PitchBook

Q1 2024

US VC Valuations Report

Sponsored by

Morgan Stanley AT WORK

Morgan Stanley
AT WORK

As the IPO Market Reopens, Will You Be Transaction Ready?

Having the right systems, processes, and people in place can be critical for planning a successful IPO. However, companies often underestimate the amount of work required, which can lead to costly transaction delays.

What can you do today to be set up for success tomorrow?

Discover what steps you can take to stay transaction ready and manage the expectations of your shareholders ahead of a future IPO or liquidity event.

Request a Transaction Readiness Assessment

CRC3500737 04/2024

Sponsored by

Morgan Stanley AT WORK

Contents

PitchBook Data, Inc.

John Gabbert Founder, CEO

Nizar Tarhuni Vice President, Institutional Research and Editorial

Dylan Cox, CFA Head of Private Markets Research

Institutional Research Group

Analysis

Kyle Stanford, CAIA
Lead Analyst, Venture Capital
kyle.stanford@pitchbook.com

Kaidi Gao
Analyst, Venture Capital
kaidi.gao@pitchbook.com

Data

Collin Anderson
Data Analyst

pbinstitutionalresearch@pitchbook.com

Publishing

Report designed by **Julia Midkiff** and **Jenna O'Malley**

Published on May 8, 2024

Click here for PitchBook's report methodologies.

Key takeaways

- At the median, top-line valuations showed a quarter-over-quarter uptick across all stages, which is a positive sign. However, a look deeper in the data shows that those top-line figures are not much higher than these companies' previous valuations. Median Q1 early-stage and late-stage valuation step-ups were either flat or down, and RVVC and VVC figures show that growth between rounds has remained lower than trend.

- AI continues to drive investment figures, and the valuations the technology is generating are another highlight of the interest it drives from investors. The median late-stage AI valuation is $40 million higher than that of fintech or SaaS, and the sector has shown continuous growth in its median valuation since the market began its slowdown. Other sectors cannot say the same.

- Exit step-ups are low. The few IPOs that have occurred have shown as positive signs for the market, but there remains a large disconnect between public and private valuations. Reddit took a roughly 40% haircut at its IPO from its previous valuation ($10 billion). For all exit types, later-round investors are taking a hit at exit, or they are not seeing the immediate returns they had expected from their investments.

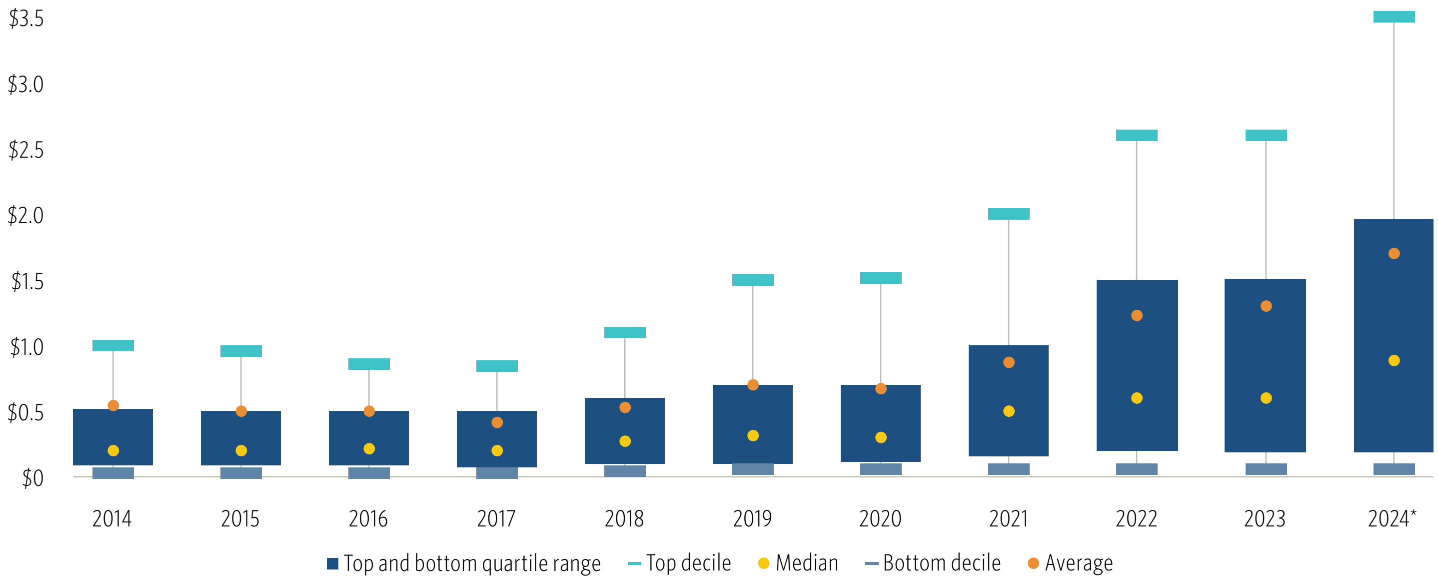
- Secondary data shows that shares were trading at median and average discounts of 37% and 28%, respectively, showing the challenge of realizing sturdy returns. Though those are an uptick from early in 2023, they remain well below the price at which many investors would like to offload shares. The lengthy slowdown has worked to decrease the bid-ask spread, which is a benefit for more timely sales.

- The recent talk around bridge financing reflects the ongoing challenging fundraising dynamics. The number of flat and down rounds as a proportion of all VC deals expanded consistently since Q1 2022 on a QoQ basis, notching 27.4% in Q1 2024—the highest level in a decade. Common stockholders and early-stage investors face the challenge of highly dilutive terms.

Dealmaking

Median pre-seed hits nearly $1 million

Pre-seed deal value ($M) dispersion



Source: PitchBook • Geography: US • *As of March 31, 2024

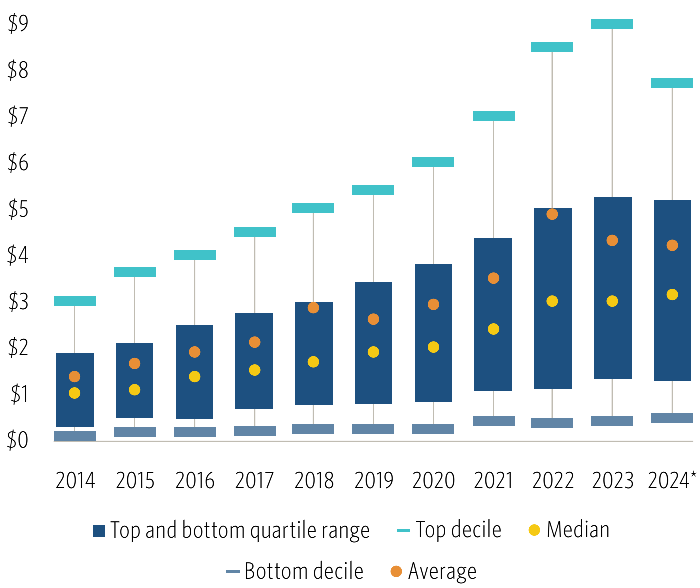
Broadly speaking, the market uncertainties that caused the swift shift in market prices remain, albeit at a relatively lower level than a year ago. Inflation remains sticky in the US. The March Consumer Price Index figure came in at 3.8%, notching an uptick from the month before and keeping the inflation figure well above the Federal Reserve's (Fed's) 2.0% target. The multiple interest rate cuts that the market expected at the beginning of the year are now more likely going to be a single cut, or none at all. The continued pressure this will put on markets will inevitably continue to burden the pricing of VC financing rounds. Public market multiples have expanded slightly, which can relieve a bit of pressure on VC, but by and large, the industry continues to reckon with the loose funding market of a couple years ago.

Pre-seed and seed strength

Pre-seed- and seed-stage deals continue to show heightened valuations, despite the corrective movements at the later stages of VC. Several factors lead to such high levels, including the high deal sizes that continue to show up. At $900,000 and $3.1 million, respectively, these two investments are showing the highest median deal sizes for any quarter in our dataset.

Median seed hits highest level to date

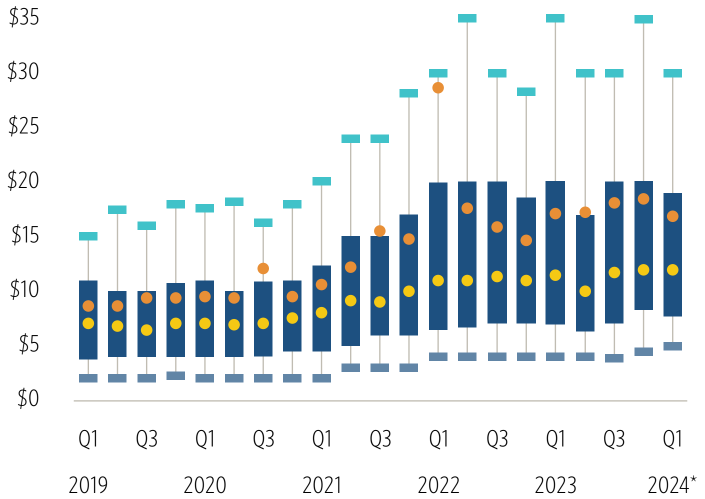
Seed deal value ($M) dispersion



Source: PitchBook • Geography: US • *As of March 31, 2024

Median seed valuation remained at $12 million

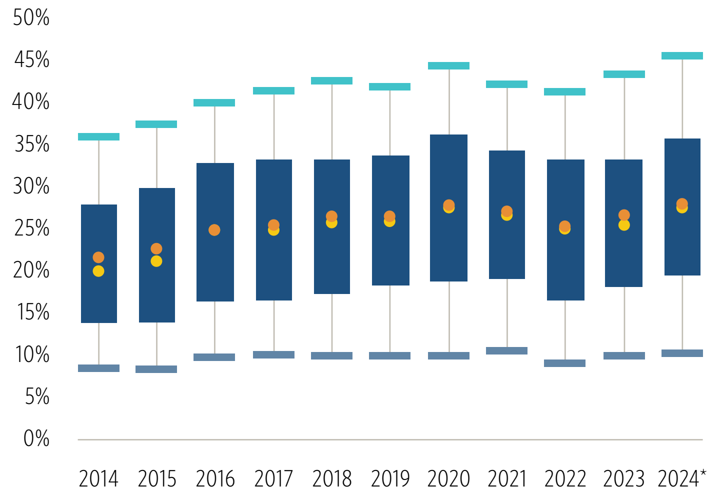
Seed pre-money valuation ($M) dispersion by quarter



Source: PitchBook • Geography: US • *As of March 31, 2024

Investors taking larger stakes

Seed share acquired dispersion



Source: PitchBook • Geography: US • *As of March 31, 2024

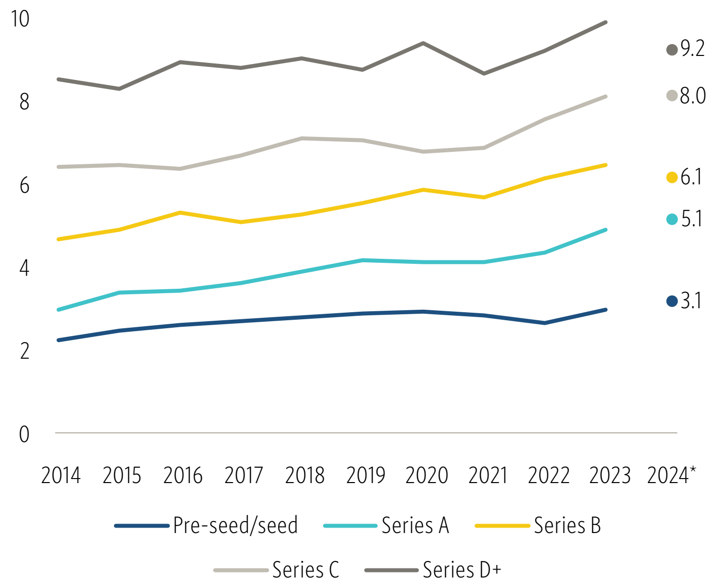
The relative quality of the companies underlying today's investments is higher than during a couple years ago. However, not only are investors at this stage being more selective and asking for high key performance indicators (KPIs) from a financial and development aspect, but companies able to receive funding are being funded with larger rounds with the intention of providing plenty of capital to endure the slowdown.

