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2015 began with the same ebullience that characterized the venture industry in 2014. The party was full throttle for much of the year: a fast-paced deal environment, FOMO (“fear of missing out”) behavior by VCs of all shapes and sizes, copious participation by mutual funds, hedge funds, and corporate VCs, large late stage financings completed at lofty valuations, and an obsession with tallying new unicorns (venture-backed companies valued at $1 billion or more).
Introduction

2015: the year did not end as it began

2015 was shaping up to be another record year in many respects, but the sands started shifting midway through the year.

Volatility rocked the public markets in the third quarter amidst slowing growth in China and global economic weakness as the Fed decided to delay an interest rate increase. VCs became more cautious about valuations and where we were in the cycle as they watched the IPO and M&A markets weaken. Square made headlines when it completed its public offering at a valuation below its last private round. Fidelity caused a stir when it marked down several of its private technology companies, including Snapchat and Zenefits. And industry participants took note when former startup darlings Quirky and Homejoy shuttered operations, and high profile companies like Twitter, Jawbone and HotelTonight announced layoffs. As CRV remarked in a letter to its investors, “the good times cycle is closer to the end than the beginning.”

The negative sentiment manifested itself in a drop off in fourth quarter activity – fewer financings were completed, less capital was invested, and valuations declined – while VCs began to position their portfolio companies for a period of greater uncertainty. Entrepreneurs were no longer able to raise “easy” capital to fuel the growth of their companies. As the balance of power shifted back to the VCs, their conversations with entrepreneurs shifted to managing burn rates, focusing on unit economics, getting to profitability, and being realistic about the valuations of their companies.

Because the year was bifurcated, to best understand the state of the venture capital industry today we should look beyond the headlines and record setting data from 2015 and more closely examine trends in the fourth quarter and into the first quarter of 2016.
Introduction

2016: what a difference a year makes

Growing caution during the third and fourth quarters of 2015 became more entrenched in early 2016. When comparing CB Insights data from the first quarter of 2016 to the first quarter of 2015, the trend is clear:

Financing rounds were down 10%
Capital invested declined 26%
Pre-money valuations dropped 65%
IPOs were off 50%

As industry participants shifted their attention from tracking new unicorns to tracking down-round financings and “unicorpses” (companies once considered to be unicorns), and as sales of the proverbial ping pong tables in Silicon Valley weakened, Bloomberg declared “RIP: Silly Times” (evoking Sequoia’s “RIP: Good Times” presentation in 2008).

First Round Capital publicly shared its first quarter letter to investors, where it made several well-articulated observations that capture the current state of the industry and are thus worth repeating:

- Many private companies are pursuing operating plans that are predicated on old assumptions — and we’ve encouraged them to review their plans under new market assumptions, and make changes where appropriate.
- For the last several years, there has been a massive dislocation between valuations of public companies and valuations of private companies. This temporary dislocation is rapidly being corrected.
- A key difference between today and prior tech market corrections is the fact that today’s valuation adjustments often happen in public — whereas before 2010, most private companies valuations were kept private. (Companies announce or leak, Fidelity and T. Rowe Price publish monthly.)
- Entrepreneurs, by nature, are optimists — it’s why they are successful. But unchecked optimism can be a founder’s Achilles heel. There is an entire generation of founders (and funders) who have only experienced one kind of market — the boom time market of the last eight years. They have never experienced a downturn, and many believe that this is just a temporary blip.
- We don’t believe this is the “new” normal. Rather, we think (and hope that) this is a return to the “old normal.” A recognition that the >3x increase in valuations (and the metrics they were based on) over the last few years had gotten ahead of reality.
- …evolving from a unicorn into a cockroach will be extremely painful — but…the sooner you realize the situation on the ground has changed, the more time you have to [fix the] problem and succeed.
- …great companies emerge during both boom times and bust times — and sticking to our investment model (and strategy) is especially important during both ends of the cycle.
After a robust fundraising environment in 2015, VCs in the US raised more capital — almost $12 billion — in the first quarter of 2016 than in any quarter over the past ten years, according to Thomson Reuters.
2015: another strong year for fundraising

While fewer venture capital firms raised new funds in 2015 and less capital was raised relative to 2014, 2015 was a strong year historically and saw the largest venture fund ever raised ($2.8 billion by NEA).

