Apocalypse NOT: COVID-19 and the Early Stage Funding Environment in 2020

December 9, 2020

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Our Speaker

Ron Weissman
Band of Angels

ANGEL CAPITAL ASSOCIATION

Apocalypse Not

Current US Early-Stage Investment Climate

December 2020

Dr. Ronald Weissman

Chairman, Software Group
Band of Angels

Member of the Board of Directors
Angel Capital Association

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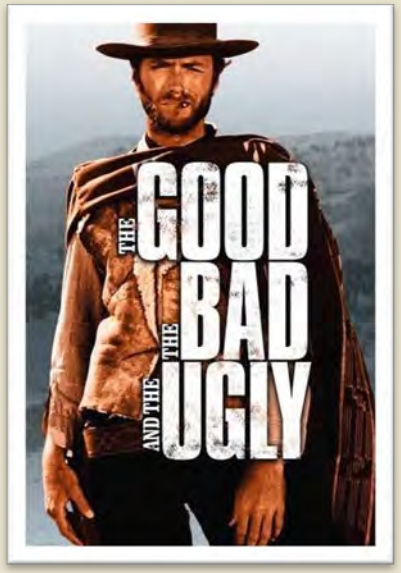
AGENDA



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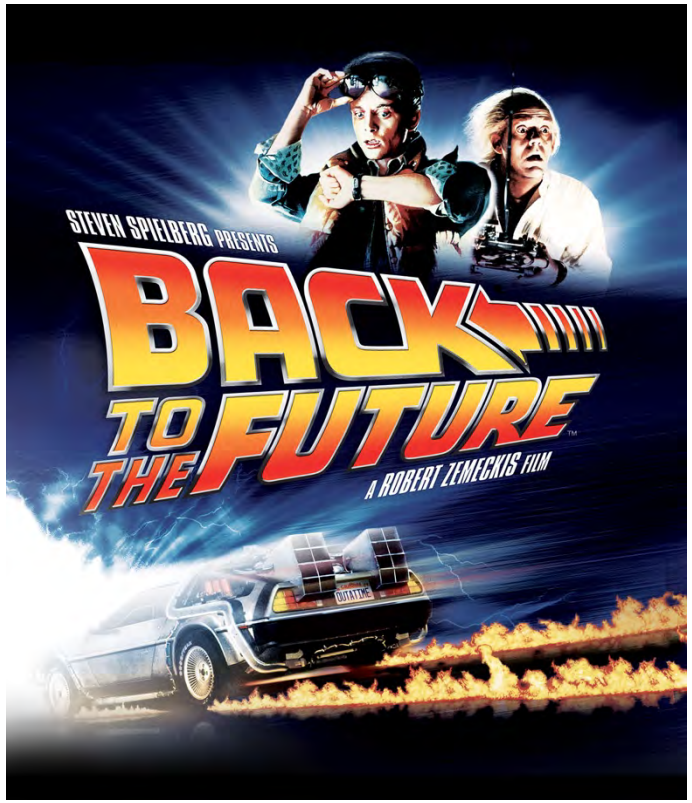

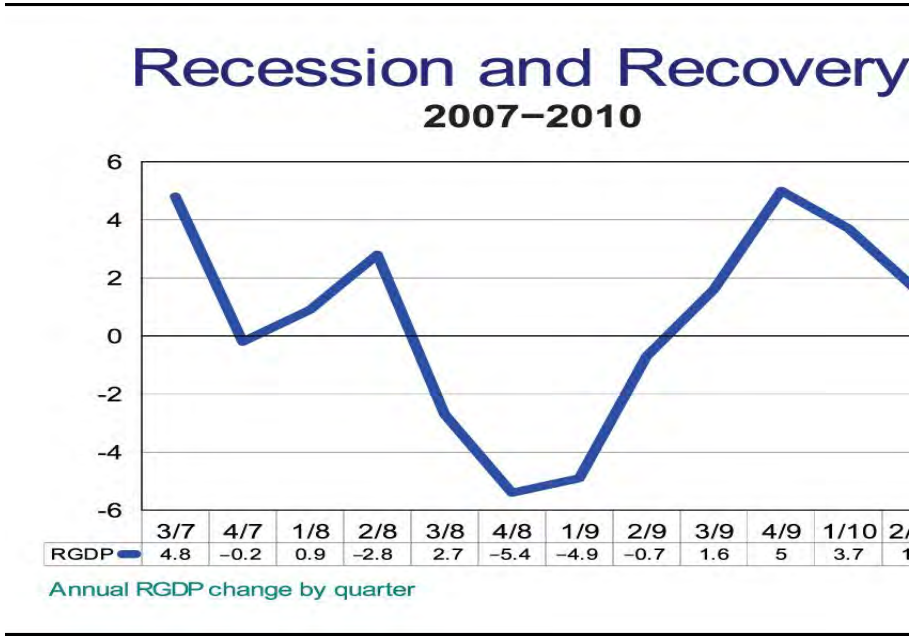

THE GREAT RECESSION SETS OUR EXPECTATIONS FOR FUTURE CRISES

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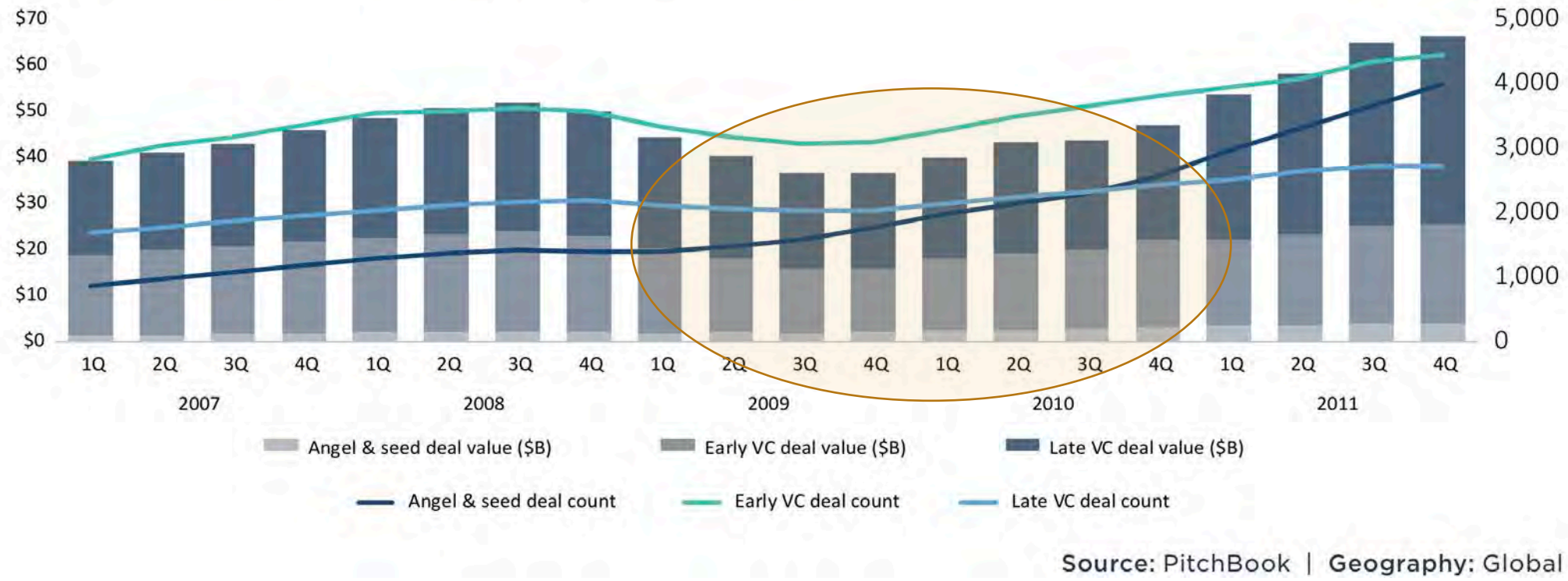
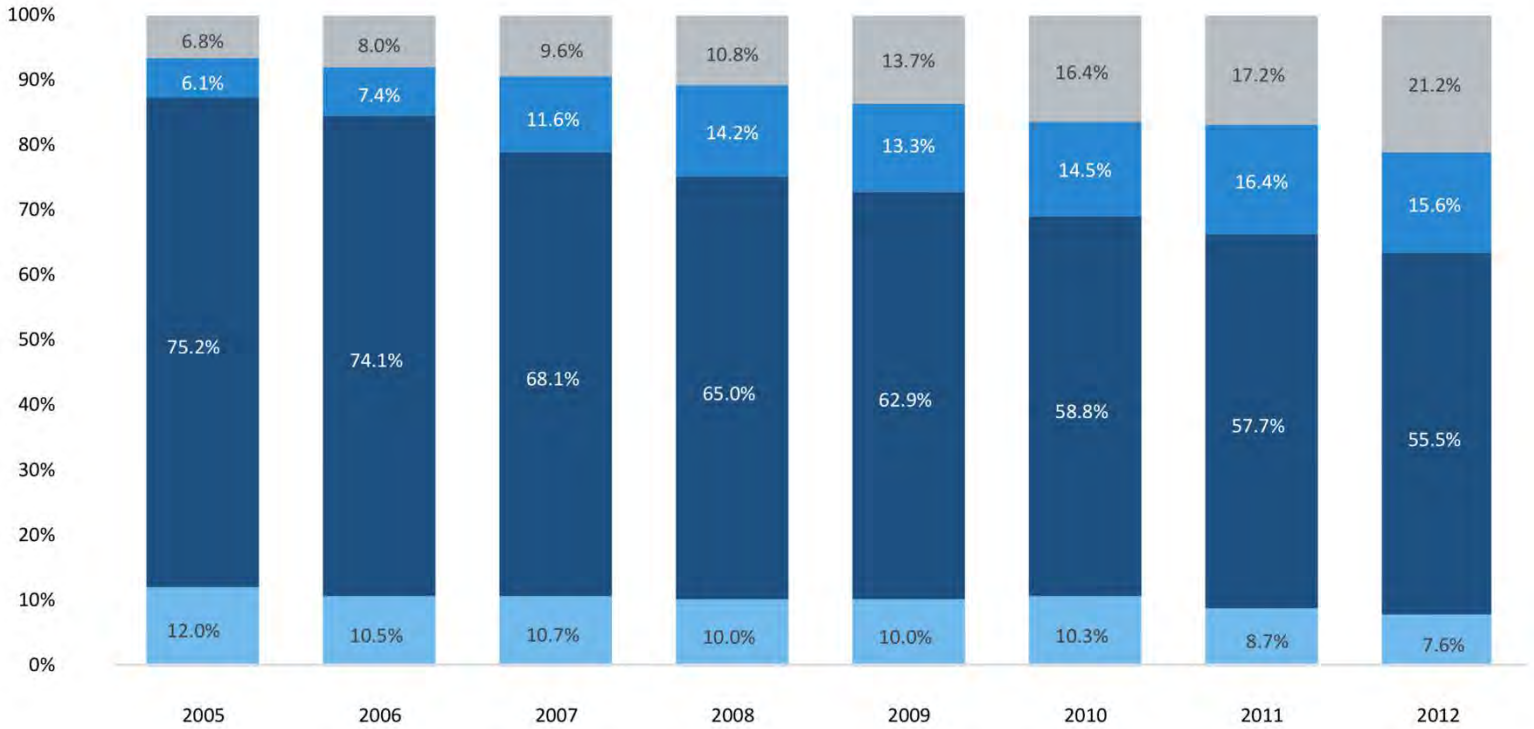
Decline in Early-Stage Deal $



Source: PitchBook | Geography: Global

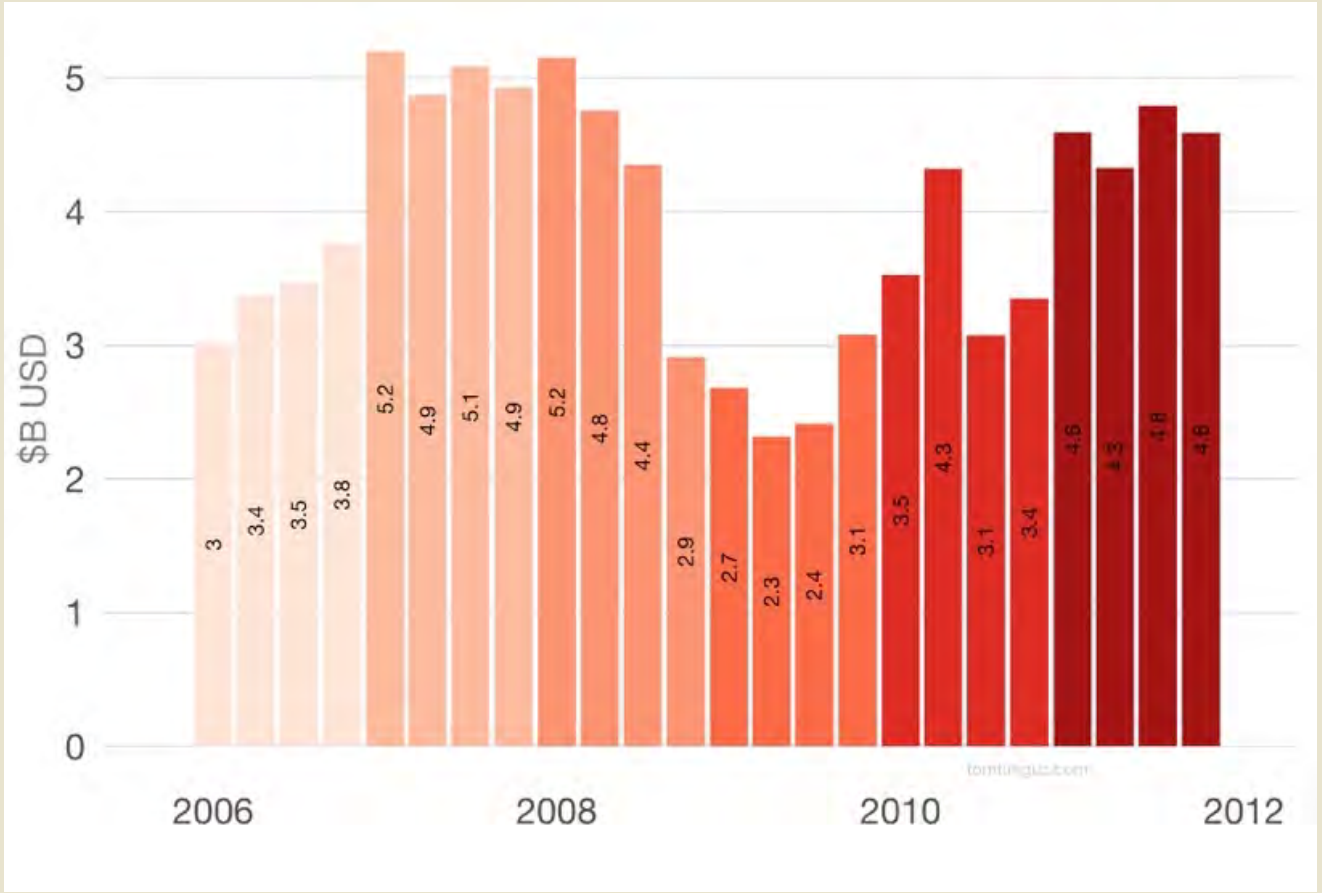
More Zombies, Fewer Exits, Fewer Follow-ons, More Bankruptcies



Source: PitchBook | **Geography:** Global

FUNDING TOOK 18 MONTHS TO RECOVER FROM THE GREAT RECESSION

During the Great Recession Early Stage VC (A, B, C) Financing Declined 40% & Recovery Took Six Quarters

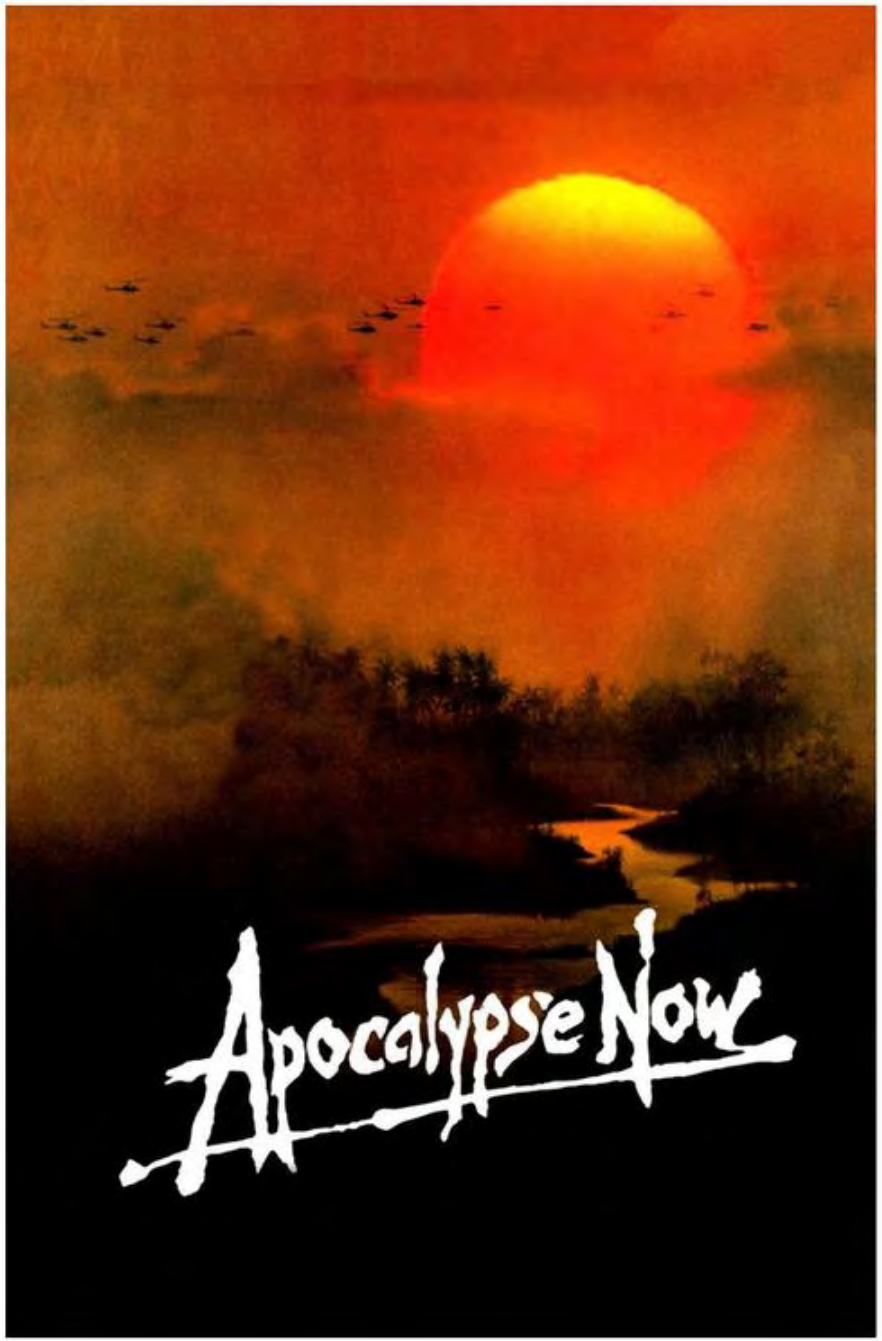


Source: https://tomgunguz.com, March 12, 2020 (Thomas Tunguz, Redpoint Ventures)