Across venture stages, the time between rounds has risen substantially in the past year. Pre-seed/seed-stage companies that closed a round in Q1 were a median age of 3.1 years—the highest figure that data point has shown. Those raising Series A rounds were more than 5 years old at the median, which is also the highest figure. As benchmarks for investment have risen, the need to extend capital runways has grown accordingly. Where later-stage companies can adjust spending to increase capital efficiency, younger companies have fewer levers to pull, aside from raising larger rounds. Investors at this stage are hyperaware of the challenges companies face in raising the next round, and are sure to adjust investment accordingly.

Over the past few years, most funds closed in the US have been closed on less than $50 million of commitments. While there has been a large-scale pullback from the late stage, particularly by nontraditional investors, smaller funds have less ability to cease investment or move to another stage of VC. This keeps competition for strong deals relatively high.

Seed-stage companies getting older

Median time (years) from founding by series

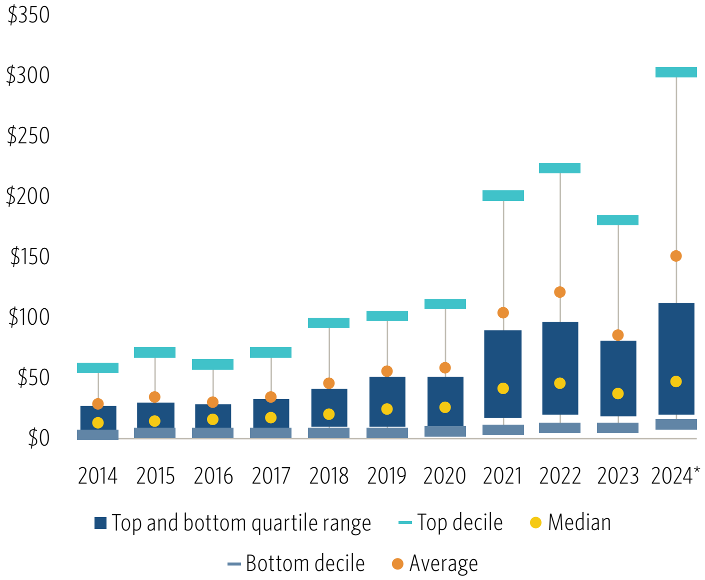


Source: PitchBook • Geography: US • *As of March 31, 2024

Altogether, these factors continue to put upward pressure on valuations at the earliest stages of VC, and the ongoing trends

Early-stage valuations jump back up

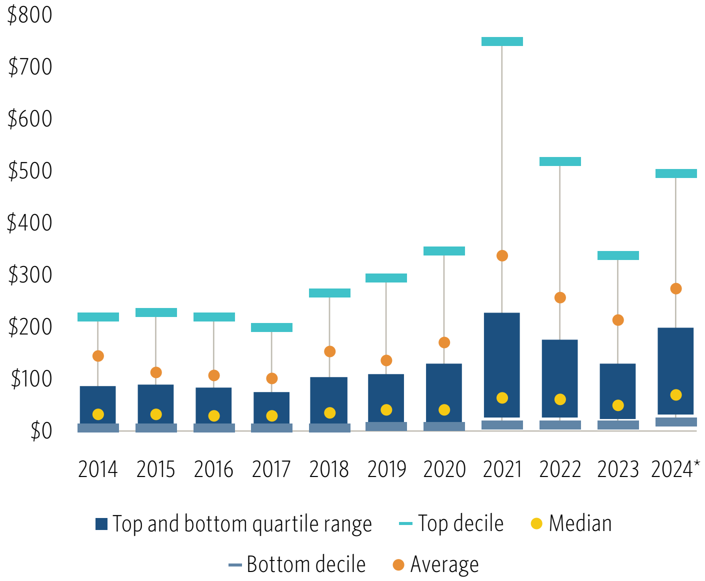
Early-stage pre-money valuation ($M) dispersion



Source: PitchBook • Geography: US • *As of March 31, 2024

Late-stage valuations see big increase

Late-stage pre-money valuation ($M) dispersion



Source: PitchBook • Geography: US • *As of March 31, 2024

at the stage lead us to believe these factors will continue. Though pre-seed/seed deal activity has been negatively impacted by global headwinds, this stage remains relatively insulated from the immediate impacts, at least as long as the US economy remains robust.

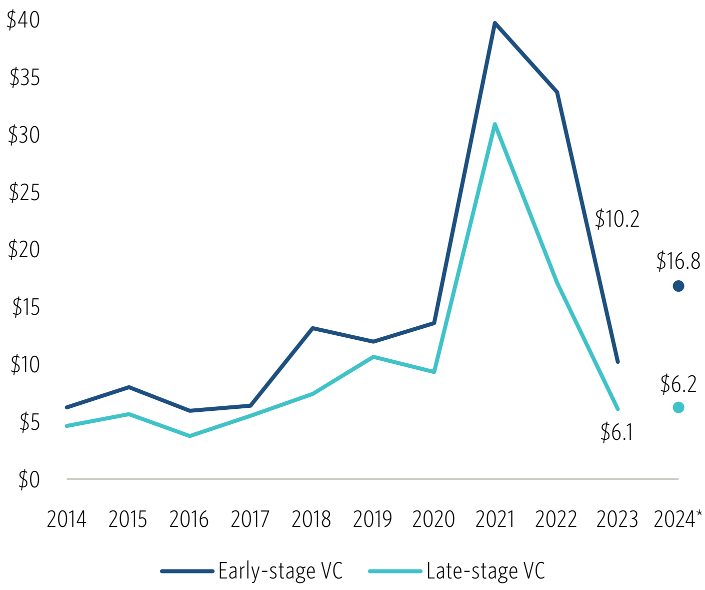
Valuation growth between rounds remains compressed

In Q1, median valuations rose across all stages from the quarter before. Early-stage and late-stage rounds ticked up rather significantly to $46.5 million (16.3%) and $70.1 million (36.1%), respectively, though were not able to quite reach the high medians seen during the peak exuberance of 2021. Multiples remain compressed, which leads to an assumption that revenues have not been severely hurt from economic uncertainty.

When those high top-line valuations are looked at through the lens of annual growth since the prior round, the valuation growth comes into a different light. For both early- and late-stage deals, the annualized valuation growth remains well below the high calculations. Companies that raised an early-stage round in Q1 added roughly $16.8 million to their valuation, but that was an increase of just 36.2%—the lowest figure for early-stage rounds in the past decade, except for 2023.

VVC showing relatively slow growth

Median velocity of value creation (VVC) by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

In conjunction with the longer time between venture financings, the heightened top-line figures make it increasingly difficult to continue growing at the same step-up multiple over time, even if the numerical figure is relatively high. The median early-stage step-up multiple in Q1 was just 1.7x—a figure akin to the market growth in 2016. For late-stage companies, the past few quarters have been the slowest in terms of an extended period of step-ups in the past decade.

Late-stage companies are in a particularly challenging environment because of the lack of capital availability to support the need to remain private because of market conditions. While top-line valuations have remained high, or have grown in recent quarters, the tenuous nature of the late stage is highlighted by the inability to continue growth at or near the same levels earlier in the lifecycle. Slower growth leads to excess dilution to early investors and company employees. A resurgence of valuation growth at both the early and late stages will continue to be challenged by the high prices the market has paid up to this point, and a large portion of the US company inventory faces high barriers to raise again in the private market.

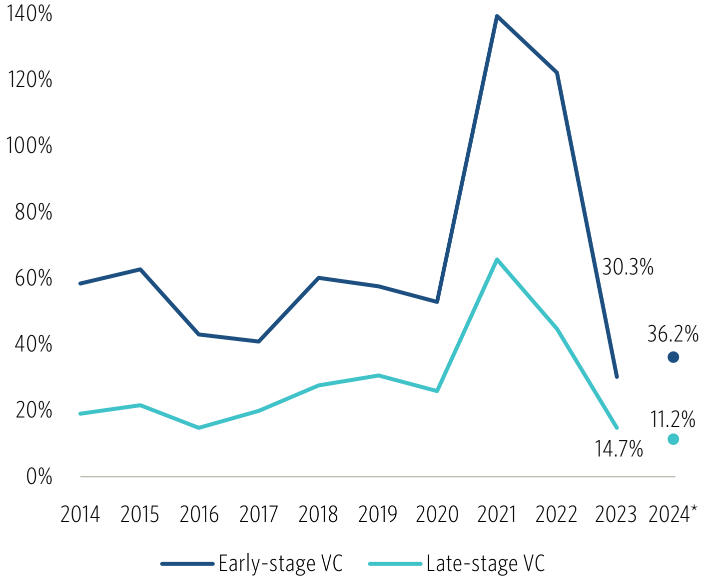
These depressed figures of annualized valuation growth also highlight the problem that many VCs currently face. Slower growth and lengthened hold times drive IRRs lower and reduce return expectations. As fundraising timelines have lengthened to accommodate the slower dealmaking environment, the inability to showcase strong interim returns will make raising a new fund even more challenging, especially for emerging managers that have less of a track record to showcase to prospective LPs.

AI versus the rest of VC

Artificial intelligence continues to be the leading investment vertical for the US venture market. In Q1, roughly 22% of deal count and 34% of deal value in the US venture market went to AI companies. Of course, large corporate deals have been a major portion of venture dollars in the space—OpenAI and Anthropic deals from Microsoft and Amazon have nearly reached $20 billion over the past couple years—but up and down the venture lifecycle, AI companies are raising at high valuations as other verticals struggle with the current market dynamics.

