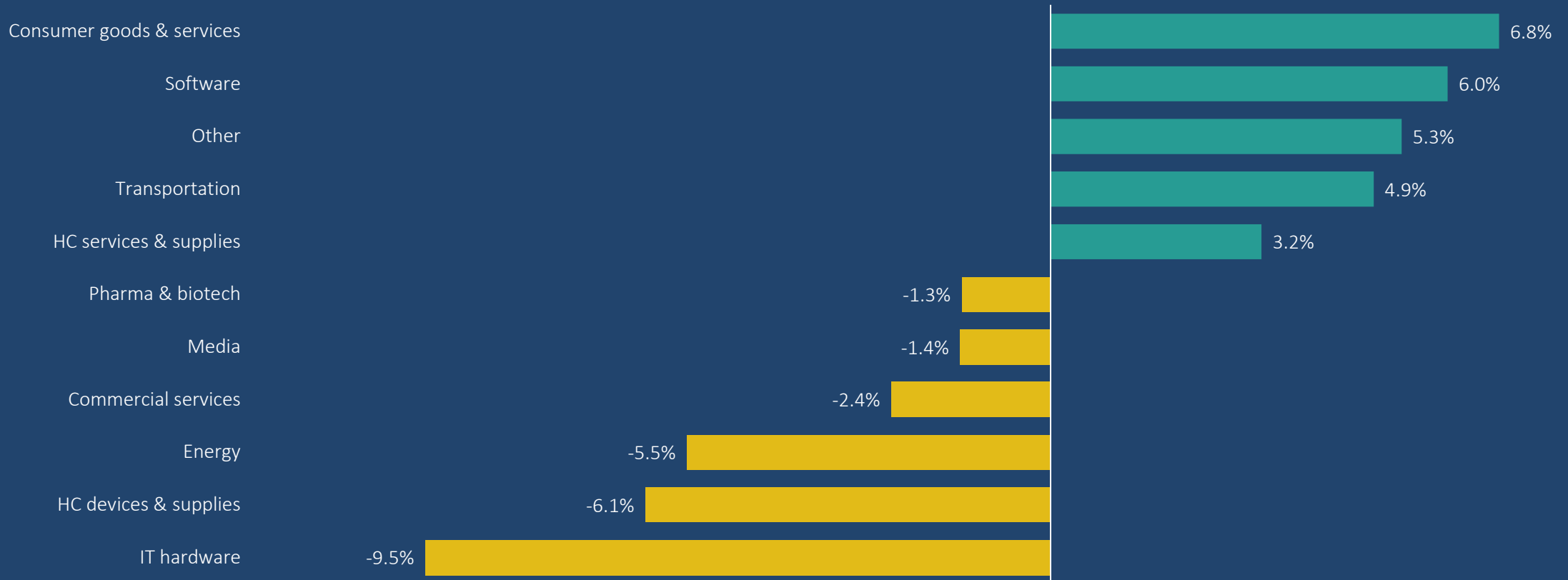
When applied to VC dealmaking, we see that, since 2006, an increasing share of capital has flowed into fewer sectors.

Source: PitchBook | Geography: US
*As of June 30, 2021



...with consumer goods & services and software increasing their shares of aggregate VC invested, and IT hardware seeing the largest reduction in capital investment.

*Change in share of VC invested by industry between 2006 to 2010 and 2016 to 2021 YTD**



