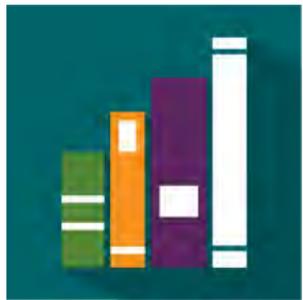


# THE RISE OF STARTUP VALUATIONS

July 14, 2021



**ANGEL CAPITAL ASSOCIATION**



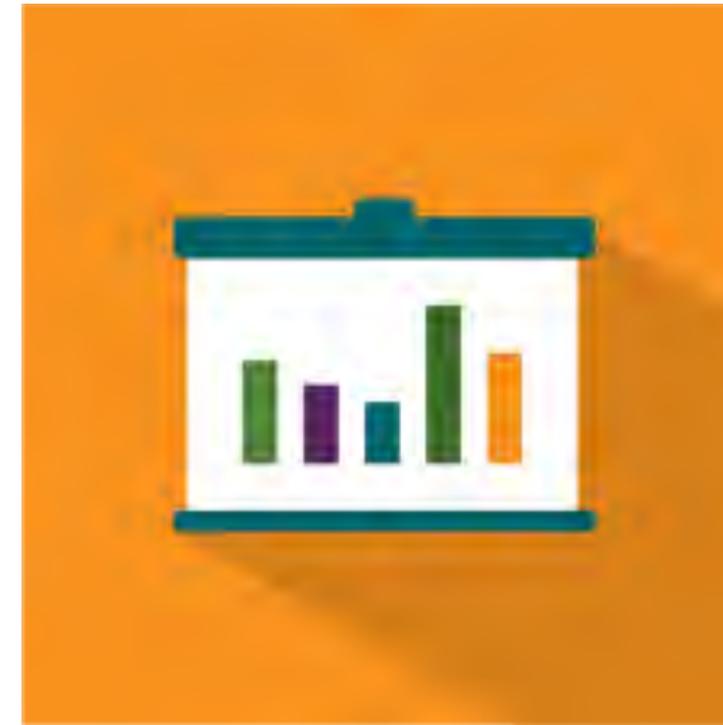
# Angel Capital Association Today



Great  
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Advocacy in DC

**WORLD'S LARGEST PROFESSIONAL SOCIETY OF ACTIVE  
ACCREDITED ANGEL INVESTORS - [WWW.ANGELCAPITALASSOCIATION.ORG](http://WWW.ANGELCAPITALASSOCIATION.ORG)**



# HOW TO GET VALUE FROM THIS WEBINAR



- Use chat to submit questions
  - Yes, you'll get the slides and video
  - We're recording, so come back and listen again
  - Contact Heather Krejci with questions:  
[hkrejci@angelcapitalassociation.org](mailto:hkrejci@angelcapitalassociation.org)
- 

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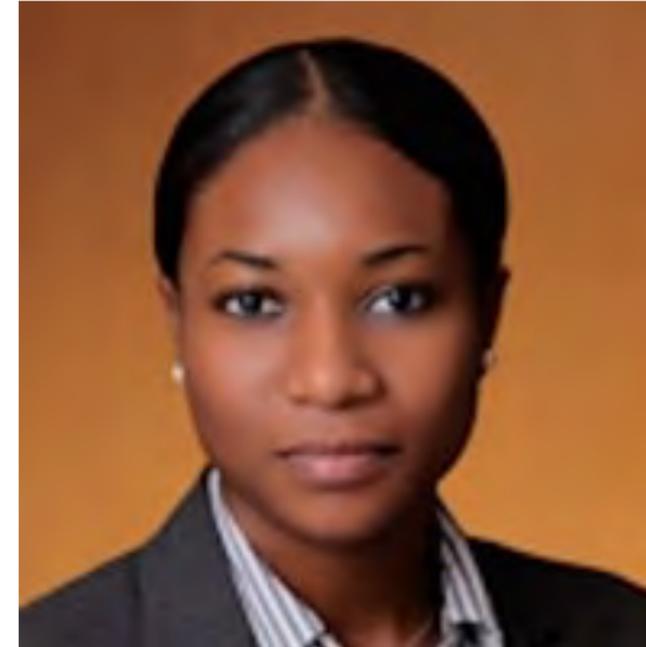
# SPEAKER AND MODERATOR

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**Ron Weissman**

Band of Angels



**Ashley Flucas**

Flucas Ventures



# THE RISE OF STARTUP VALUATIONS

Ron Weissman

Chairman, Software Industry Group, Band of Angels  
Vice Chair, Angel Capital Association



**ANGEL CAPITAL ASSOCIATION**



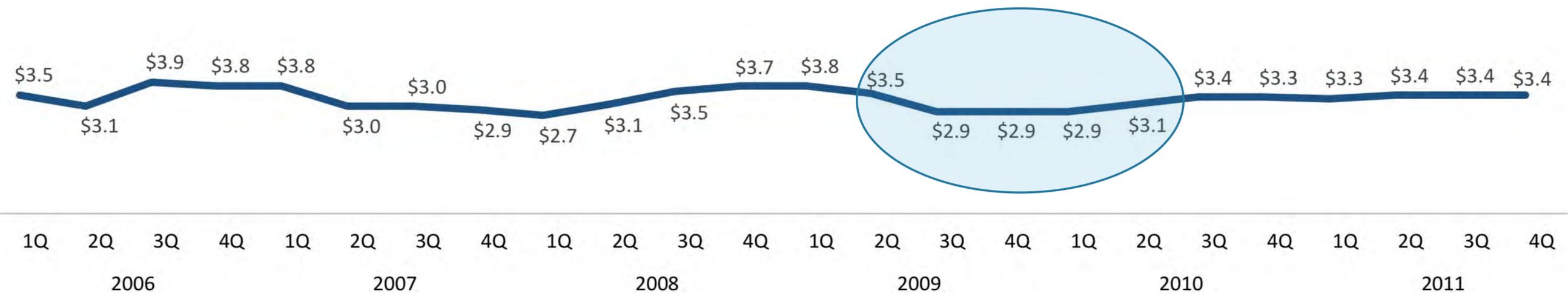
# AGENDA

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- Expectations for 2020
- 2020: What Actually Happened?
- 2021 Valuations and Asset Bubbles
- Valuation Smart Practices