Percentage growth between rounds relatively low

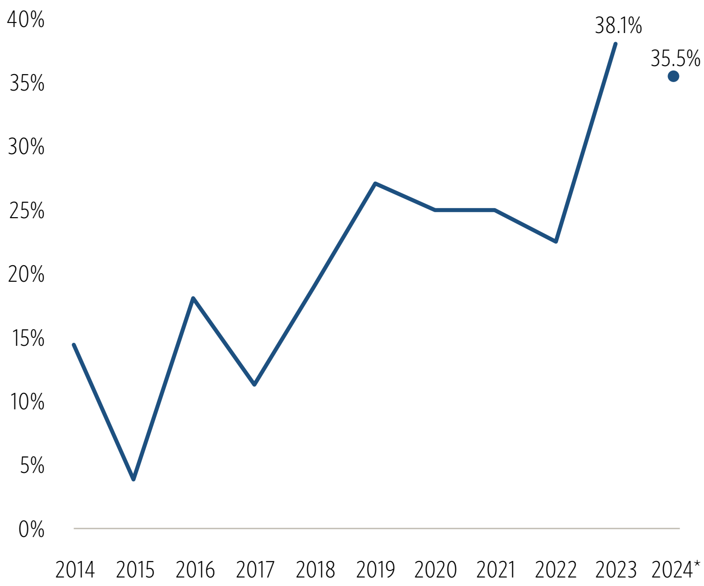
Median relative velocity of value creation (RVVC) by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

37.5% of unicorn deals in the past two years have been to AI

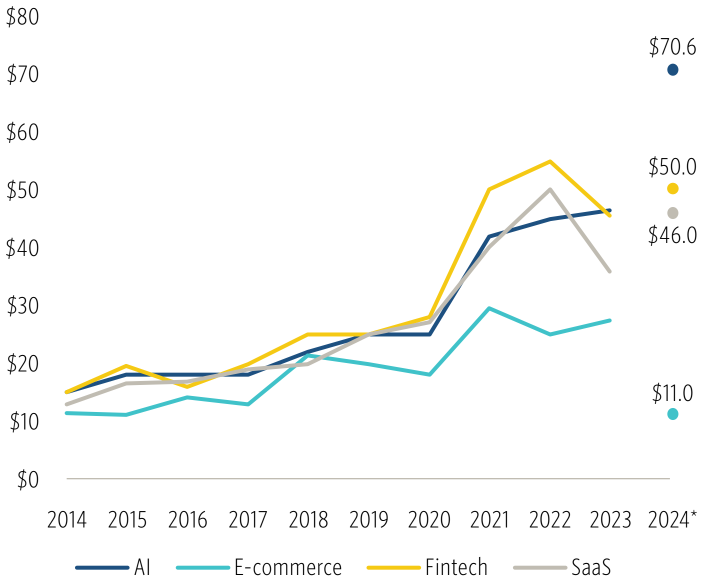
AI unicorn deals as share of all unicorn deals



Source: PitchBook • Geography: US • *As of March 31, 2024

AI has separated itself from other verticals

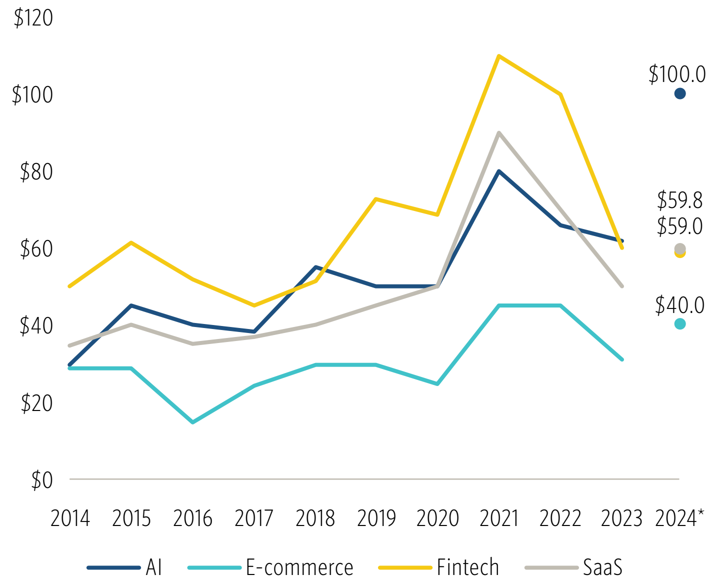
Median early-stage pre-money valuation ($M) by select verticals



Source: PitchBook • Geography: US • *As of March 31, 2024

Median late-stage AI valuation hits $100 million

Median late-stage pre-money valuation ($M) by select verticals



Source: PitchBook • Geography: US • *As of March 31, 2024

The median early-stage AI valuation in Q1 reached above $70 million, though a single quarter produces a relatively low sample size. However, AI has consistently shown an increase in its median early-stage valuation over the past few years. Looking back at the median valuation of several important VC sectors such as AI, software as a service (SaaS), and fintech presents the case that AI companies have begun to separate from the broader tech ecosystem in terms of value creation.

Median late-stage valuations across sectors have been more volatile than at the early stage. Even here, AI has shown its pricing power in the market. The median AI company valuation in Q1 reached $100 million—$40 million higher than SaaS and fintech, which have fallen well below their zero interest-rate policy (ZIRP)-era highs. AI has shown contrary movement, continuing its growth.

In a recent Quantitative Perspectives report, we highlighted the disparity that the rising valuations of AI have created between public market caps and the value remaining locked in the private market. Specifically for AI companies at the time, the private market cap of VC-backed AI was nearly 2.8x the market cap of recently public AI companies. Investors seem primed to continue paying high prices for AI startups. In Q1, 35% of the deals with a $1 billion-plus valuation were in AI companies.

A WORD FROM MORGAN STANLEY AT WORK

Transaction readiness: The power of preparation

What is Morgan Stanley at Work?

Morgan Stanley at Work provides workplace financial benefits that help build financial confidence and foster loyalty—helping companies attract and retain talent. Our end-to-end offering spans Equity, Retirement, Deferred Compensation, Executive Services, and Saving and Giving Solutions. Each solution includes a powerful combination of modern technology, insightful support, and dedicated service, providing your employees with the knowledge and tools to help make the most of their benefits and achieve their life goals.

Whether preparing for a liquidity event or IPO, planning a restricted stock unit (RSU) release or expanding your equity plan globally, Morgan Stanley at Work can help you take charge of where you are today and where you're going next.

As IPO conditions improve, why should companies focus on transaction readiness?

As companies start thinking about their plans for going public, they should also anticipate the amount of preparation work that goes into transitioning from a private to public company equity plan. We call this "transaction readiness," and while it can sometimes be an afterthought, companies can benefit from understanding all the various components of this process and planning accordingly. From our experience, it can easily take a company at least a year or more to gather the right systems, processes, and people to prepare for the rigors of public company life and support the needs of its shareholder base.

We recommend that private companies familiarize themselves with the transaction readiness process early on, rather than after they start accelerating their IPO plans. You may want to begin by evaluating the systems, staff, and processes you may need to address or enhance to be ready to operate as a public company. Then, consider starting a conversation with your business partners about the compliance and regulatory hurdles you'll likely need to navigate. Being proactive about transaction readiness can help companies avoid costly delays in their IPO plans and mitigate equity plan issues that might have a negative impact after going public.

Sam Adams
Executive Director, Issuer Strategy and Excellence

Sam Adams is an Executive Director at Morgan Stanley at Work leading a specialized team focused on helping private companies transition their stock plans into the public market.

For companies considering a future IPO or liquidity event, what are some of the key factors that might determine whether they're transaction-ready?

Data integrity is a good place for companies to start their transaction readiness journey. All of the data that feeds into a company's equity plan must be accurate, reconcilable, and easily accessible—this includes not just the equity ownership records of every shareholder but also the data from accounting, payroll, and HR systems that determine how grants are issued and taxed. We typically see companies start with a full audit of their capitalization table. Often, a degree of data cleanup is required, as well as some corrective action regarding things like stock-based compensation expense. In addition to the audit, companies should consider what policies and processes might help align their systems and cross-functional teams around preserving data integrity in the future.

Next, companies will want to evaluate whether they have the right systems and infrastructure in place to transition to a public company equity plan. Public companies must meet various Sarbanes-Oxley (SOX) Act compliance, reporting, and corporate governance requirements. Having a foundational infrastructure and knowing where there are overlaps or potential gaps within it is essential for being transaction-ready. Companies might also want to consider how their current equity systems and infrastructure will scale. They may ask themselves: Are there opportunities to improve the shareholder experience or the integration between accounting, payroll, and HR systems? Can we introduce automation that could help minimize the risks of error and offset some of the manual work of the equity administration team? All of this is important as companies think about how their equity plan might evolve over time and whether they have a foundation they can build upon or if they'll eventually need to move to a new system.

Another overlooked aspect of transaction readiness is the global tax and regulatory requirements for companies that issue equity to international or remote employees. There can be several nuances when it comes to how shares must be issued or taxed in various jurisdictions, which can impact how a company decides to structure and manage its equity plan.

Lastly, companies will want to consider their overall shareholder engagement and communication strategy. An IPO is an important equity milestone, and equity administrators may need to guide shareholders through how it could impact them and their various responsibilities and tax liabilities. This will likely require information sessions, external resources, and ongoing shareholder engagement. We also think this is an opportunity for companies to reinforce their values and culture through equity programs, reminding employees how equity ties into their overall compensation as well as the overall performance drivers of the organization. Doing this can help employees feel more engaged with the plan and prepared to navigate the dynamics of being a public company shareholder.

How does Morgan Stanley at Work support private companies in becoming transaction-ready ahead of an IPO or liquidity event?

Transaction readiness may be unfamiliar territory for many private company leaders; our goal is to give them the resources and support they need to navigate their transaction-readiness journey. We've published many resources on this topic on our Insights page, and we also offer one-on-one consultations to help companies understand the timeline, milestones, and deliverables for becoming transaction-ready. Then, once companies are transaction-ready, we help them execute against their goals and stay aligned.

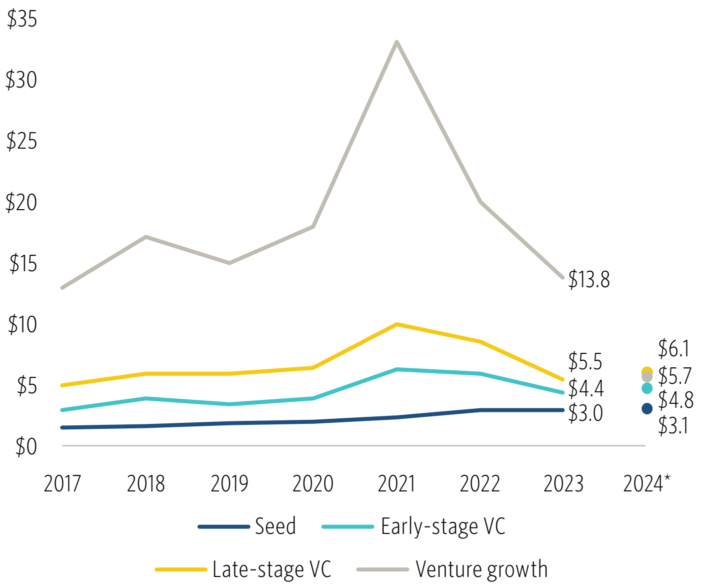
From our perspective, transaction readiness is a powerful way for a company to maintain control of its IPO journey, even as market conditions remain uncertain. Whether companies plan to go public imminently or in the future, it helps to start asking questions and begin the process of becoming transaction-ready. And we are here to help.

DEALS BY SECTOR

Fintech

Deal value expanded across the venture lifecycle for fintech startups, except for venture growth

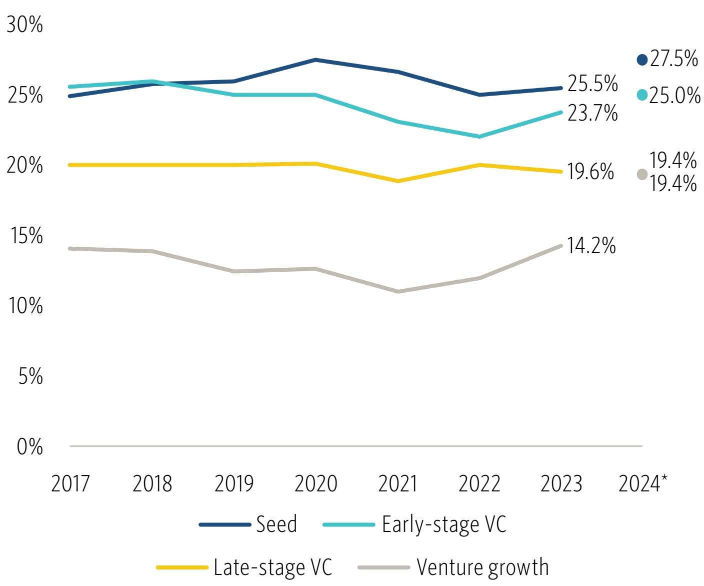
Median fintech VC deal value ($M) by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