According to Pitchbook, just 14% of US venture funds missed their targets during the year, and closing times declined for the second consecutive year, indicating a healthy fundraising market for 2015. Similar to 2014, venture capital raised in 2015 exceeded amounts each year between 2009 and 2013; however, the 2014 and 2015 amounts raised remained well below the amount raised during the peak of the Internet bubble in 2000, and were shy of levels reached in 2005 and 2006 prior to the financial crisis.

Total US Venture Capital Raised

Thomson Reuters as of December 31, 2015. Includes fundraising by US venture capital and venture capital-type investors (funds with limited partners).
2015: early stage fundraising mirrored overall market

When we isolate and examine seed/early stage data only, we find the trends in 2015 to be the same as in the overall market: fundraising was robust even though fewer early stage funds raised less capital compared to the prior year.

Seed/Early Stage US Venture Capital Raised

As it did in 2014, average fund size increased, although there were fewer funds and less venture capital raised overall. The average seed/early stage fund size in 2015 of $103.7 million was consistent with historical sizes and was actually lower than the averages in 2000, 2001, 2006 and 2011.
Fundraising

2015: capital continued to consolidate with fewer firms

During 2015, we continued to see fundraising dominated by a handful of firms —

3% of firms raised 47% of capital
6% of firms raised 61% of capital

This “flight to quality” is a long-term trend in the venture market that we have highlighted in previous reports. By and large, the experienced VCs with unique and sustainable competitive advantages, strong track records, and excellent reputations among entrepreneurs and LPs continue to raise sizable pools of capital today.

6 FIRMS CLOSED ON $1+B FUNDS

[Graphics of firm logos]
To estimate the number of active firms in the market over time, we first analyzed the number of firms that raised capital in 2015 and in the previous four vintage years. We then analyzed the number of firms that invested in at least three and five companies each year. The first method – depicted by the blue bars – proxies the number of funds with capital available for new investments, as venture capital investment periods typically span five years. According to this metric, 447 funds were within their investment periods during 2015. While the number of active funds has fluctuated on a yearly basis over time, it is notably 70% lower than in 2001, which marked the peak of the data set. To examine the number of funds we believe were truly active, we determined how many invested in three or more – and five or more – deals during each year. In 2015, 291 funds invested in three or more deals, a decrease of 14% year-over-year and 78% less than in 2001. Similarly, 211 funds invested in five or more deals in 2015, 16% fewer than in 2014 and 82% fewer than in 2001.

While the industry continued to right-size in 2015, the higher number of active funds in 2015 and 2014 relative to 2013 and 2012, as well as the strong fundraising markets in 2015 and 2016, may signal a plateau of active firms or perhaps a reversal of the long-term trend. As such, we will continue to monitor future data in order to assess the overall health of the venture capital ecosystem.

Thomson Reuters as of December 31, 2015. Includes all US venture capital funds greater than $10 million that raised capital in 2015 and the previous four vintage years.
Fundraising

2016: fundraising is off to a strong start

VCs in the US raised more capital — almost $12 billion — in the first quarter of 2016 than in any quarter over the past ten years, according to Thomson Reuters.

Unlike other current aspects of the venture market highlighted in this report, fundraising in early 2016 appears to be full steam ahead. In Q1 2016...

• 59% more capital raised by US funds compared to Q1 2015 (Thomson Reuters).
• Median fund size increased globally by 66% over Q1 2015 (Pitchbook).

7 FIRMS CLOSED ON $1+B FUNDS
Following on the heels of a very active investing year for VCs in 2014, 2015 proved to be an equally active year.

$72.3B INVESTED ACROSS ALL STAGES—A POST BUBBLE RECORD
2015: record year for investing due to late stage activity

Total US Venture Capital Invested

Following on the heels of a very active year for VCs in 2014, 2015 proved to be an equally active year; while fewer companies overall received funding, capital invested into those companies increased to a level not seen in the past 15 years. As discussed later in this report, venture disbursement data in 2015 reflects larger round sizes, especially for later stage financings.