# EXPECTATIONS FROM THE GREAT RECESSION (2008-2010)

## Decline in Angel and Seed Pre-Money Valuations



Source: PitchBook | Geography: Global

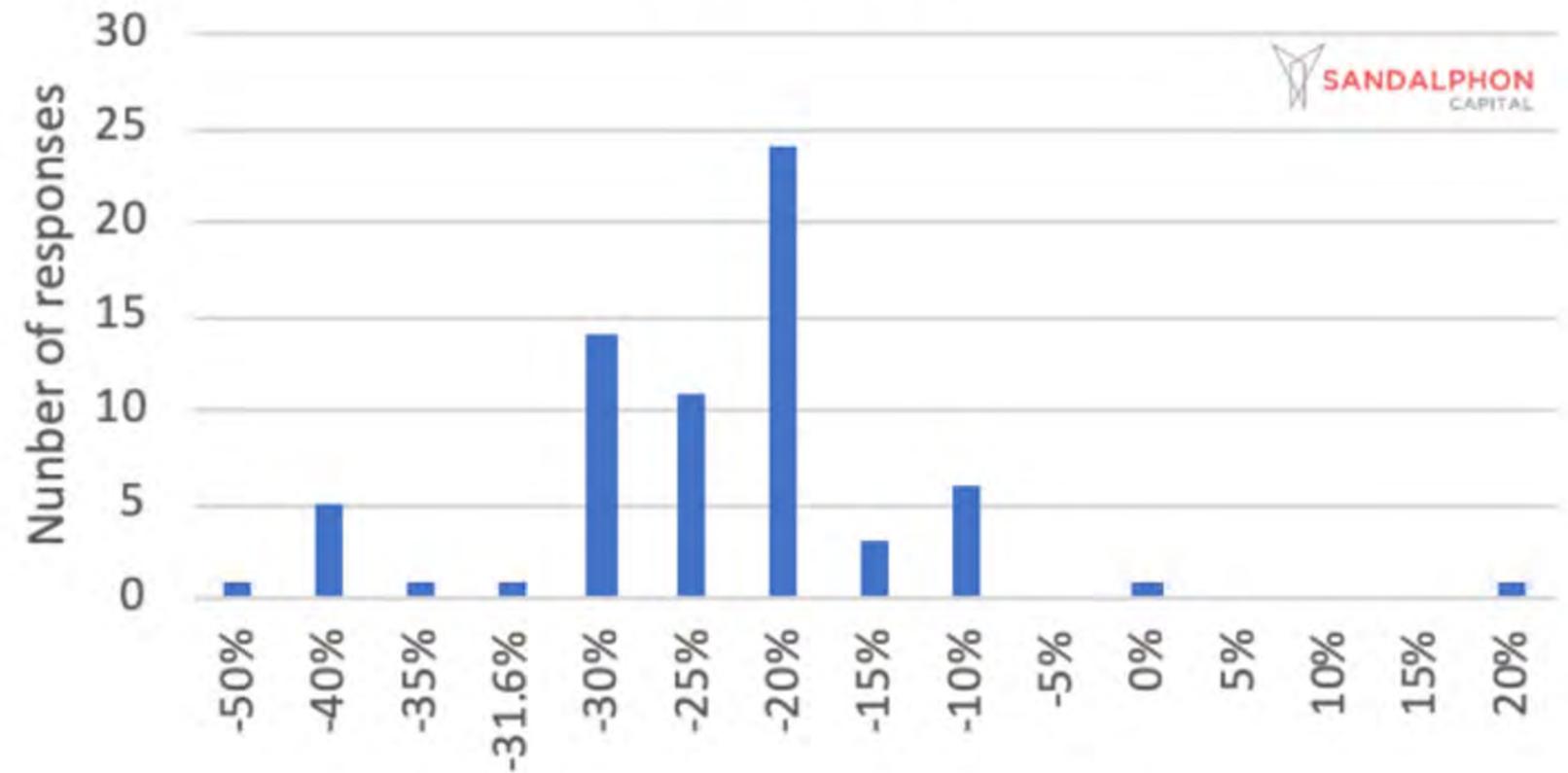
# SHARP COVID-CAUSED DROP IN S&P MIRRORS PUBLIC CONFIDENCE

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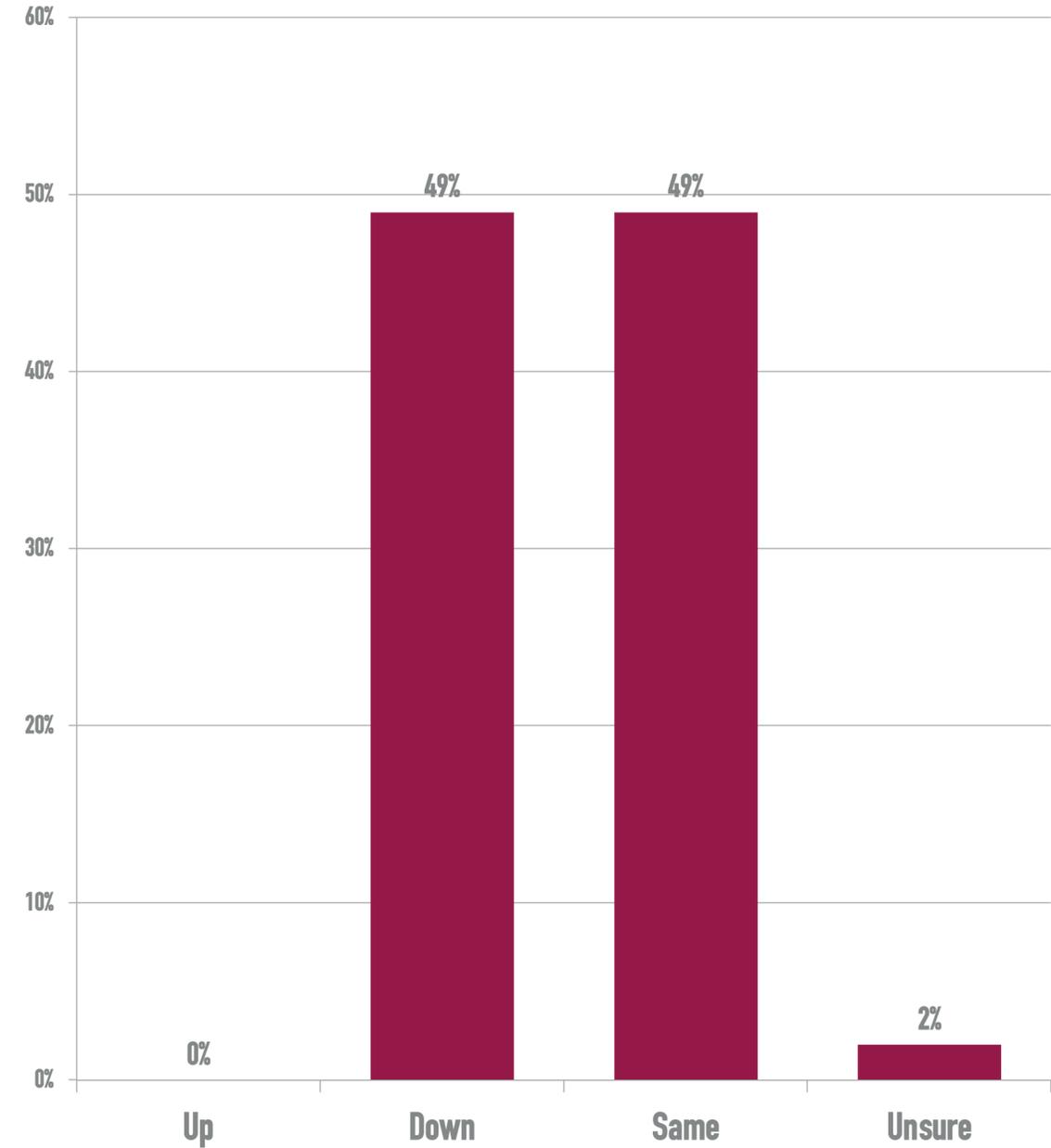
**IN APRIL VCS EXPECTED VALUATIONS TO FALL 20% – 30% (SANDALPHON, APRIL 2020)**

**Expected % change in average valuations from 2019 to 2020**





# IN APRIL 2020, ACA'S PANDEMIC STUDY REVEALED A SHARP DECLINE IN ANGEL-LED VALUATIONS

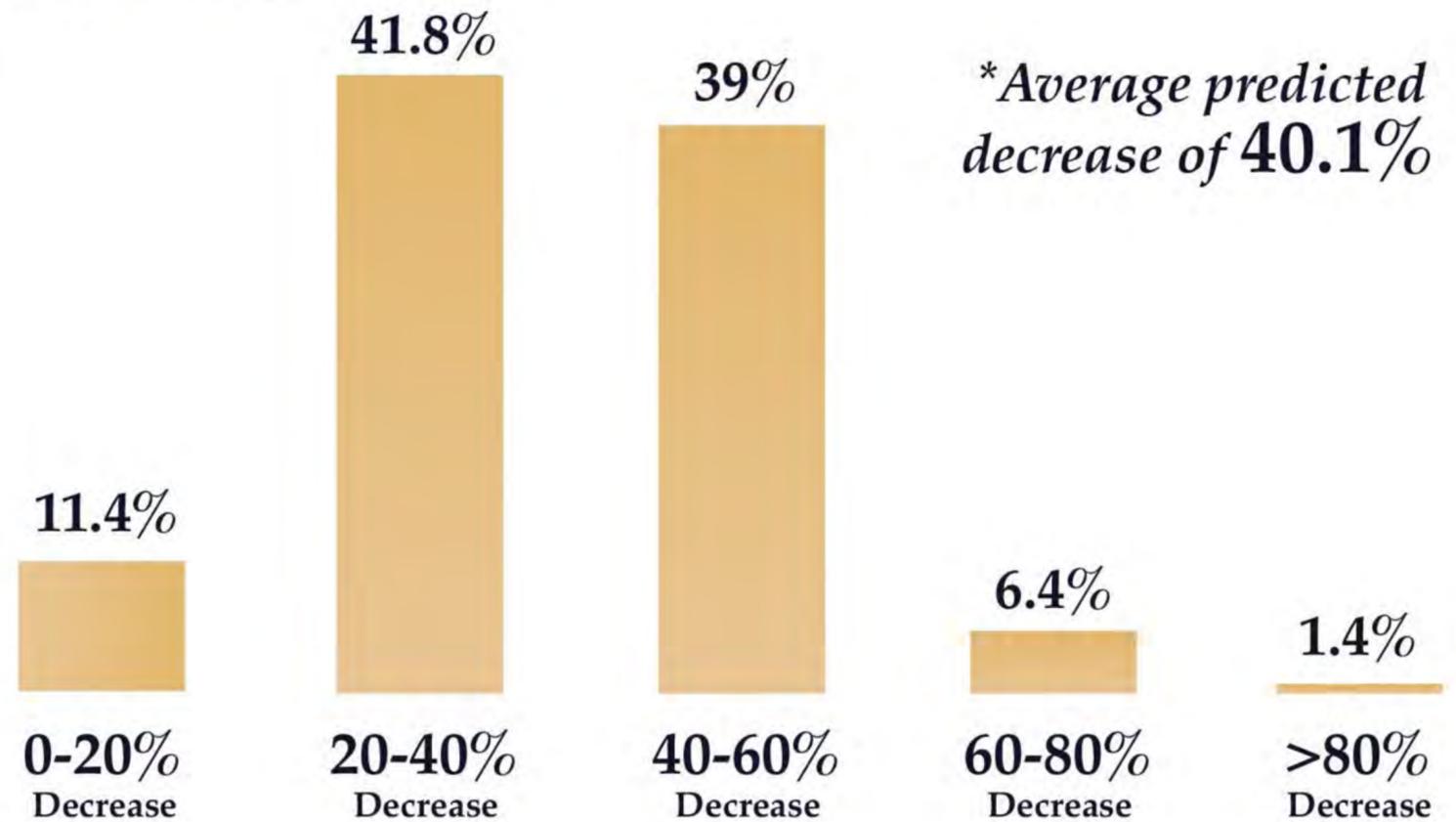


# JUNE 2020 SURVEYS PREDICTED STRONGER VALUATION DECLINE

Summary - What do VCs think the overall decrease in valuations will be from pre-pandemic levels?

NfX

VC/Startup Sentiment #2 (6/2)



INVESTORS

# Q3 2020 – EARLY-STAGE VC FUNDING CONTINUED TO LAG

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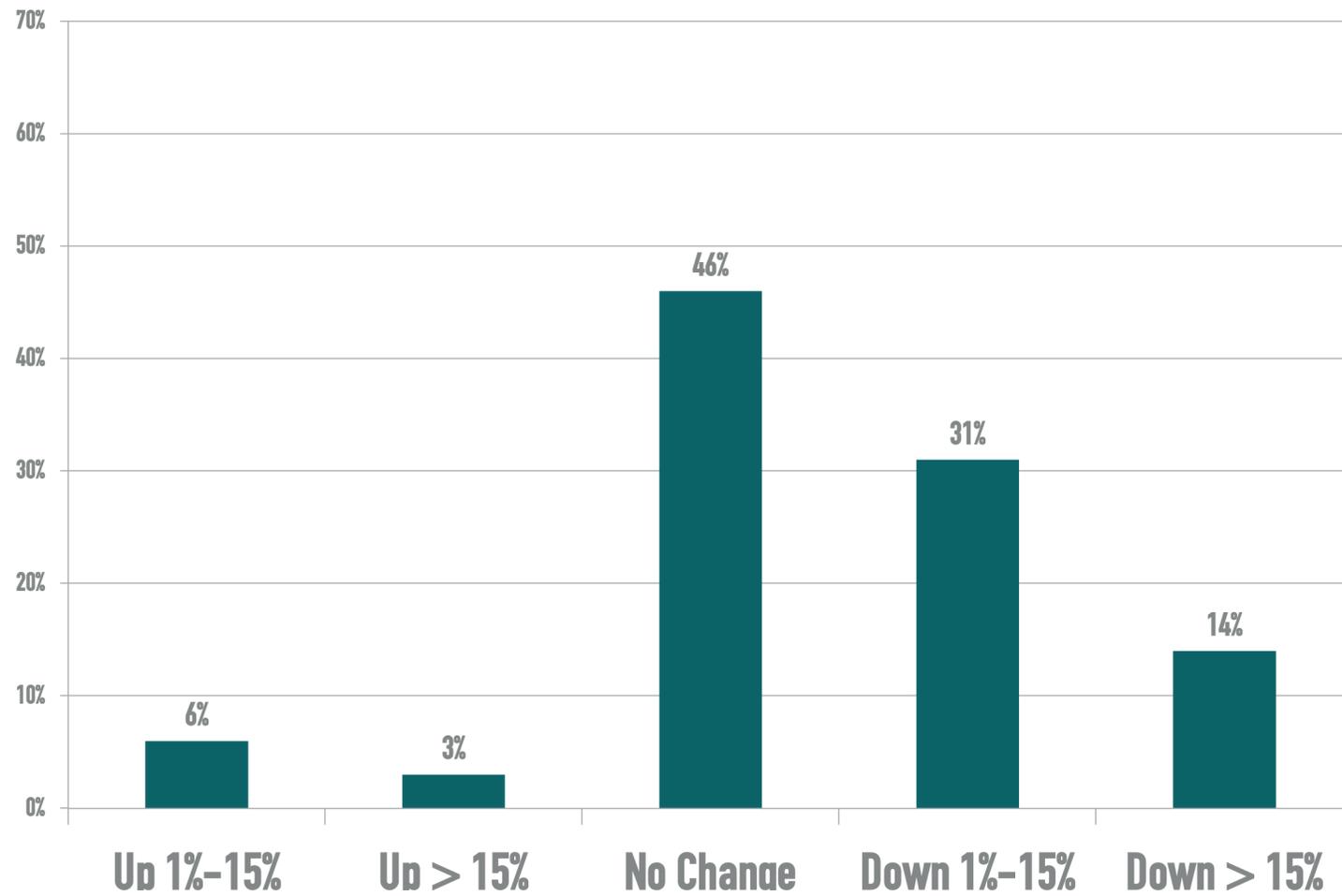
- % of US deals under \$5M the lowest since 2010
- % of \$ in first time deals = 5.5%, a record low
- Only 23.7% of deals were first time financing
- Money shifted from early stage to growth stage (\$25M - \$50M tier)
- First time funds raised a record low of 3.4% of all capital raised by VCs
- Takeaway: Near term, it will be a bit harder for angel-backed companies to raise next round capital from VCs