EXPECTATIONS FROM THE GREAT RECESSION (2008 – 2011)

- VC Fundraising fell by more than 50%
- Decline in dollars but angel deal counts were up
  - Easier to get initial capital, harder to get follow-ons
- Angel, seed and early-stage valuations fell by 25%
- Companies funded during the recession had fewer follow-on financings, more bankruptcies
- Ecosystem post-recovery remained weak
  - Fewer follow-ons, fewer exits, bankruptcies still 2x pre-crisis
- 6+ quarters to recover
- **The Great Recession set our expectations for the COVID crisis. But are those expectations accurate?**

Q1 2020:
THE PANDEMIC ARRIVES



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Q1'20: EXITS FALL AND LPs RETREAT TO LATER STAGE FUNDS

M&A

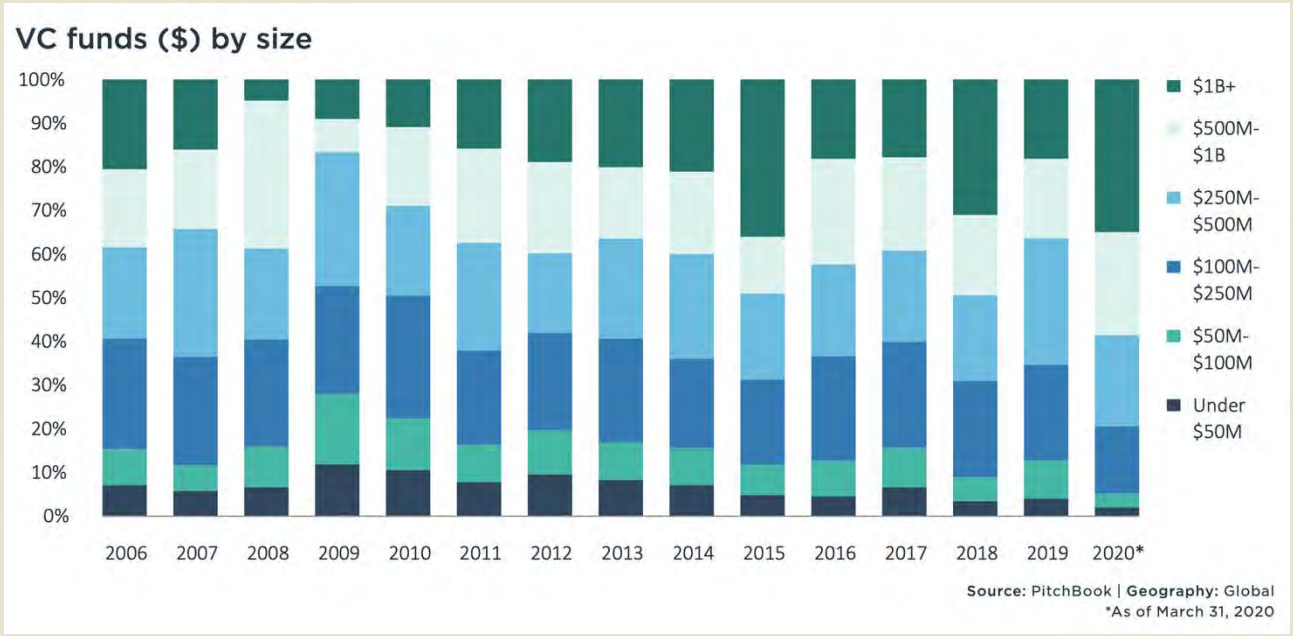
- The number of M&A exits fell 17% from Q4'19 to Q1'20
- The deal value of M&A fell 50%

IPO

- The number of Q1 IPOs fell 50% (Crunchbase).
- Early Q2: The value of April IPOs was the lowest since 2010 (Bloomberg)
- IPO $ value fell 50%+ from 4/19 to 4/20 and >50% from Q4'19 to Q1'20

LPs

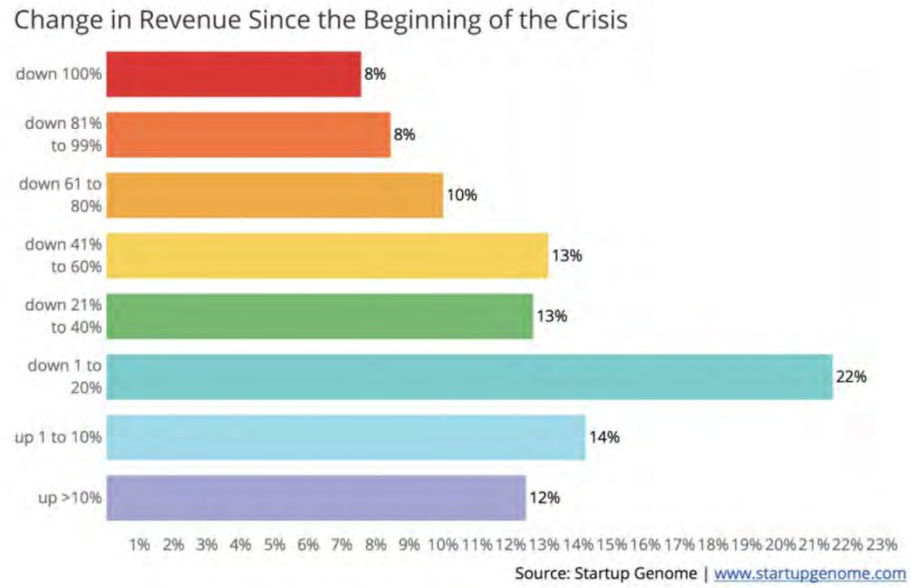
- LPs claim to remain committed to existing funds but have not yet felt the impact of fewer IPO and M&A distributions
- Global flight to late stage: 60% of new funds were $500M+ and the number of funds <$250M fell from 35% in '29 to 20% in 2020. The fall was sharpest for funds < $100M. This is the sharpest fall in more than a decade.

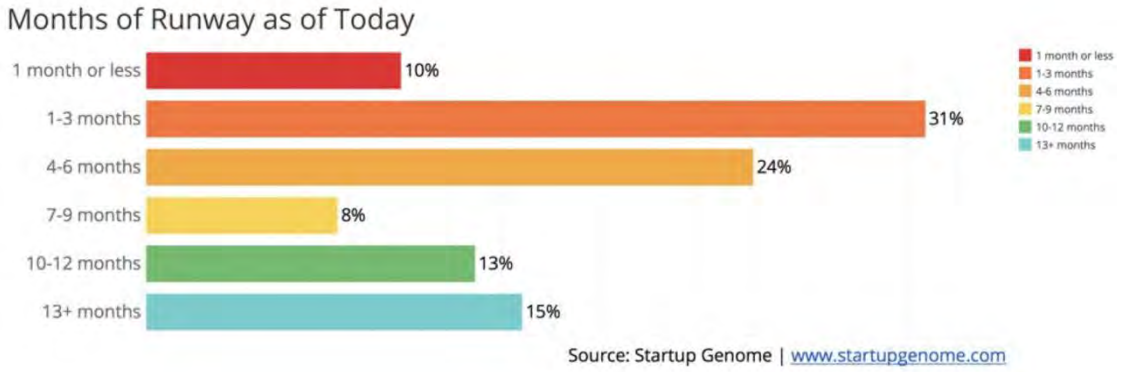


APOCALYPSE SOON?

52% OF STARTUPS REPORT > 20% REVENUE DECLINE

41% HAVE LESS THAN 3 MONTHS OF CASH





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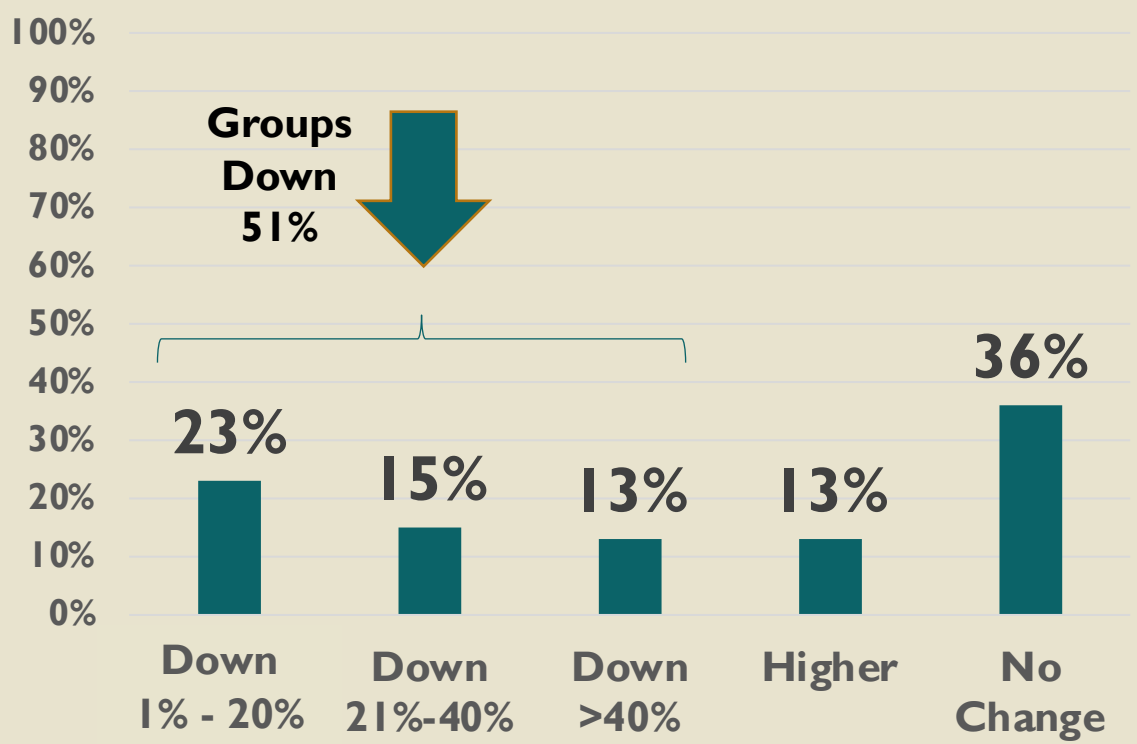
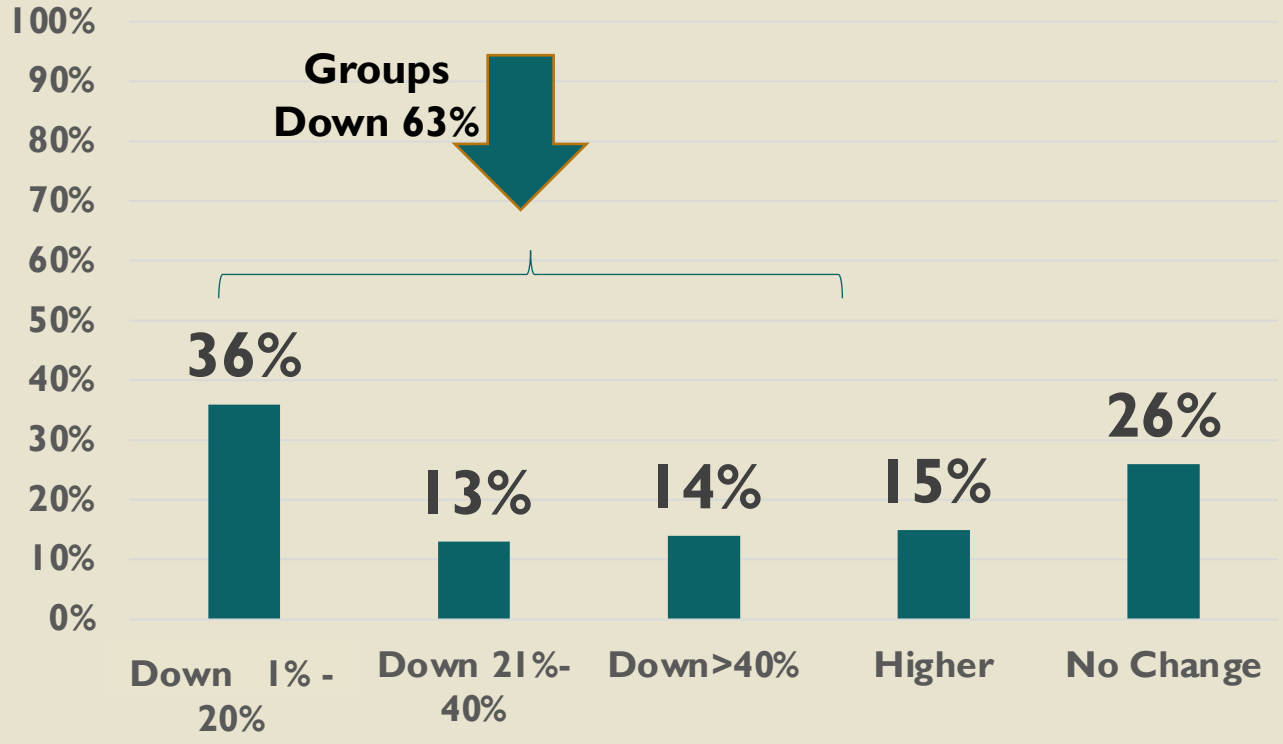
APRIL ACA PANDEMIC SURVEY: 2/3 OF ANGEL GROUPS EXPECTED TO INVEST FEWER DOLLARS IN 2020 THAN 2019

Estimate of Dollars Invested Jan-April (2020 vs 2019)



Estimate of Dollars Invested Total Year (2020 vs 2019)



Source: Angel Capital Association survey of impact of COVID-19 on angel groups, April 2020