VCs are acquiring a large stake, but late-stage deals surfaced a slight dip

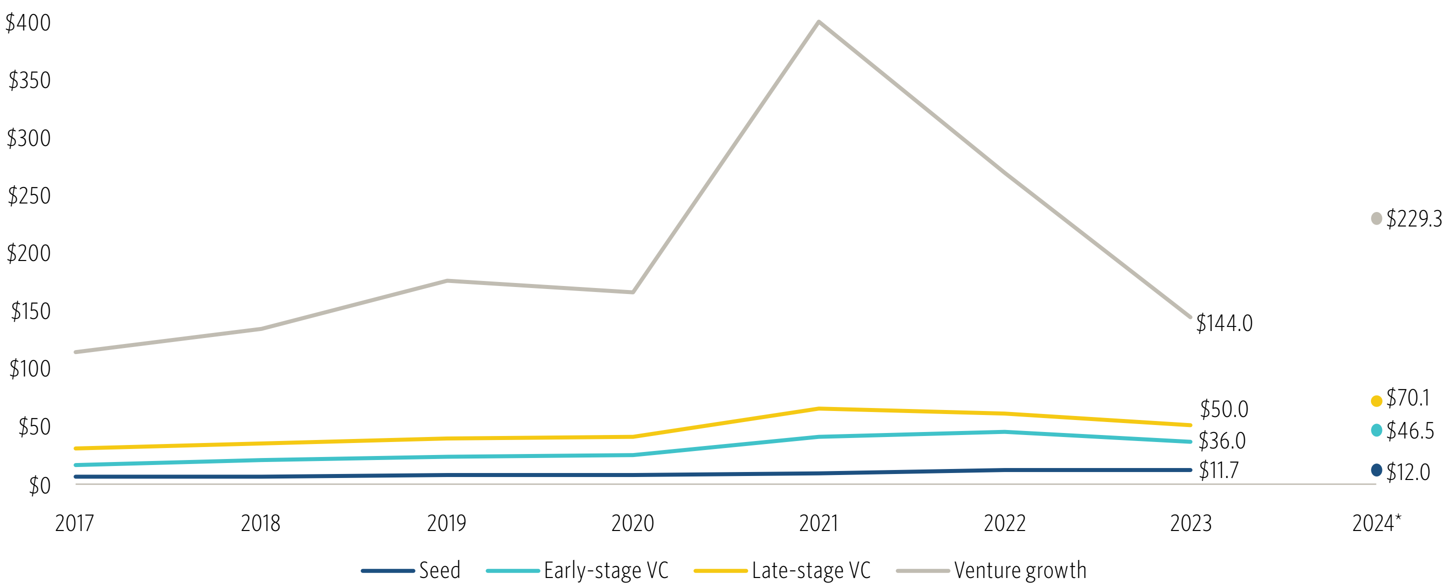
Median fintech VC share acquired by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

Median pre-money valuation expanded consistently YoY

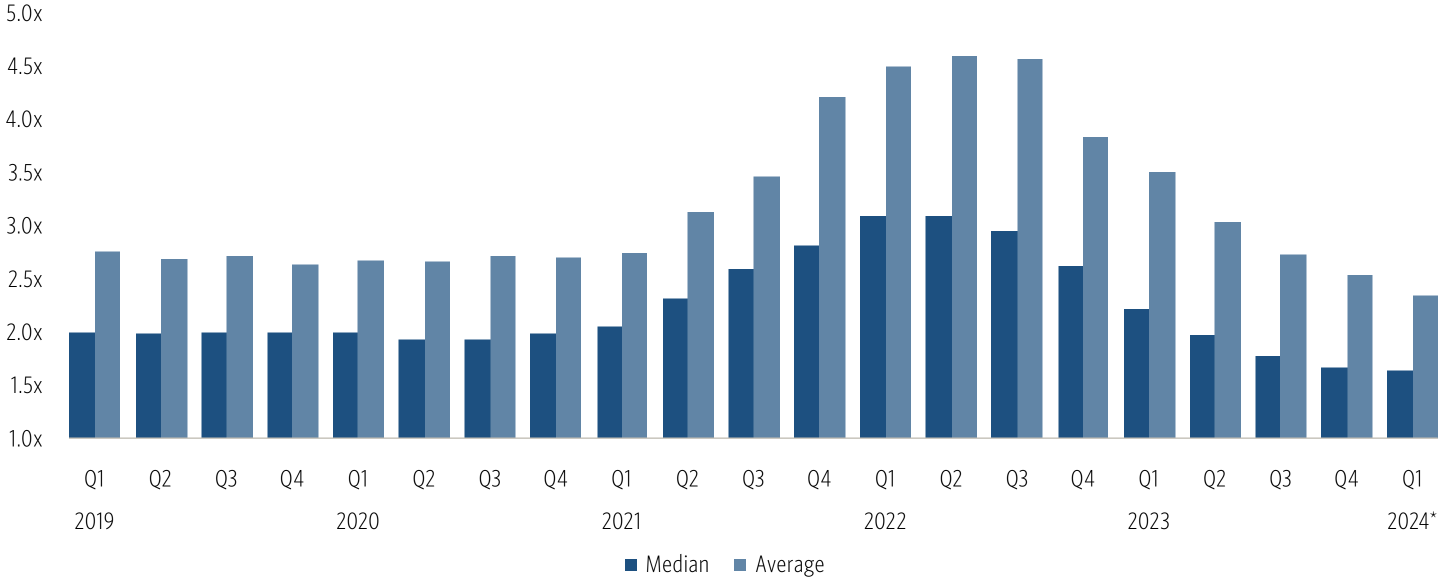
Median fintech VC pre-money valuation ($M) by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

Median early-stage fintech step-up declined QoQ since Q2 2022

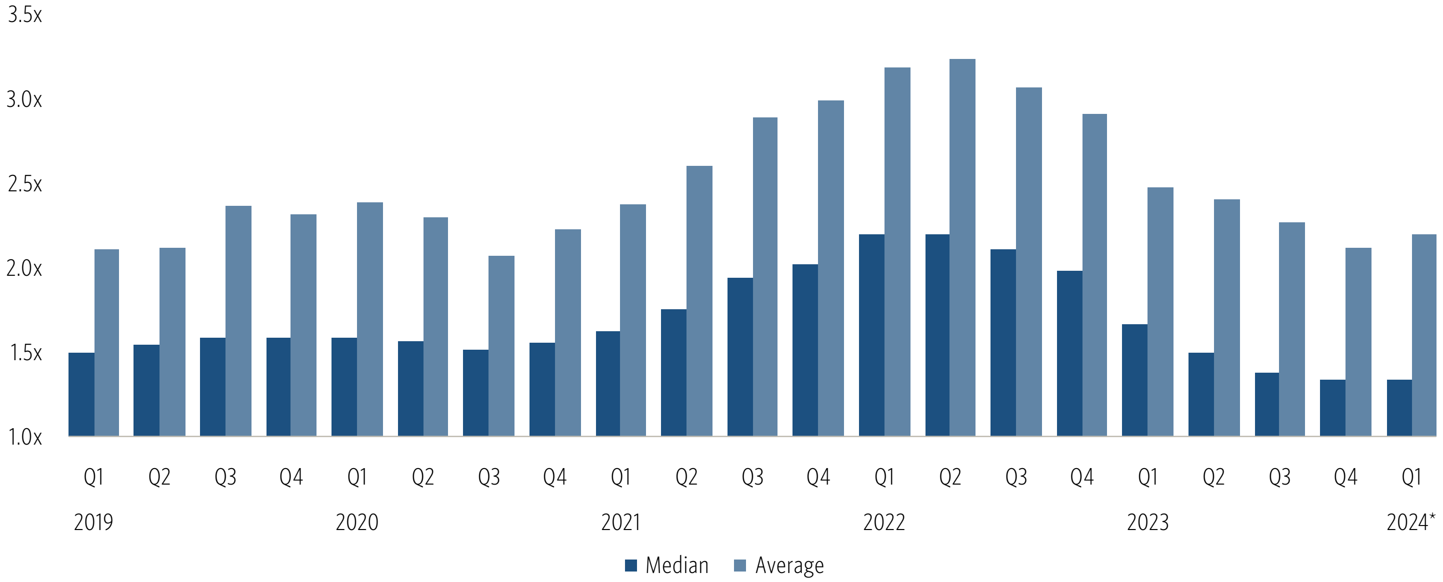
Rolling four-quarter median and average fintech early-stage VC valuation step-up



Source: PitchBook • Geography: US • *As of March 31, 2024

Median late-stage fintech step-up remained on the same level as the prior quarter

Rolling four-quarter median and average fintech late-stage VC valuation step-up



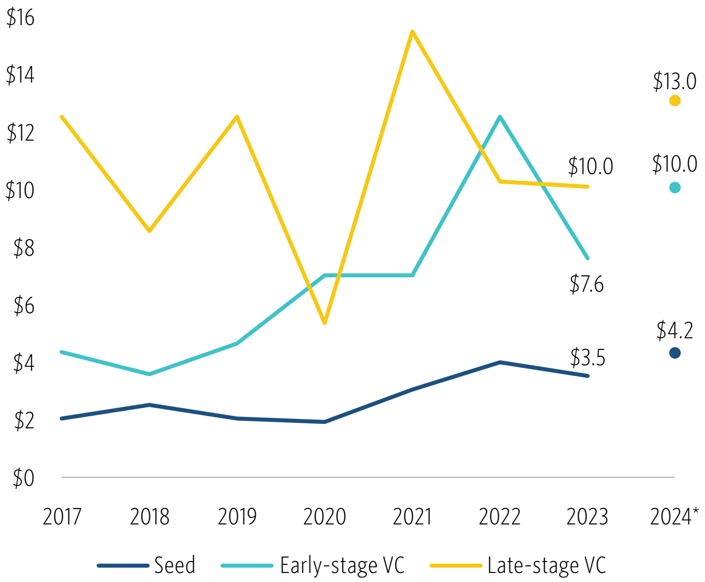
Source: PitchBook • Geography: US • *As of March 31, 2024

DEALS BY SECTOR

Gaming

Gaming deal sizes show an uptick

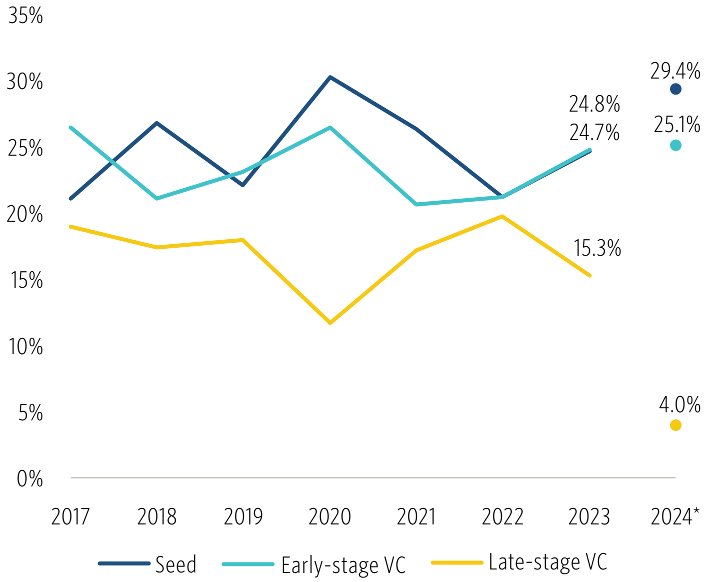
Median gaming VC deal value ($M) by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