Source: PitchBook | Geography: US
*As of June 30, 2021

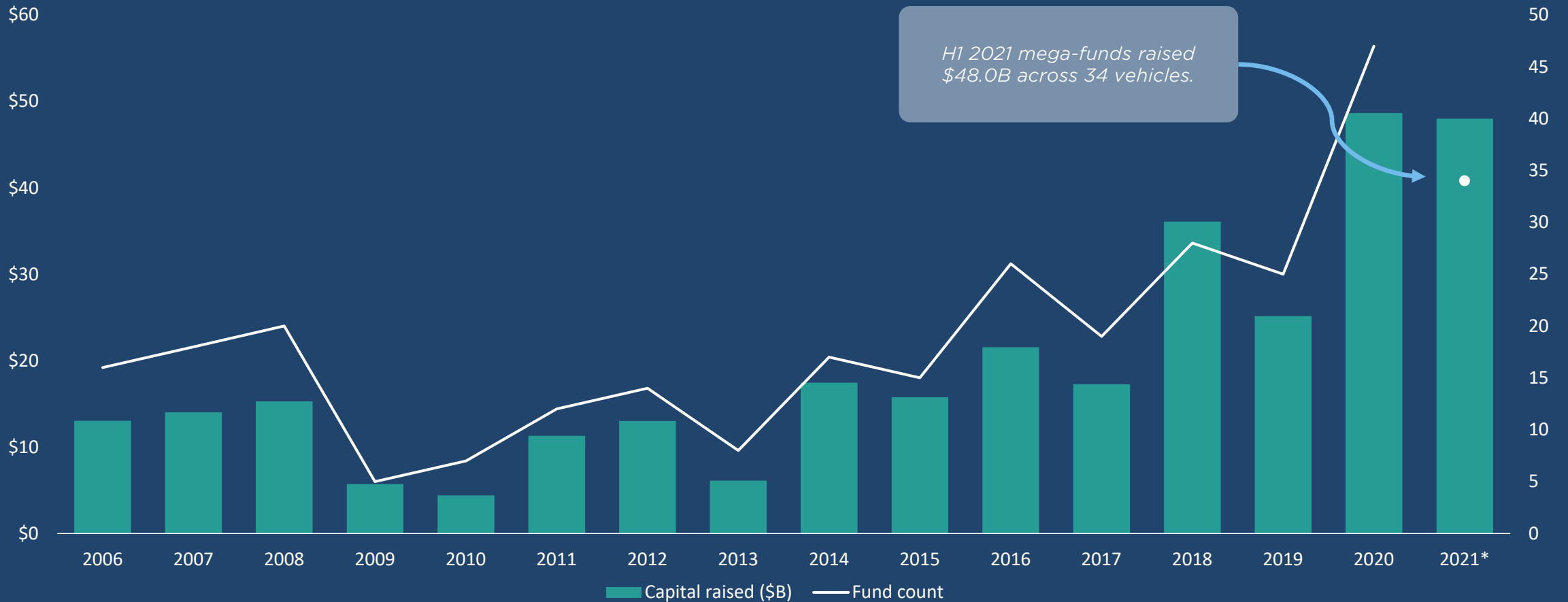


Supply & demand of capital



Mega-fundraising reached new heights in 2020, and 2021 continues that trend: The year has already nearly eclipsed 2020's record in only five months.

VC mega-fundraising activity (funds >\$500 million)

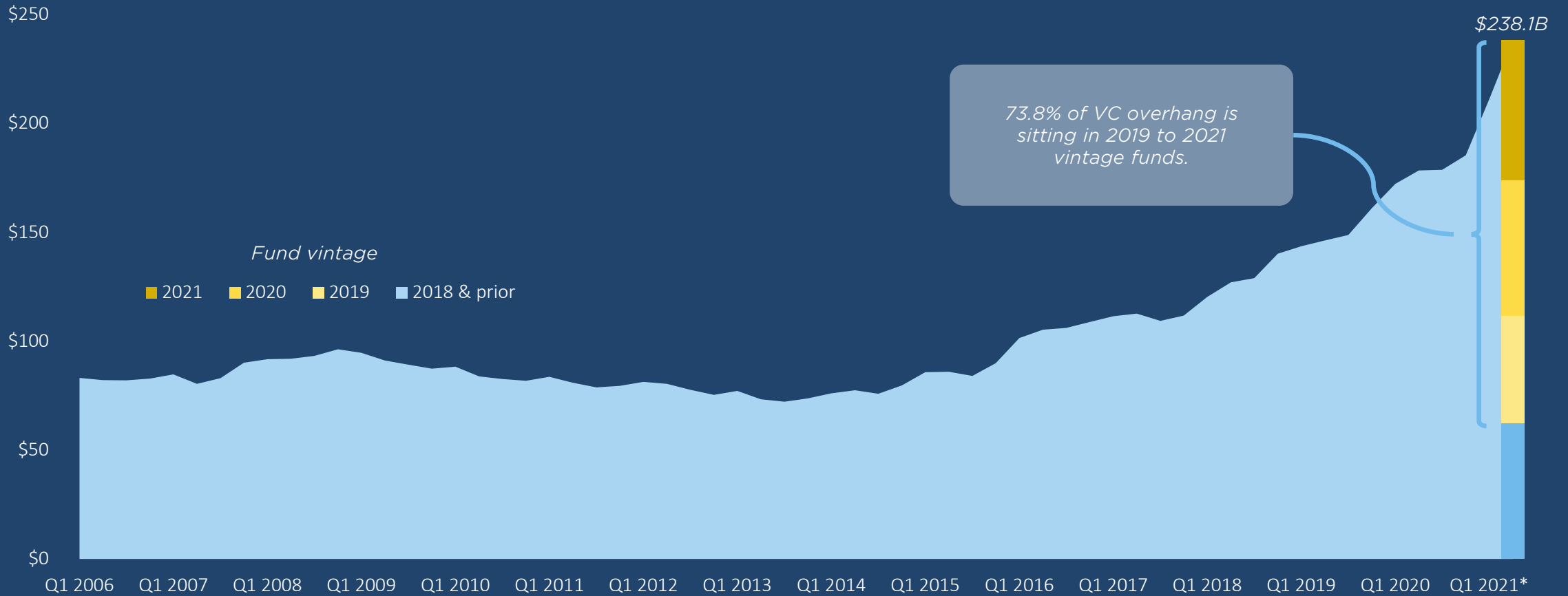


Source: PitchBook | Geography: US
*As of June 30, 2021



As such, venture funds sit on a mountain of investable capital, with a large share residing in recently raised funds.