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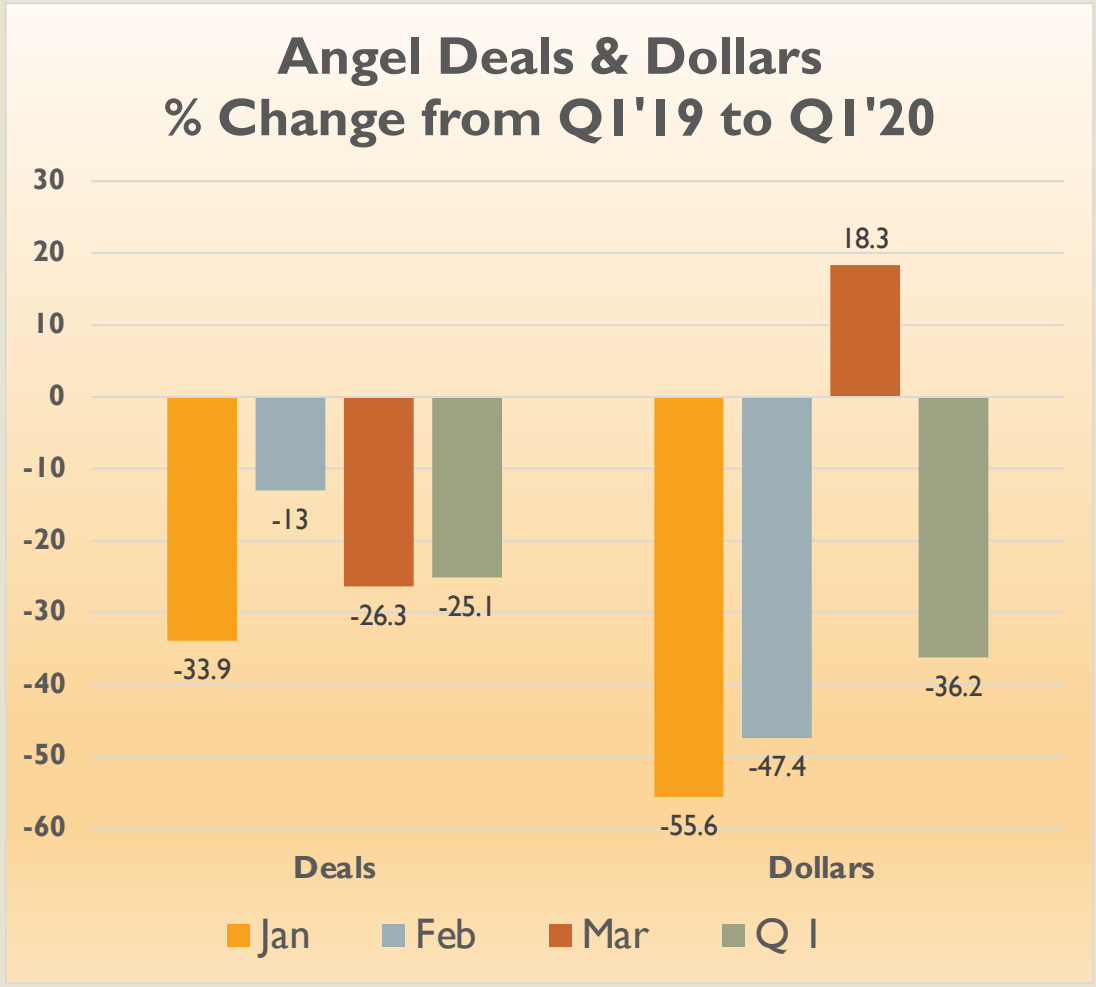
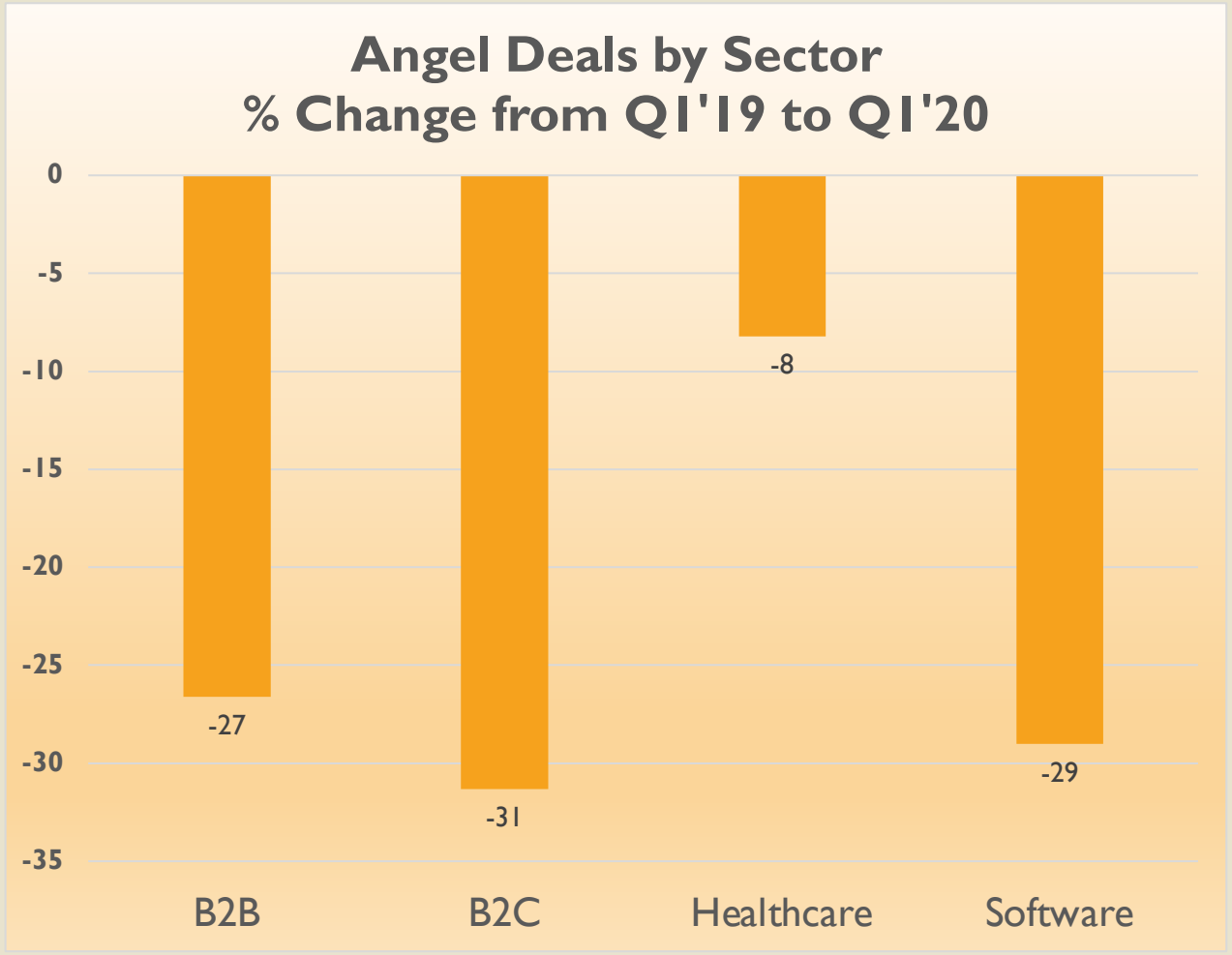
Q1'20 ANGEL $ FELL TO 64% OF Q1'19 $
THE NUMBER OF DEALS FELL BY 25%





Source: Jeffrey Sohl, et. al, "The Angel Market and COVID-19: Building Bridges or Piers," Center for Venture Research, University of New Hampshire, May 19, 2020

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Q1 SUMMARY

- IPOs at lowest point since 2010
- New VC funds move later stage, dramatic fall in new seed and early-stage funds < $100M
- Startup Apocalypse predicted as 41% have < 3 months of cash
- Angel and seed round funding fell 21%
- Corporate VC deals down 13%, $ down 25%
- 2/3 of angel groups expect to invest less in 2020 than 2019
- Strong sector and regional differences (Midwest stronger than East or West coast)

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Q2’20

Q2 FORECAST: MORE OF THE SAME

- Startup deals will continue to decline across all stages
- Deal sizes will shrink
- Valuations will continue to decline
- Deal terms will begin to favor investors
- Mass death of startups (Startup Genome)
- Early stage will be a less attractive asset class for limited partners considering new venture funds
- Sector attractiveness will continue to vary widely based on COVID-related factors

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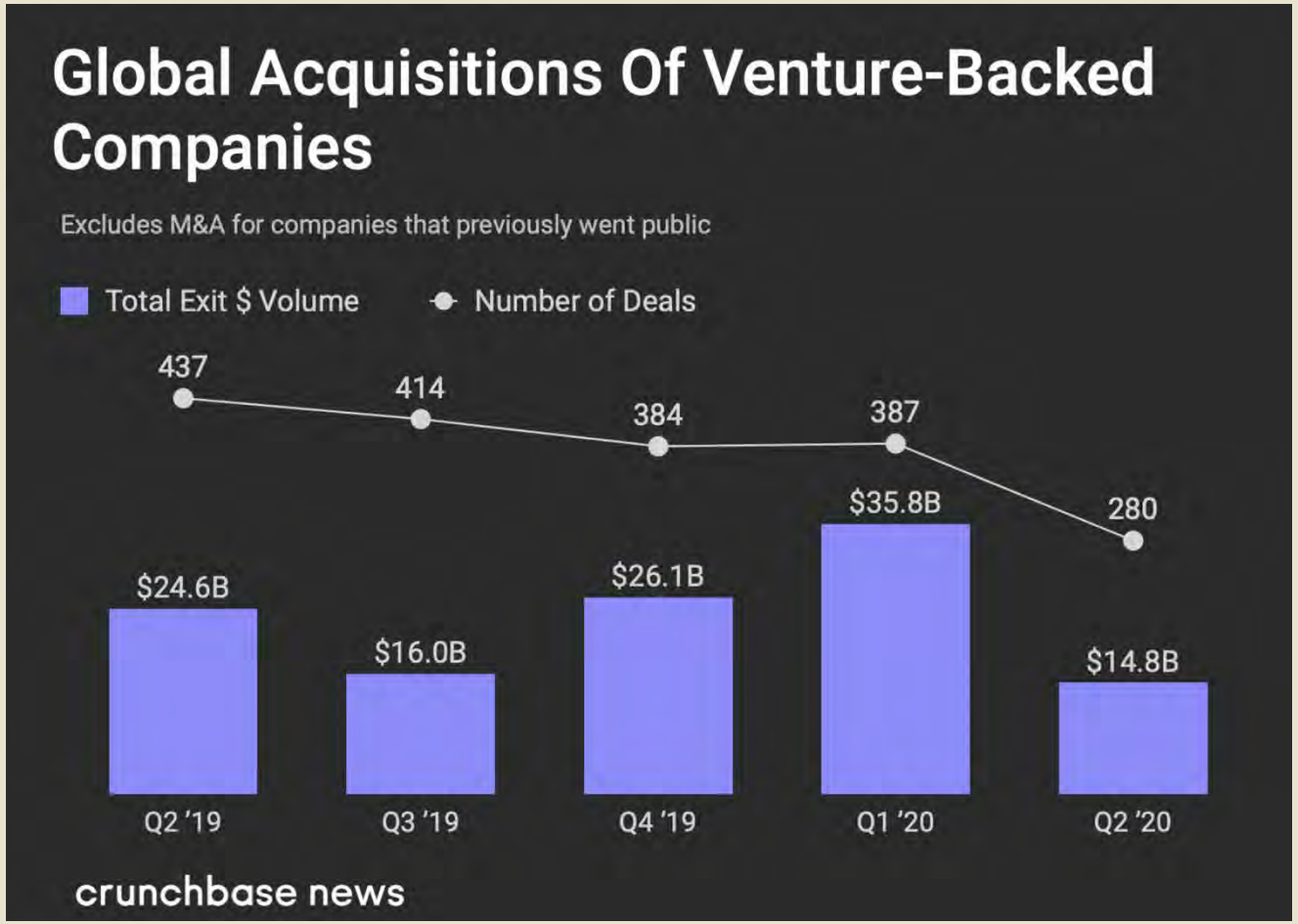
Q2’19 TO Q2’20:

M&A $ DOWN 40%,
DEAL COUNT DOWN 36%

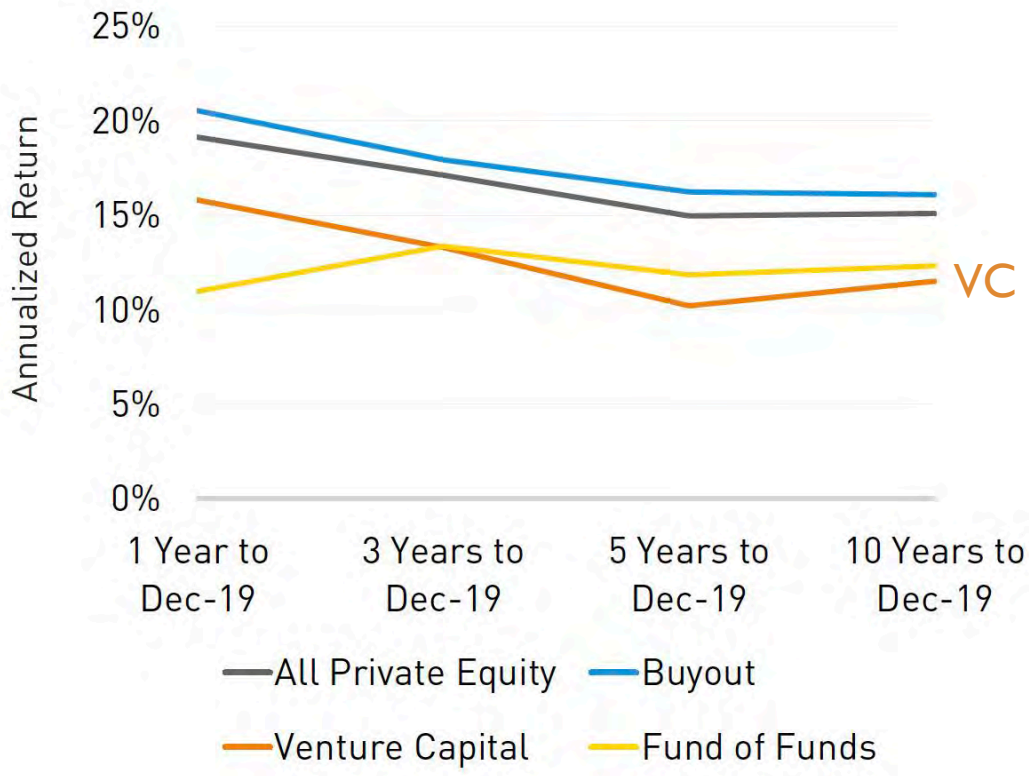
”EXIT COUNT IN 2020 IS TRACKING TO BE THE LOWEST SINCE 2011”

– NVCA



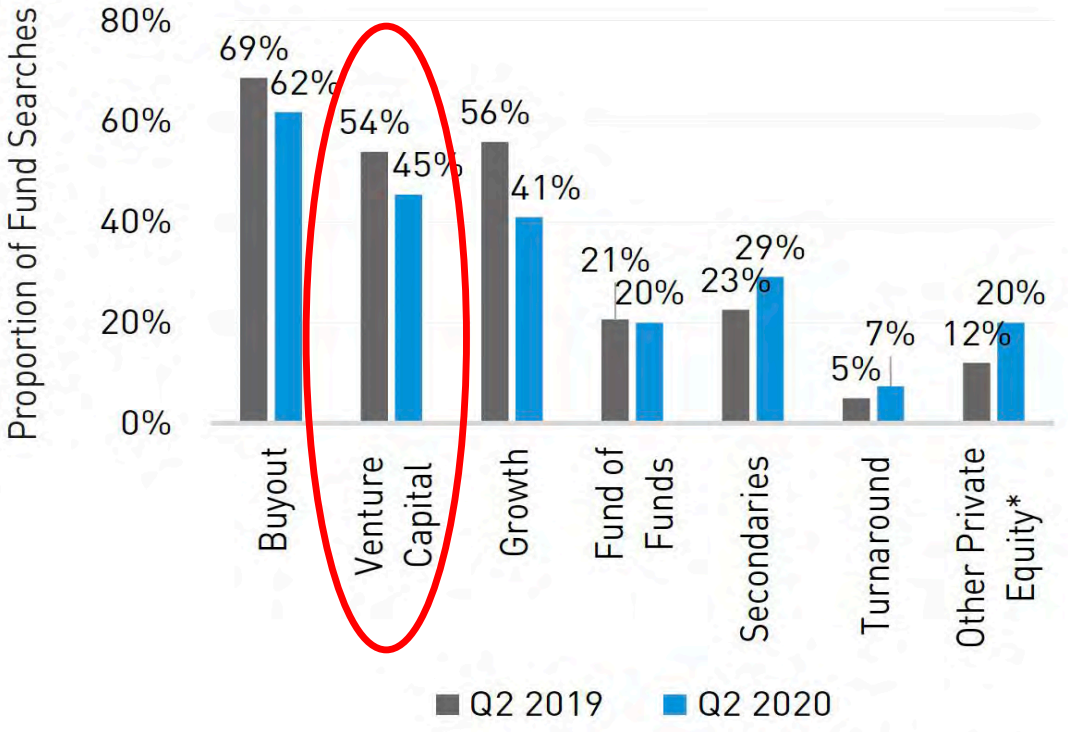
VC WEAK PERFORMANCE -- BECOMING LESS ATTRACTIVE TO LPS

Median IRR by Fund Type (VCs target = 20% to 30%)



Source: Preqin Pro

Fig. 8: Fund Types Targeted by Private Equity Investors over the Next 12 Months, Q2 2019 vs. Q2 2020



Source: Preqin Pro

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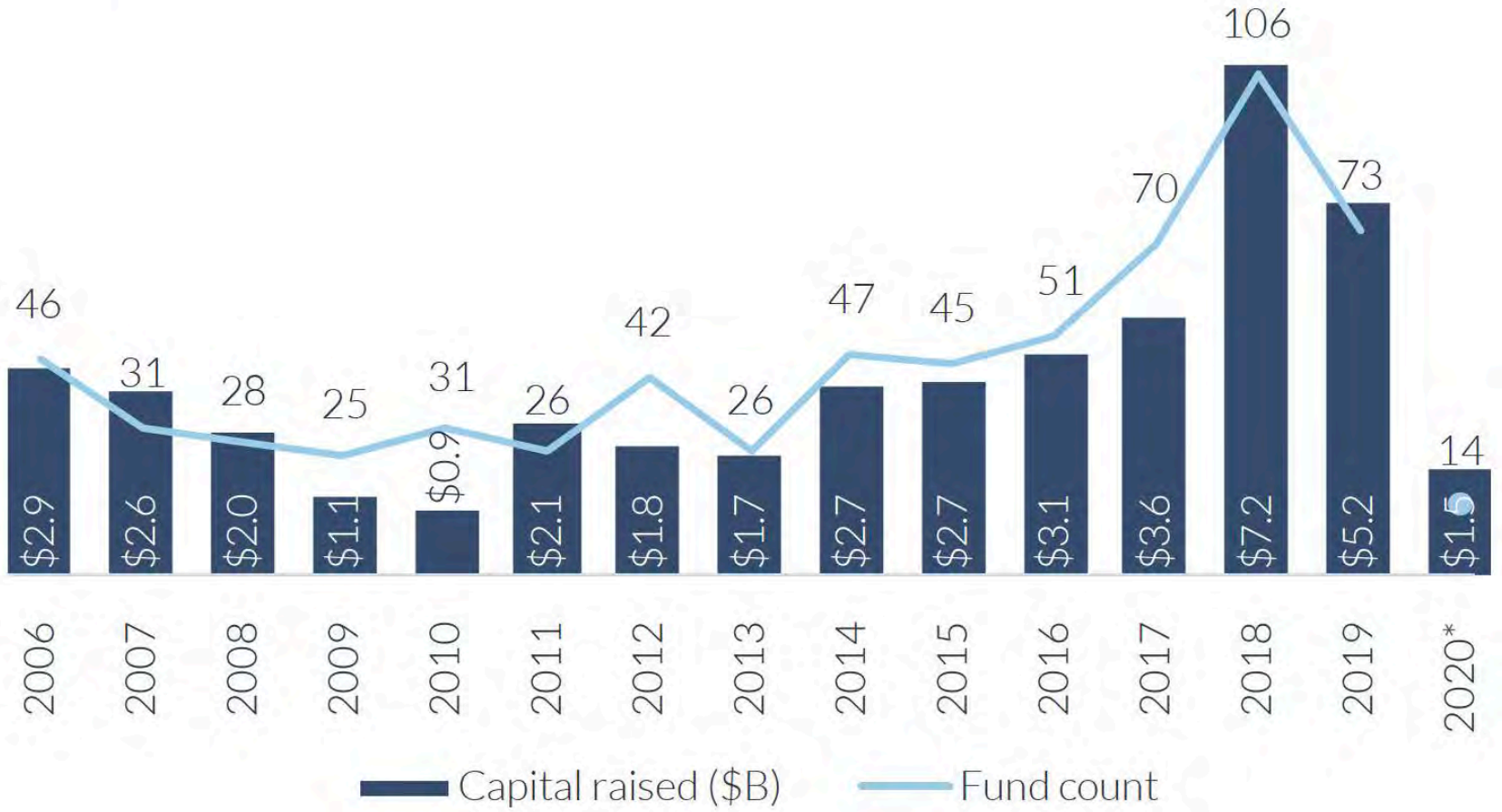
Source: Preqin, 2020