As Bill Gurley of Benchmark remarked, there was an absence of fear in Silicon Valley during much of 2015 and the defining characteristic of the environment was the absurd amount of capital being raised by portfolio companies.
Investing

2015: late stage investing rose to all-time high

Late stage investment activity over the last two years was nothing short of robust. After a record breaking year in 2014, late stage investing in 2015 continued its upward climb, both in terms of the number of companies financed and capital invested. Since 2012, capital invested has increased proportionally more than the number of companies financed; as a result, the average amount invested in late stage rounds more than doubled, from $16.0 million in 2012 to $35.0 million in 2015, according to Thomson Reuters data. Very large late stage financings became a phenomenon in 2014, and the trend continued in 2015 with the close of over 100 “mega” rounds (defined as $100 million or more by CB Insights). And the list of companies to raise “super mega” rounds also grew in 2015; according to Pitchbook, six deals of at least $1 billion in financing were raised by SpaceX, Airbnb, SoFi, and Uber in the US, plus Coupang and DiDi abroad.

Thomson Reuters as of December 31, 2015.
Why has late stage investing seen a dramatic “up and to the right” trend?

PARTICIPATION BY NON-TRADITIONAL AND CORPORATE VCs

In the US alone, non-traditional VCs accounted for 55% of capital invested in VC-backed companies in 2015 (in round sizes of at least $20 million), compared to just 37% in 2012 – a 50% increase over three years.

One factor is the increased participation of non-traditional investors such as mutual funds and hedge funds — in addition to multi stage VCs and growth equity players — in late stage, pre-IPO financings. Mutual funds such as T. Rowe Price, Wellington, and Fidelity, who once could participate in company growth in the public markets, continued their search for growth in the private markets. In 2015, mutual funds participated in deals raised by 23 unicorns combined, including those for Airbnb, Snapchat and Pinterest (according to Pitchbook).

Corporate VCs set a 15-year record in 2015 by allocating $7.6 billion to US-based startups (according to Moneytree/Thomson Reuters). And worldwide, nearly 200 corporate VCs pumped $27.4 billion into startups in 2015, compared to just $8.9 billion in 2012 — a three-fold increase over three years, according to Pitchbook.

Availability of capital has allowed companies to stay private longer and continue growing without regulatory and public investor scrutiny. In fact, in the late 1990s, it took over five years for a company to IPO after at least four rounds of financing, compared to the more recent average of nine years after nearly seven rounds. And the median time to exit by acquisition — seven years, according to Pitchbook — is not much better. All this, of course, had an impact on late stage valuations in 2015 (which we address later in this report) and encouraged a lack of discipline by some in the industry (in the form of indiscriminate follow-on financings by VCs or unsustainably high burn rates by companies, for example).
“Companies are taking on huge burn rates to justify spending the capital they are raising in these enormous financings, putting their long-term viability in jeopardy. Late stage investors, desperately afraid of missing out on acquiring positions in possible ‘unicorn’ companies, have essentially abandoned their traditional risk analysis. Traditional early stage investors, institutional public investors, and anyone with extra millions are rushing in to the high-stakes, late stage game.”
- Bill Gurley, Benchmark (Above the Crowd blog)

“Ten years ago there was about the same amount of money committed to venture capital funds as invested into startups. But in the past two years, 2.5 times more money was invested into startups than was committed to the asset class.
- Mark Suster, Upfront Ventures (Fortune)

“There’s way too much money in the system ultimately chasing few really great companies. The problem with that is you have a bunch of imposter companies get funded for a lot longer than [is] traditionally the case.”
- Chamath Palihapitiya, Social Capital (Fortune)

Late-stage investment in the third quarter [of 2015] surged 25% from a year earlier.

Over 80% of all capital invested at the late stage in 2015 was in deals of $25 million or more, easily a record and close to 30% higher than levels seen 10 years ago.
Investing

2015: more early stage capital flowed to fewer companies

Despite the dips in 2008 and 2009, the overall trend has been an increasing number of early stage companies funded over the last 12 years; however, the number remains well below the peak in 2000. While fewer early stage companies were actually financed in 2015, more early stage capital was invested compared to the prior year. This divergence demonstrates that early stage financing rounds have grown larger as a result of both a competitive marketplace and the accelerated development of many companies raising Series A rounds. A reality today is that seed rounds have become the new Series A rounds in regards to size, participants, and pre-money valuation, and companies are indeed waiting to raise Series A rounds until certain user and/or revenue metrics are established. In fact, according to Thomson Reuters data, the average amount invested in early stage companies in 2015 was $7.0 million, 32% more than the $4.7 million average two years prior. Those companies without substantial momentum at the Series A stage, however, can find it difficult to get funded by new outside investors, in which case insider-led rounds or bridge rounds may be the next best option.
Investing

2015: seed investing moderated unlike early and late stages

While the venture industry as a whole had a record year for investment in 2015, seed stage activity continued along a trend of moderation both in terms of companies formed and capital invested.