VC fund dry powder (\$B) by quarter

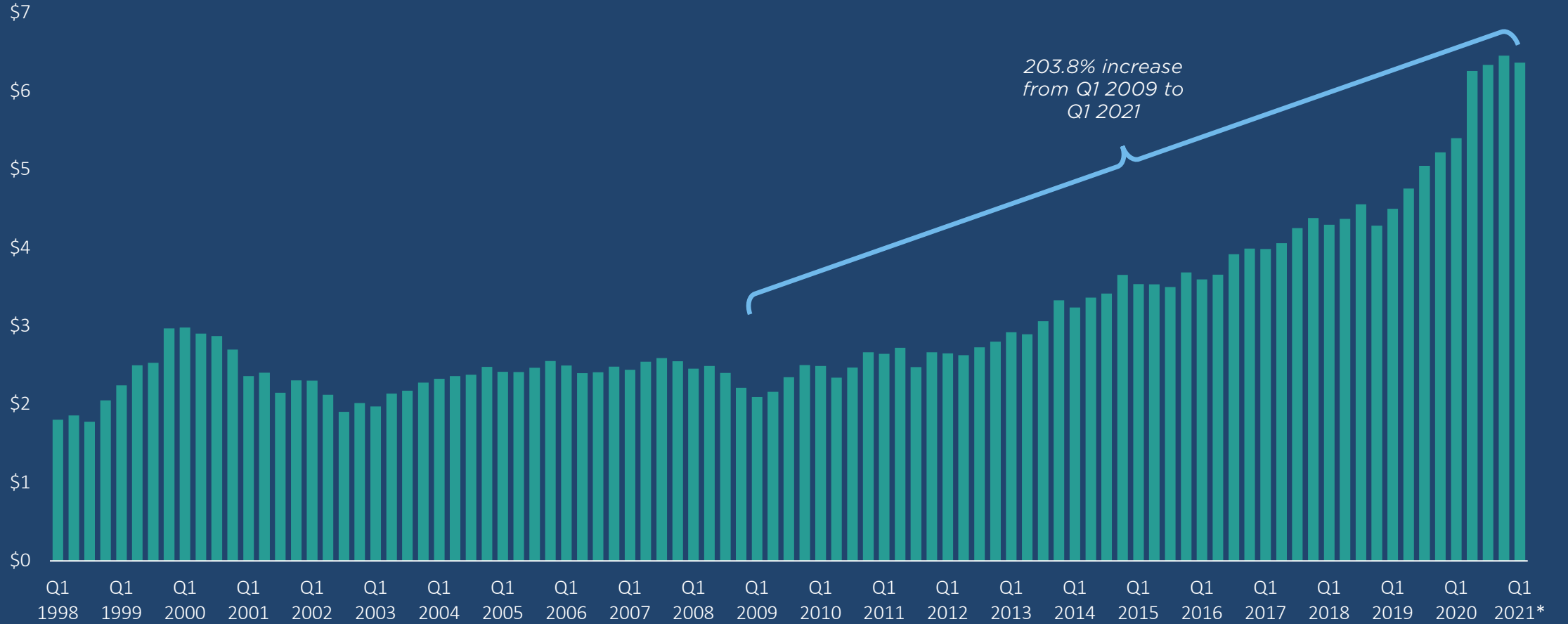


Source: PitchBook | Geography: US
*As of June 30, 2021



Corporations have taken a more active role in VC dealmaking, and the increase in their available cash indicates they can continue to do so.

Nonfinancial corporate business core liquid assets (\$T)