Pandemic has severely depressed new fund capital raising from limited partners

US VC first-time fundraising activity



PitchBook-NVCA Venture Monitor

*As of June 30, 2020

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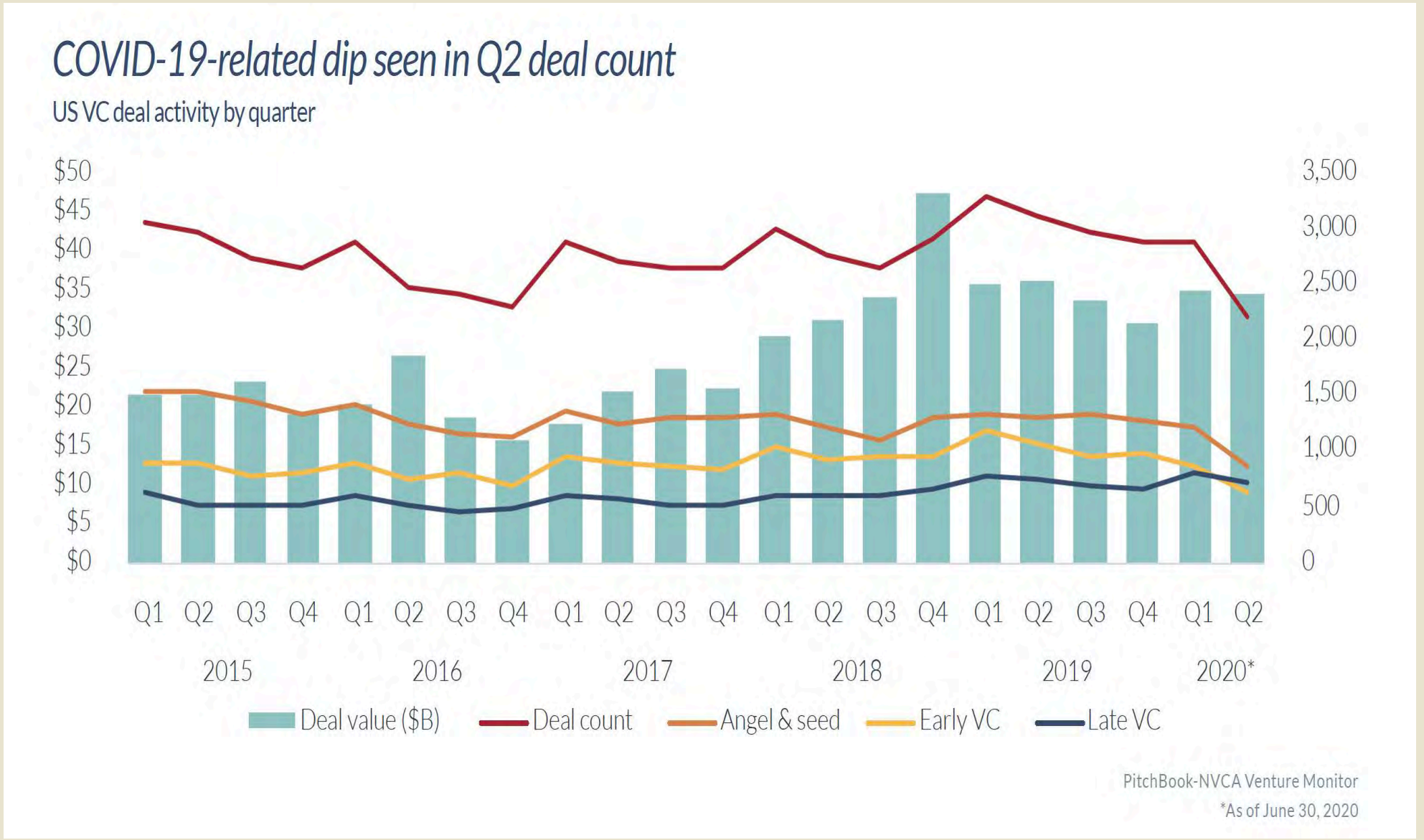

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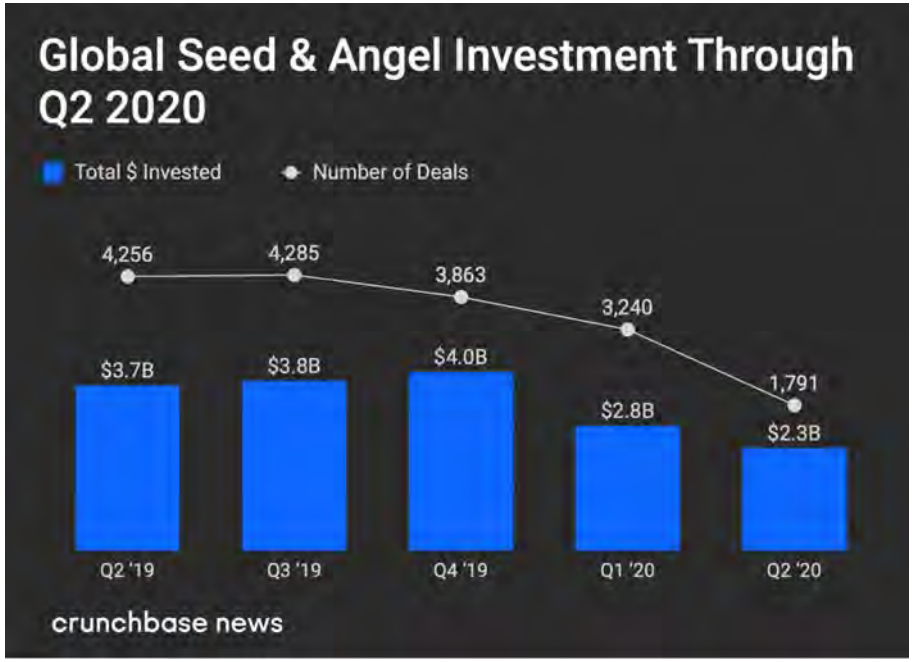

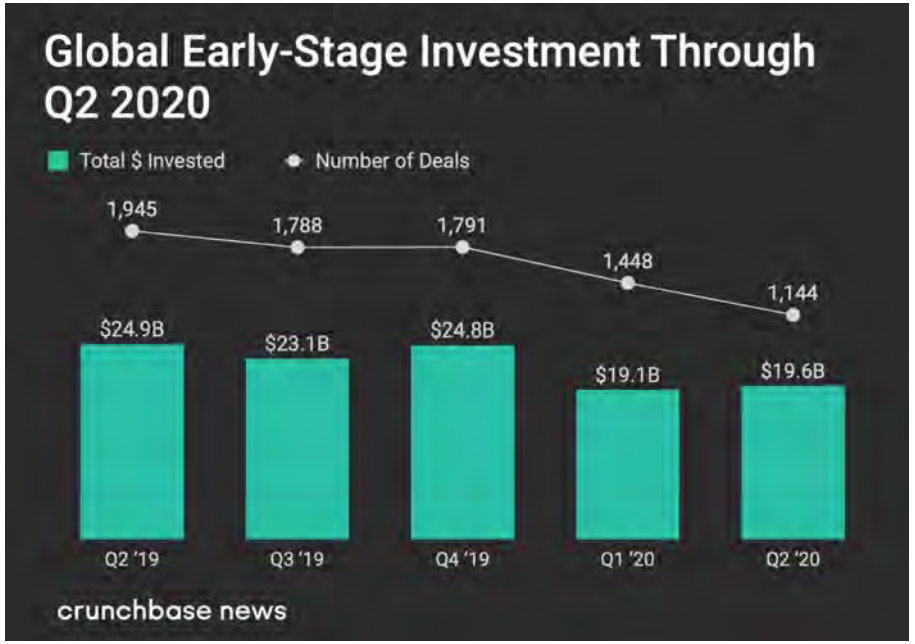

Q2'19 VS. Q2'20

ANGEL DEALS DOWN 38%, $ DOWN 58%

EARLY STAGE DEALS DOWN 41%, $ DOWN 21%,

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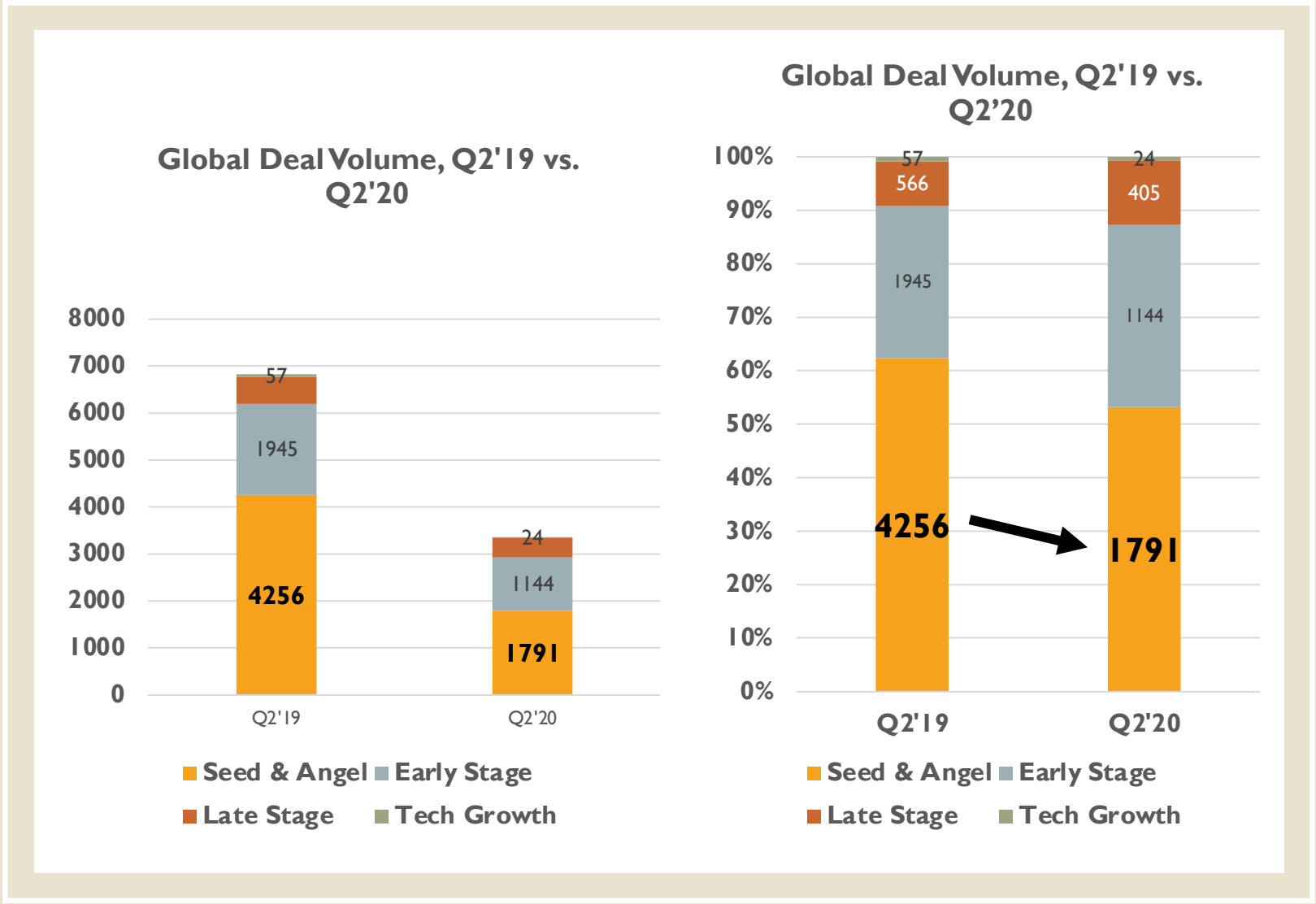
GLOBAL DEALS & $ MOVE LATER STAGE



Crunchbase

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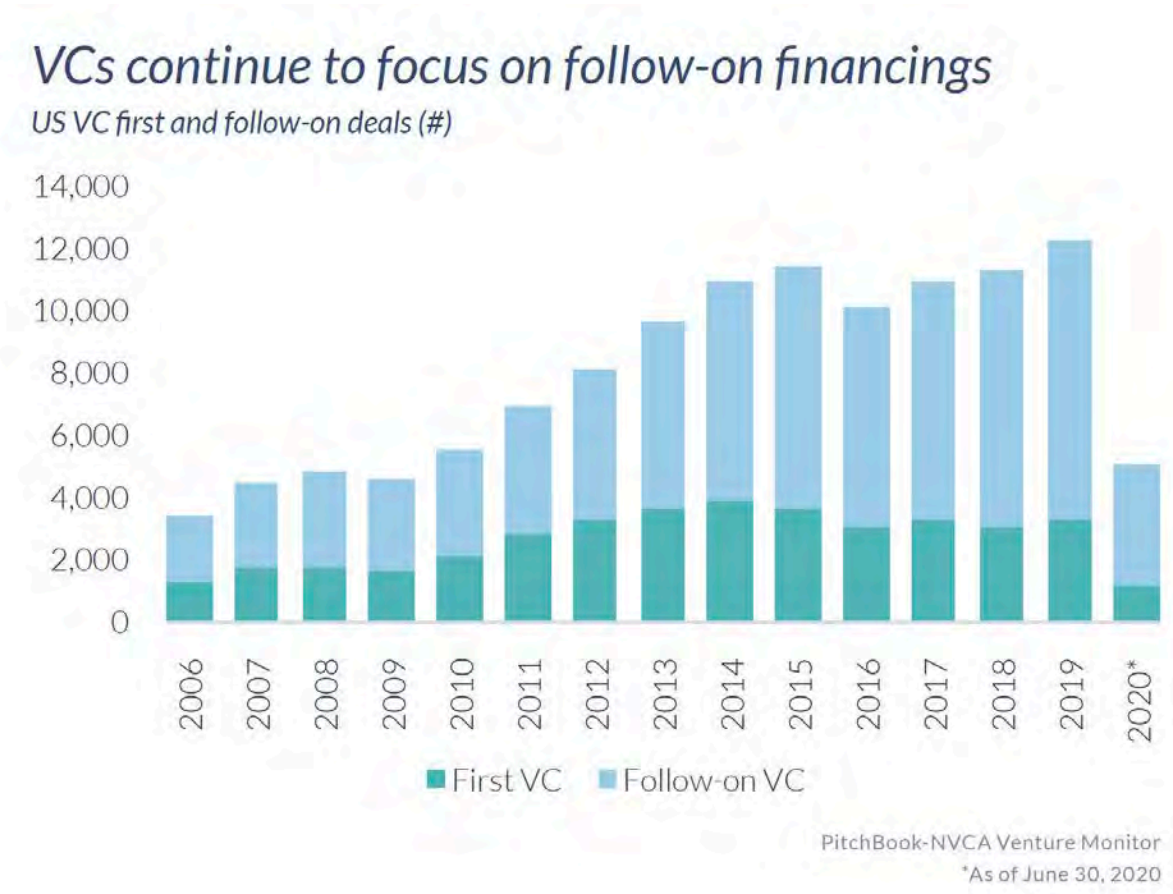
WHO WILL WRITE THE NEXT CHECK AFTER OUR ANGEL ROUND… OR, THE IMPORTANCE OF ANGEL SYNDICATION