Starting in 2011, the industry saw a proliferation of new micro-VCs, just as the industry was embracing a paradigm shift in company formation. With the onset of new seed investors came increased competition and larger/more institutional pools of capital. The outcome was seed rounds of financing that were larger than in the past, such that they looked more like Series A rounds. In fact, according to Thomson Reuters data, the average seed stage investment has grown by 66%, from $700,000 in 2009 to $1.2 million in 2015. At the same time, companies with early traction sometimes skipped seed rounds and raised Series A rounds instead, as traditional Series A investors looked to identify, invest and capture ownership earlier. The result: a continued blurring of the lines between seed and early stage companies and financings.
2015: seed stage data reflects lower startup costs

While seed stage activity has declined steadily since 2012, the 2015 data suggests that company formation and seed stage funding remained at healthy levels. Compared to 2000 when a record amount of seed stage capital was invested, a similar number of companies were funded in 2015 but with 46% less capital, in large part due to dramatically lower startup costs. With cloud computing, software-as-a-service (SaaS) business models, and viral marketing, the cost to start an Internet technology company has decreased dramatically since 2000, and as a result, companies can effectively prove their products and services using far less capital.

Despite higher valuations, the attractive economics of startup formation and the talented seed stage VCs who are backing the best ideas and entrepreneurs continue to make the seed space an attractive one in which to selectively invest.
2015: investing pace slowed in Q4

“The grow-at-any-cost mantra is gone, and has been replaced by unit economics. Companies that have counted on large sums of cheap cash to fuel unprofitable growth must find ways to fund future expansion on their own.” - Ari Levy (CNBC)

The fourth quarter of last year marked a departure from the active and buoyant venture capital environment over the past two years. The shifting sands, instigated by public market volatility and weak global economic indicators, were no surprise to industry participants, as many had wondered whether we had been riding the coattails of a bubble. The data in the fourth quarter represents the start of a correction, if not exactly a bubble bursting. CB Insights reported a sharp decline in capital invested into US startups (31% decline from the third quarter) and a second consecutive quarterly decline in US deal activity (21% fewer deals than the second quarter).

While fewer deals closed, those that did took longer as the frenetic pace earlier in the year subsided. According to a survey by Mark Suster of Upfront Ventures, 45% of investors in the fourth quarter said it took longer to get deals funded (and 77% of VCs expect it to take even longer in 2016). The slowdown in the fourth quarter was, not surprisingly, led by late stage investment activity. According to CB Insights, after 39 $100+ million venture rounds closed in the US in the third quarter, investors pulled back and closed just 18 of these “mega” rounds in the fourth quarter.
2016: investment activity remains stifled

“The start of 2016 marked the end of the steroid era of startups—the time between 2010 and 2015 when money was cheap and more plentiful, and used as a performance enhancing drug for company acceleration. The period of cheap capital and billion dollar checks has ended. In this capital constrained market, buying scale is no longer going to be a credible lever for the next generation of startups.”
- Simon Rothman, Greylock Partners (Greylock website)

While the Wall Street Journal headline “Startup Investors Hit the Brakes” may be exaggerating the current state of the industry, it is fair to say that US venture activity in early 2016 is a far cry from this time a year ago. But in reality, it is roughly in line with the fourth quarter of 2015. A Moneytree report that finds a “steadying venture investment environment” is probably a more accurate descriptor.

CB Insights data suggests that deal volume dropped for the third consecutive quarter, while invested capital rose slightly (but is still far from the peak in the third quarter of 2015). The tally of “mega” rounds in the US was flat in the first quarter, and after annualizing the tally through mid-May, CB Insights suggests that “mega” rounds in 2016 are on track to beat 2014 but will fall short of the peak in 2015.