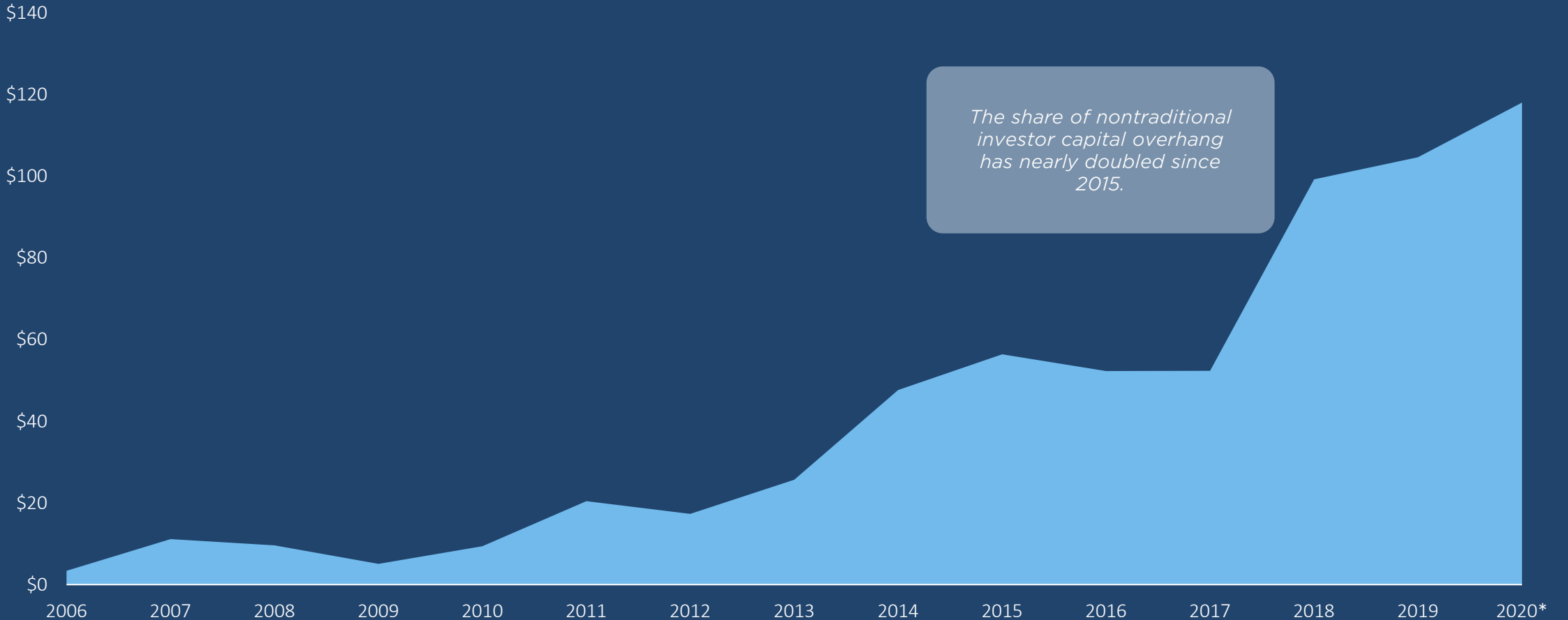


Source: FRED | Geography: US
*As of March 31, 2021



Nontraditional investors have also assumed a more active role in VC deal activity. Little suggests that this trend will reverse anytime soon.

Nontraditional investor dry powder (\$B)

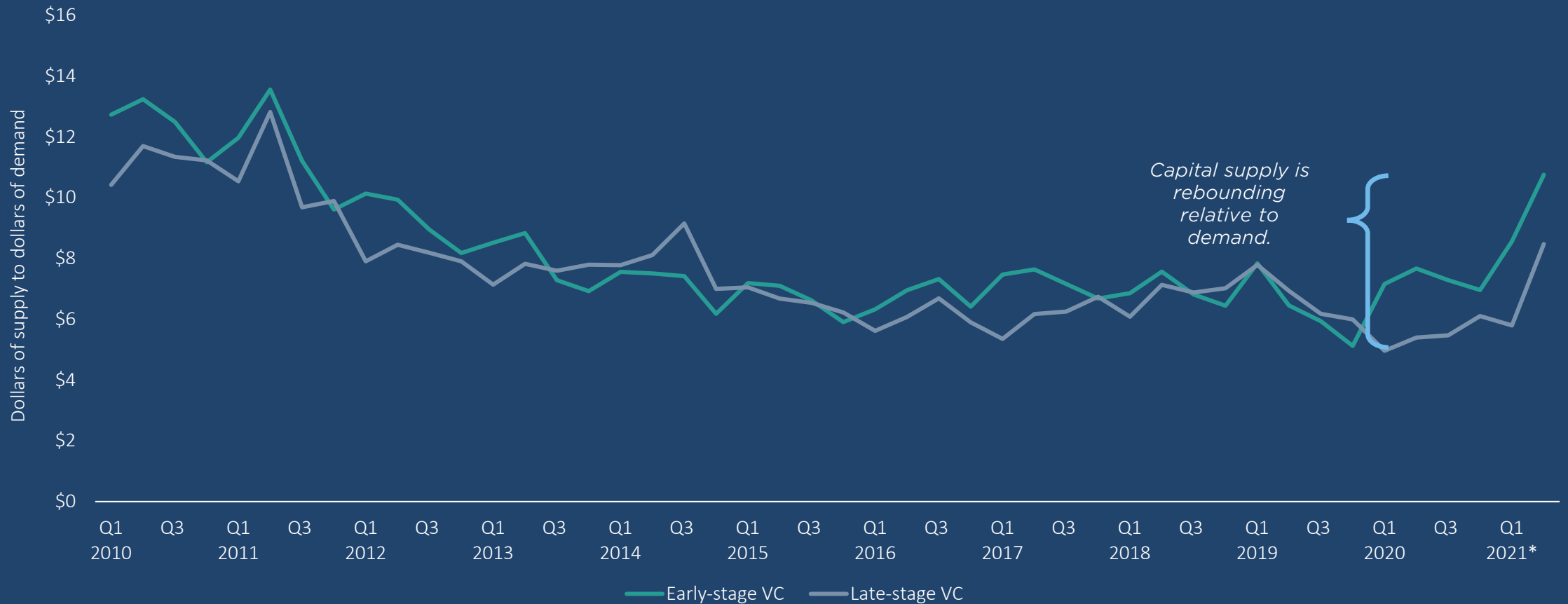


Source: PitchBook | Geography: US
*As of December 31, 2020



This run up in capital supply has reversed a decadelong trend of startup demand for capital increasing at a faster clip than investors could raise additional supply.