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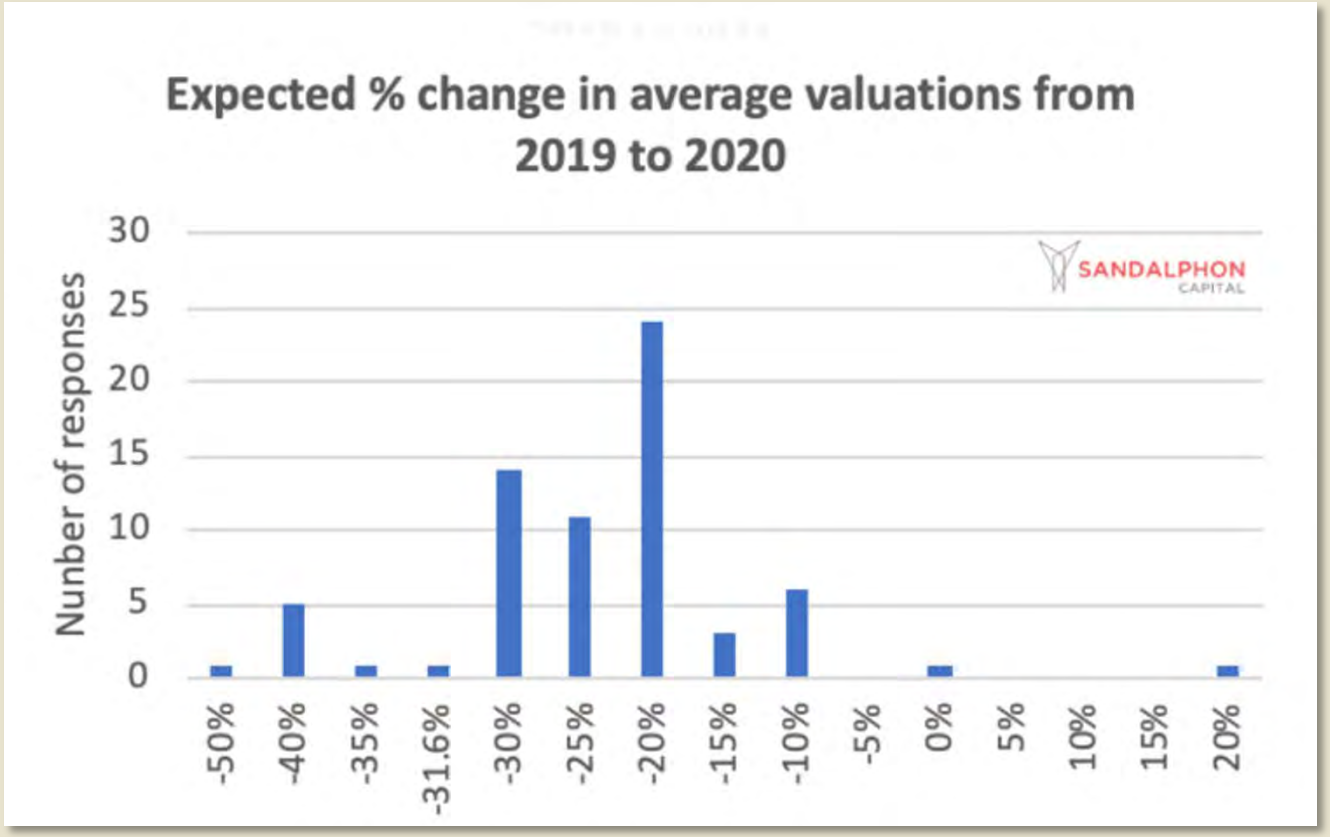
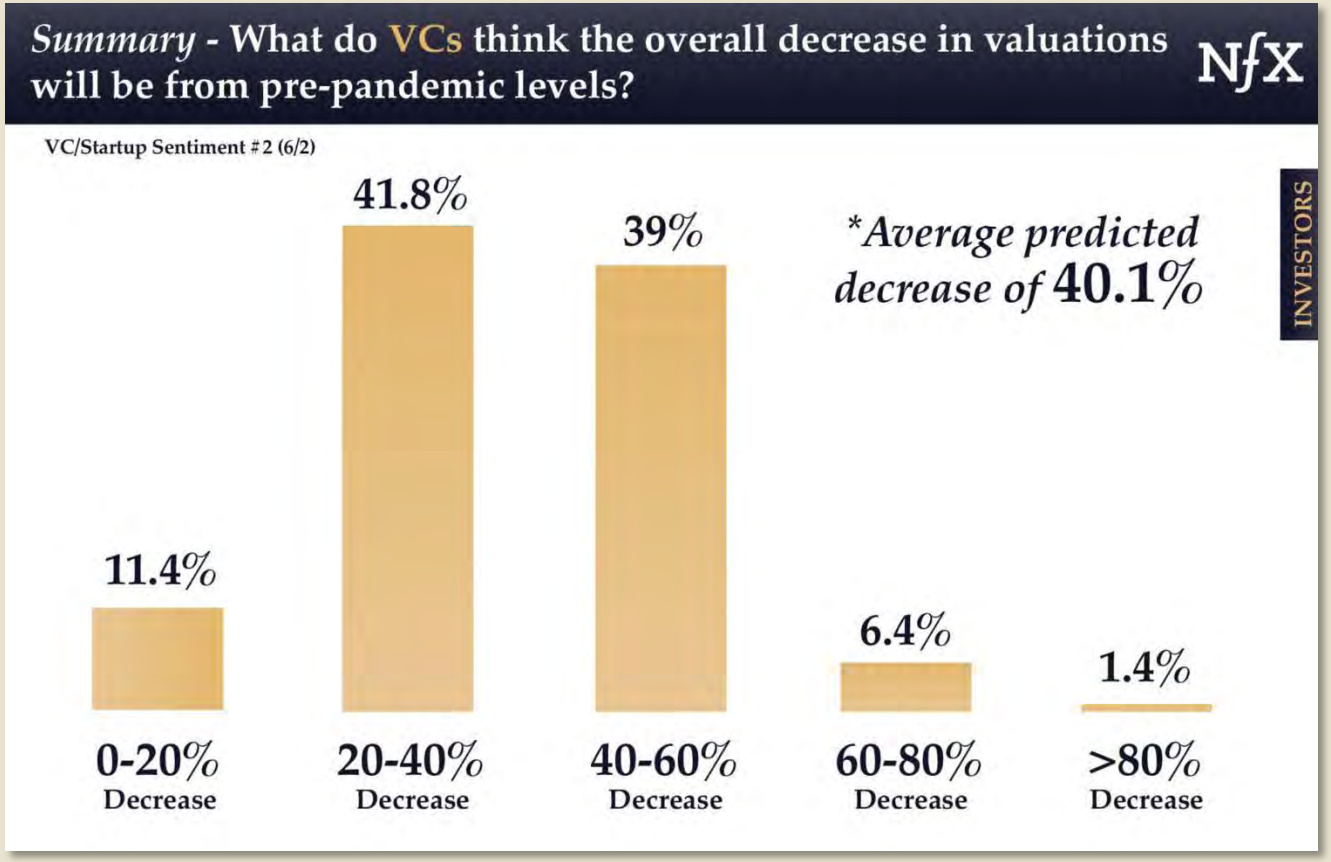
IN APRIL VCs EXPECTED VALUATIONS TO FALL 20% – 30%
(SANDALPHON, APRIL 2020)



JUNE SURVEYS PREDICTED STRONGER VALUATION DECLINE

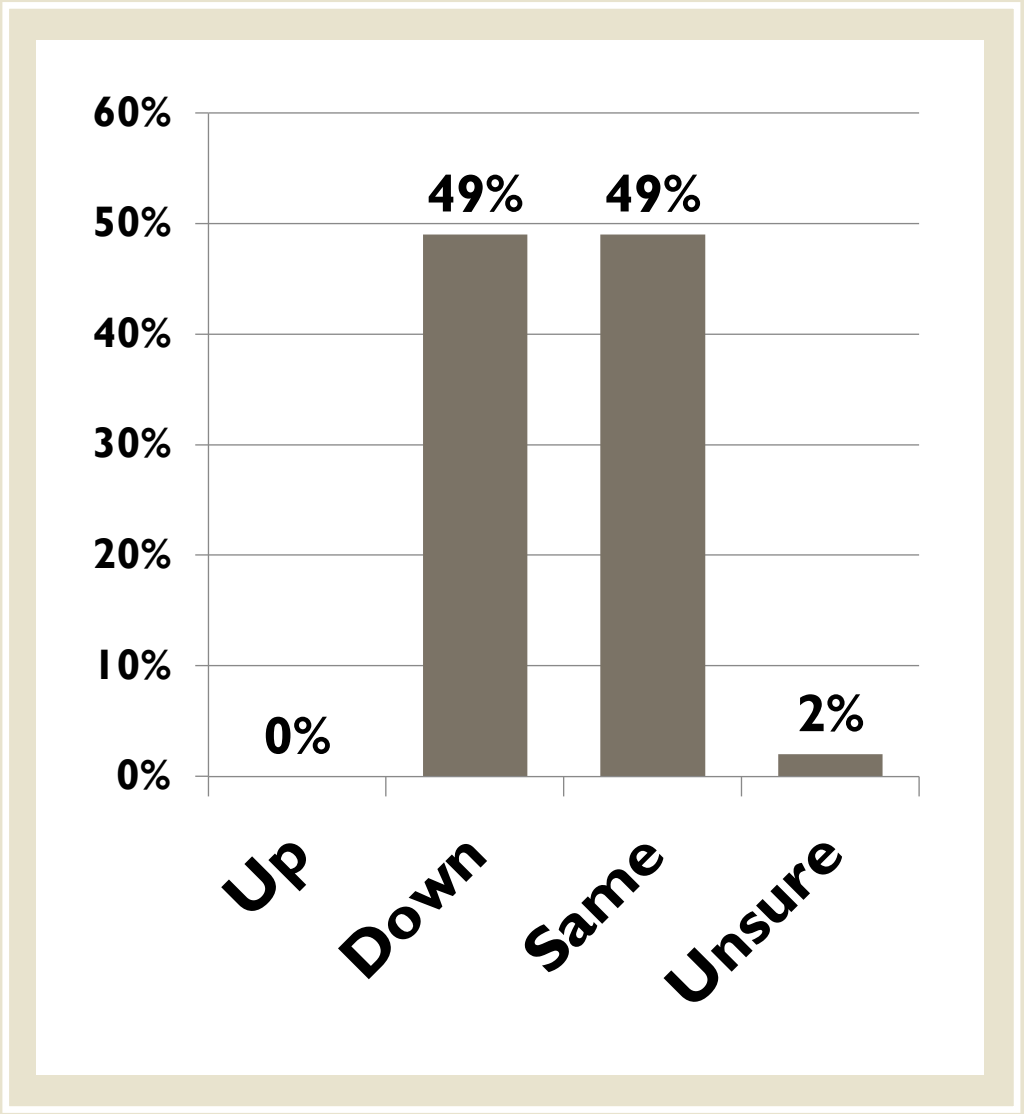


ACA PANDEMIC SURVEY (4/20): 50% REPORT LOWER VALUATIONS SINCE COVID CRISIS BEGAN

Valuations already appear to be declining

"Same" may also signal that it is too early to assess—perhaps no recent deals

Source: Angel Capital Association, COVID-19 impact survey of angel groups, April 2020



COVID DID NOT CREATE AN EQUITY BUYER'S MARKET

IN Q2 THE % EQUITY OWNED BY ANGELS CONTINUED TO DECLINE

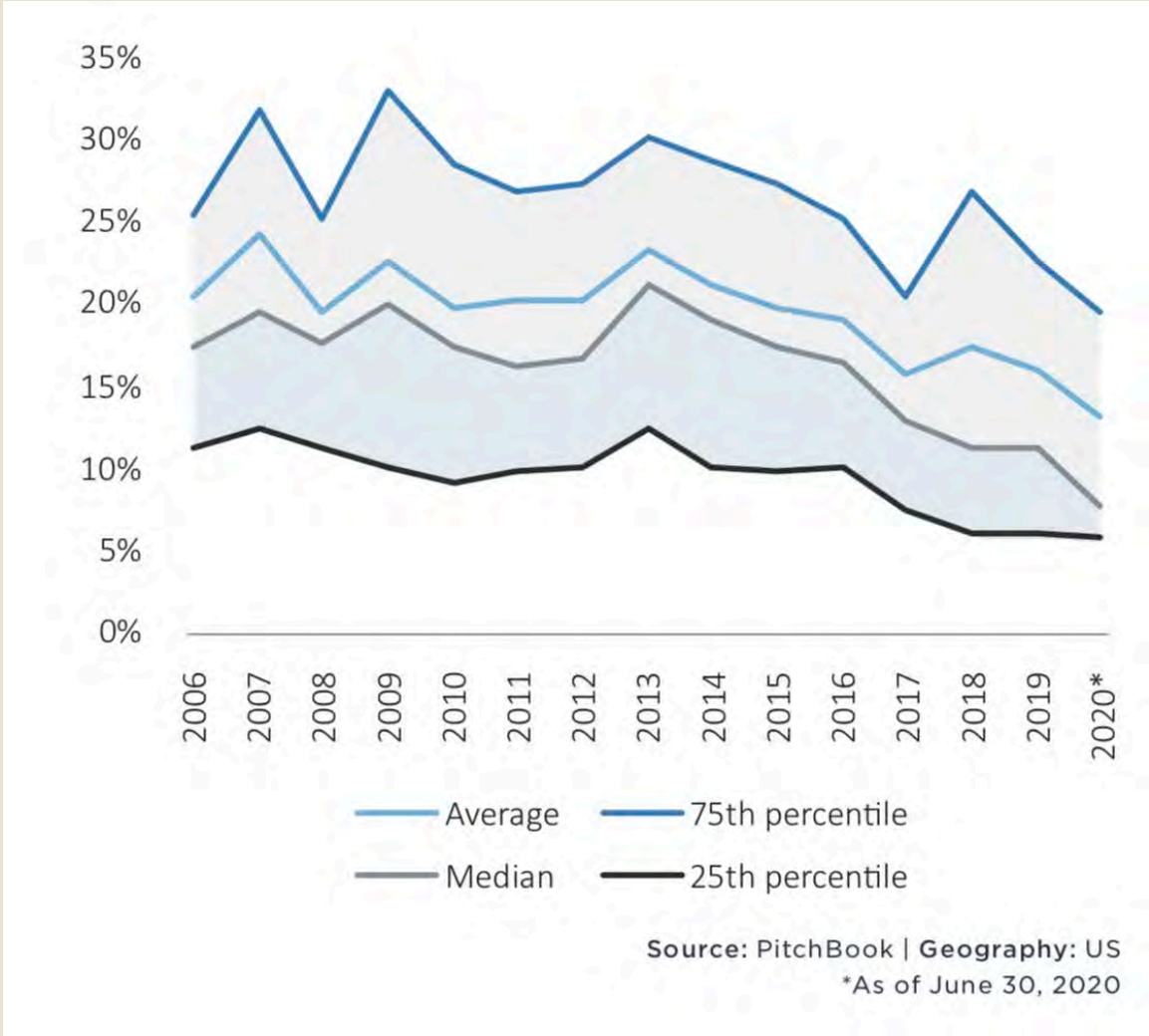
A BIT TOUGHER Q2 TERMS:

- 3X # OF DEALS WITH MULTIPLE LIQUIDATION PREFERENCES
- 3X PAY-TO-PLAY SINCE Q3'19
- 2X CUMULATIVE DIVIDENDS SINCE Q4'19

THESE TERMS AFFECTED ONLY A SMALL (BUT GROWING) % OF DEALS

(FENWICK & WEST)

Angel % Equity Continues to Decrease



PitchBook

BUT VERY STRONG SECTOR DIFFERENCES

COVID ACCELERATES EMERGING TRENDS

- TELEMEDICINE
- REMOTE MONITORING
- DRUG RESEARCH IN SILICO
- TELE-WORK, TELE-PLAY
- DISTANCE LEARNING
- ROBOTIC CARE / AUTOMATION
- AI-BASED WORK PROCESS
- AUTONOMOUS DELIVERY
- TOUCHLESS SERVICE
- HARDENED SECURITY
- HIGH PERFORMANCE, AI-EMBEDDED EDGE COMPUTING

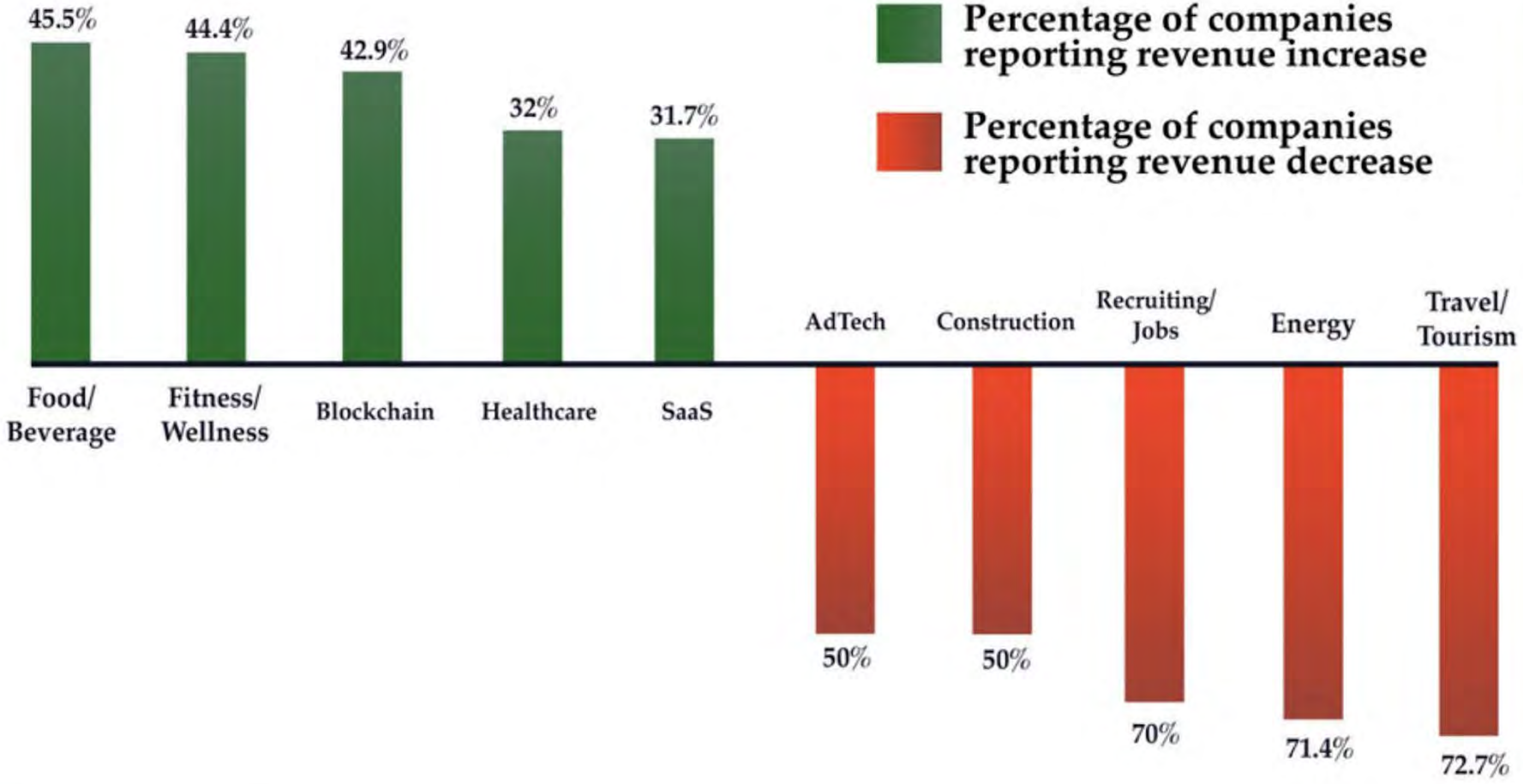
💰 Life Sciences
💰 Mobile
💰 Robotics
💰 Process Automation
💰 Security
💰 Defense Technology
💰 Food & Beverage
💰 Delivery Services
💰 Hardware
💰 Edu-tech
💰 Blockchain
💰 Verticalized AI
💰 Collaboration & Communications

💉 Local Services
💉 Hospitals
💉 Advertising
💉 Automotive
💉 Civilian Aerospace
💉 Transportation
💉 Leisure
💉 Retail
💉 High-end Fashion
💉 Hotels & Hospitality
💉 Travel
💉 Commercial Real Estate
💉 Sports and Recreation
💉 Arts & Entertainment
💉 Parking

In what markets are Founders most widely reporting revenue change?