Sources: NVCA/Pitchbook, Crunchbase

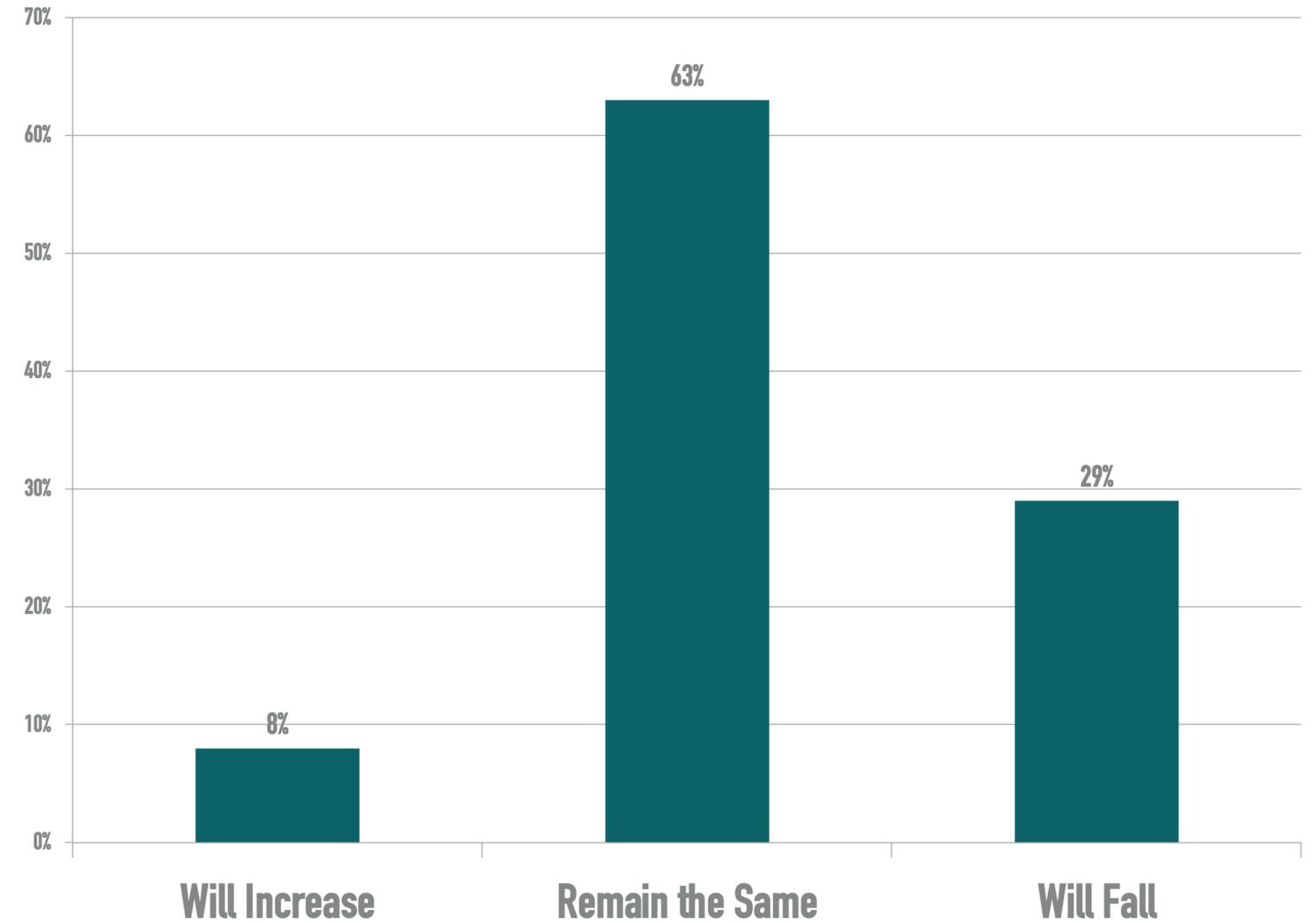


# SEPTEMBER 2020: 45% OF ANGEL GROUPS REPORTED LOWER VALUATIONS. BUT ONLY 29% BELIEVED THIS WOULD CONTINUE.

Valuation Changes



Valuation Expectations For Remainder of 2020



# SO, WHAT ACTUALLY HAPPENED IN 2020?

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- There were short-term valuation declines early to mid 2019
- Full year predictions that 2020 valuations would decline by 20% to 40% did not happen
- Comparing 2019 to 2020, valuations across all stages increased
- Median overall 2020 seed stage valuations increased 8% compared to 2019
- Later stage valuations increased by as much as 20% to 25%

Sources: Angel Capital Association Data Analytics initiative, CB Insights, NVCA/Pitchbook



# WHY THE VALUATION RECOVERY? THE INITIAL S&P COVID DROP WAS SHARP... BUT

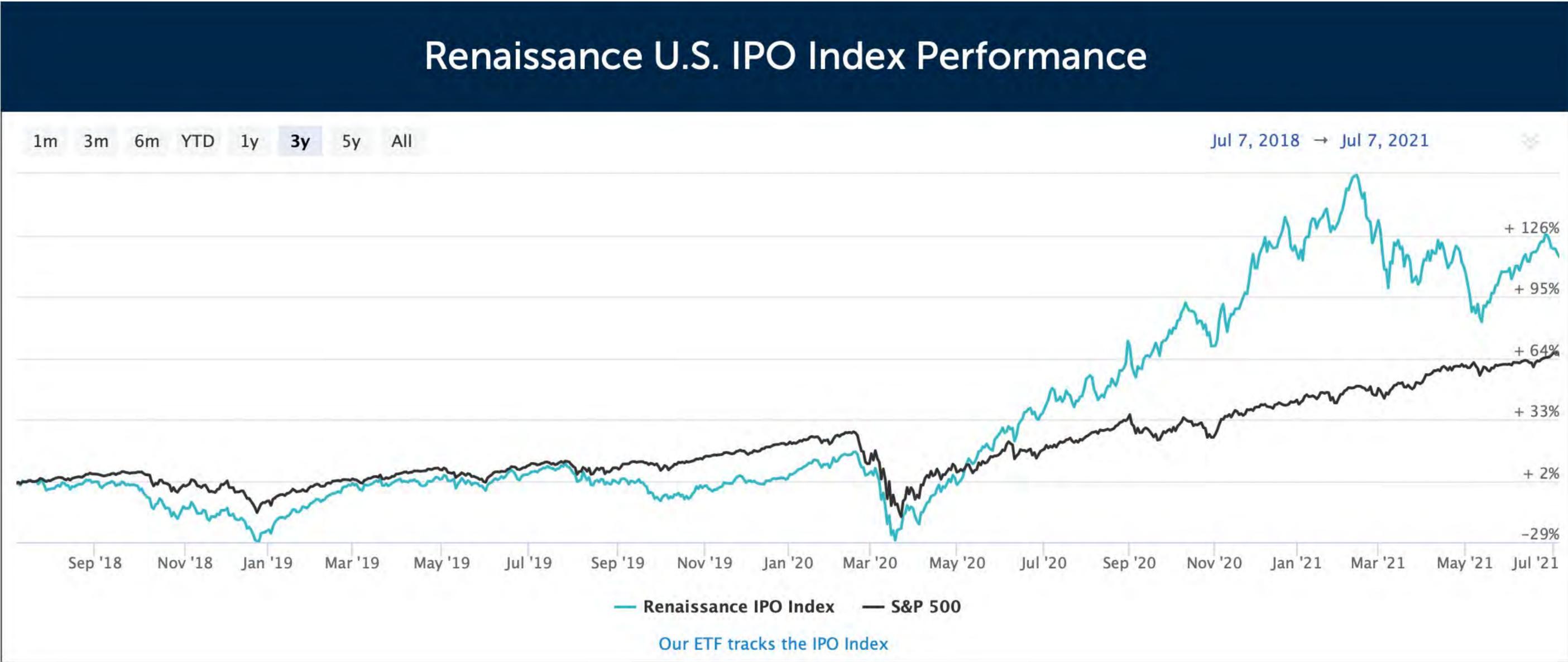
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# S&P PUBLIC CONFIDENCE BOUNCED BACK SOONER THAN EXPECTED