VC capital supply versus capital demand by stage

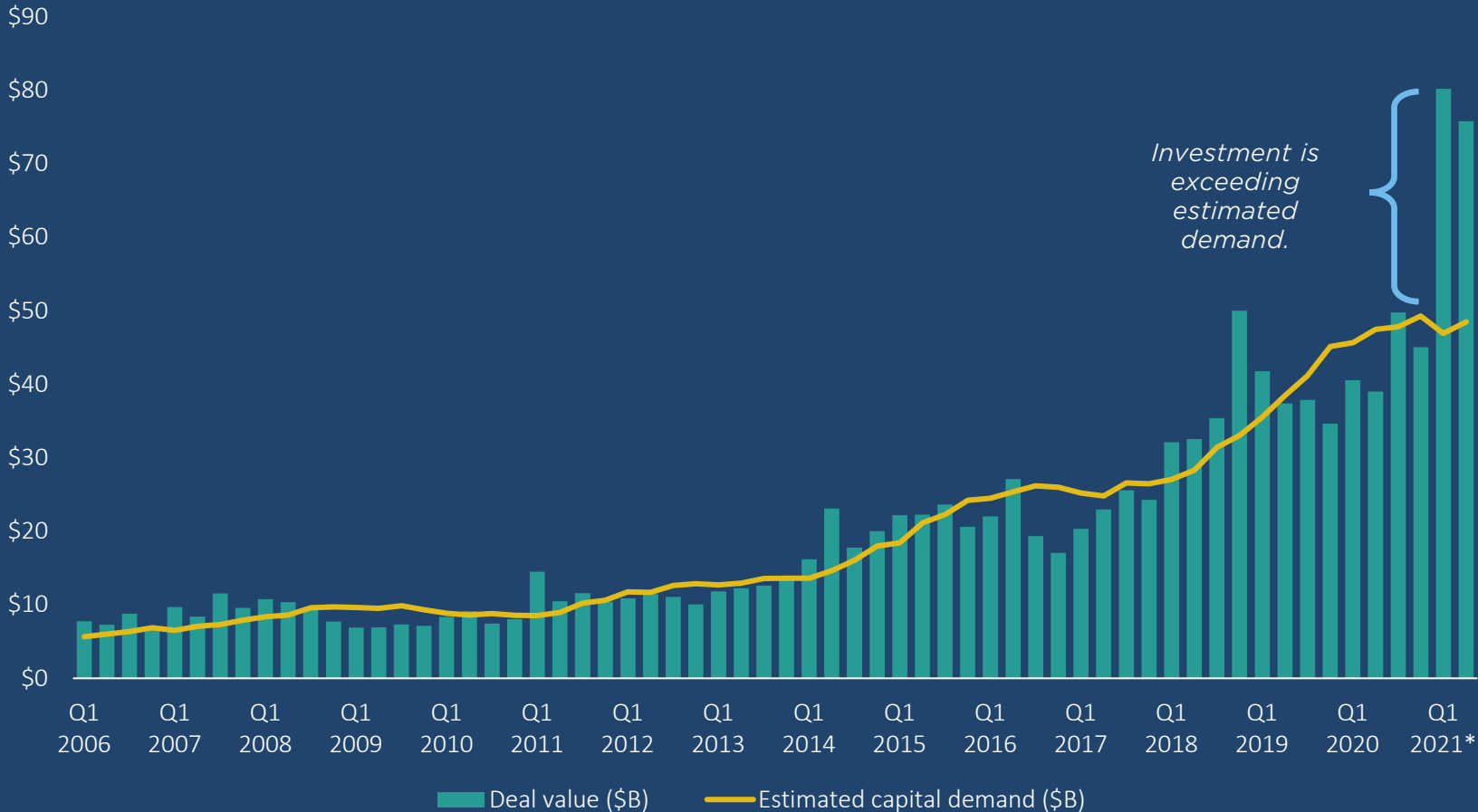


Source: PitchBook | Geography: US
*As of June 30, 2021



With capital supply so high, capital demand has outpaced estimates, as companies are raising faster than expected.

Estimated VC capital demand compared with observed invested VC



Highly capitalized companies are returning to a market flush with capital at a faster pace than in the past—and can secure larger check sizes when they do.

As we have noted, the capital supply in VC funds is relatively young, so plenty of capacity to fuel deal flow should remain over the next couple years. It is less certain whether nontraditional VC investors will maintain their focus on fueling activity.