Investors getting tighter on stakes

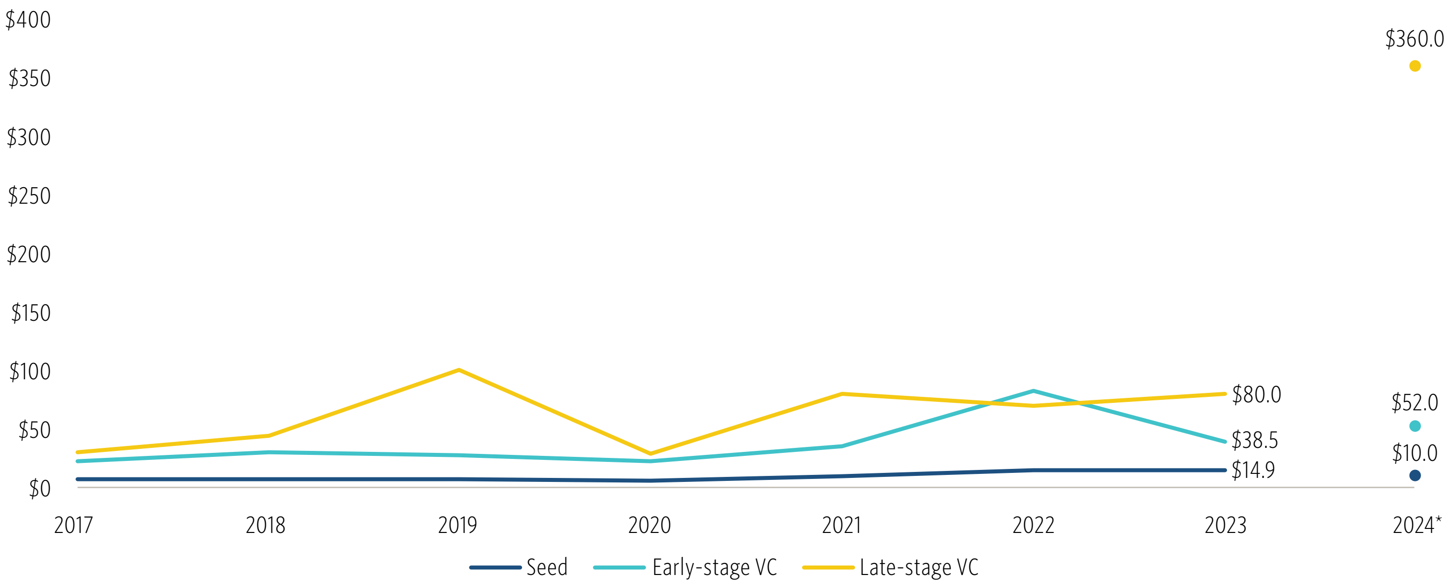
Median gaming VC share acquired by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

Gaming activity leading to low data count

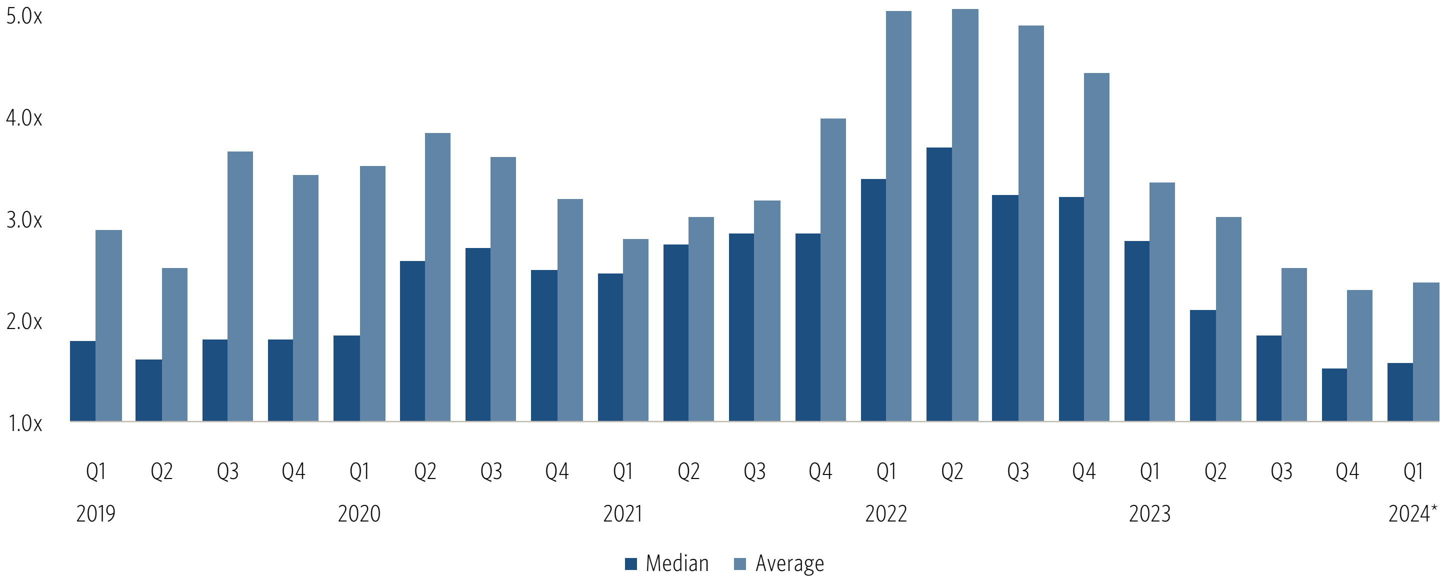
Median gaming VC pre-money valuation ($M) by stage



Source: PitchBook • Geography: US • *As of March 31, 2024

Rolling early-stage valuations show continued slide

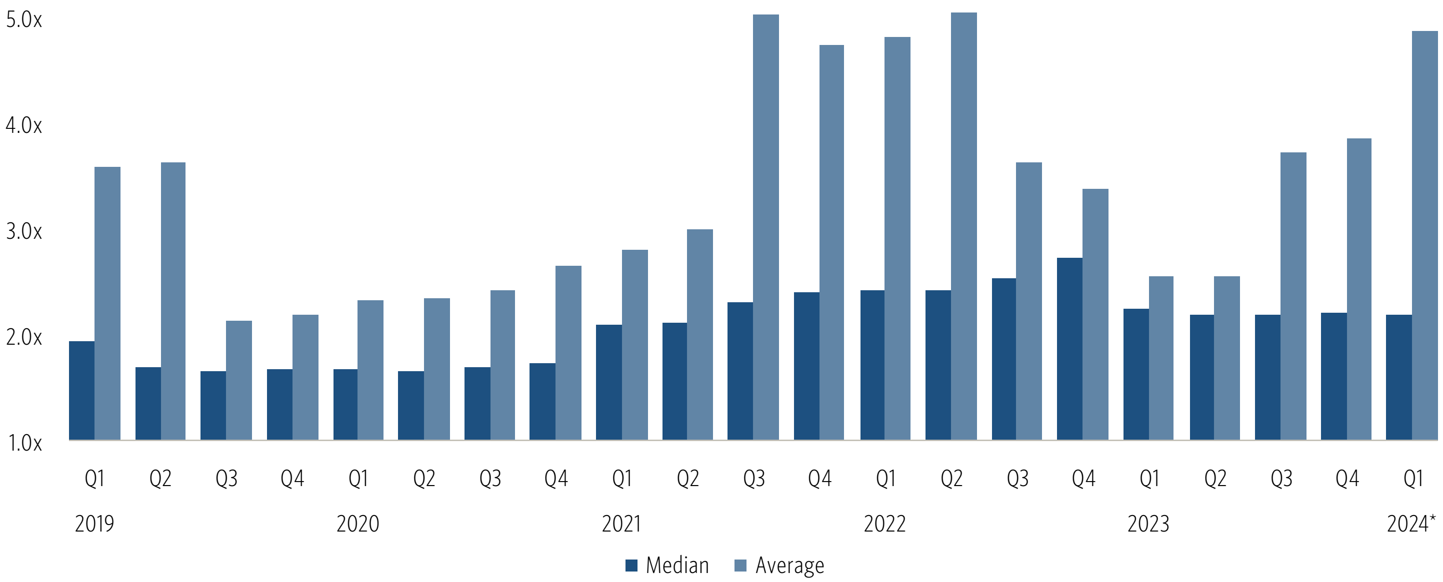
Rolling four-quarter median and average gaming early-stage VC valuation step-up



Source: PitchBook • Geography: US • *As of March 31, 2024

Rolling late-stage step-ups show slight uptick in Q1

Rolling four-quarter median and average gaming late-stage VC valuation step-up

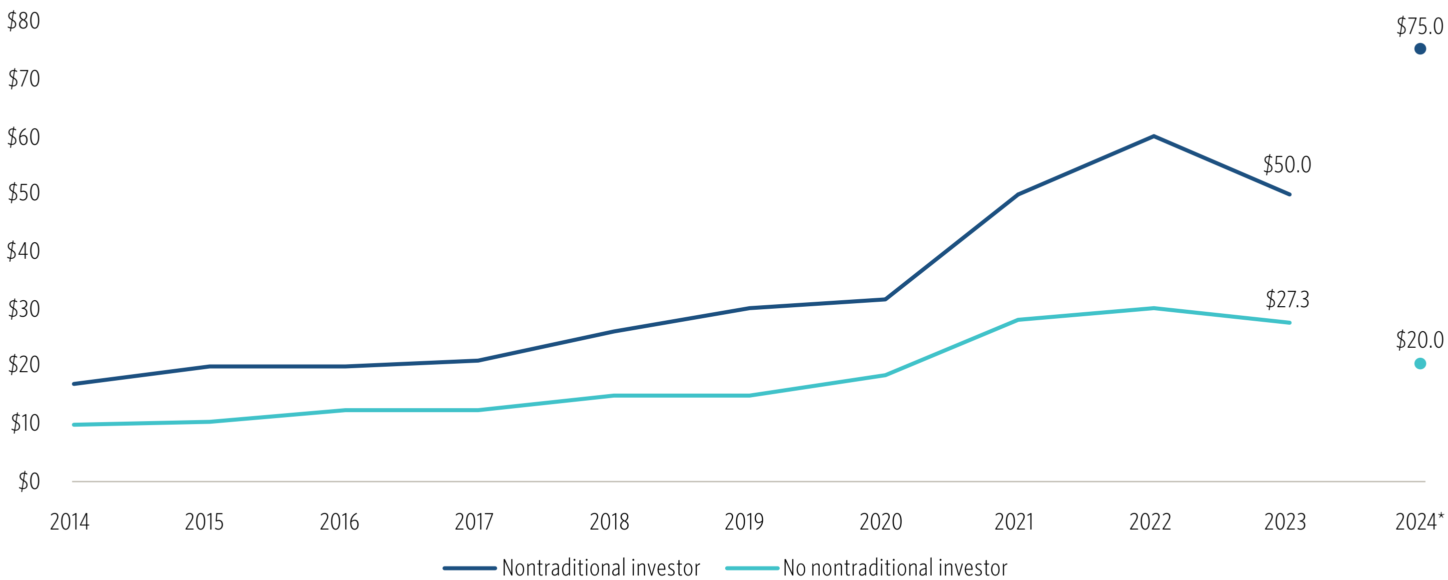


Source: PitchBook • Geography: US • *As of March 31, 2024

Investor trends

Gap at early stage widening

Median early-stage VC pre-money valuation ($M) with nontraditional investor participation



Source: PitchBook • Geography: US • *As of March 31, 2024

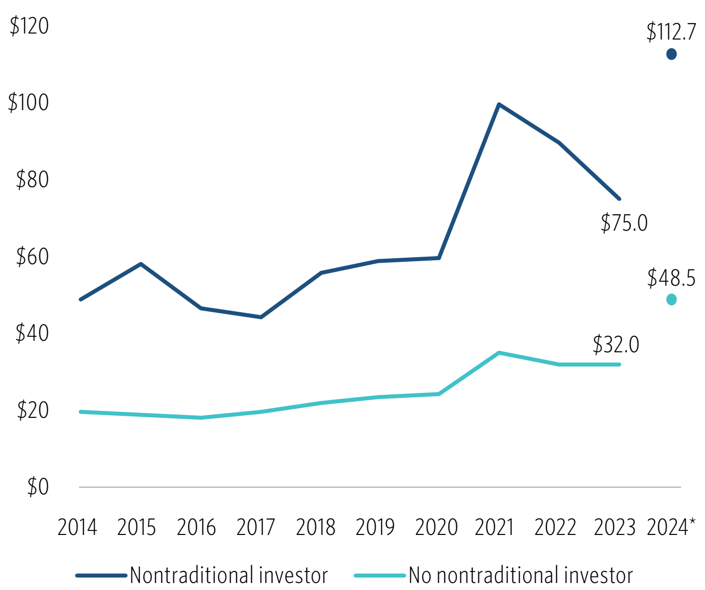
Nontraditional investors stay away

There is likely not a scenario in which nontraditional VC investors consistently pay lower prices on startup financings than VC firms. Even as nontraditional investment continues its decline within the US market, these institutions continue to show their ability to invest at much higher prices. The Q1 data highlights the necessity of nontraditional investor activity for highly valued later-stage companies that must raise further in the private market. At a $112.7 million median late-stage valuation, the deals that nontraditional investors are choosing to participate in are toward the higher end of the market.