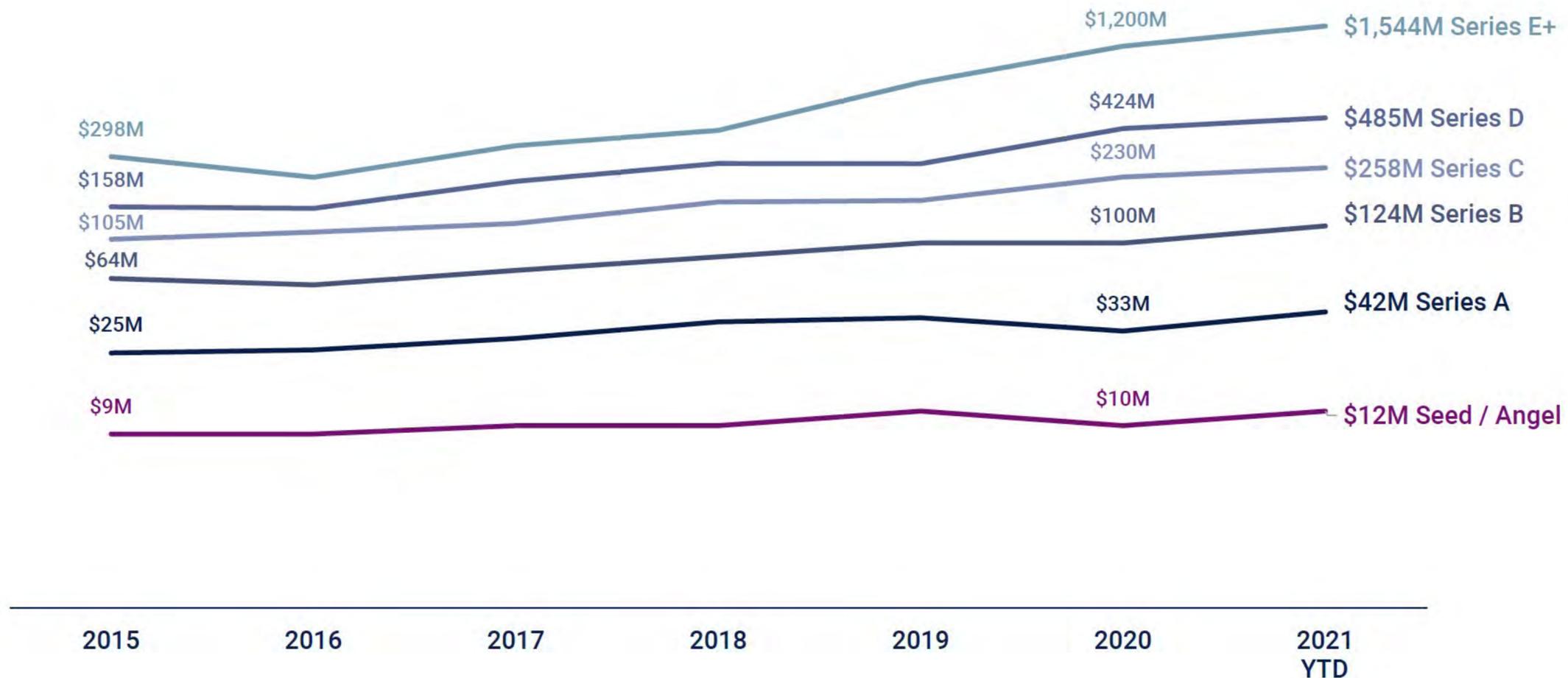


# S&P 500 AND IPO INDEX CONTINUE GROWTH IN 2021



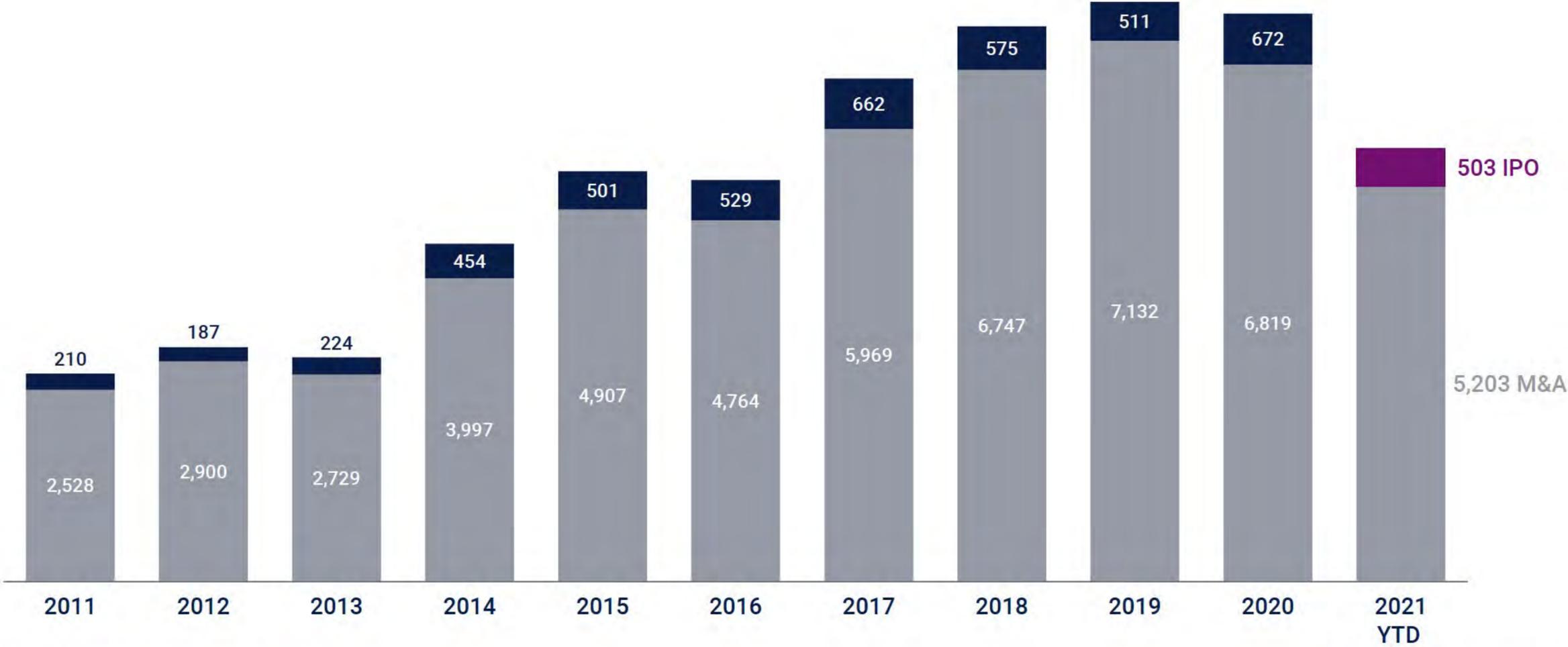
# WHERE ARE WE NOW? VALUATIONS HAVE ALREADY RISEN 20%+ IN 2021

## US median valuation per round by year



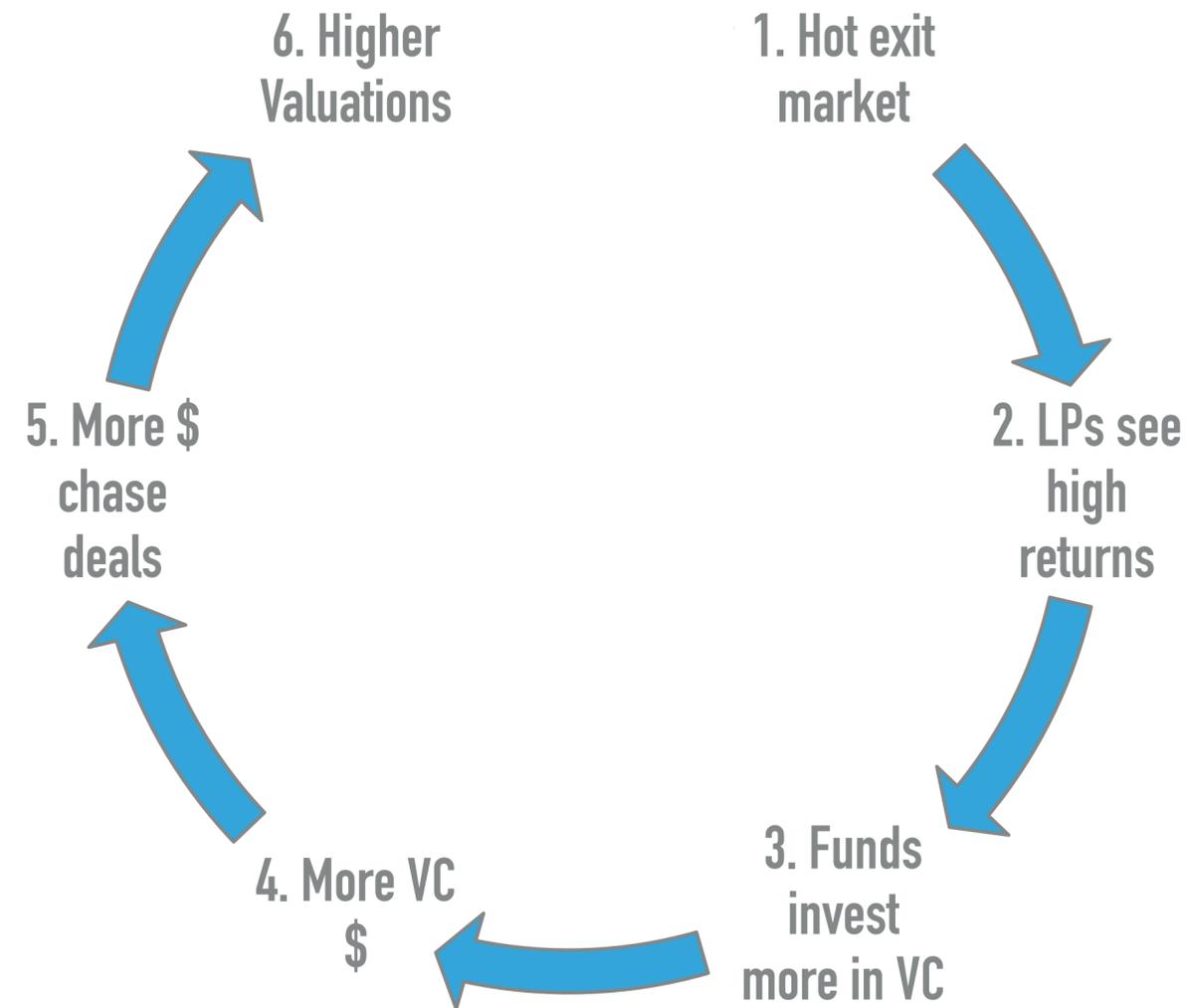
# THE EXIT MARKETS ARE AT ALL TIME HIGHS, FUELING GROWTH IN VENTURE FUNDING

## Global exits in H1'21 already 76% of 2020's full-year total



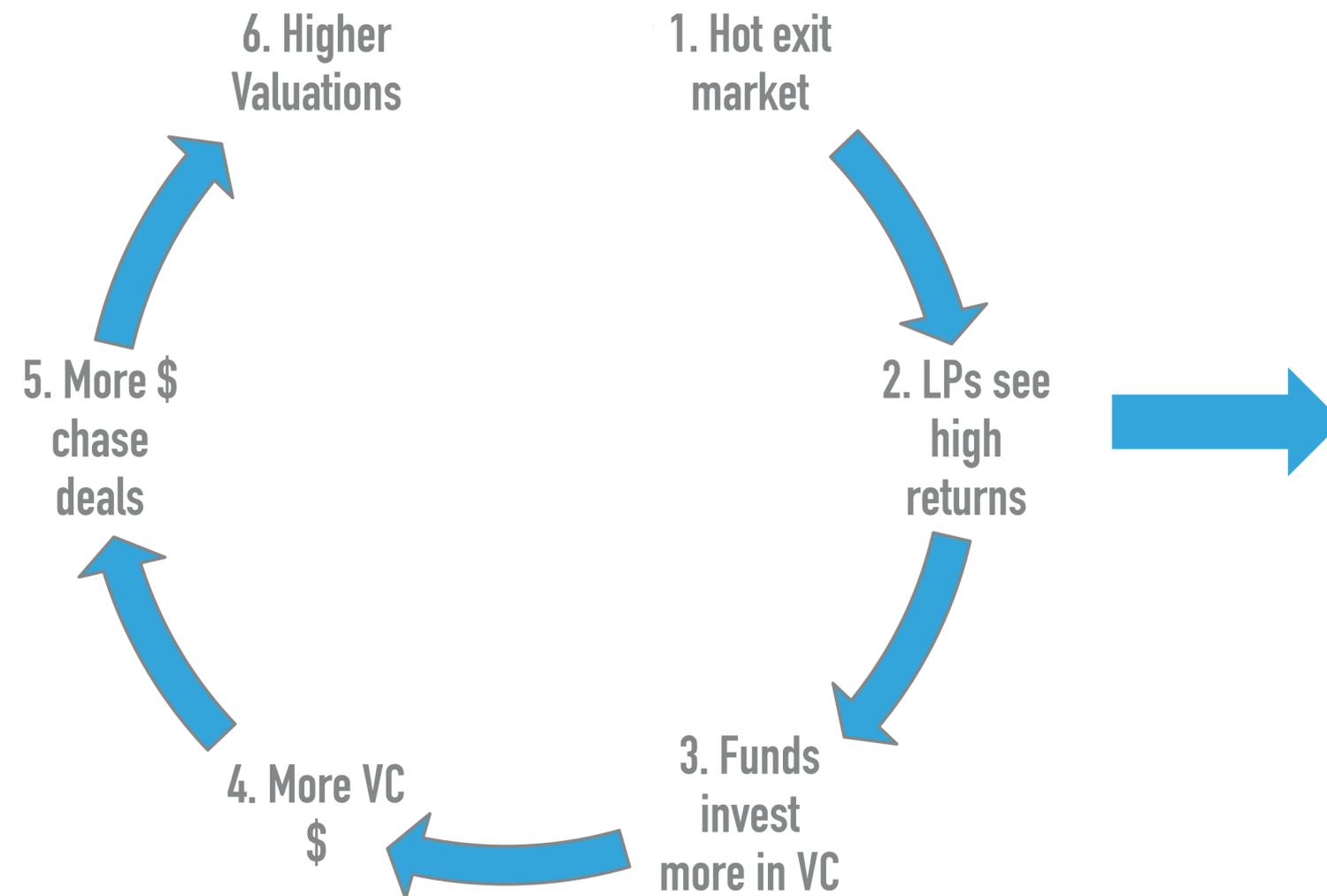
# VENTURE CAPITAL CYCLES: STRONG EXITS ENCOURAGE MONEY FLOOD INTO VC

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# VENTURE CAPITAL CYCLES: MONEY FLOOD INFLUENCES ANGEL ROUNDS, TOO

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## VC Bubble Can Affect Angel Rounds

- “Bubble psychology”
- “Hot” sectors create their own demand