Source: PitchBook | Geography: US
*As of June 30, 2021

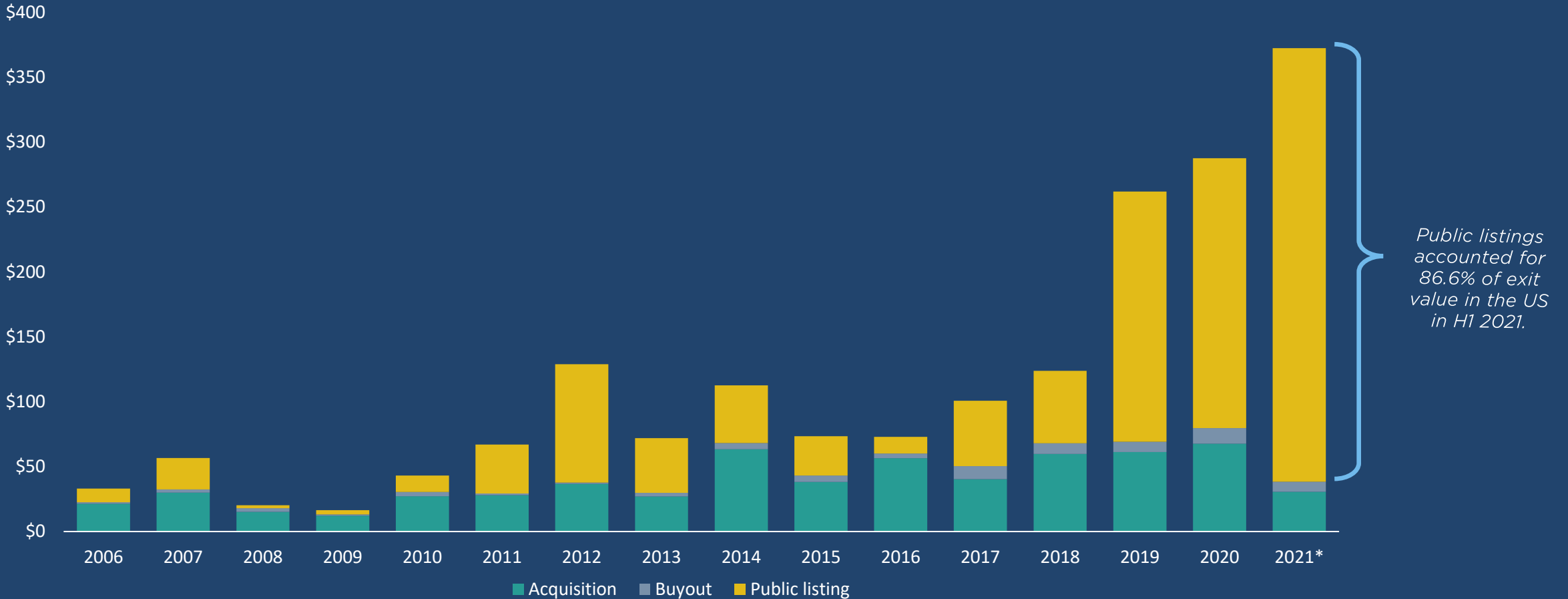


Exits & SPACs



As with deal flow, exits showed no sign of a slowdown during the pandemic, with public listings driving liquidity for venture-backed companies...

VC exit value by type (SB)

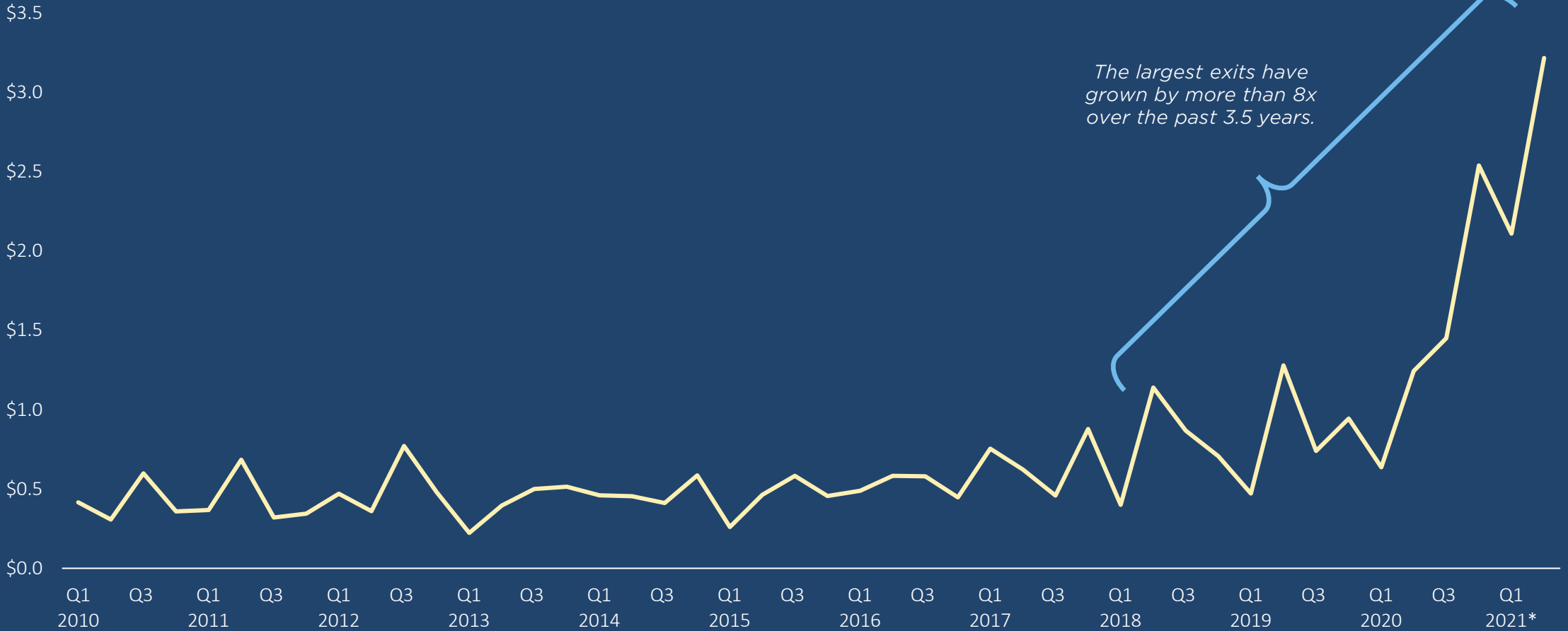


Source: PitchBook | Geography: US
*As of June 30, 2021



...with the largest exits continuing to fetch increasingly higher prices.