Yet the flattening, softening trends are not necessarily uniform across the industry. For example, according to a report from PricewaterhouseCoopers, the National Venture Capital Association and Thomson Reuters, corporate VCs invested $2.5 billion in US startups in the first quarter of 2016, an increase of 95% over the fourth quarter of 2015. Corporate VCs participated in nearly a quarter of all venture capital deals in the first quarter (the highest percentage since 2008) and corporate dollars made up over 20% of all venture capital dollars invested (the highest quarterly level in the history of the industry). Time will tell if, when and why corporate VCs begin to slow their pace in line with the rest of the market.
"You cannot raise on the same sort of ecosystem momentum that you might have been able to before…it’s a return to the mean. I think these are healthy adjustments that people are making."

Matt Mazzeo, Lowercase Capital
Valuations

While seed and early stage valuations were at post-bubble highs in 2015, late stage valuations reached an all-time high for the third consecutive year.
2015: seed/early stage valuations at post-bubble highs

Early stage valuations (for Series A rounds) continued their climb for the second consecutive year but increased more moderately than mid and late stage valuations, while seed valuations remained at the post-bubble high reached in 2014. While reaching their own post-bubble high in 2015, early stage valuations have been rather volatile, with more frequent yearly increases and decreases since 2000.

- Seed valuations held steady at $5.0 million in 2014 and 2015.
- Early stage valuations crept 17% higher to $15.5 million, but remained 23% lower than in 2000.

VentureSource as of December 31, 2015.
2015: late stage valuations reached all-time high

Mid stage valuations, typically represented by Series B and C financings, increased substantially in 2015 but were overshadowed by late stage valuations, which reached an all-time high for the third consecutive year. Late stage valuations (Series D rounds and later) were on a steady climb since 2003, only decreasing yearly in 2009 in the wake of the financial crisis. Since 2003, the median late stage valuation increased a whopping 1,371%, and since the dip in 2009, 759%. While the magnitude of these increases were eye-popping, they were not necessarily unexpected given the record amount of late stage capital invested over the preceding years. And there were other factors, some of which we’ve discussed in prior reports, that help explain the trend in rising valuations.

- Mid stage valuations rose 60% over 2014, reaching a record high of $80 million.
- Late stage valuations skyrocketed to $500 million, 100% higher than 2014 and 334% higher than in 2000.
What has been driving late stage valuations?

A NEW GENERATION OF TECH COMPANIES

From a technology standpoint, the impact that mobile devices and cloud computing have had on disrupting new industries is significant – akin to our generation’s Industrial Revolution. There are over three billion Internet users and over 2.5 billion smartphone users globally, according to Mary Meeker’s Internet Trends Report. Since the end-user markets for technology products and services are so vast, company valuations should arguably reflect this reality. The excitement around this new generation of maturing technology startups naturally attracted investors to the sector.

AGGRESSIVE INVESTOR BEHAVIOR

In some cases, valuations were driven higher by aggressive participants – VCs driven by FOMO and the desire to associate hot company logos with their own brands; hedge funds and mutual funds that were eager for pre-IPO exposure and were less sensitive to price; and corporate VCs that were flush with cash.

COMPANIES STAYING PRIVATE LONGER

As noted earlier in this report, as companies are taking longer to go public, private investors have had more time and opportunity to invest and participate in the steep portion of companies’ value creation curves. As a result, these companies have grown larger and stronger in terms of fundamentals, and thus merit – or are expected to grow into – their high valuations.
“We didn’t want to compete with crossover investors who were not as price sensitive…if they were looking for a 1.5x or 2x, that’s not our sort of deal.”
- Scott Nolan, Founders Fund

“We saw a ton of momentum rounds. A lot of companies...were able to raise with far less proof points at far higher valuations. [And] we saw a lot of funds acting out of fear that they had a lot of capital on hand.”
- Matt Mazzeo, Lowercase Capital
Valuations

2015: the flurry of new unicorns

As valuations rose in 2015, so too did the number of unicorns, or technology startups valued at $1 billion or more.

Some surmise that 2015 will go down as the “year of the unicorn” since, according to Pitchbook, an average of 1.5 new unicorns were “born” each week during the year.

While the media obsessively tracked and pontificated on unicorns, many VCs became annoyed at the phenomenon and perceived it to be a distraction to entrepreneurs who should focus more on building their businesses, not the valuations of their businesses.

