TrueBridge

THE TIDE HAS TURNED IN 2022

STATE OF THE VENTURE CAPITAL INDUSTRY

On the web at

truebridgecapital.com/state-of-vc/

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We have become accustomed to seeing statistics move up and to the right year after year, but 2022 was a very different year for the US venture capital market. Perhaps we became desensitized to the rapid pace of dealmaking and the steep valuations given to companies, especially later stage assets. In 2022, most of those statistics reversed course and the easy capital retrenched, in part due to tourist capital and crossover funds finding more value in beaten-down public markets.

With the macroeconomic backdrop of the war in Ukraine, ongoing global supply chain issues, rising interest rates and inflation, and a looming recession, the economic bubble finally burst and we were confronted with the resulting fallout.

Investors pumped the brakes on new financings, turning their focus to existing portfolios. They counseled founders not to raise capital unless it was absolutely necessary, to extend cash runways through layoffs and other cost reductions, and to take a less aggressive stance by pursuing more efficient methods of growth. While there was some M&A activity in 2022, the IPO window that was open wide in 2021 had firmly shut.

"Capital flipped from abundant to scarce, valuations swung from generous to stingy, and many businesses selling into the startup ecosystem were faced with the deterioration of their customer base. The mettle of all entrepreneurs is under tension, and now, more than any moment since we have practiced venture investing, it is critical that founders are building 'for the right reasons.'"

Zigg Capital

On a positive note, we returned to a more rational deal environment, we saw less rash "FOMO"-fueled behavior, and pre-money valuations began to recede.

Passionate early-stage founders with big ideas still got funded, and later-stage companies with solid growth and sound fundamentals were able to raise impressive rounds. 2022 was not all doom and gloom. Many investors ended the year thinking that the next several vintage years could be some of the best ever, given the shift in market conditions and the resilience of innovation.

“In many ways, we feel bullish about the future potential. The founders who are starting companies now, in the face of these headwinds, have a different caliber and determination than many who started them in the frenzy. It’s also our view that in general, change favors startups, and as markets are inevitably shuffled, opportunities will open up.”

Jack Altman, Jack Altman Fund

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FUNDRAISING

A BRIGHT SPOT AMIDST THE TURMOIL

Fundraising held up particularly well in 2022 in contrast to most industry metrics.

RAISED

$163B

6% increase over 2021

2022 COMMITMENTS

$163B

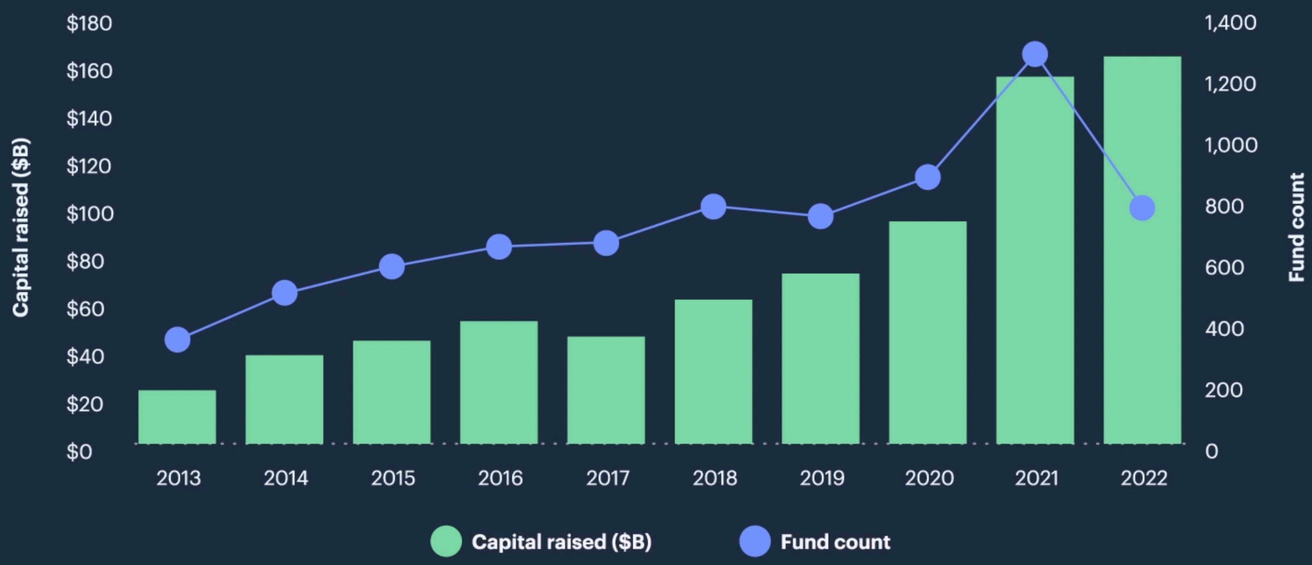
Closed in Q1 and Q2

US venture firms raised over $162 billion last year, surpassing 2021's total in just three quarters. The amount raised in 2022 was roughly 6% more than 2021, marking an industry all-time high. However, the year-over-year increase did not nearly keep pace with the 65% increase between 2020 and 2021. The beginning of the year was more productive than the end of the year, with nearly 75% of commitments closing in the first and second quarter.