A common discussion topic is whether VC dry powder can support the many companies within VC right now. Despite ample available dry powder, much of it remains targeted toward earlier stages, as well as concentrated within relatively few firms. When it comes to long-term partners for late-stage companies, VC firms are generally not needed to be net-new investors on the cap table; rather, crossover firms or other institutions aiming to hold stakes for some time are sought after. VC firms are hamstrung, to a point, in holding on to company stakes once an IPO takes place.

Median late-stage valuation highest in dataset

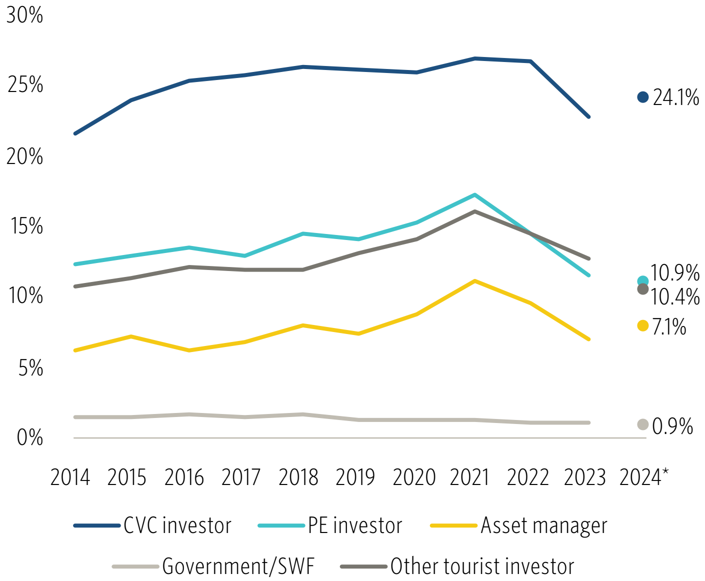
Median late-stage VC pre-money valuation ($M) with nontraditional investor participation



Source: PitchBook • Geography: US • *As of March 31, 2024

Deal count participation falling

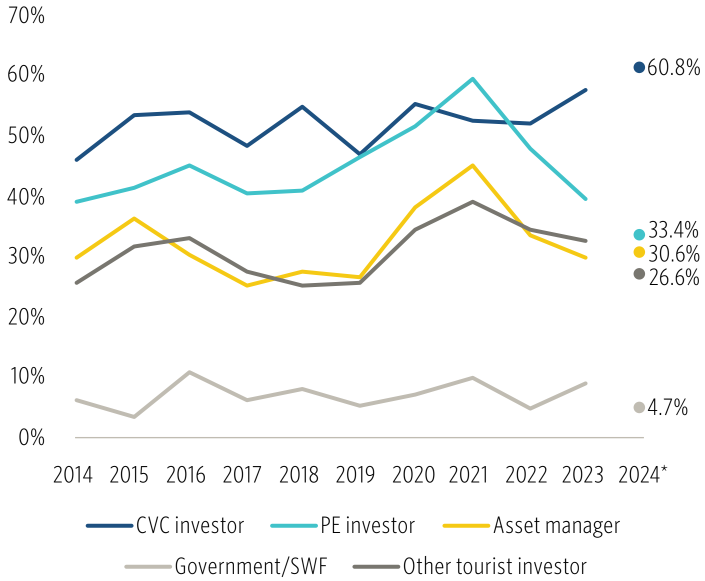
Deals with alternative VC investor participation as a share of all VC deal count by investor type



Source: PitchBook • Geography: US • *As of March 31, 2024

CVC deal value participation hits high

Deals with alternative VC investor participation as a share of all VC deal value by investor type



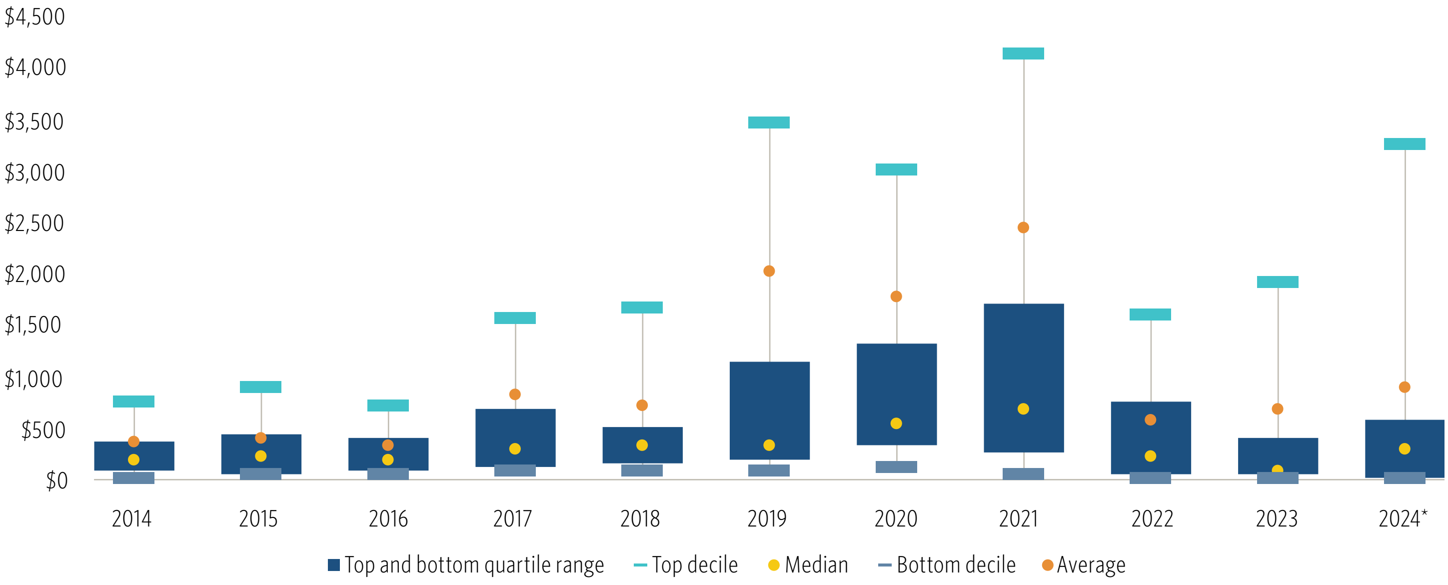
Source: PitchBook • Geography: US • *As of March 31, 2024

With current market dynamics in place, companies that remain in a holding pattern late in their venture lifecycle will likely pursue nontraditional investors if capital is needed, which keeps that median valuation with nontraditional investor participation high. However, deal count participation has dropped dramatically. PE investor activity dropped from 17.2% of deals in 2021 to just 10.9% in Q1 2024. Asset manager participation has similarly fallen from 11.1% to less than 8% of completed deals. Without an increase in the incentive to invest in private companies through either large discounts in promising companies or a resurgence of the exit market, nontraditional investors as a whole likely will not shift back to a more active investment strategy in VC.

Liquidity

Few IPOs diluting dataset

Public listing VC exit valuation ($M) dispersion



Source: PitchBook • Geography: US • *As of March 31, 2024

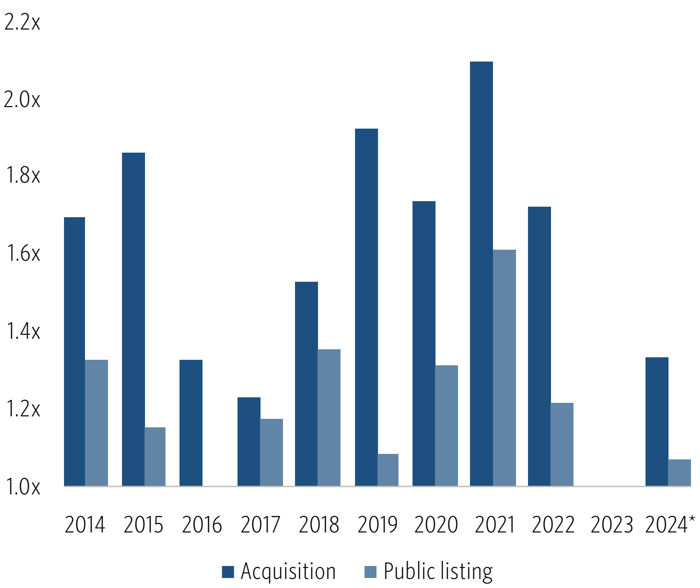
IPOs have been a major narrative of the venture market during the past quarter because of the overall lack of IPOs, but also because of the IPOs of Reddit and Astera Labs. The two listings generated more than 70% of the Q1 exit value, and both were unicorns, which are significant information points in the analysis of the market.

The two IPOs were both seen as successful—a positive trend from the less-than-positive IPOs of Klaviyo and Instacart in Q3 2023. However, the positive narrative glosses over important pieces of information from the Q1 listings. Reddit took a 35% haircut from its previous private financing, and its current market cap remains well below that figure. The company's Series F sold shares at $61.79 per share, and even its Series E was sold at $42.47 per share, which as of this writing is also underwater, albeit only a small amount. This is not to say that the IPO was unsuccessful. The company created liquidity after years in private portfolios, and raised capital for further growth. However, that success varies widely.

Astera Labs had a much different valuation step-up at its IPO, growing its valuation by around 55%. A 1.55x step-up is above the median that the market has achieved across all years except 2021. Prior to its listing, Astera Labs raised $235 million and generated a pre-money IPO valuation of $4.85 billion. That

Exit step-ups showing low returns

Median VC step-up at exit by type



Source: PitchBook • Geography: US • *As of March 31, 2024
Note: Step-ups for 2023 and public listing step-ups for 2016 were negative.

capital efficiency is much higher than that of Reddit, which raised $1.85 billion to generate a pre-money valuation of $4.89 billion in its exit.

Still, the major challenge for many of the highly valued tech companies that are still private is the gap between current market pricing and the high valuation multiples many raised at with their last private investment. Coming into 2024, sentiment for an increase in IPO activity was relatively high, though that has shifted recently as interest rates are now widely expected to remain higher for longer, with few, if any, cuts expected this year. Public index performance has been more muted YTD, and multiples have seen little to no increase. For IPOs to begin unlocking value, more companies will need to compromise on price.