Mark Suster of Upfront Ventures, for example, is convinced that the unicorn phenomenon “will be the thing most historians laugh most about in this era.”
2015: 76 new unicorns

- Unicorn tally reached 143
- Nearly $33B was invested in unicorns, with a median deal size of $158M
- Median length of time to become a unicorn was 6 years after consuming an average of $95M of capital

2016: only 18 new unicorns

- If annualized, year-end tally could be 50% less than 2015
- 14 decacorns each valued at more than $10B, up from 10 a year ago

**FIRMS WITH THE MOST UNICORNS**

- **SEQUOIA**: 37
- **ACCEL**: 29
- **ANDREessen HORowITZ**: 28

Sources: CB Insights Pitchbook, Spoke Intelligence, and VentureBeat.
2015: valuations and unicorns retrenched in Q4

Conversations with entrepreneurs began to evolve from raising “easy” capital to fuel growth to raising “rainy day” capital for protection, especially if the exit markets dried up.

After the S&P 500 fell 11% in a single week in August 2015, private market valuations recalibrated rather quickly between the third and fourth quarters. As a consequence, CB Insights started a down-round tracker to record the “wounded companies of the unicorn era.” And as Fidelity and other mutual funds attracted attention and added to the market’s trepidation by publicly marking down (rightly or wrongly) estimated share prices of unicorns in their portfolios, the Wall Street Journal created The Startup Stock Trader to follow these changes.

More importantly however, entrepreneurs were forced to acknowledge that they may have to raise capital at the same or lower valuation than in their last rounds — a departure in thinking from the last several years. Dharmesh Thakker of Battery Ventures commented to CNBC that the phrase he heard a lot was “open-minded” in reference to how founders and companies are approaching their value.

In Q4 2015...

- Median valuations of new financings declined by 55% (VentureSource).
- Late stage private cloud companies dropped from a peak average valuation of 15x revenue earlier in the year to 11.8x at year-end (Byron Deeter of Bessemer Venture Partners to CNBC).
- 12% of financing rounds were down rounds, a notable change from the prior quarter when only 4% were down rounds. A disproportionate number of down rounds were Series E and later; 26% of these rounds saw their valuations marked down, versus 11% in the third quarter (Fenwick & West).
2016: retrenching stays the course

“Many entrepreneurs are getting capital, just less than before, and they’re working harder for it. The balance of power is shifting across tech startup land. Not long ago, entrepreneurs had the upper hand. Investors are exerting their newfound power by asking more questions about a startup’s prospects and taking more time to invest.”

The trends in early 2016 have stayed the course: fewer new unicorns and more down rounds and down exits.

According to CB Insights, 30 companies have settled for lower financing or exit valuations so far in 2016, which is just short of the figure for all of last year. Businesses with poor or questionable unit economic models are the most impacted, but some good companies could be swept up in the more general market malaise (in the on-demand food delivery space, for example).

While the headlines have naturally been focused on the valuation correction and its effects, as well as the stories of Zenefits and Theranos — once high-flying startups that hit bumps in the road due to growth and management missteps — the market has not experienced an indiscriminate pullback in capital raising.

Premium companies with impressive revenue and user adoption metrics can still raise capital at attractive valuations. A few recent examples include Slack, an enterprise messaging platform (April 2015 round done at $2.6 billion, latest round done at $3.6 billion); Lyft, an on-demand transportation service (May 2015 round done at $2.4 billion, latest round done at $4.5 billion); Snapchat, a photo messaging application (March 2015 round done at $15.0 billion, latest round done at $17.5 billion), and Uber, another on-demand transportation service (July 2015 round done at $50.0 billion, latest $3.5 billion round done at $62.5 billion).
Exits & Returns

After a strong showing in 2014, public market appetite for venture-backed companies softened in 2015.
Exits & Returns

2015: IPO market softened

84 venture-backed companies went public, 29% fewer companies than in 2014, and the median market cap decreased to $325M

After a strong showing in 2014, public market appetite for venture-backed companies softened in 2015. As Bill Gurley at Benchmark remarked, the IPO market was open in 2015, but companies opted not to use it; companies got spooked after watching poor performing IPOs such as Etsy’s, and companies such as Box and Square price below the valuations of their last private rounds.