Despite the record amount of capital raised, we saw a decline in the number of funds raised. A total of 769 funds closed in 2022, a 39% decrease from the 1,270 closed in 2021. Fundraising was thus dominated by large funds – the number of $1 billion+ funds closed increased while smaller-sized funds decreased – indicating that the long-term trend of concentrating capital persisted.

TOTAL US VENTURE CAPITAL RAISED

$162.6B
769 FUNDS



Pitchbook as of December 31, 2022.

FUNDS CLOSED IN 2022

769

DECREASE FROM 2021

39%

The combination of strong fundraising and slower dealmaking has resulted in a record high cumulative overhang of nearly $300 billion in the US.

The proverbial dry powder has been piling increasingly higher on an annual basis since 2012, when it stood at $72 billion. Over the last decade, the capital overhang has more than tripled in size.

Although 2022 marked the fifth consecutive year-over-year increase in fundraising, 2023 is proving to be a more difficult year for raising capital as the deal environment moderates, the exit markets stall, and limited partners cinch their purse strings tighter. As a sign of the times, Tiger Global initially targeted $6 billion for its new fund before reducing the target to $5 billion — less than half of the $12.7 billion size of its prior fund.

INVESTING

EARLY-STAGE INVESTING HOLDS STRONG

Deal count and capital invested — two key metrics for the state of the funding environment — were both down significantly year-over-year in 2022.

15% ↓
Decrease in deals

31% ↓
Decrease in capital invested

Compared to 2021, approximately 15% fewer deals were done, and capital invested decreased by approximately 31% to $238 billion. Unlike 2021 when deal volume increased with each successive quarter, 2022 saw the opposite trend as deal volume decreased every quarter.

We saw year-over-year decreases in deal count and deal value across both early and later stages. A relative bright spot, angel and seed-stage companies experienced a lower deal count, but a greater amount of overall capital invested. This translated to higher round sizes for seed-stage companies in 2022, many of which opted for longer runway protection in preparation for an uncertain 2023 fundraising environment.

2022 VS 2021

DEAL VALUE

+ 69	- 22	- 36%
Seed stage	Early stage	Late stage

DEAL COUNT

- 18%	- 12%	- 10%
Seed stage	Early stage	Late stage

MEGA DEAL VALUE

-	- 26%	- 37%
Seed stage	Early stage	Late stage

Long term activity continues to increase

Although venture investment activity was largely lower across the board in comparison to 2021's outsize advances, the longer-term trend exhibits consistent and steady increases in activity. The rise in the number of mega rounds ($100 million or more) continues to have an outsized impact on the amount of early- and late-stage capital invested.