NfX

VC/Startup Sentiment #2 (6/2)



FOUNDERS

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THE FORECAST VS. THE REALITY FOR Q2

Startup deals will continue to decline across all investing stages

Early-stage capital will be harder to raise

Deal sizes will shrink

US startup valuations will continue to decline

😐 Deal terms will begin to favor early-stage investors

Mass death of startups (Startup Genome)

Early-stage investing will be a less attractive asset class for CVCs & Fund investors

Industry attractiveness will continue to vary widely based on COVID-related factors

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GENERATION Z: COPING WITH COVID

- Board Games
- Series Z
- Public Market Recovery

TERM SHEETS
LEVERAGE MOVES FROM FOUNDERS TO INVESTORS

- More emphasis on Board oversight
- We are at the beginning of a global reset in venture capital (Morgan Stanley)
- More down rounds expected
- More participating liquidation preferences
- Fewer $: 60% of VCs will deploy <60% $ as '19
- More full-ratchet anti-dilution provisions

Sources: NfX (June 2020 VC Survey), Wall St. Journal (6/10/20), Pitchbook

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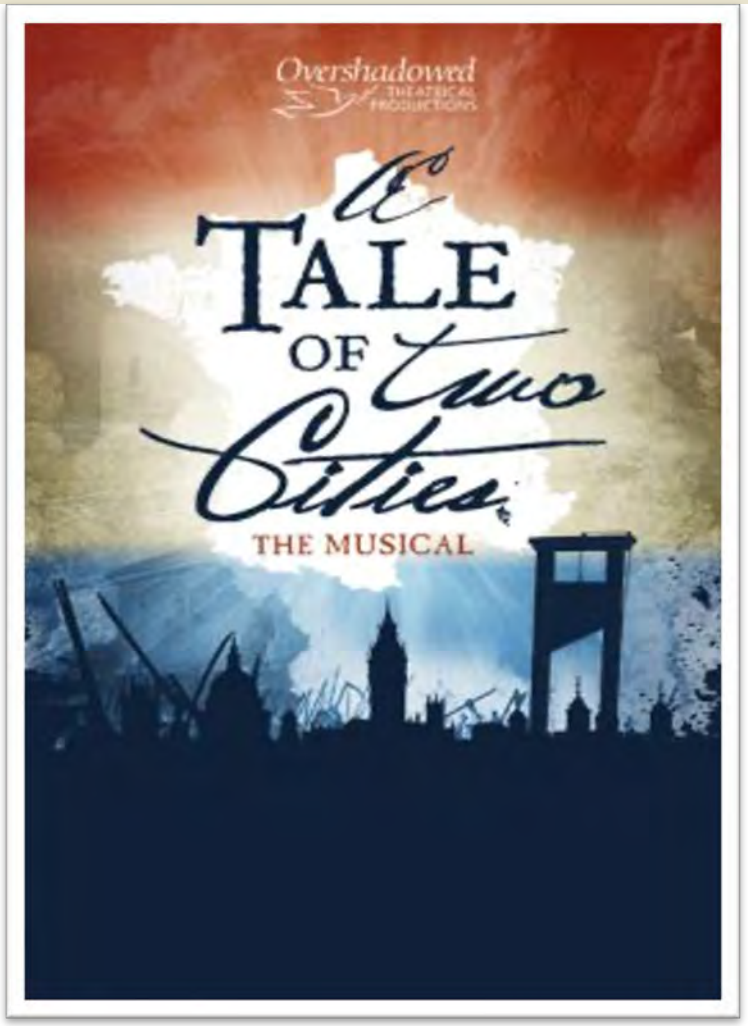
Q3

A Tale of Two Investors:

- While Angel and Seed $ continue to decline, angel confidence returns at the end of Q3
- Early-Stage VC continues to weaken



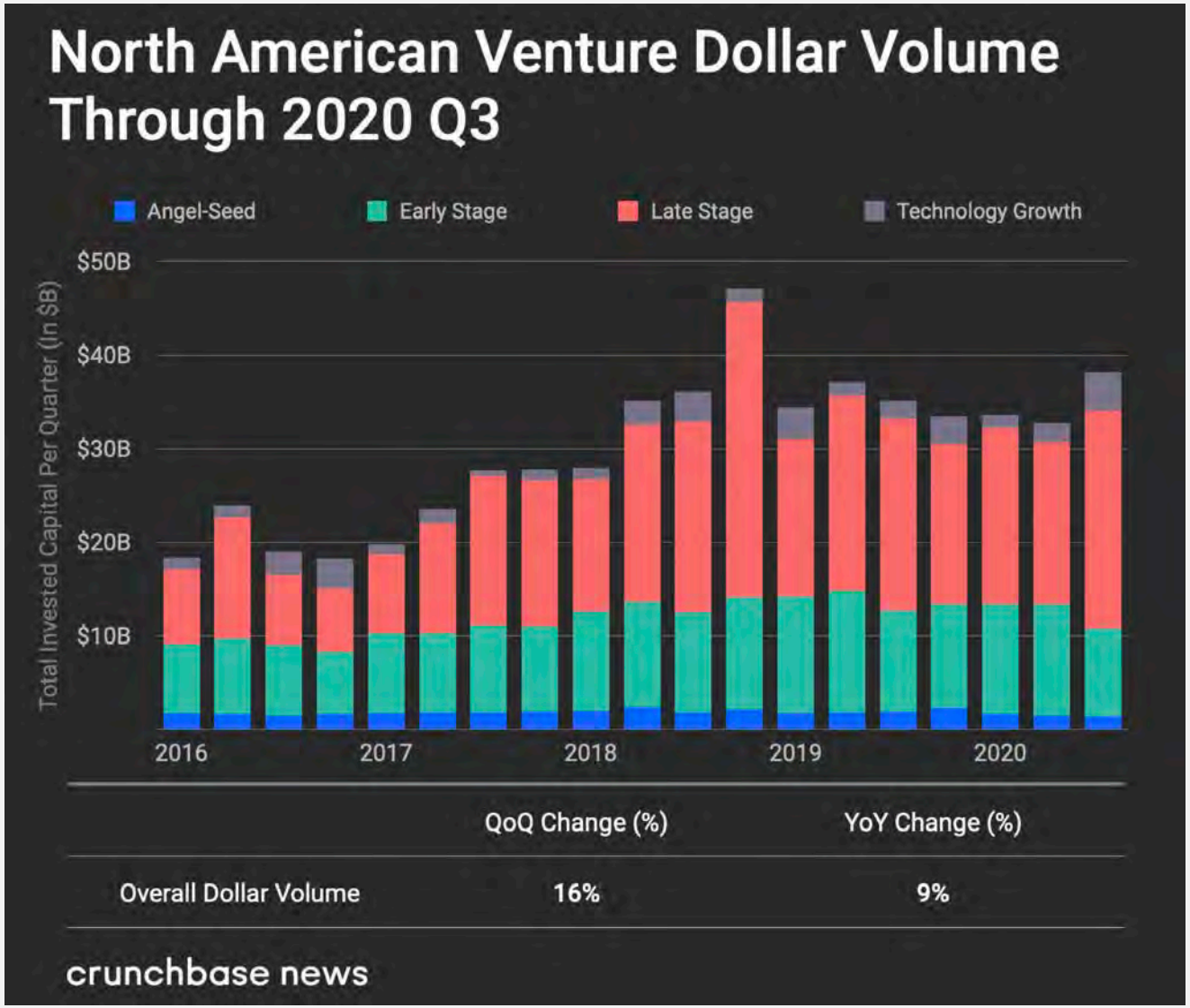
Q3: VENTURE FUNDING RECHARGED

Q3: $37B invested, 7 quarter high

Up 22% from Q3'19, Up 30% from Q2'20

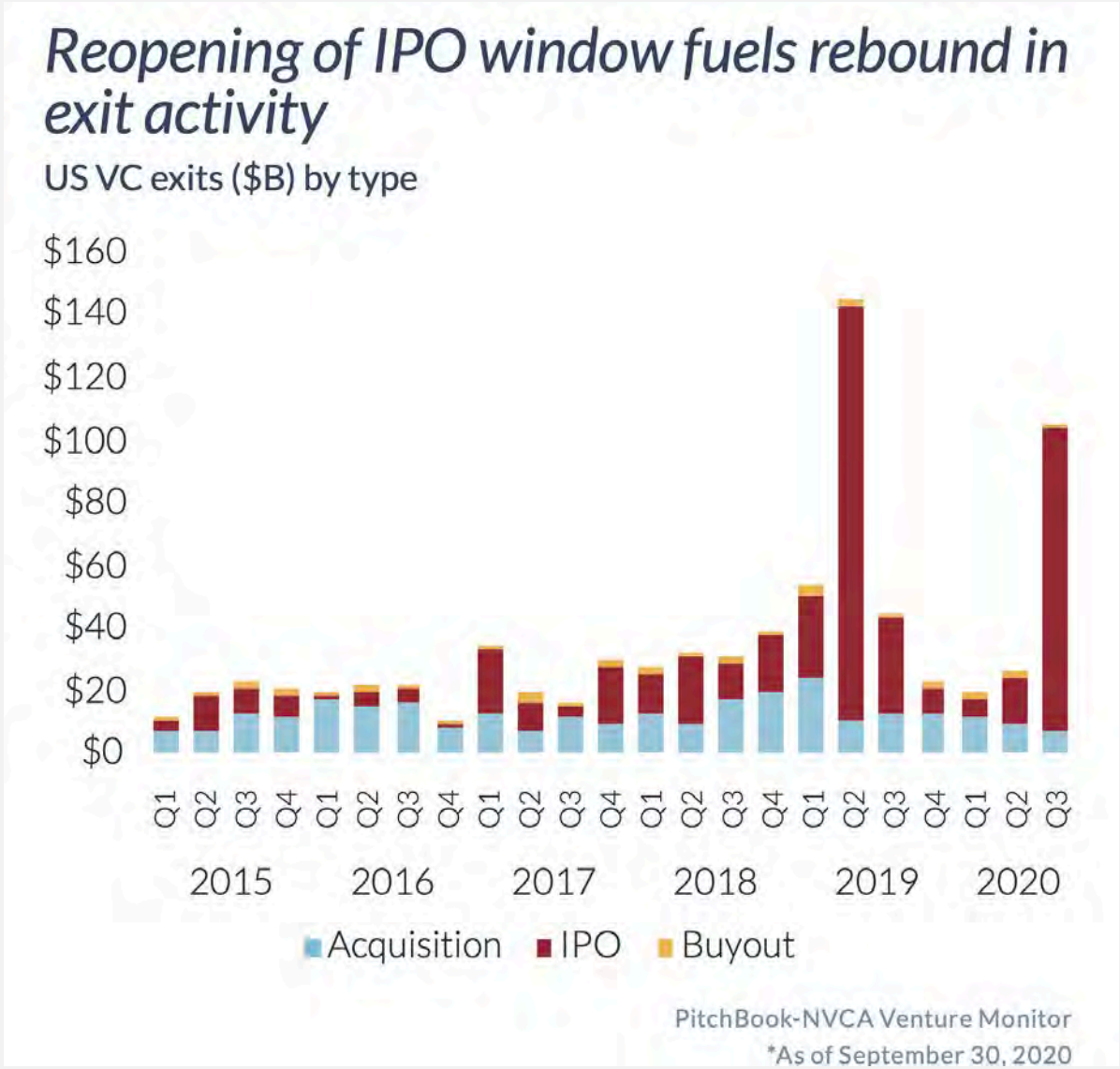
Deal count (2990) flat from Q3'19; $ up 9% YoY

Q1 – Q3 VC funds have raised as much as all of 2019



BUT IPOS AND LATE STAGE DOMINATE Q3 VC

- 88 MEGA-ROUNDS OF $100M+, ON PACE FOR 2020 TO SET A RECORD
- MEDIAN PRE-MONEY FOR LATE STAGE (SERIES E) ROSE FROM $70M TO $90M; SERIES D ROSE AS WELL
- 17 US UNICORNS
- 2ND BEST QUARTER FOR IPOS SINCE 2015
- LARGE FUNDS DOMINATED FUNDRAISING



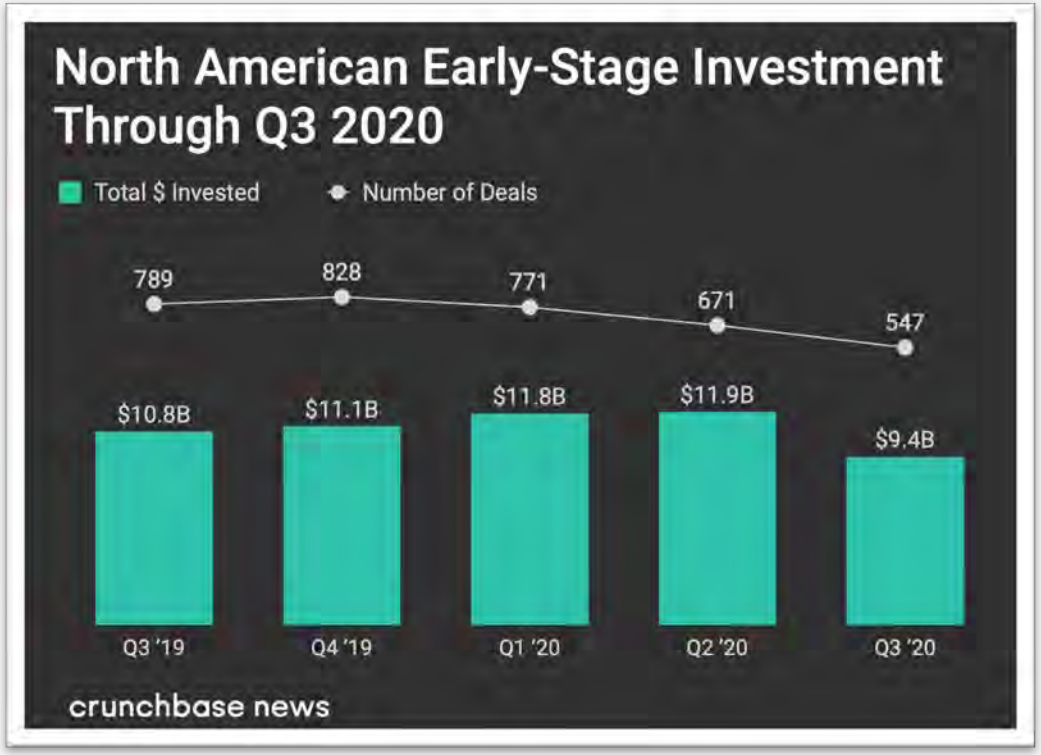
Angel & seed capital investment shows a slowdown over recent quarters

US angel & seed combined deal activity by quarter (with deal count estimation)

PitchBook-NVCA Venture Monitor
*As of September 30, 2020

EARLY STAGE CONTINUES TO LAG

- % of US deals under $5M the lowest since 2010
- % of $ in first time deals = 5.5%, a record low
- Only 23.7% of deals were first time financing
- Money shifted from early stage to growth stage ($25M to $50M tier)
- Early-stage VC $ (source of follow-on for angel rounds) is expected to fall 20% to 25% below 2019
- First time funds raised a record low of 3.4%
- But Seed stage showed a slight rebound in Q3 after 3 bad quarters
- Takeaway: Near term, it will be a bit harder for our investees to raise follow-on capital from VCs