While the number of IPOs in 2015 was lower than in both 2014 and 2013, the tally was still significantly higher (over 8x) than the low point of 2008. The largest technology IPO in 2015 was First Data, which raised $2.8 billion, whereas the largest venture-backed technology IPO was Fitbit, which raised $841 million. While the median market cap for newly minted public companies rose slightly in 2015, the declining trend since 2011 remained evident. Given that biotechnology companies, which tend to have lower market capitalizations than their technology brethren, made up more than half of all venture-backed IPOs over the last three years, this declining trend was not surprising.
Exits & Returns

2015: M&A activity decreased

415 venture-backed companies were acquired, 18% less than in 2014, and the average acquisition value decreased to $304M.

2015 was also a rather weak year for venture-backed mergers and acquisitions, measured by both the number of acquisitions and the average acquisition price. The largest venture-backed acquisition news of the year was in the healthcare sector, with AstraZeneca agreeing to acquire a majority stake in Acerta Pharma that could value the company near $7 billion. Hitachi’s $600 million acquisition of Pentaho was the largest venture-backed M&A event in the technology sector last year.
Exits & Returns

2016: sluggish start for exits

It’s fair to say that 2016 has not been kind to venture-backed exits, particularly in the technology sector. But with companies like Airbnb, Uber, Pinterest, Palantir, Slack, Lyft, and Tanium in the pipeline, 2017 and 2018 could be better years for venture-backed exits.

The year started with the announcement that e-commerce company Gilt Groupe, once a unicorn, had sold for $250 million, thus becoming a “unicorpse.” Since then, exit news has been bleak.

The IPO market has certainly been in a drought by many measures. According to Thomson Reuters and the National Venture Capital Association, the number of IPOs in the first quarter of 2016 was off 65% from the first quarter of 2015 and was the slowest quarter since the third quarter of 2011. And if it weren’t for life science companies, first quarter IPOs would have been non-existent. The first quarter ended without a single technology IPO, which marked the first time in seven years that no venture-backed technology company had listed publicly. The technology IPO drought came to an end in April with the NASDAQ debut of SecureWorks, but the company priced fewer shares below the target price, dampening hopes that it might jumpstart the sluggish market. Industry participants will be watching the IPO pipeline closely over the remainder of the year, particularly Twilio, which recently priced above its range and last private round of financing, and is the first technology unicorn to go public since Square in November of last year.

The M&A market showed more signs of life during the first quarter of 2016, but even still, the volume was 19% less than in the first quarter of 2015. However, several large M&A announcements in the second quarter could bode well for the future. Venture-backed companies Stemcentrx and Marketo are being acquired by AbbVie for $10.2 billion and Vista Equity for $1.8 billion, respectively. Although not venture-backed, Symantec’s plans to acquire Blue Coat Systems for $4.7 billion and Microsoft’s (MSFT) plans to acquire LinkedIn (LNKD) for $26.2 billion, which could surpass Facebook’s acquisition of WhatsApp as the largest-ever technology M&A, just might spark the technology M&A market. As Dan Primack of Fortune surmised, it could be that both strategic and financial buyers now believe that assets are under priced.

In Q1 2016...

- Only 6 venture-backed IPOs, all life science companies (annualized would be 29% of 2015 volume).
- 79 venture-backed M&A deals announced (annualized would be 76% of 2015 volume).
“As those really strong companies choose to go public, eventually I think you’ll see better IPOs.”

Scott Nolan, Founders Fund
Fund performance and returns to limited partners are directly impacted by exit markets, as well as by other factors such as private and public market valuations and portfolio company operating metrics.

It is now well understood that low absolute returns during the early 2000s were driven primarily by an overcapitalized venture industry and too many funds chasing too few compelling investments. As discussed already, the industry has consolidated meaningfully when measured by the number of active venture firms. This consolidation has contributed to improved returns. Cambridge Associates’ venture capital index increased by nearly 14% in 2015, following increases by close to 24% in 2014 and over 27% (a post-bubble record) in 2013. In fact, the venture capital index has outperformed all major public indices (e.g. Russell, MSCI, Dow Jones, S&P) over the one-, three-, five- and ten-year periods ending December 2015, thus reflecting the strong “run” for the asset class. Top quartile returns for each meaningful vintage year since 2007 are above 18% net to LPs, and the particularly strong vintages of 2010-2012 are the highest recorded since 1981 outside of the 1992-1997 vintages that rode the bubble. Not surprisingly, strong performance, record distributions back to limited partners, and a bull market were followed by increased commitments to and enthusiasm for the venture asset class. With the market correction, softening valuations, and uncertain exit markets, we will watch carefully how well recent strong paper gains can be realized in the years to come.
In many ways, the bylines in 2015 read much like those in 2014. VCs raised an historically large sum of capital, yet that capital continued to concentrate in the hands of relatively few firms. Early and late stage investment activity increased, thanks in part to the sustained participation of non-traditional investors such as mutual funds and hedge funds, as well as corporate VCs. Early and late stage valuations again reached record highs as the unicorn count continued to grow. And investors remained excited about the investment opportunities arising from the long-term bull market for technology. But differences between 2014 and 2015 are equally important to highlight. The exit markets in 2015 were certainly less fruitful than in 2014. And as we observed in the introduction to this report, 2015 concluded with dampened statistics and a more muted, cautious, and uncertain tenor, compared to the party that was still going strong at the close of 2014.
Conclusion