2022 VS 2020

DEAL VALUE

Seed stage	Early stage	Late stage
+ 80%	+ 53%	+ 34%

DEAL COUNT

Seed stage	Early stage	Late stage
+ 5%	+ 35%	+ 30%

MEGA DEAL VALUE

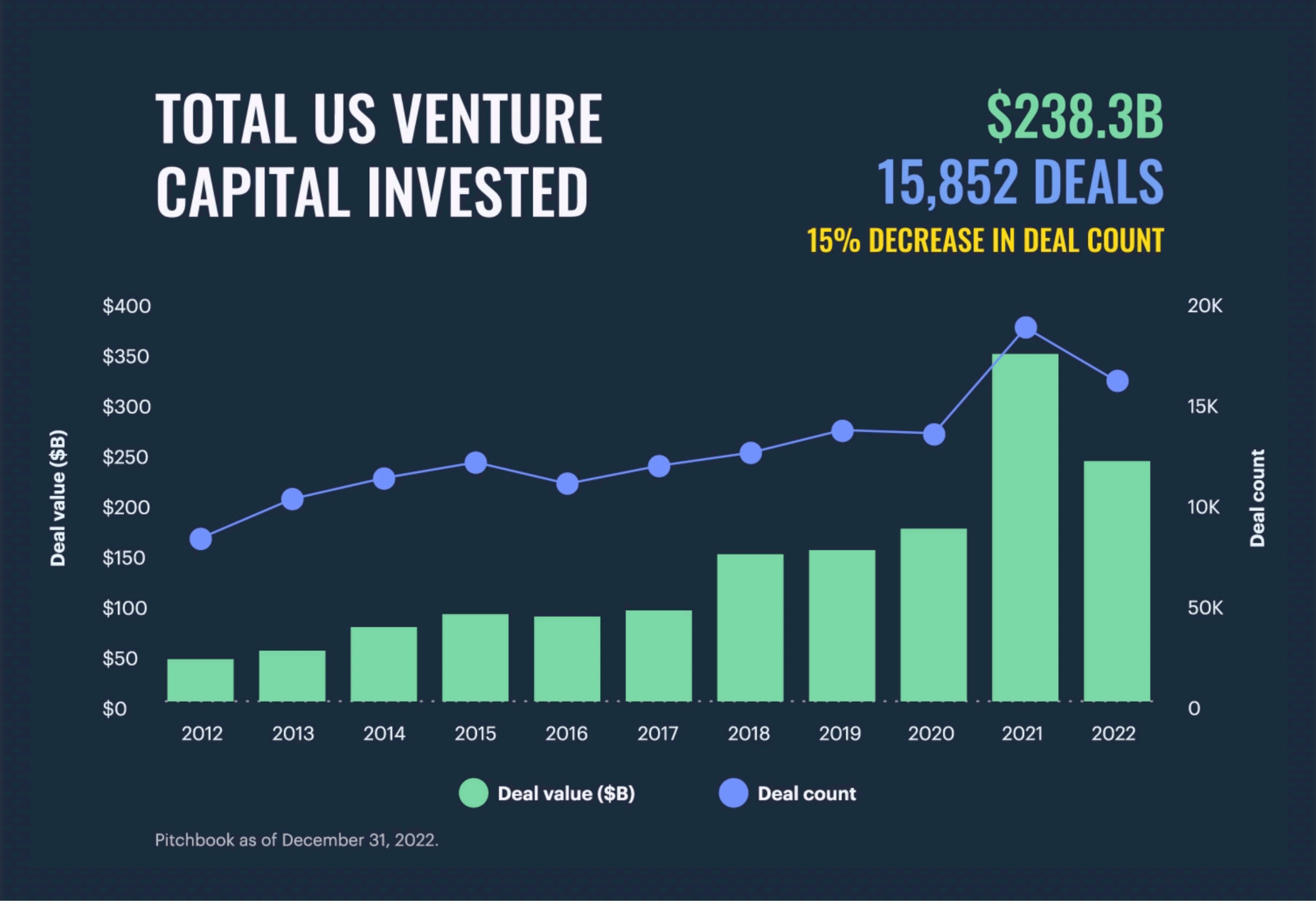
Seed stage	Early stage	Late stage
-	+ 76%	+ 82%

The lower velocity of deals and capital invested in 2022 was in many ways a stark reversal of what drove the frenzied pace of activity in 2021:

- Less virtual dealmaking as investors and operators moved back to in-person work
- Longer due diligence processes
- Longer time between financings after many companies raised more than enough capital for their short-term operations in 2021

Several major long-term trends remain at play, continuing to drive investment activity, particularly at later stages:

- Less virtual dealmaking as investors and operators moved back to in-person work
- Longer due diligence processes
- Longer time between financings after many companies raised more than enough capital for their short-term operations in 2021



TREND

Blockchain should emerge stronger amidst disruption and caution

2022 highlighted the strengths and shortcomings of blockchain. Read more about the companies who continue to be trendsetters in the space.

stateofvc.truebridgecapital.com/trend-blockchain/

TREND

Venture secondaries: The coming quarters are primed to be a productive vintage for investors seeking early liquidity and more favorable valuations.

Despite the broad reversal of COVID tailwinds that buoyed performance and boosted investor appetite for tech startups, losses in liquid assets have rendered many investors overallocated to illiquid portions of their portfolios. Faced with this dilemma, institutions are facing pressure – or even legal obligations – to rebalance their portfolios by selling illiquid positions in the secondary market.

50%+

LPs looking for secondary opportunities

The outperformance of venture over the last decade has contributed to the trend of increased selling by LPs who believe recycling secondary market liquidity into new fund commitments could have greater benefit than holding onto older portfolios. After a string of vintage years that outperformed historical 20-year benchmarks, some sellers are drawn to the secondary market by the opportunity to crystallize unrealized gains and reallocate into a more favorable valuation environment. In fact, more than half of LPs have reported they plan to allocate capital to secondaries ahead of other strategies.

As this trend continues, more secondary sellers are placing emphasis on the speed of liquidity and certainty of close, rather than optimizing price as they have for the last several years. With the absence of net new buyer demand, increased supply has paved the way for buyers to negotiate steeper discounts.