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GROWING POSITIVE SIGNS

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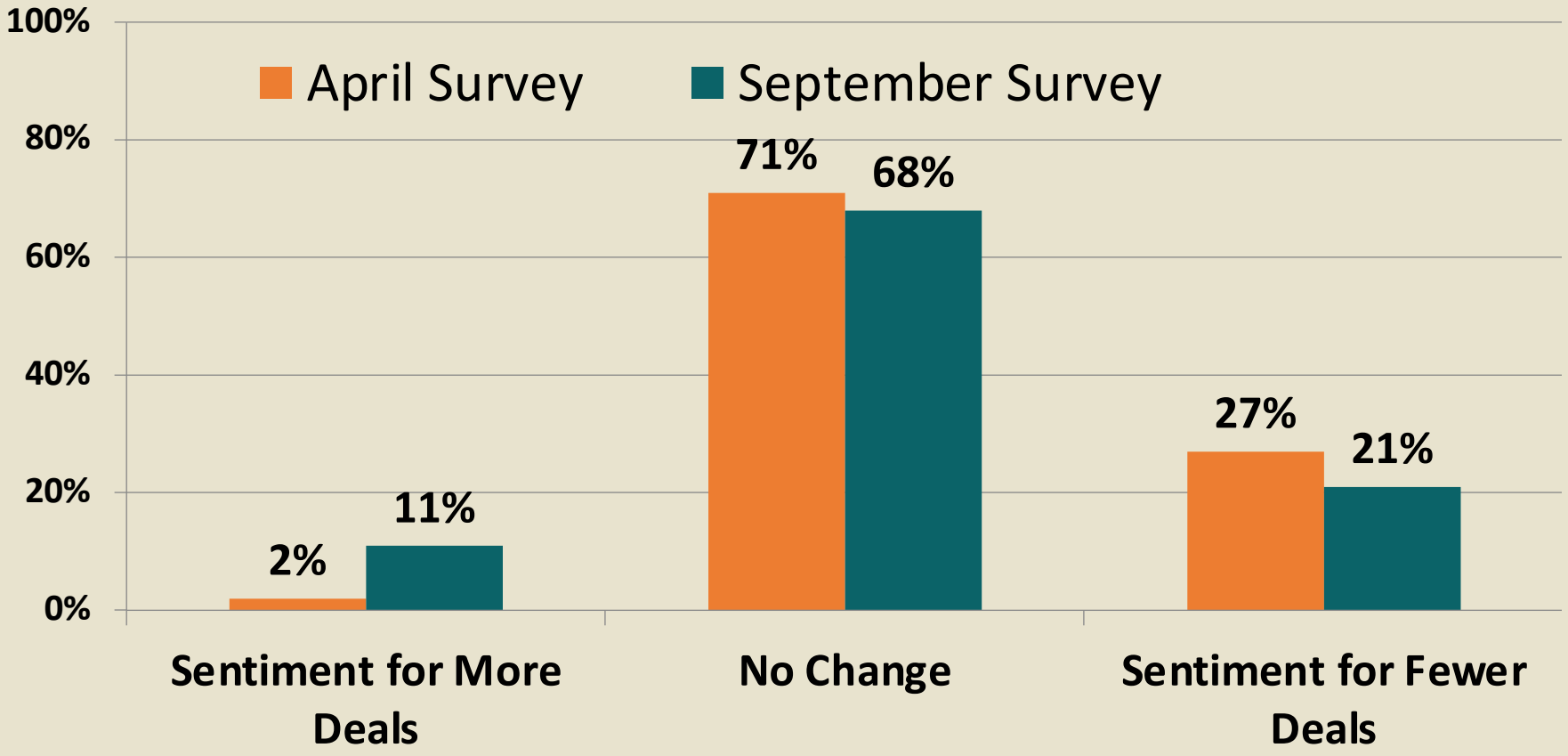
ANGEL INTEREST IN DEALS HAS INCREASED BETWEEN APRIL AND SEPTEMBER



- **While there is some sentiment for fewer deals since the pandemic, most angel groups or funds do not have a desire to change the current flow of incoming deals**
- **We saw a slight increase for groups wanting to do more deals**

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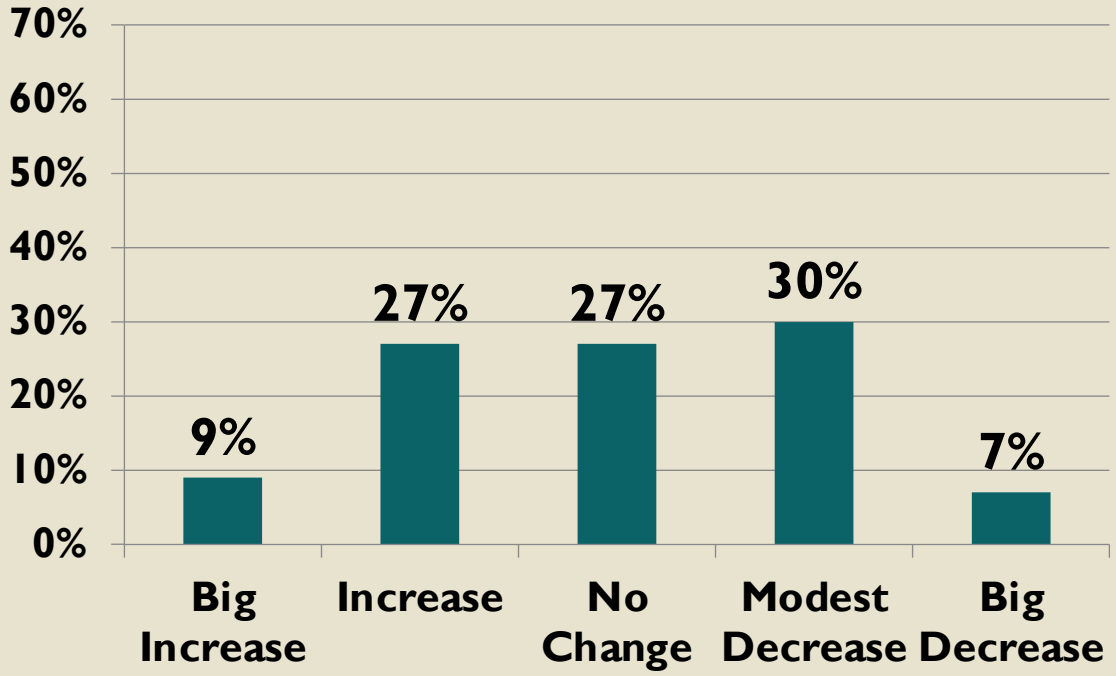
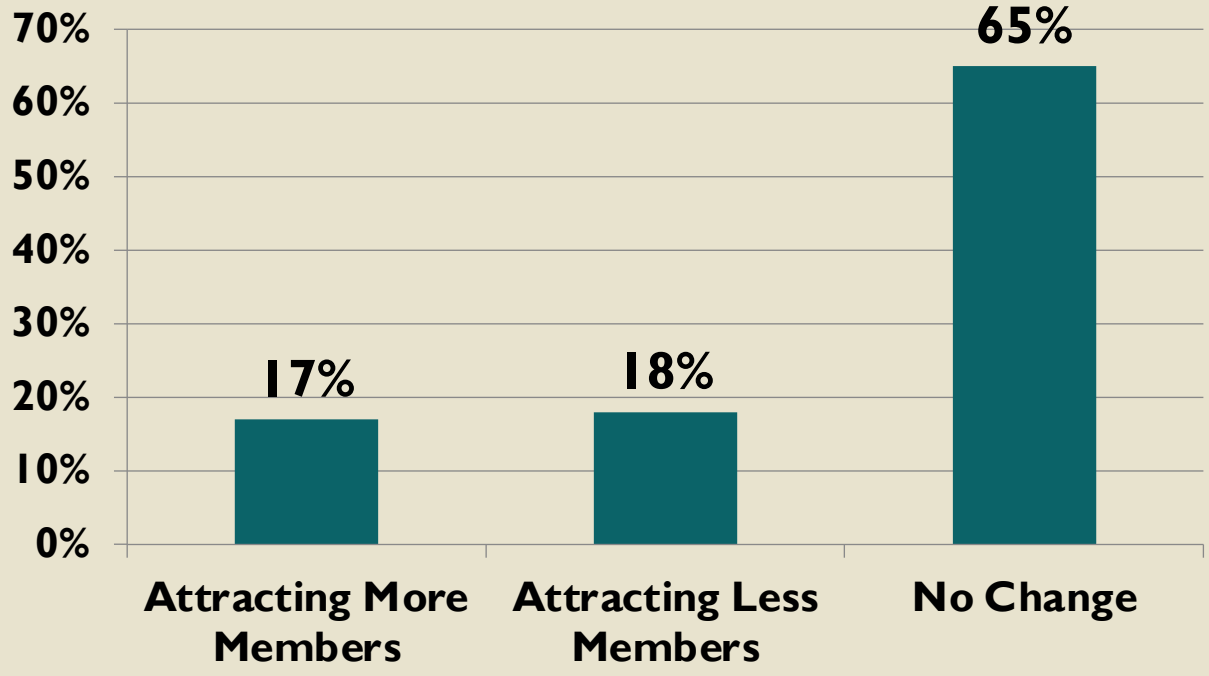
2/3 OF ANGEL GROUPS REPORT EITHER NO CHANGE OR INCREASING DEAL FLOW

Impact on Incoming Deals



Deals Via Video Conferencing and Impact With Members



- Deal flow is down, but only modestly
- 2/3 of groups have seen no change in members participating in deal meetings since video conferencing

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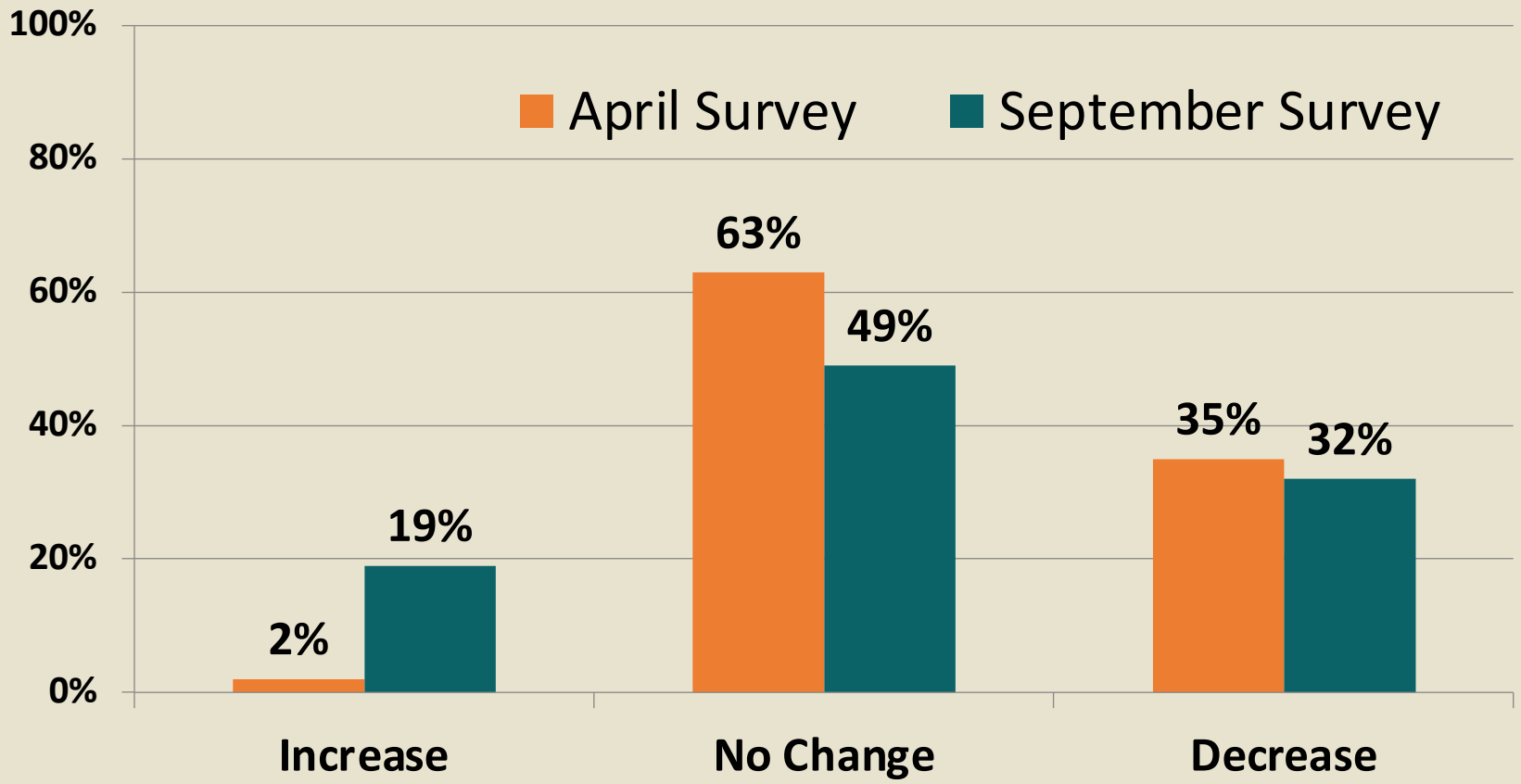
68% OF ANGEL GROUPS HAVE THE SAME OR GREATER INTEREST IN NEW DEALS AS BEFORE THE PANDEMIC



- **April to September 2020, members' willingness to invest in new investments has grown to 19%from 2%**
- **The overall decrease in interest is virtually unchanged.**

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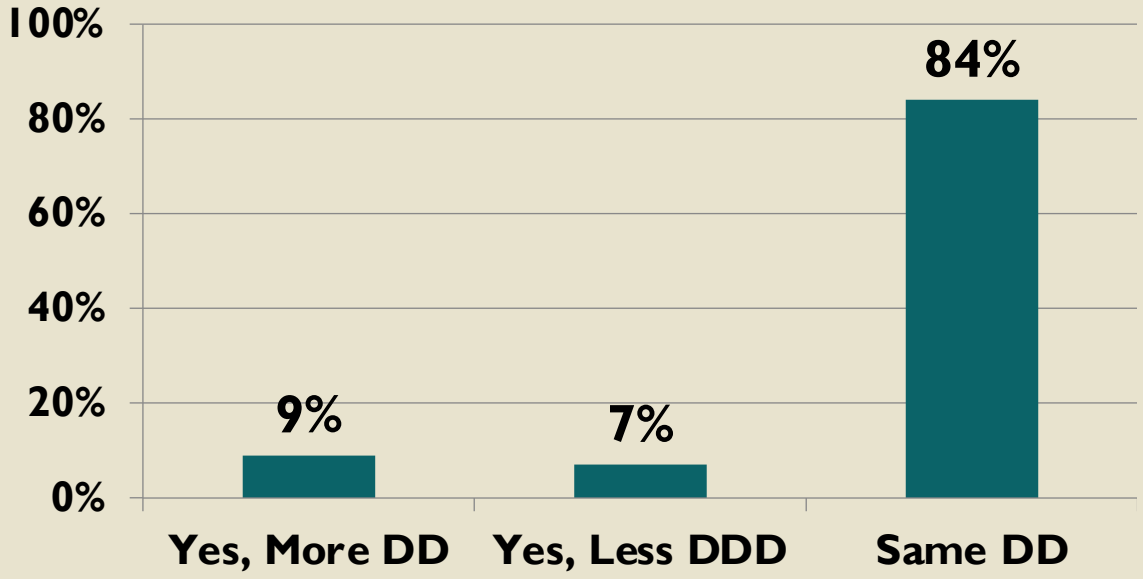
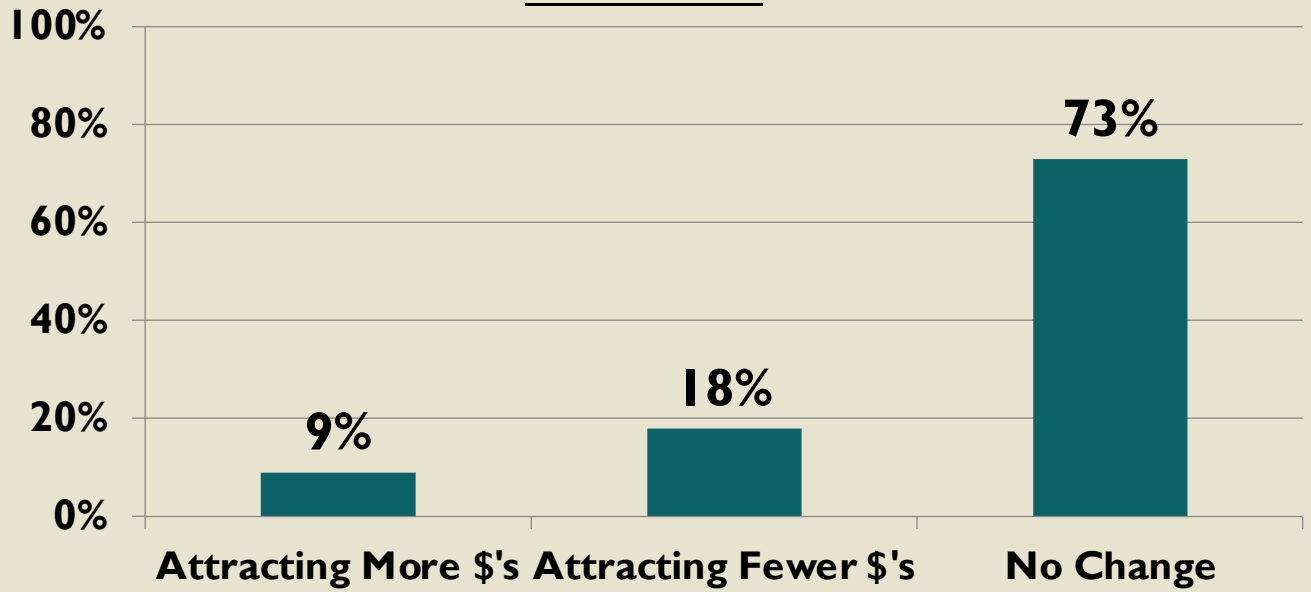
THE PANDEMIC HAS NOT AFFECTED ANGEL DILIGENCE, ONLY 18% OF GROUPS SAY THEY'RE INVESTING LESS

Is Pandemic Affecting Due Diligence on Deals?