- Revenue multiples used to justify angel valuations rise, encouraging higher angel valuations
- Larger exits create higher exit comparables AND excite investor greed reflex
- Raised CEO expectations
- Micro VCs competing at seed stage

# AND SO, AS PREDICTED....

## Global funding to startups rises to an eye-popping new record

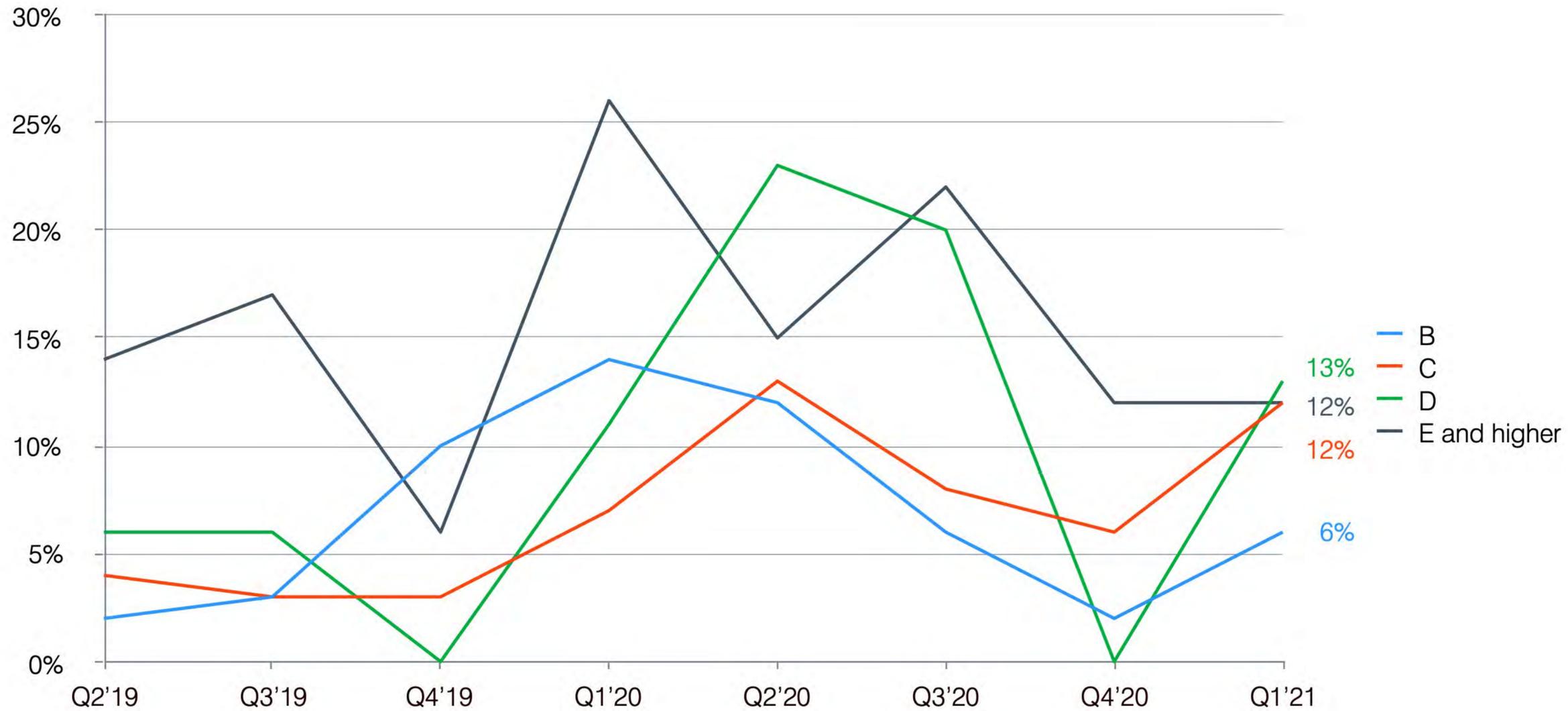
*"VC funding is a lagging indicator, as VCs and their LP funders respond to the activity of exit markets. Q2/Q3's very strong IPO recovery will (eventually) lead to a return of early-stage VC, and with it, more next-round dollars for Angels' investees."*

*- ACA COVID-19 PANDEMIC REPORT, Angel Capital Association, Winter 2020*



# SILICON VALLEY DOWN ROUNDS HAVE BEEN DECREASING

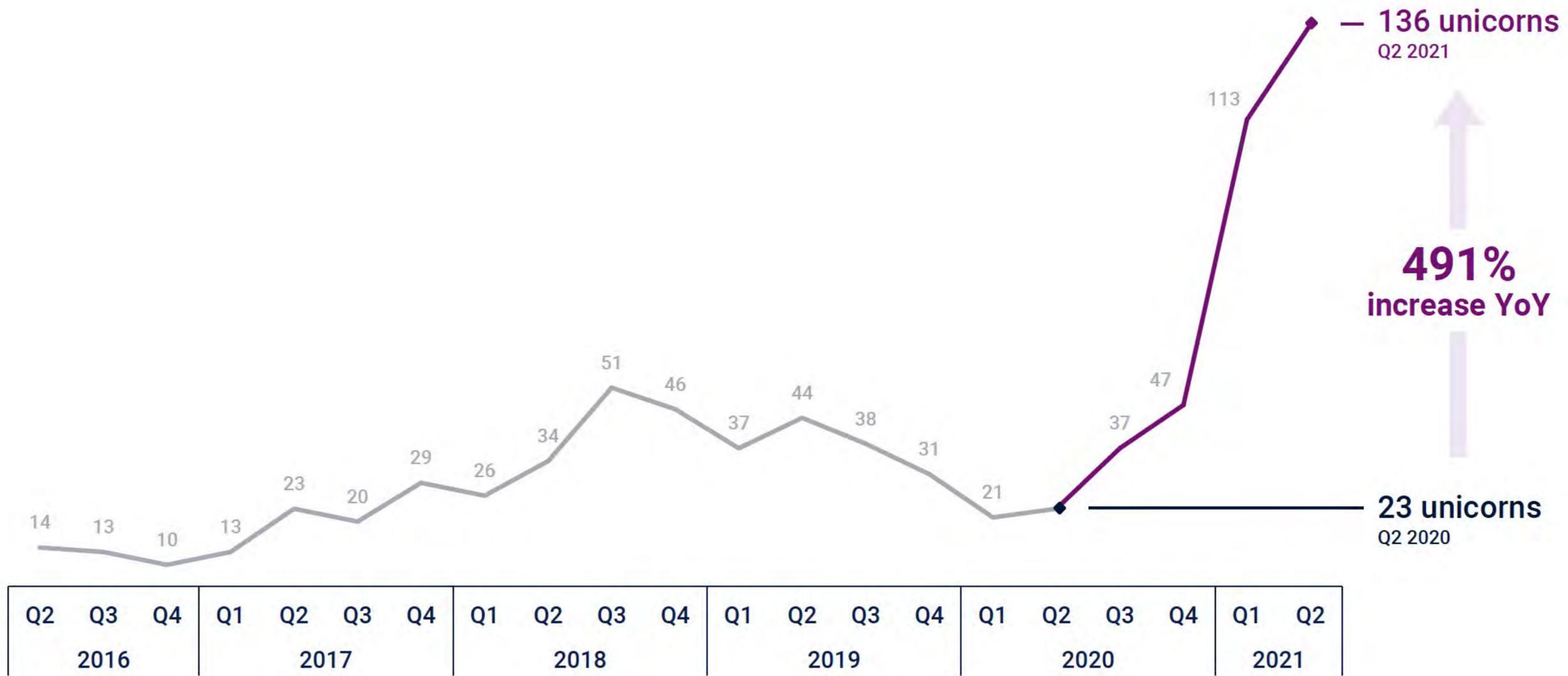
The percentage of **DOWN ROUNDS** by series were as follows:



SOURCE: FENWICK AND WEST VENTURE CAPITAL SURVEY FIRST QUARTER, 2021

# LATE-STAGE DEALS CONTINUE TO ATTRACT MASSIVE FUNDING

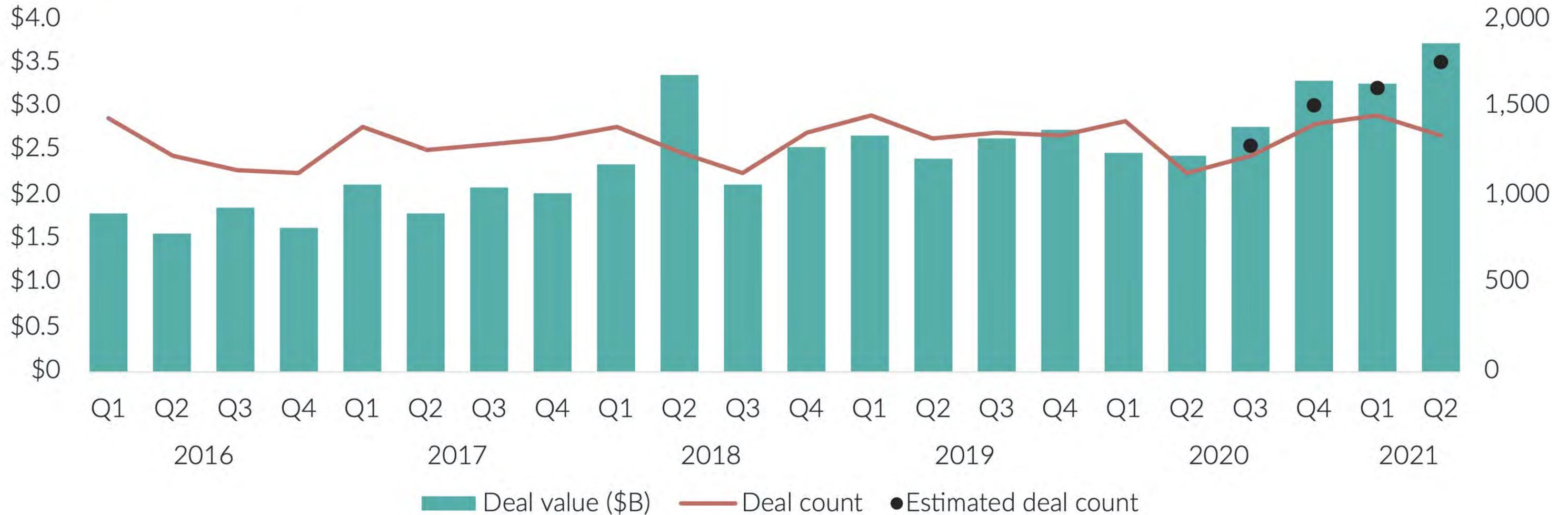
## Q2'21 shatters previous record for unicorn births, up 491% YoY



# BUT US ANGEL/SEED FINANCINGS ARE ALSO AT RECORD HIGHS

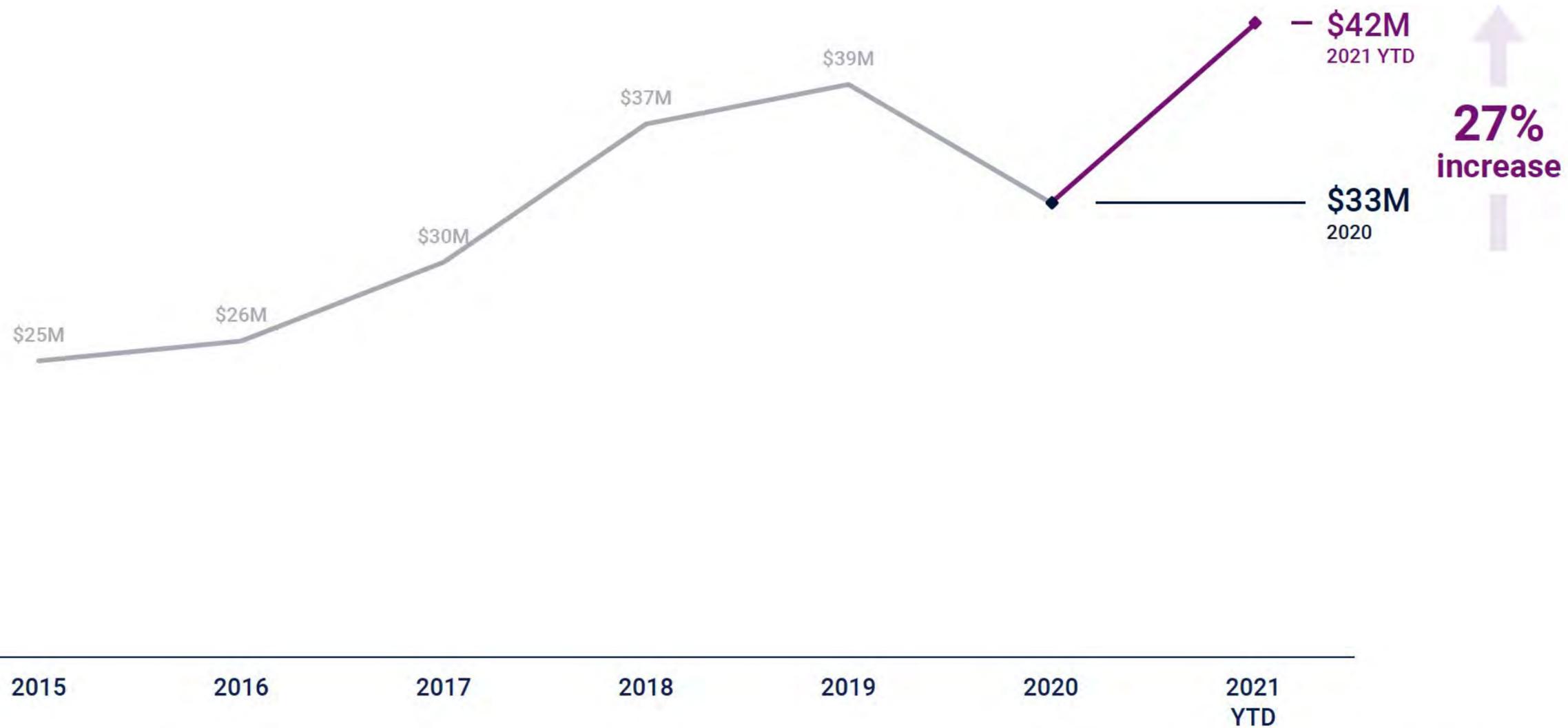
*Past two quarters set highs for deal count in our dataset*

US angel & seed deal activity by quarter



# AND EARLY-STAGE VALUATIONS HAVE EXPLODED, TOO

## Median valuations for US Series A deals reach a massive new high



# CONTEXT FOR HIGHER VALUATIONS: ECONOMIC RECOVERY

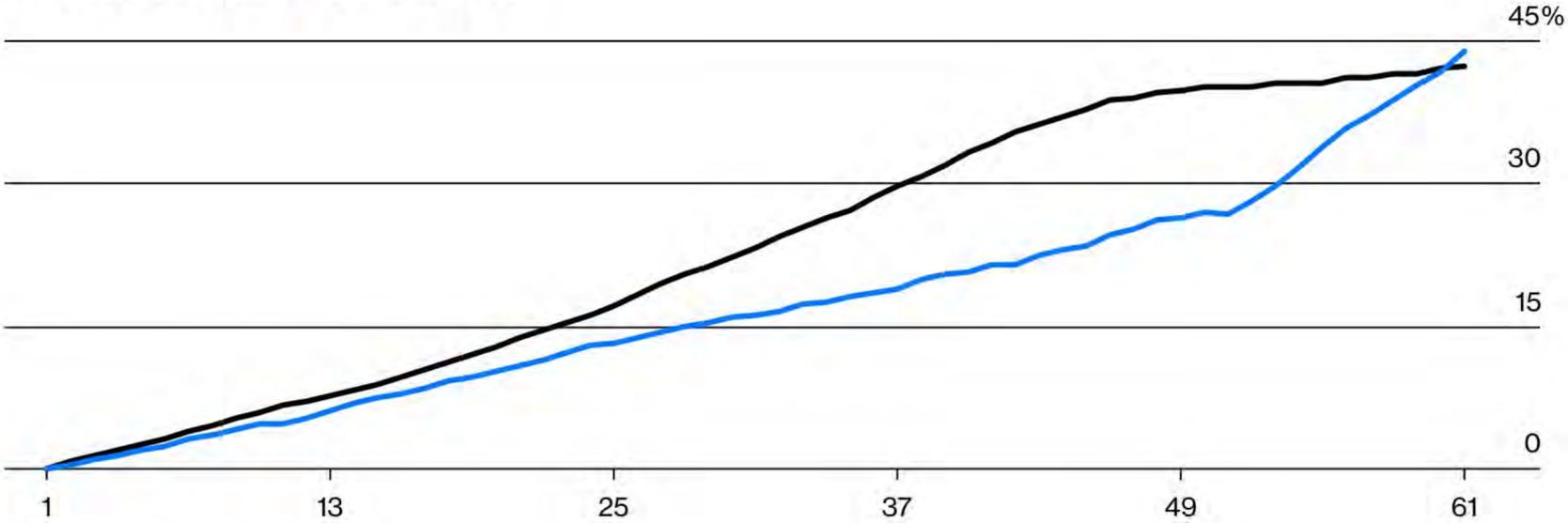
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- Historically Low Interest Rates
- Strong Corporate Earnings
- Consumer Confidence Index
- Post-Pandemic Pent-Up Consumer Demand
- The Strongest Equity Exit Markets in History
- Many Assets are Experiencing Bubble Economics
  - Some asset markets, like Art and Housing were closed during the pandemic
  - Equities
  - NFTs
  - Crypto
  - SPACs

