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VENTURE CAPITAL

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The U.S. venture capital exit market has been slowing but, unlike the buyout market, deal flow is up for both early-stage and late-stage companies. However, venture capital fundraising has been moderating. Perhaps the biggest challenge facing the U.S. venture capital market is the IPO environment. While the IPO market showed some signs of recovery in early 2017, several IPOs were not well received, and it remains very difficult to successfully navigate the intricacies of taking a company public. On a more positive note, the anticipated repatriation of large amounts of capital currently held by public companies in off-shore accounts due to proposed changes to the U.S. corporate tax code could positively impact an already robust acquisition market.

With venture capital (VC) dry powder at an all-time high of more than $121 billion and a steady increase in venture capital fundraising over the past three years, it is not surprising that the capital raised in 2017 showed a decline. The drop in fundraising was due, in part, to the decrease in the number of funds raising capital. The number of VC funds raising capital fell from over 400 in 2016 to less than 350 in 2017; the lowest it has been in the past seven years. However, there were some notable mega-funds that raised in 2017, including SoftBank's Vision Fund that closed on $98 billion in November, New Enterprise Associate's 16th flagship vehicle that closed on $3.3 billion in June, Institutional Venture Partner's Fund XVI that closed on $1.5 billion in September, and Rocket Internet that closed its latest fund of $1 billion in January.

Venture capital investing activity made a comeback in 2017.

Although fundraising saw a decline, venture capital investing activity made a comeback in 2017. VC fund managers invested more than $148 billion into private companies in 2017. Some notable investments included WeWork, Didi Chuxing, and Meituan-Dianping. However, as total capital invested has been on the rise, the opposite can be said for the number of deals. Deal count over the past two years has declined from approximately 19,000 deals in 2015 to less than 15,000 deals in 2017. Seed-stage and expansion-stage investments saw an increase in the number of deals from Q2 to Q3 in 2017, while early-stage and late-stage investments saw a decrease in the number of deals. Despite a year-over-year decline in deal volume, global VC investments showed positive momentum through the second and third quarters of 2017. Two of the most active VC's in 2017 were New Enterprise Associates and Google Ventures; combined they invested in 110 U.S. companies over the period.

Valuations have been increasing at a steady rate across both early and late-stage companies since 2014, despite a decline in the number of deals being completed. The largest increase by stage has been late-stage investments which, after a decline in 2016, have seen almost a $10.0M median increase in valuations. Certain sectors have been feeling the impact of these valuation increases more than others. U.S. Biotech and U.S. Commercial Services are among those seeing the highest median valuation increases, with late-stage rounds witnessing the largest median increase in pre-money valuations year-over-year.

The time companies stayed private almost doubled from 4.9 years in 2006 to 8.3 years in 2016.

The number of exit opportunities for VC firms has also been decreasing. The peak of VC-backed exits came in 2014 and 2015 with almost 2,000 exits in each of those years. Since that peak, exit activity has been decreasing with exits falling to less than 1,500 in 2017. A large part of this decline has to do with a less receptive IPO market and companies staying private longer. The time companies stayed private almost doubled from 4.9 years in 2006 to 8.3 years in 2016. An interesting recent development has been the increasing number of financial sponsors that are looking to purchase assets with the intention of holding them for an extended period of time. Thus, it is becoming more difficult to justify spending the resources to go through the IPO process when an equal or greater amount can be earned through a private transaction to these long-hold financial sponsors. While fewer companies are going public, strategic buyers remain active in the market. In 2017, four out of the five largest VC-backed exits were through corporate acquisitions; Snap, Inc. was the only one out of the five to exit through an IPO.

VC firms have raised more capital in the past four years than ever before. As a result, there are record levels of dry powder in the market. A large portion of the potential increase in deal activity resulting from the high level of dry powder could result in investments in Artificial Intelligence and other capital intensive technologies. In recent years, significant capital has been invested into technologies that have yet to go mainstream or develop into marketable products. The recent changes in the tax law allowing for a one-time tax-advantaged repatriation of cash from overseas could provide additional tailwinds for corporate acquisitions and spending in 2018.

Unless otherwise cited, all market information provided by Pitchbook.

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