A return to the old normal

While the party atmosphere no longer characterizes the venture capital market in 2016, there are certain aspects to the hangover that are welcome: more rationale valuations and behavior by venture capitalists; a slower deal pace; less FOMO; and a renewed focus on operating metrics and profitability, not just growth projections. Yet the same excitement remains for the opportunities to start and invest in truly transformational technology companies that are disrupting verticals from insurance to real estate to automobiles, and new excitement is building based on advancements in artificial intelligence, virtual reality, software-enabled biotech, and quantum computing. This all indicates that it is likely a great time to be investing in and alongside the most experienced, high quality venture managers. So perhaps this is a return to the old normal, as First Round Capital suggests, but also the beginning of another era of innovation.

VC COMMENTARY

“In this next era, growth will give way to profitability. Leveraging capital will give way to leveraging people and product. Focus will move from the balance sheet to the income statement. The center of gravity will shift from financial to strategic. Yes, the post-steroid era will be harder but companies will be more sustainable and built upon a stronger foundation as founders will use creativity instead of money to solve problems.”
- Simon Rothman, Greylock Partners (Greylock website)

“Just as in the last cycle, I believe the category-defining companies of the next decade will be launched and funded in the next couple of ‘less exciting/slower’ years. Not ‘Uber for X’ but ideas that could create new markets and enjoy infinite runway in terms of growth.”
- Niko Bonatsos, General Catalyst Partners (TechCrunch)

“The healthiest thing that could possibly happen is a dramatic increase in the real cost of capital and a return to an appreciation for sound business execution.”
- Bill Gurley, Benchmark (Above the Crowd blog)

“The next 3 years will value patience over speed at all costs.”
- Mark Suster, Upfront Ventures (Upfront VC Analysis 2016)
Conclusion

A note about the data referenced throughout this report: We acknowledge that there are numerous sources of industry data that may differ materially in methodology, breadth, and statistics. For consistency, we primarily reference two sources throughout this report. Thomson Reuters tends to capture a greater percentage of fundraising activity, and VentureSource typically captures a greater share of investment activity. We therefore leveraged Thomson Reuters’ platform to analyze venture capital fundraising, and VentureSource to analyze venture capital investments. Two distinct databases were used in favor of data integrity and at the expense of direct comparisons between fundraising and investment activity. Readers will notice that venture capital investing actually exceeds fundraising for most years; the reason is that investment data includes activities by corporate, government, and other entities, while fundraising data enables analysis of purely institutional venture capital fundraising. True capital invested by institutional venture capital firms is likely lower than the statistics referenced in these analyses, but we believe the data to be directionally accurate. In addition, the data we present has not been adjusted for inflation, so many of the comparisons made between 2015 and 2000 data are even more pronounced.

Conclusion

About TrueBridge Capital Partners

Established in 2007, TrueBridge Capital Partners is an alternative asset management firm laser-focused on generating superior returns in the venture capital industry.

TrueBridge identifies and invests in high-performing, access-constrained venture capital opportunities that generate premium value for its partners. TrueBridge prides itself on a data-driven approach to investing in both venture funds and venture-backed companies. In addition to extensive due diligence processes, the firm regularly gathers, analyzes, and publishes information about the venture industry and trends at truebridgecapital.com/insights. The firm is recognized for its longstanding partnership with Forbes to produce The Midas List, an annual ranking of technology’s top investors.

The State of Venture Capital is an annual market analysis of key venture capital industry trends spanning fundraising, investments, valuations, exits, and returns.

Follow @TrueBridgeCP for latest updates and insights.

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