Top-decile VC-backed exit size (\$B)

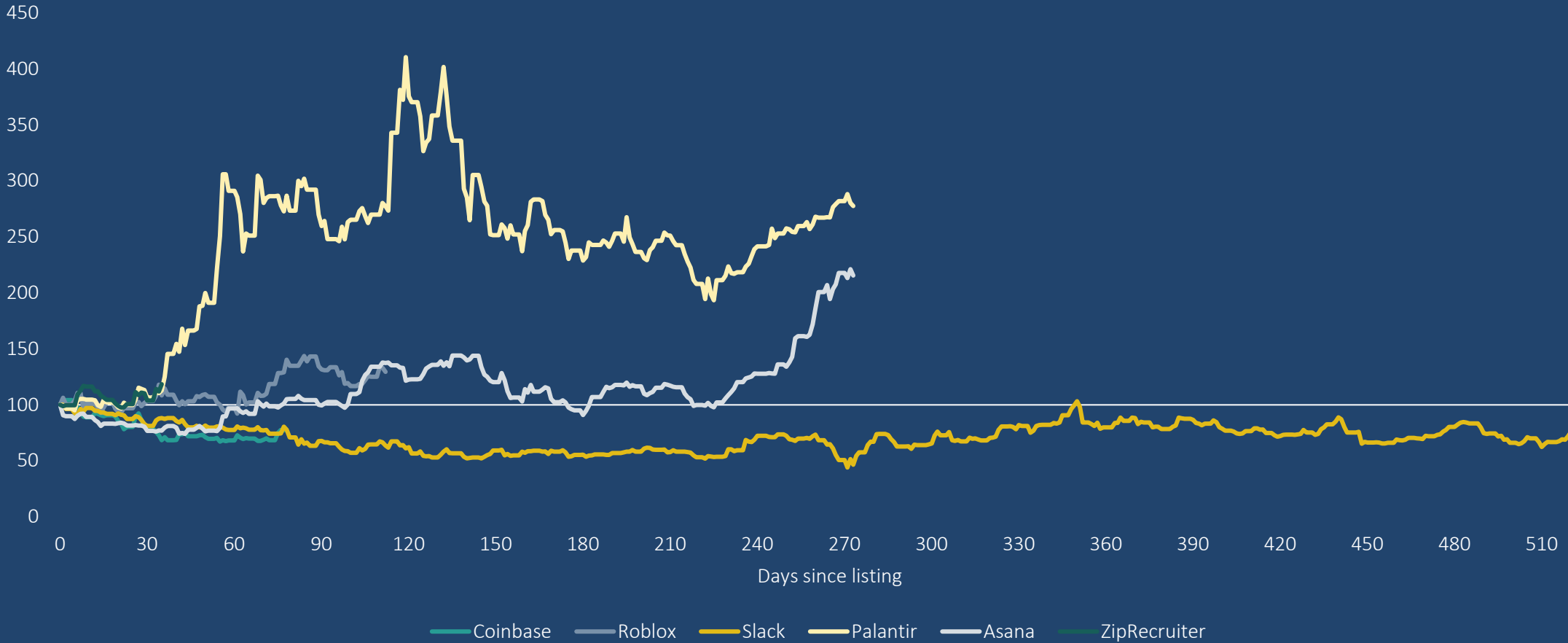


Source: PitchBook | Geography: US
*As of June 30, 2021



Direct listings were poised to disrupt the IPO, but few VC-backed companies have taken that route thus far, and performance after the fact is mixed.