Pandemic Impact on Dollars Invested in Deals



- Pandemic has not impacted due diligence
- Virtually no change to dollars invested in deals since the pandemic

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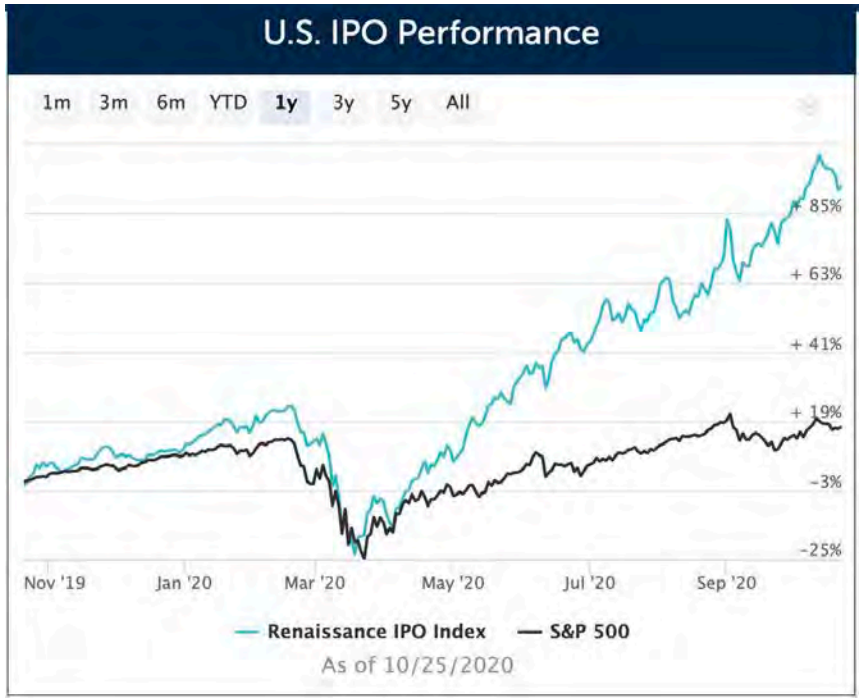

Notable North American IPOs In Q3 2020

Name	Sector	Headquarters	Money Raised in IPO	Recent Market Cap	Symbol
Snowflake	Data warehousing	San Mateo, CA, U.S.	$3.4B	$69.8B	NYSE: SNOW
Unity Technologies	3D development	San Francisco, CA, U.S.	$1.3B	$22.9B	NYSE: U
Palantir Technologies	Data analytics	Denver, CO, U.S.	NA*	$22.8B	NYSE: PLTR
GoodRx	Online pharmacy	Santa Monica, CA, U.S.	$1.1B	$21.7B	NASDAQ: GDRX
Amwell	Telehealth	Boston, MA, U.S.	$.7B	$9.0B	NYSE: AMWL
Nuvei	Payments	Montréal, Quebec, Canada	$.8B	$7.0B	TSX: NVEI
Asana	Workplace collaboration	San Francisco, CA, U.S.	NA*	$4.0B	NYSE: ASAN
Lemonade	Home and renter insurance	New York, NY, U.S.	$.3B	$3.0B	NYSE: LMND

crunchbase news

IPO MARKET ROARS BACK

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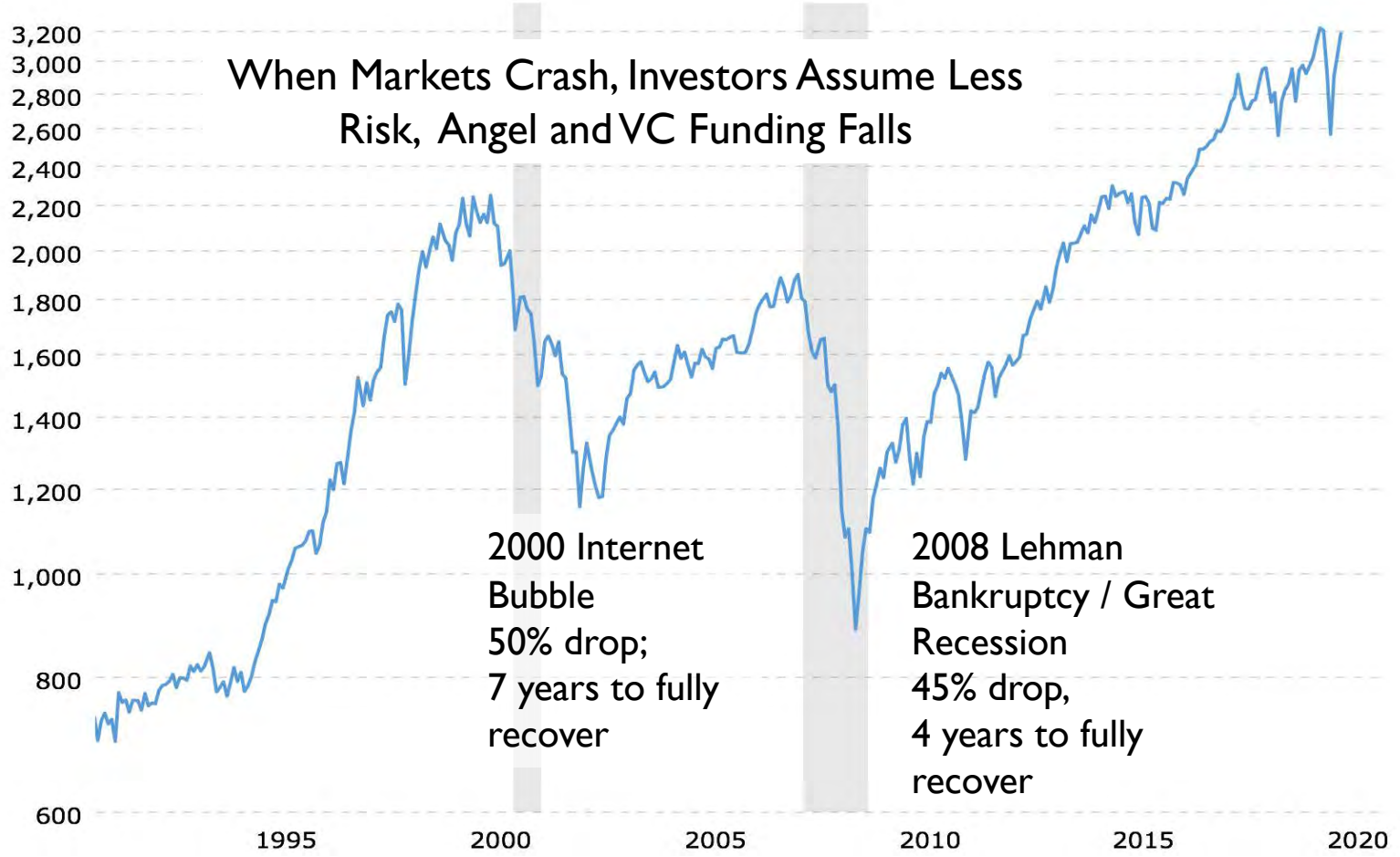
S&P 500



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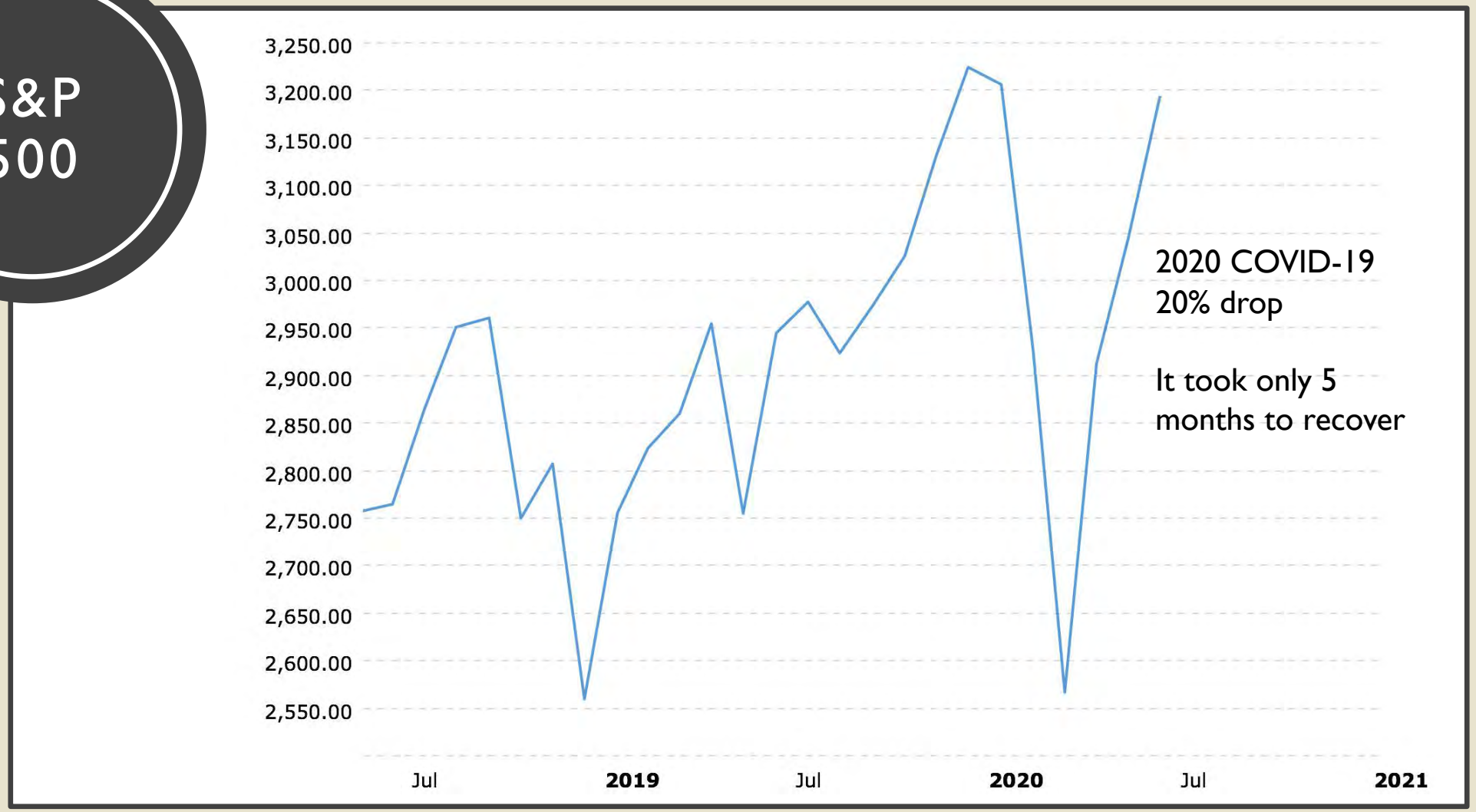
S&P 500



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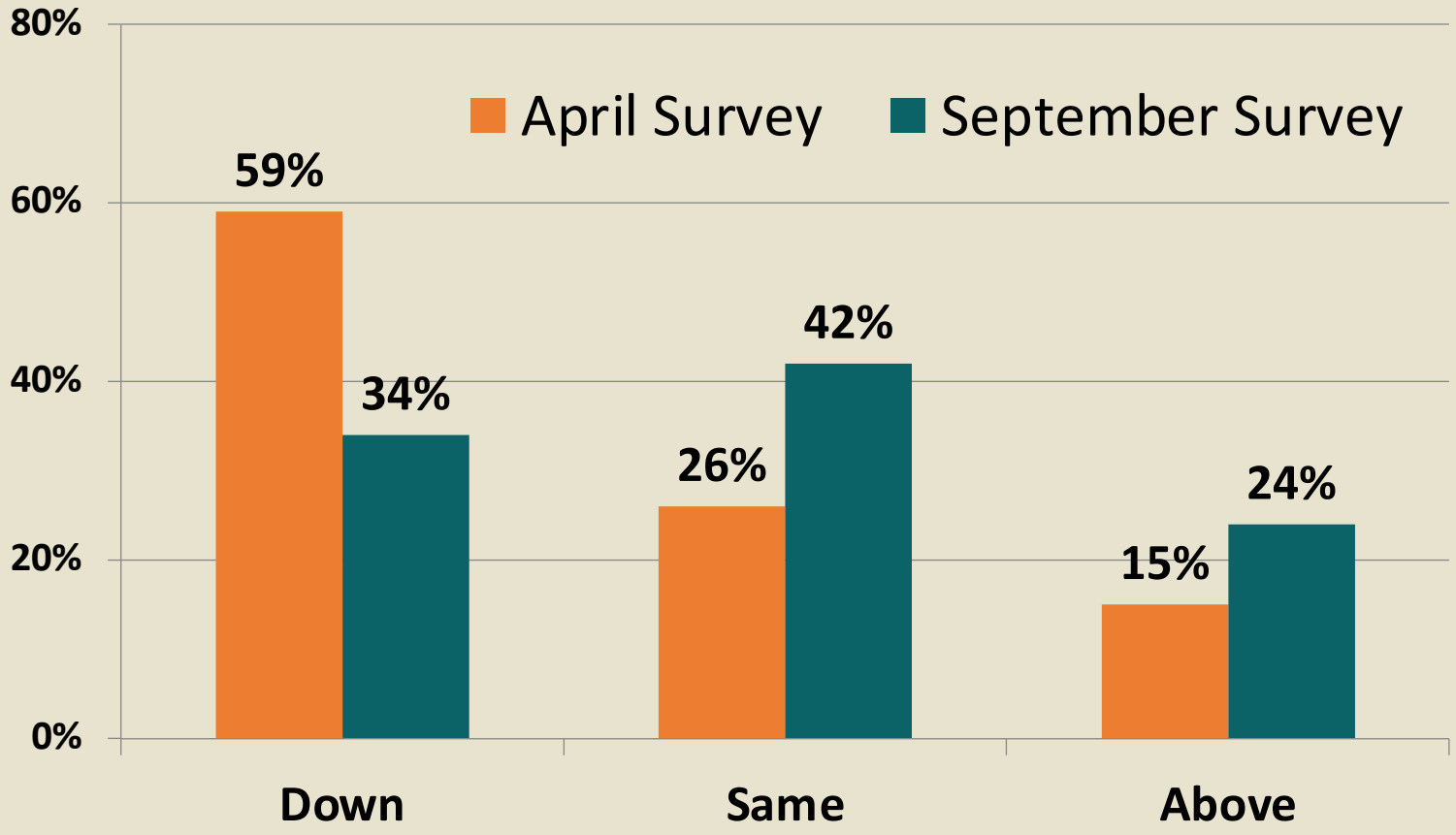
ANGEL INVESTING EXPECTATIONS STABILIZING:
ESTIMATE OF DOLLARS INVESTED BY GROUP FOR TOTAL YEAR (2020 VS 2019)



- **Five months since the first pandemic survey has seen a big change sentiment**
- **In April, 59% were estimating $'s invested to be down only 34% in the September survey forecast investing less**
- **Two thirds of angel groups will invest the same or more than in 2019**

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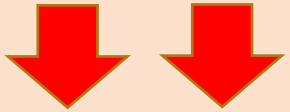
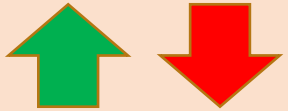
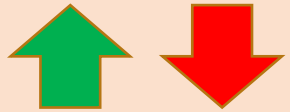
ANGEL AND VC REACTIONS TO THE PANDEMIC

	Angels*	VC Trends**
Early-Stage Deal Volume		
Early Stage $$		
Sentiment		Late  Early
Valuation		
First time vs. Follow-ons		Follow-on  New

**Angel Funders Report 2020,* Angel Capital Association, October 2020

*** Q3 2020 Crunchbase and NVCA/Pitchbook/MoneyTree* reports

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GENERAL CONCLUSIONS

- *Early-stage capital markets remain down compared to 2019, but are starting to stabilize and some sectors are very strong*
- *It is not an apocalypse and hardly the multi-year collapse predicted by some due to our prior experience with the Great Recession*
- *Viewed in context, quarterly ups and downs don't matter all that much. Angels build companies for the long term, typically with a 7-year exit horizon.*
- *As the ACA Pandemic survey illustrates, angel funding, diligence and post-investment mentoring haven't materially changed from 2019. Despite COVID, North American Angel investing remains quite active and healthy.*

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CONCLUSION: MARKET TRENDS

There are many healthy signs:

- The S&P 500 recovered after 5 months
- Q2/Q3 IPO market was one of the strongest and Q4 is red hot
- Angel funding has stabilized. 76% of survey respondents anticipate either no change or an increase in angel funding year over year

But a few worrisome signs, too:

- As VCs move later stage, angels are asking, "Where will next round $ come from?"
- A continued decline in angel equity ownership = reduced angel influence on term sheets, governance, corporate culture and responsible governance

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CONCLUSIONS: MOVING FORWARD

- Investors are embracing "Generation Zoom" deals and experimenting with new models of diligence and deal execution
- The Pandemic has accelerated the adoption of telehealth and remote learning and networked meeting tools—major investment opportunities
- Down markets are a terrific time to invest
- Investors continue to play a critical portfolio role as mentors in troubling times

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CONCLUSIO Don't Panic! O COMPANIES

- Angels and VCs report more resilient CEOs and companies than in prior crises
  - 68% of portfolio companies have reduced headcount and adopted "cash is king" policies
- Angels have a critical role to play in keeping our companies healthy and funded particularly while VCs retreat from funding new early-stage deals (our follow-ons)
- While the VC ecosystem has moved late stage, the angel ecosystem has recovered well from the initial pandemic impact and the health of the US angel ecosystem remains strong

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- **2021 ACA Summit – May 4-6**

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