# EXAMPLE: HOUSING

## Change in House Price Index

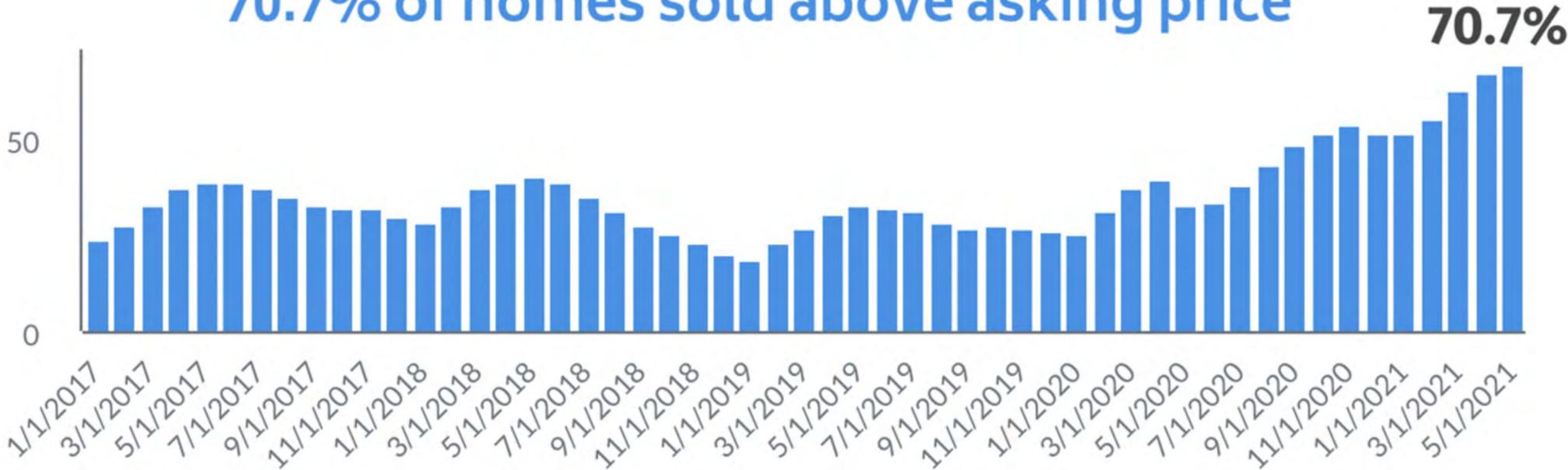
By month  
4/2002 to 4/2007 3/2016 to 3/2021



Data: Federal Housing Finance Agency

California (California Association of Realtors)

### 70.7% of homes sold above asking price



# POSSIBLE HEADWINDS

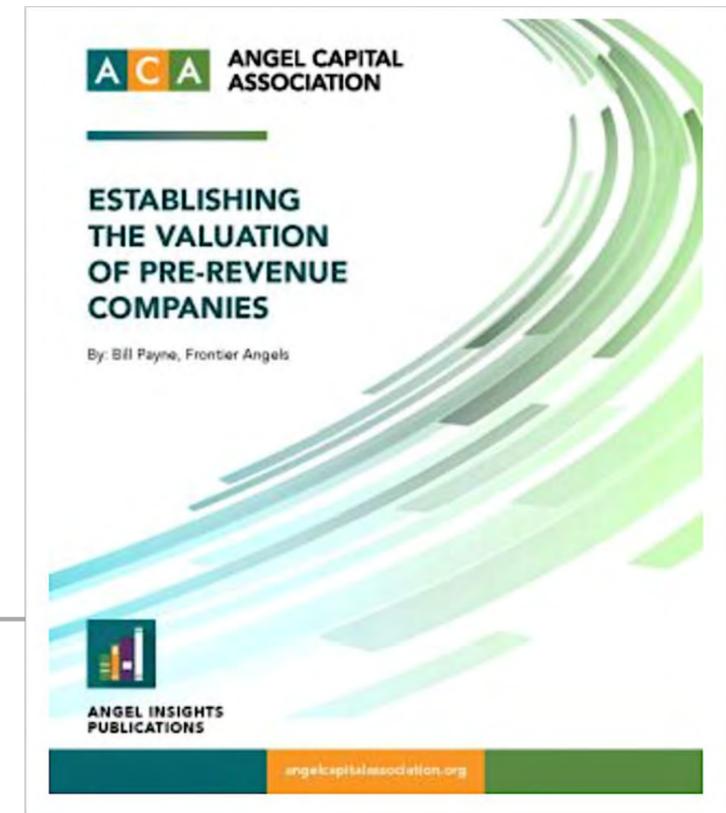
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- Rising interest rates in Q4'21
- Global and regional COVID uncertainties
- Rising inflation starting to worry markets
- Potential doubling of long-term capital gains taxes
- It may become harder for tech companies to exit via M&A

# A FEW THOUGHTS ON VALUATION



ACA ANGEL UNIVERSITY



# VALUATION IN CONTEXT

- Naive CEOs ask, “What’s the valuation?”
- Smart CEOs ask, “What’s the deal?”
- A valuation is a summary reflecting a balance of many risks and potential rewards

Technology/Product Risk

Management Risk

Market Risk

Competitive Risk

Deal Term Risk

Execution Risk

IP Risk

Financing Risk

Regulatory Risk

Exit Risk



Realistic Investor Returns

- Valuation is just one deal term among many

# WHAT MOST ANGEL VALUATION METHODS HAVE IN COMMON

- Start with a fact-based baseline valuation:
  - Pre-Revenue Stage: Scorecard methods. Example:
    - Compare each success factor (Team, product, market, etc.) to other deals in your region
    - Increase the median valuation of deals in your region by % that this deal is better/worse
  - Revenue Stage
    - Enterprise Value or Sales multiples
    - Discounted M&A exits
    - Recent comparable financings in sector
- Add uppers that reduce risk & subtract downers that increase risk
- Determine if proposed equity ownership can make investors money
- Negotiate a final, fact-based valuation

# VALUATION IS PART OF A BROADER DEAL NEGOTIATION

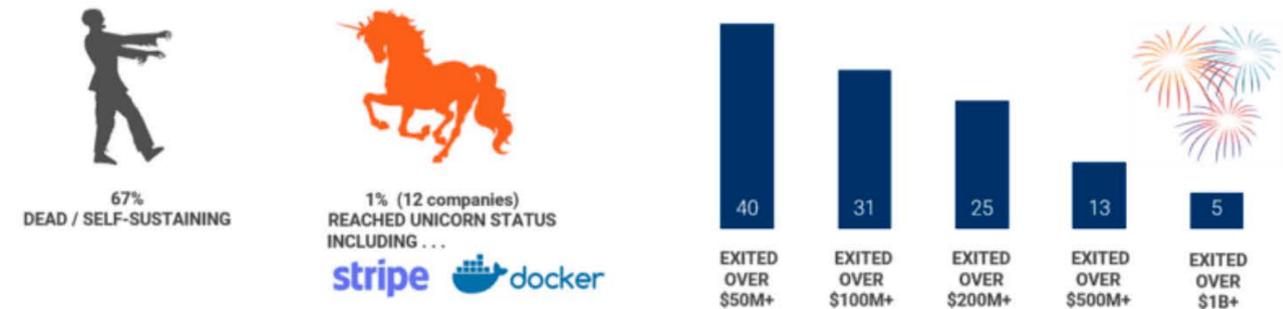
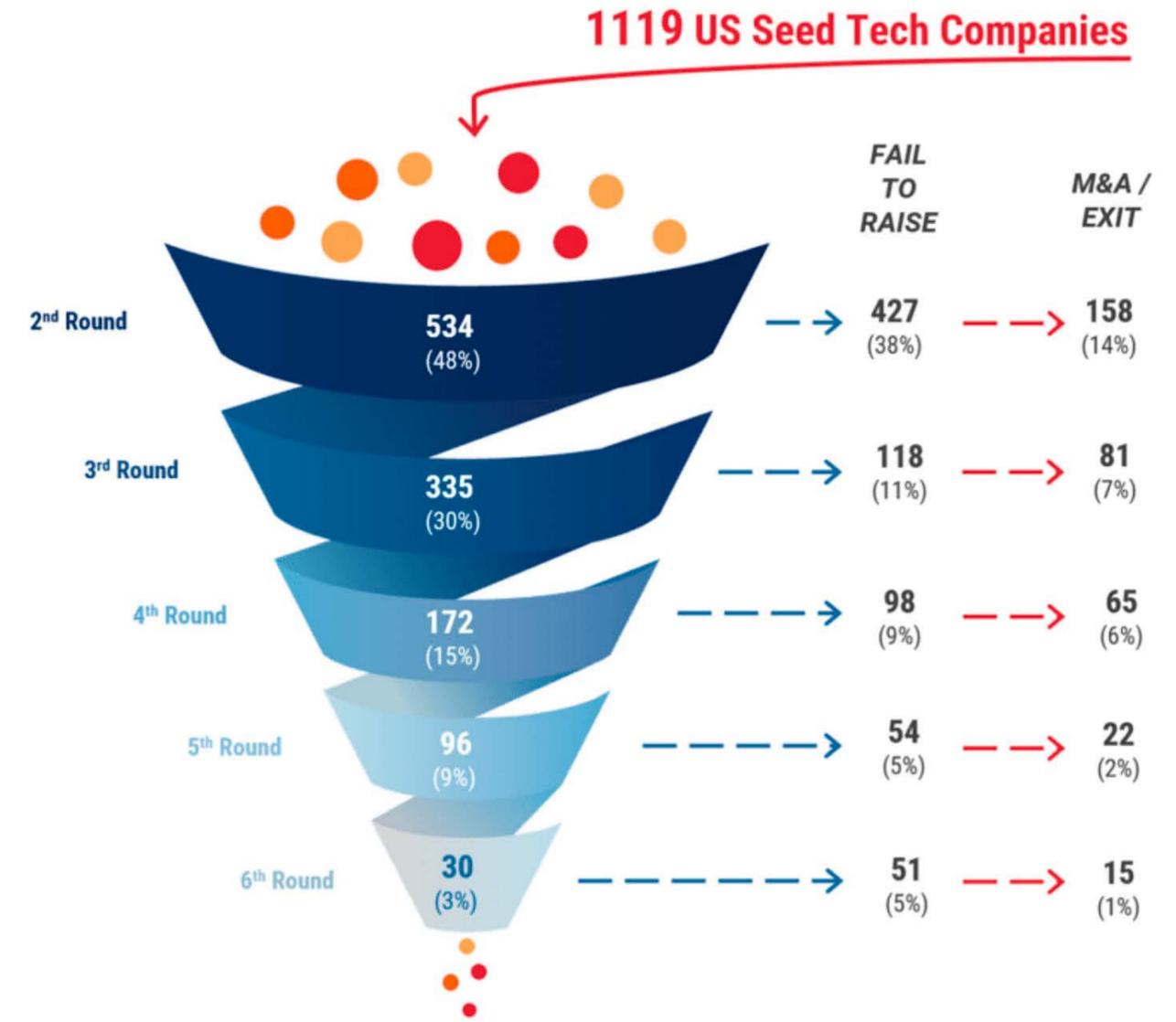
	What Investors Want	Management's View/Offer to Investors
Investor Equity	Angels: 15% to 25%, VCs: 40% to 50%	Newbies: 5% to 10%, Experienced: at market: 15% to 50% depending on who is investing and investment context
Valuation	Fact-based, often on actual or projected TTM or FTM revenues	As high as possible
Liquidation Preference	Good economy, lower risk environment: 1X non-participating Bad economy: 1.5x to 2x participating	Newbies: what's this? Experienced: 1x non-participating
Conversion of Notes & SAFEs	These convert in the pre-money (Founders pay)	These convert in the post-money (everyone takes dilution)
Dividends	West Coast: none unless Board-issued; East Coast: 8% accumulating	"Isn't that for retirees?"
Control Rights, Protections	Series investors on Board must approve: fundraising, partnership agreements, key financial commitments, M&A/IPO, exec hires, anti-dilution, founder/executive stock sales restrictions	"Whatever. It is just a bunch of legalese. All that matters are \$\$ and valuation."
Board	CEO & co-founder, 2 investors, 1 mutually agreed independent	CEO, Co-Founder, Crony/Friend
Mandatory Redemption	West Coast: rarely unless investors fear founders want a lifestyle business East Coast: more frequent, used to fix "bad deal" five years later	"Sounds like something in my car insurance policy."
Stock Option Pool	Early stage: enough to cover employee hires until next financing round, funded in pre-money. Growth stage, ensure 15% to 20% pool.	15% to 20% of equity, funded by everyone including new investors out of post-money
Founder Re-vesting	Angels: 75%, VCs, some zero, some as much as 100%	"What??"
Uses of Capital	Future growth, not fixing past events. No payment to fundraisers. No repayment of Founder loans. May agree to repay loans in future, if company executes well.	Fund growth but also fix past issues: pay fundraiser's fee, repay founders for loans, give founders a funding "bonus"
Closing	No-shop, Key-person Insurance, Escrow funds until company has closed minimum sufficient capital to ensure ongoing business operations.	"Fund me now!"