*Direct listing stock price indexes (based to 100)**

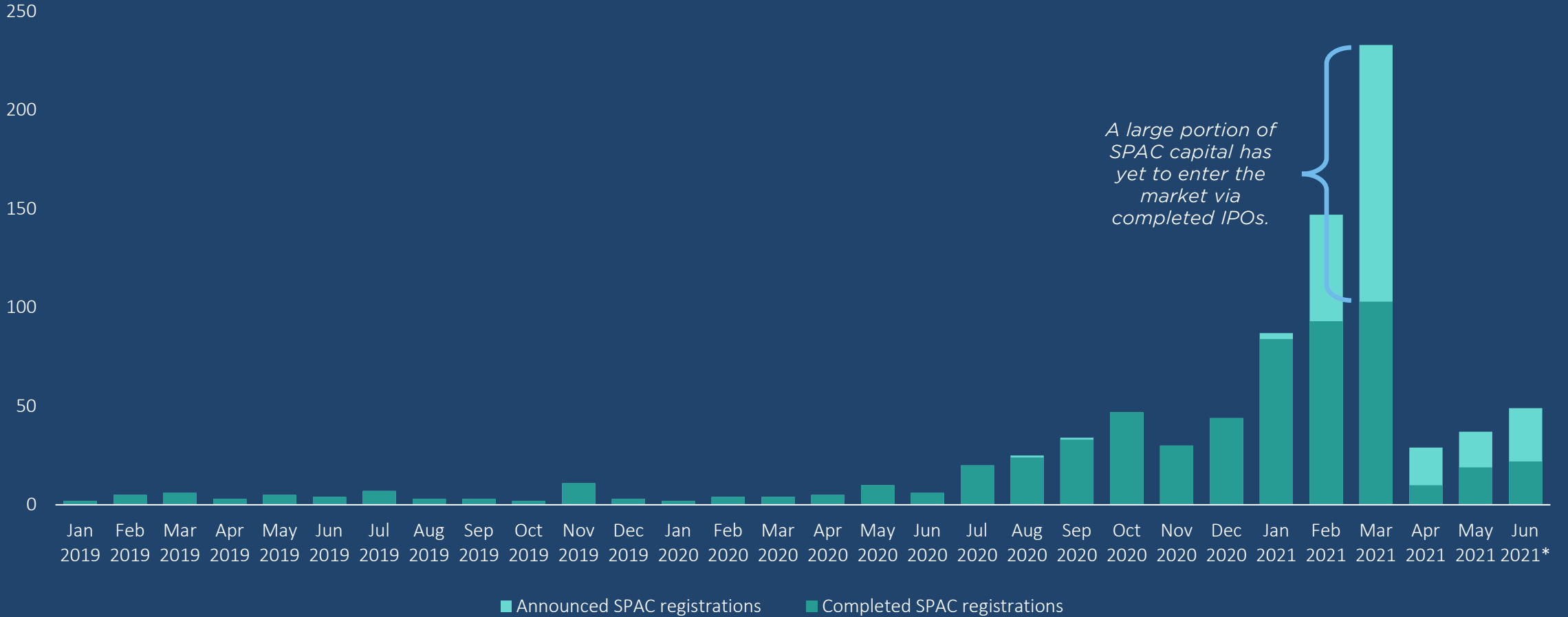


Source: PitchBook | Geography: US
*As of June 30, 2021



The SPAC has captured the imagination of industry watchers, though it has yet to be proven as a game-changing exit route...

Announced and completed SPAC registrations

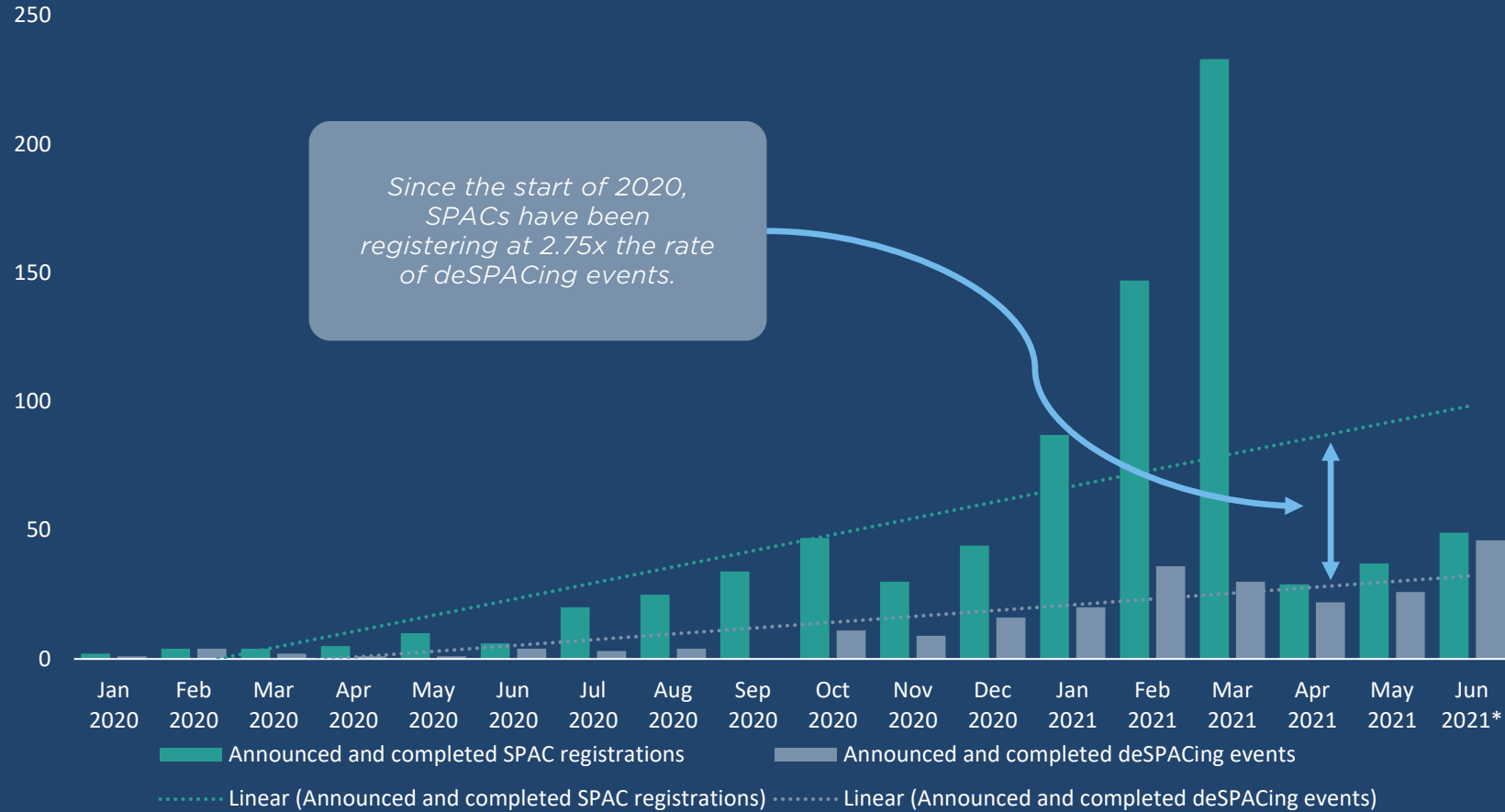


Source: PitchBook | Geography: US
*As of June 30, 2021



...as the number of SPACs dramatically outpace the number of deSPACing events.

SPAC registrations versus deSPACing events



As the number of SPACs registering an IPO increases, the deSPACing activity seems unable to keep up. This could indicate a lack of worthy SPAC targets, and that capital could be returned in the coming year as many of these SPACs come up against the standard two-year covenant to deploy capital.

Source: PitchBook | Geography: US
*As of June 30, 2021



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