Secondaries highlight liquidity issues

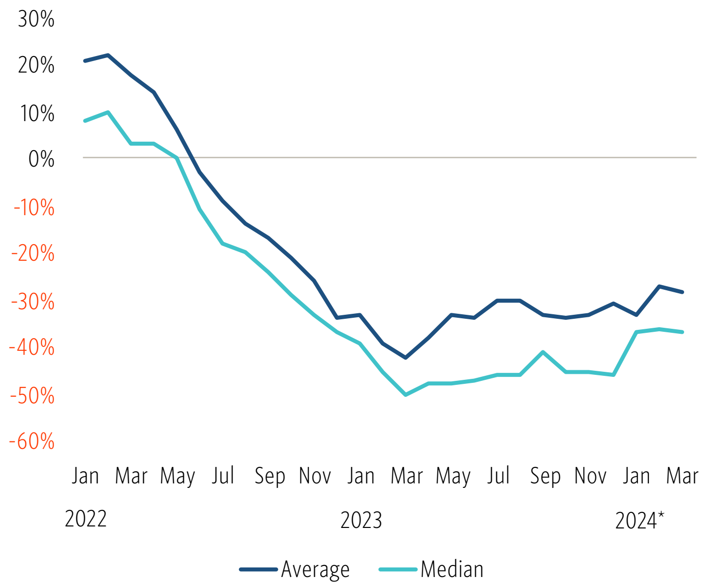
Secondary sales of private company stakes have increasingly been used by GPs for liquidity as companies stay private and navigate the poor exit environment. Liquidity management is not always a need for investors most broadly, but the lack of distributions to LPs over the past couple years has induced the need for many to create returns when their portfolio companies cannot. In the Q1 2024 PitchBook-NVCA Venture Monitor, we examined the challenges that slow distributions to LPs were creating, specifically regarding fundraising, which had one of the lowest quarters since 2017, with just $9.3 billion in commitments closed.

Data on secondary transactions can also provide a window into current market pricing, especially as it relates to the change from high valuations from of a couple years ago. According to data from Zanbato, the median and average discount to the previous private round were 37% and 28%, respectively, in Q1. Though these discounts are relatively large, they show that pricing has rebounded slightly from the 50% and 42% median and average discounts from early 2023. Our VC-backed IPO Index has shown some rebound in sales multiples, which has helped boost private market valuations, albeit to a limited degree.

These decreasing discounts are likely also a product of balancing bid-ask ratios. As more buyers enter the market due to a slight return of risk tolerance over the past few quarters, prices reflect a more balanced state within the broader slow market. A full balance of buyers and sellers would not wipe away discounts, especially from companies with high multiples from the market from a few years ago, but it would reduce the pressure that sellers may feel to further compromise on price in order to secure a sale.

Discounts intriguing to buyers

Median and average discount to last VC round



Source: Zanbato • Geography: Global • *As of March 31, 2024

Bid-ask spread slimming down

Average bid-ask spread

Source: Zanbato • Geography: Global • *As of March 31, 2024

We expect secondary sales to continue to grow as liquidity issues remain hovering over the market. GPs running low on dry powder will likely feel more motivation to realize returns to send back to LPs to ease pressure during an upcoming fundraising cycle.

M&A

Sometimes what is not in the data tells the story. M&A volume has been relatively strong on an overall count basis. The number of deals collected in Q1 2024 is roughly on par with what we would have expected in 2019 or 2020. However, most of the deals collected have unannounced deal values, which leads us to the assumption that the realized value of these deals for investors is relatively minimal. Just $4.5 billion in M&A transaction value was collected for our Q1 2024 PitchBook-NVCA Venture Monitor—an extremely low total that cannot support the return needs of venture investors.

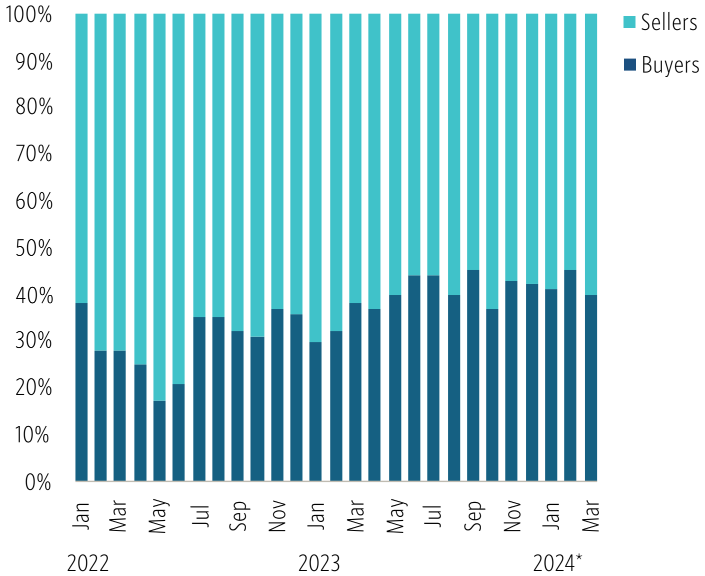
The concerning level of M&A value highlights the pressure that late-stage companies face in the current market. The increasing cost of capital adds an extra burden to acquirers and lowers the incentive to boost bid-side pricing to get deals done. In Q1, just two M&A deals generated an exit size of at least $500 million—the lowest quarterly total since the slowdown began. Both acquisitions generated strong returns for investors, but the companies likely are not harbingers for M&A strength. GSK acquired Aiolos Bio, a clinical-stage biopharma company, to expand its patient treatments for asthma, while Cox Enterprises acquired OpenGov after investing in the company since 2019. Both acquisitions are idiosyncratic.

Creativity seems to be key to evade the Federal Trade Commission, as well. In March 2024, Microsoft craftily invested $650.0 million into AI company Inflection in a deal that would allow Microsoft to use Inflection's models and hire most of its staff, including the co-founders. The deal will provide liquidity to investors at reportedly 1.5x their investment, while not acting as a true exit for the company, which remains VC-backed. Billions of corporate dollars have been spent on AI, either through acquisitions or simply through minority investments. Though this transaction will not show up in M&A data, it highlights the challenges that Big Tech sees ahead from regulatory bodies around the world.

Broadly speaking, the wedge between buyers and sellers remains high. And gauging from future market sentiment, the sell side will need to budge on pricing demands for larger dealmaking to get done, especially at larger sizes. The lack of sizable M&A is an enormous challenge for returns, even if IPOs remain the exit route that will most likely generate the outsized returns that VC relies on.

Bid-ask ratio nearing parity

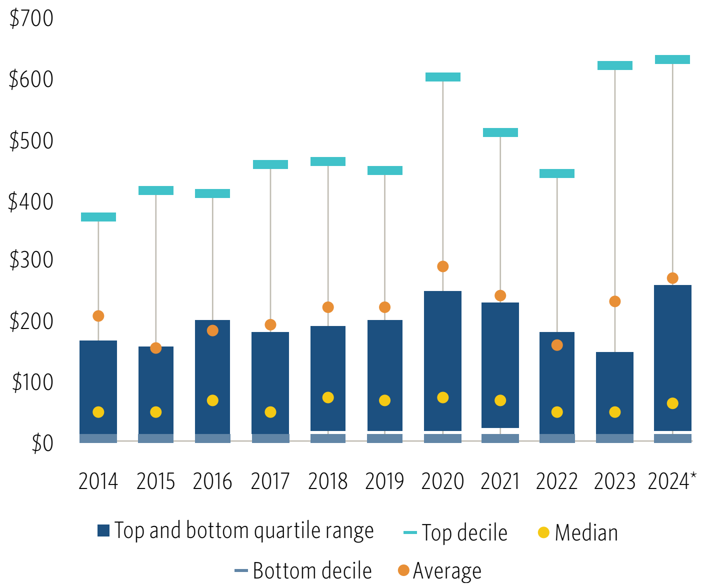
Share of bid-ask ratio



Source: Zanbato • Geography: Global • *As of March 31, 2024

Low M&A data showing little change to trend

Acquisition VC exit valuation ($M) dispersion

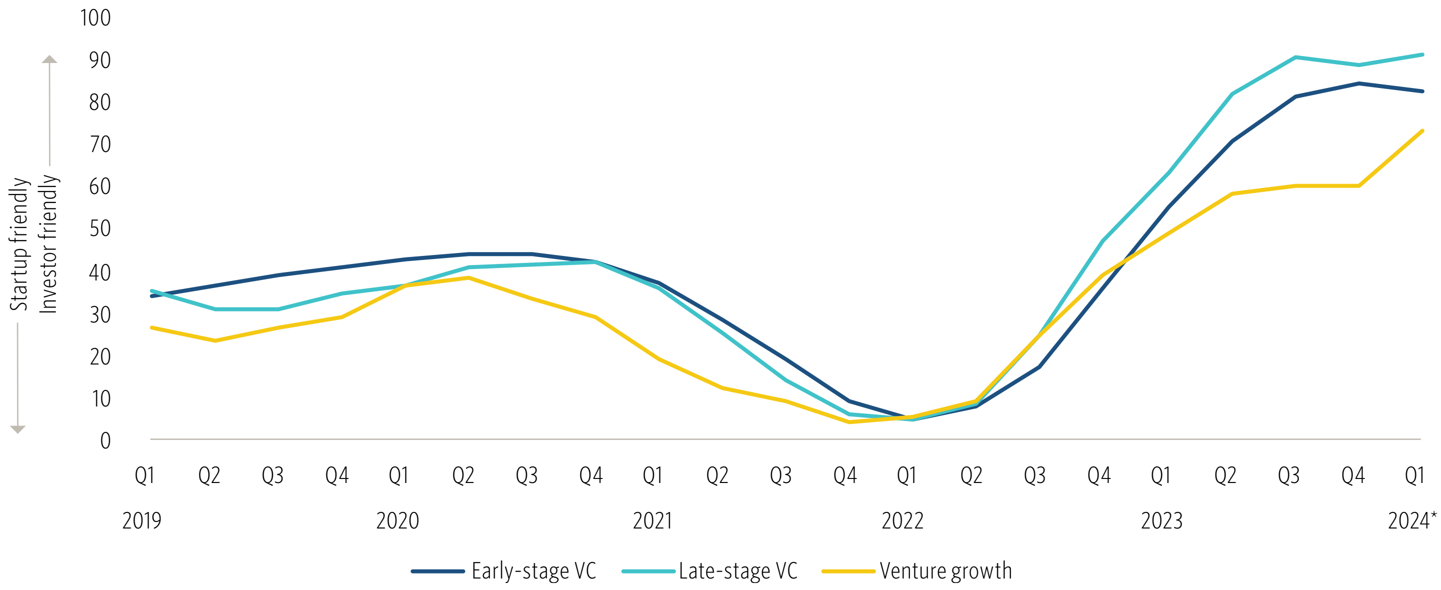


Source: PitchBook • Geography: US • *As of March 31, 2024

Deal terms

The VC market has turned the most investor friendly in over a decade

VC Dealmaking Indicator by quarter



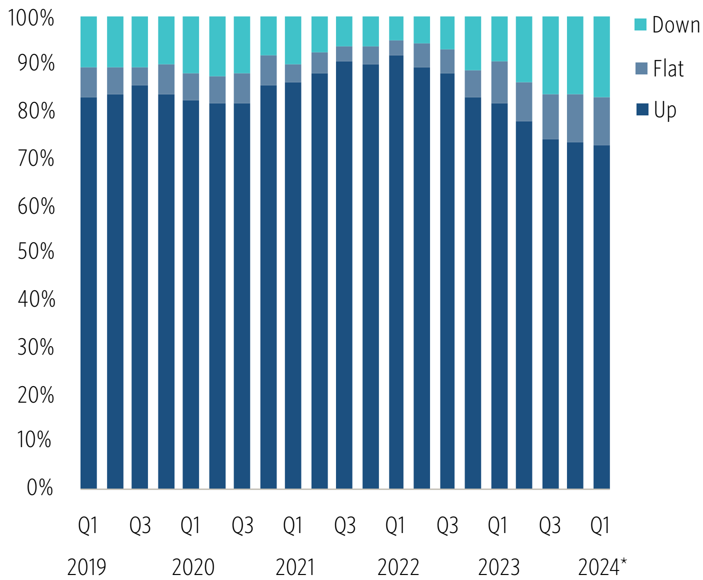
Source: PitchBook • Geography: US • *As of March 31, 2024

A lackluster exit market led to a slowdown in fundraising

With a public market that is yet to reopen, a massive amount of value is trapped in late- and venture-growth-stage startups, which has led to low DPIs and has, in turn, reduced distributions that LPs have received during the past two years. Amid a fundraising slowdown, GPs remain highly selective on where they put dollars to work for both existing portfolio companies and new deals. While founders have gradually realized that the valuation level of 2021 is a thing of the past, conversations with VCs on the valuation expectation gap nonetheless elicit strong emotional responses from entrepreneurs. A prolonged slowdown in dealmaking continues to exert downward pressure on pricing, and the market has become the most investor friendly that we have observed in over a decade. With a reset of the venture ecosystem, investors know that they can take their time with deal evaluation and execution and are driving tougher terms. While strong companies are always able to raise irrespective of the overall market sentiment, across the venture lifecycle, founders have reportedly been receiving term sheets with aggressive investor protective clauses.