# OUTCOMES FOR SEED-FUNDED STARTUPS

1119 Startups who raised seed funding 2008-2010

Outcomes by 2018

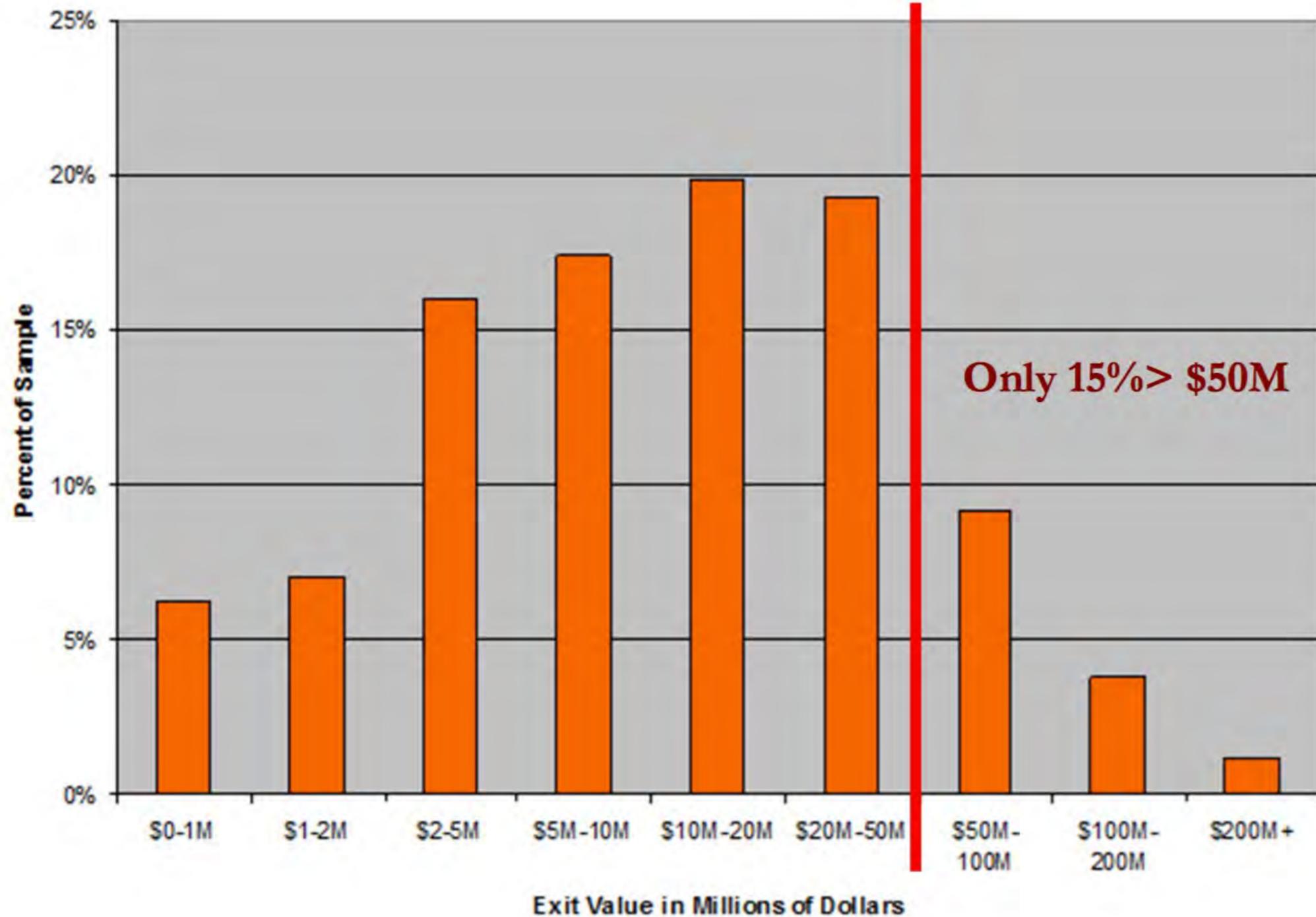
14.0%	Exit
3.0%	\$50M+
2.7%	\$100M+
1.1%	\$500M+
> 0.5%	\$1 Billion+



Note: All numbers based on cohort of companies that raised Seed in 2008, 2009 or 2010 and disclosed valuations only.

# ANGEL-FUNDED EXITS

Source: Robert Wiltbank, 2014



# IMPLICATIONS

- 97% of seed-funded companies who exit eventually do so for less than \$50M

*Please think carefully about this....*

- “Small ball” exits do not justify large valuations
- Valuations are among the highest in history now

# GETTING TO A VALUATION (2 - 3 MONTHS)

## INITIAL DILIGENCE

- Examine value proposition, solution, company vision, recent metrics & milestones
- Review business plan & forward P&L targets

## AGREE ON VALUATION RANGE

- Competitive landscape and review recent exits and similar companies in sector
- Choose appropriate valuation metrics (pre-revenue vs. revenue-stage)

## DEEPER DILIGENCE

- Team, customer, product, market diligence; identify key risks and mitigation strategies
- Suggest refinements to company's business plan and metric targets

## DRAFT TERM SHEET, INCLUDING PROPOSED VALUATION

- Refine valuation range, propose specific valuation
- Returns analysis—does valuation support our financial returns target?

## NEGOTIATION

- Fact-based, goal-based discussion of round goals, future funding, company progress
- Negotiate valuation as one element of an entire deal structure and set of terms

## FINALIZE TERM SHEET & VALUATION

- Draft deal documents for review based on negotiated term sheet
- Gain final investor approval of deal

# THE VALUATION CONVERSATION

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Management  
says:



- CEO made \$ for investors before
- Realistic, pragmatic management team right for executing this business
- Large market, “hot” sector
- Strong culture sharing a common, game-changing company vision
- Strong book of business, low customer churn
- SaaS-style business w revenue visibility
- Strong, protected IP
- Recognized market leader
- Strong references and proof of value and ROI
- Increasing sales force productivity, decreasing Customer Acquisition Cost (CAC)
- High exit values in your sector and multiple paths to exit for you
- Market-making revenue partnerships

Initial valuation factored by “**uppers**” and “**downers**”

Investor says:



- Techno-idealists lacking business skills; product people, not market people
- Weak sales team performance, regularly miss revenue targets
- Inexperienced, non-metrics driven team
- Poor business execution
- On-premise-style traditional software business with little revenue visibility
- Not on path to profitability; flat or declining revenues
- One of many “me, too” vendors, not recognized as a leader
- Investor cannot validate key business & revenue assumptions
- Weak book of business, high churn, low customer loyalty
- Market has few potential M&A buyers who can write a big check
- Slow business progress, little sense of management urgency

# ENTREPRENEUR BEST PRACTICES WHEN NEGOTIATING DEALS

- **Justify your valuation “ask” by being fair and fact-based**
- **Understand how investors think about startup risks, rewards and deal terms**
- **Understand how investors calculate their investment returns**
- **Understand valuation trends, multiples and exits in your market**
- **Your prior round valuation is not a relevant benchmark for new investors**
- **Don't make future valuation promises to current investors**
- **A high valuation is not really a merit badge—it can hurt you**
- **Seek a valuation that will not increase your future financing risks**
- **Remember: valuation is negotiated in the context of the entire deal**

# INVESTOR BEST PRACTICES WHEN NEGOTIATING DEALS

- The best valuations and term sheets are fact-based
- Trust, but verify business facts
- Explain your rationale for terms and valuation—and key disagreements
- Negotiate, don't "demand"—be ready to compromise
- Scale capital and valuation to likely outcomes
- Don't be greedy—anything you ask for sets a precedent for future investors
- Don't disincentivized management with extreme valuations or term sheets
- Don't be afraid to walk from an indefensible deal
- Try to create a win/win outcome

# APRIL 2021 NFT SALE: MEME – "DISASTER GIRL"



**\$500,000**

*A timely metaphor?*

# ACA - ANGEL UNIVERSITY

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## ACA Angel University – Fall 2021

- Fundamentals of Angel Investing - September 14
- Risks in Angel Investing – September 21
- Due Diligence Workshop - September 28
- Term Sheet Basics - October 5
- Valuation Workshop - October 12
- Angel Returns and Portfolio Strategy – October 19
- Advanced Workshop on Capitalization Tables - October 26
- Startup Boards Workshop - November 2
- Angel Exit Strategies - November 9
- Learn More <https://www.angelcapitalassociation.org/aca-angel-university/>



# SPEAKER CONTACT INFORMATION

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