The proportion of flat and down rounds reached the highest point in a decade

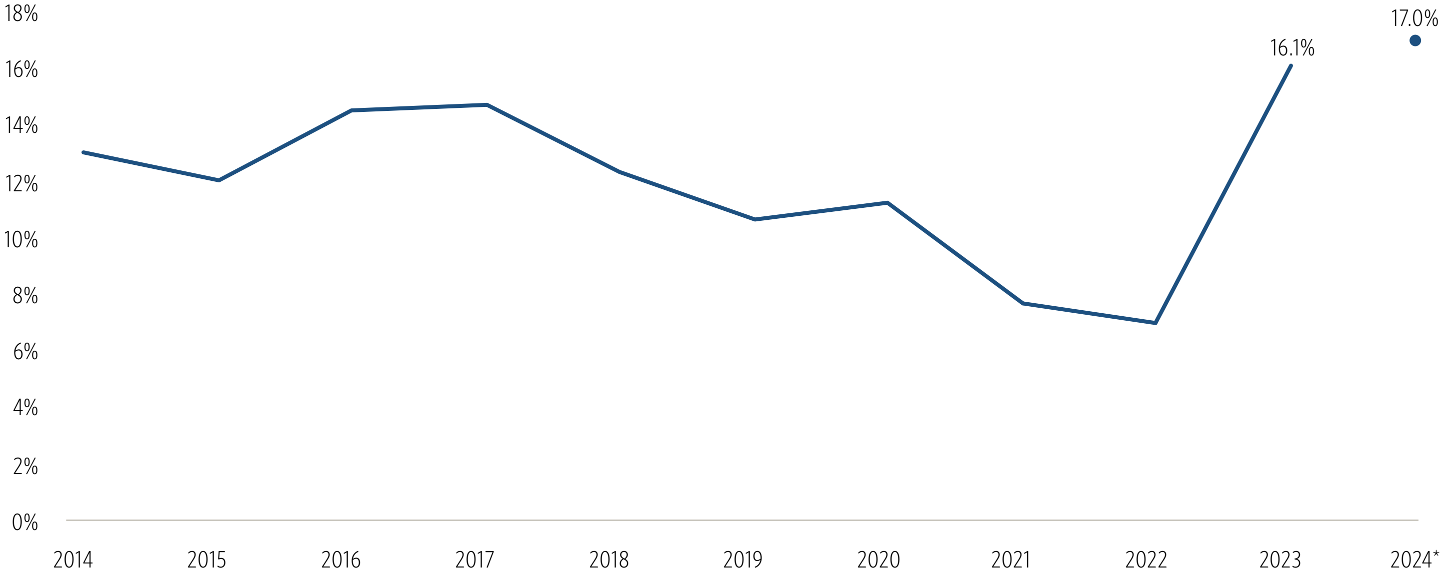
Share of VC deals by up, flat, or down rounds by quarter



Source: PitchBook • Geography: US • *As of March 31, 2024

Down rounds as a proportion of all VC deals peaked

Down rounds as a share of all rounds



Source: PitchBook • Geography: US • *As of March 31, 2024

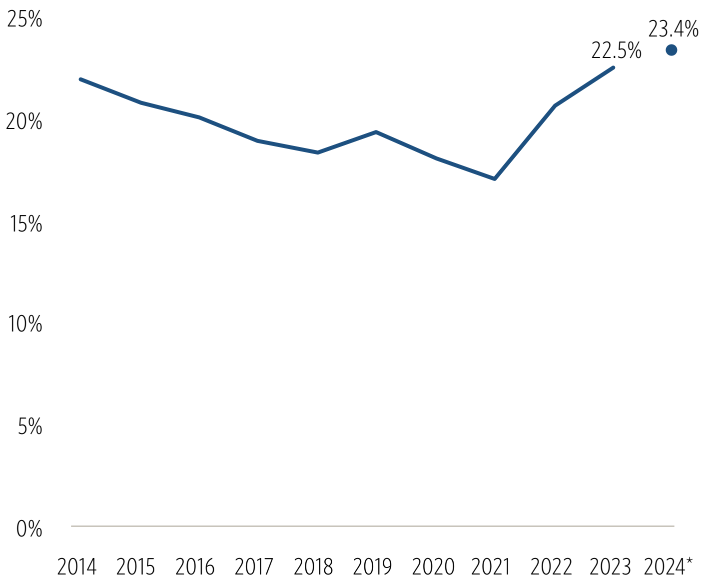
Since around two years ago, board members have been emphasizing the importance of cost cutting and runway extensions to portfolio companies. While reducing operating expenses has been a priority for businesses across the board, unless a company achieves cash flow break-even, it will have to raise a subsequent round at some point. Having burned through a meaningful amount of cash on hand, some startups have returned to the market, bracing for a harsh financing climate and looking for additional capital that will help them get to the next inflection point. A small pool of the strongest companies that manage to secure term sheets from multiple investors has more leverage at the table and can negotiate better terms, but those success stories are few and far between.

Investors are driving tougher terms

Depending on business fundamentals, financial metrics, and external market forces, some companies, including those that continue to grow but are taking longer to hit the next milestone, are having a hard time garnering traction from new investors. In such cases, existing investors may try to put together a syndicate, gather enough dollars, and make sure the terms are attractive enough for new investors while contemplating the dilutive effect on insiders.

The share of cumulative dividends climbed to the highest level in a decade

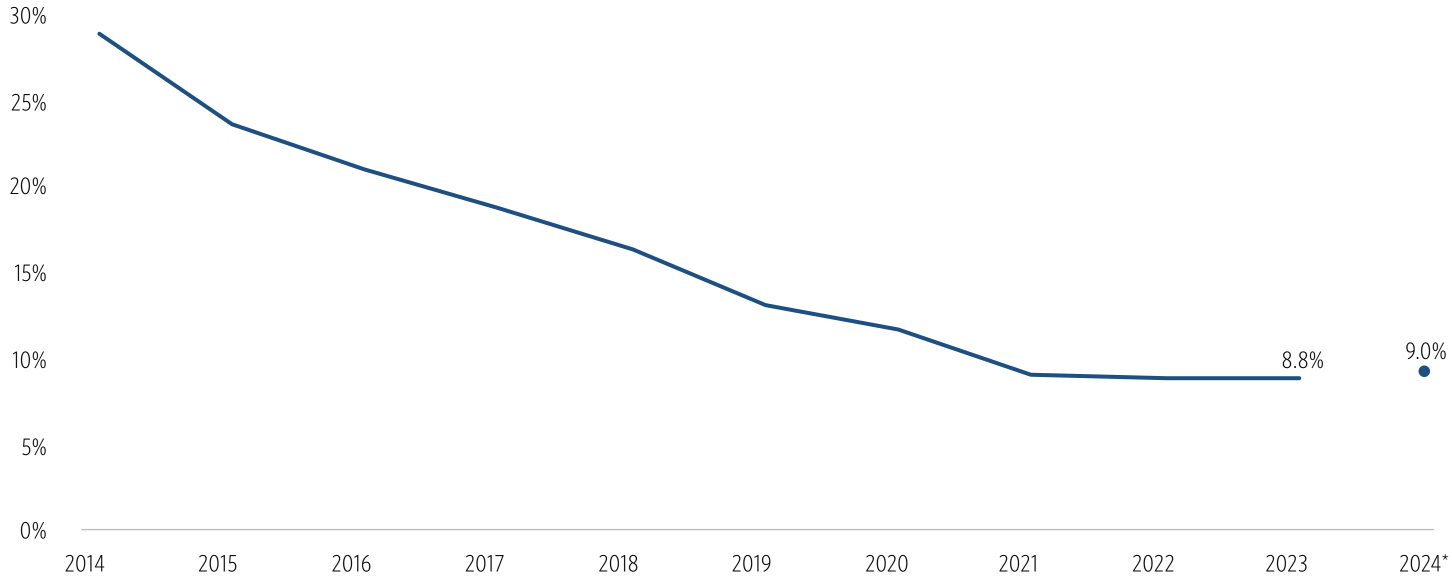
Deals with cumulative dividends as a share of all dividends



Source: PitchBook • Geography: US • *As of March 31, 2024

The proportion of participating liquidation preference experienced a slight uptick

Deals with liquidation participation as a share of all VC deals



Source: PitchBook • Geography: US • *As of March 31, 2024

The recent talk around extension rounds and bridge financing is indicative of the challenging dynamics for companies looking to raise, as is the popular occurrence of deals wherein a company's post-money valuation remains flat or dips below its most recent financing round. The number of flat and down rounds as a proportion of all closed VC deals where we have valuation data ascended consistently since Q1 2022 on a QoQ basis, notching 27.4% in Q1 2024—the highest level in a decade. Down rounds are challenging not only because founders get emotionally charged about the number, but both common stockholders and early-stage investors also need to grapple with highly dilutive terms. VCs have reportedly been seeing more pay-to-play rounds, wherein existing investors—particularly angel investors and small, early-stage-focused funds that are tapped out with their capital reserves—find their positions in a company getting heavily diluted if they do not participate with follow-on capital. Founders, too, find stringent terms hard to swallow, as they end up absorbing some of that dilution, which could lead to reduced alignment of incentives between top management and investors.

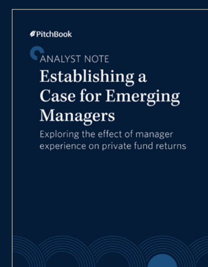
At its core, the challenging part of a highly structured deal comes down to new investors trying to lock down a multiple for guaranteed future returns. Liquidation preferences and cumulative dividends are two examples of the tendency of aggressive investor protective clauses. A full participating liquidation preference allows preferred stockholders to "double dip" in a liquidity event by being first in line to receive their full liquidation preference (lenders sit atop the preference stack) and getting their pro rata share from leftover proceeds, too. The number of VC deals with participating liquidation preference (which has been small compared with nonparticipating) as a share of all VC rounds has ticked up slightly YoY, landing at 9.0% in Q1 2024. Cumulative dividends, another less common term in venture deals that guarantee the full payout of all unpaid accrued dividends to preferred shareholders, have also been on the rise. Deals with cumulative dividends built into the structure of the terms as a percentage of all deals with dividends expanded YoY since 2021, settling at 23.4% in the first quarter of 2024.

Additional research

Private markets

Q1 2024 PitchBook-NVCA Venture Monitor

Download the report here



Q2 2024 Analyst Note: Establishing a Case for Emerging Managers

Download the report here

Q1 2024 European Venture Report

Download the report here

Q1 2024 Quantitative Perspectives: Cleared for Takeoff?

Download the report here

More research available at pitchbook.com/news/reports