Buyer demand for secondary offerings should remain relatively flat, given the historical bottlenecks associated with underwriting and closing venture secondaries transactions:

- Many VCs and companies retain a veto on sales of LP positions and employee shares
- Many choose to work solely with select existing investors/ LPs or trusted, longstanding counterparties as pre-approved buyers

In this market, a different type of buyer stands to benefit – those with advantaged GP relationships and the ability to underwrite opaque early-stage assets. With economic forecasts prospectively down into 2024, the burgeoning opportunity set in venture secondaries is a trend that will be hard to ignore in 2023.

TREND

BLOCKCHAIN SHOULD EMERGE STRONGER AMIDST DISRUPTION AND CAUTION

Blockchain technology has the potential to change the way we conduct business, manage our money, preserve data, and generally engage with the world. However, the collapse of FTX and Terra highlight shortcomings in the industry and fragility present in certain areas of the ecosystem.

As the fall of FTX unfolded in 2022, blockchain technology faced scrutiny and proved vulnerable to the opportunists who present themselves across innovation cycles.

While blockchain and crypto may face some headline reputational and regulatory risk, we believe core **blockchain technologies will persevere** through the noise and emerge more secure. Sophisticated investors with a deep understanding of the sector should be well-positioned to take advantage of a leaner, less noisy environment. As Max Webster of Hivemind Ventures noted, “with interest rates rising and the tide going out, it’s become increasingly obvious who’s been swimming naked.” In a year of cautious persistence, overvalued crypto and public securities were repriced, separating the winners in the field and highlighting those who will continue setting new standards.

Ethereum

The large spike in centralized exchange (CEX) outflows amid the recent high-profile blow-ups initiated a flight to quality and self-custody. Smart contracting platforms like Ethereum are open, transparent, and do not rely on traditional financial intermediaries, thereby reducing counterparty risk. Key players like Ethereum are poised to play an important role in 2023 and beyond, as they have the potential to supplant centralized corporate structures in favor of more decentralized communities.

15.8M+
ETH now staked

13%
Total supply

7M
Staked in 2022

215K+
Validators growing

Optimism

1000%+

Growth in active developer teams in 2022

460%+

Growth in API consumption YTD

Arbitrum

795%

Growth in active developer teams in 2022

125%

Growth in API consumption

UNISWAP

Decentralized exchanges (DEXs) such as Uniswap are exchanges that are owned and operated by their participants, rather than a centralized entity.

Uniswap's liquid decentralized exchange allows market participants to swap tokens with smart contracts without a centralized third party running an order book. Since Uniswap is built with smart contracts, code and on-chain transactions cannot be manipulated. DEXs cannot fall victim to the type of fraud and amended logs that centralized companies are at risk of.

STABLECOINS

90% of global central banks are considering the potential use of central bank digital currencies (CBDCs).

Stablecoins — crypto assets pegged to a fiat currency — are a revolutionary technology that capitalize on this trend. They are widely used for lending, trading, and payments. USDC, for example, is a stablecoin that moves at a fast speed and lives natively on the internet. USDC transcends borders and banking hours while providing security since it is backed by cash and short-dated US treasuries, making it a compelling technological advancement. As of December 1, 2022, $43 billion worth of USDC is in currency.

NFTFI

NFT lending and borrowing protocols, like NFTfi, saw strong growth in 2022.

Borrow volume peaked in the second quarter of 2022, while other platforms in the space continue to see attractive growth and increased activity levels. NFTfi plans to build other financial tools that may offer NFT ETFs and fractional NFTs prospectively.

"Using our new tokenization platform, we arranged a €100 million two-year digital bond for the European Investment Bank with two other banks, all based on a private blockchain. Typically, a bond sale like this takes about five days to settle. Ours settled in 60 seconds. By reducing settlement times, we are lowering costs for issuers, investors, and regulators. Using blockchain, we can extend these benefits more broadly in fixed-income markets and across other asset classes."

David Solomon, Goldman Sachs

Web3 and blockchain founders, investors, and proponents want a web that democratizes access and opportunity.

While still in the early stages of a transition, a remaking of business models and a shift of data ownership from companies to users will continue to change how we interact with the internet in the future. This transition is exciting and full of promise, but its complexities also raise many questions. Still, the shift is happening, as evidenced by the astounding level of developer, investor, and consumer activity. Unlike what occurred during prior downturns in the sector, Blockchain is more than a buzzword — it represents the next major technological and social shift in our society.

VALUATIONS

LATER STAGES COME BACK TO EARTH

In 2022, valuations across seed and early-stage companies largely continued the consistent increase in pace we have seen over the last several years.

Later-stage companies saw lower valuations than in 2021.

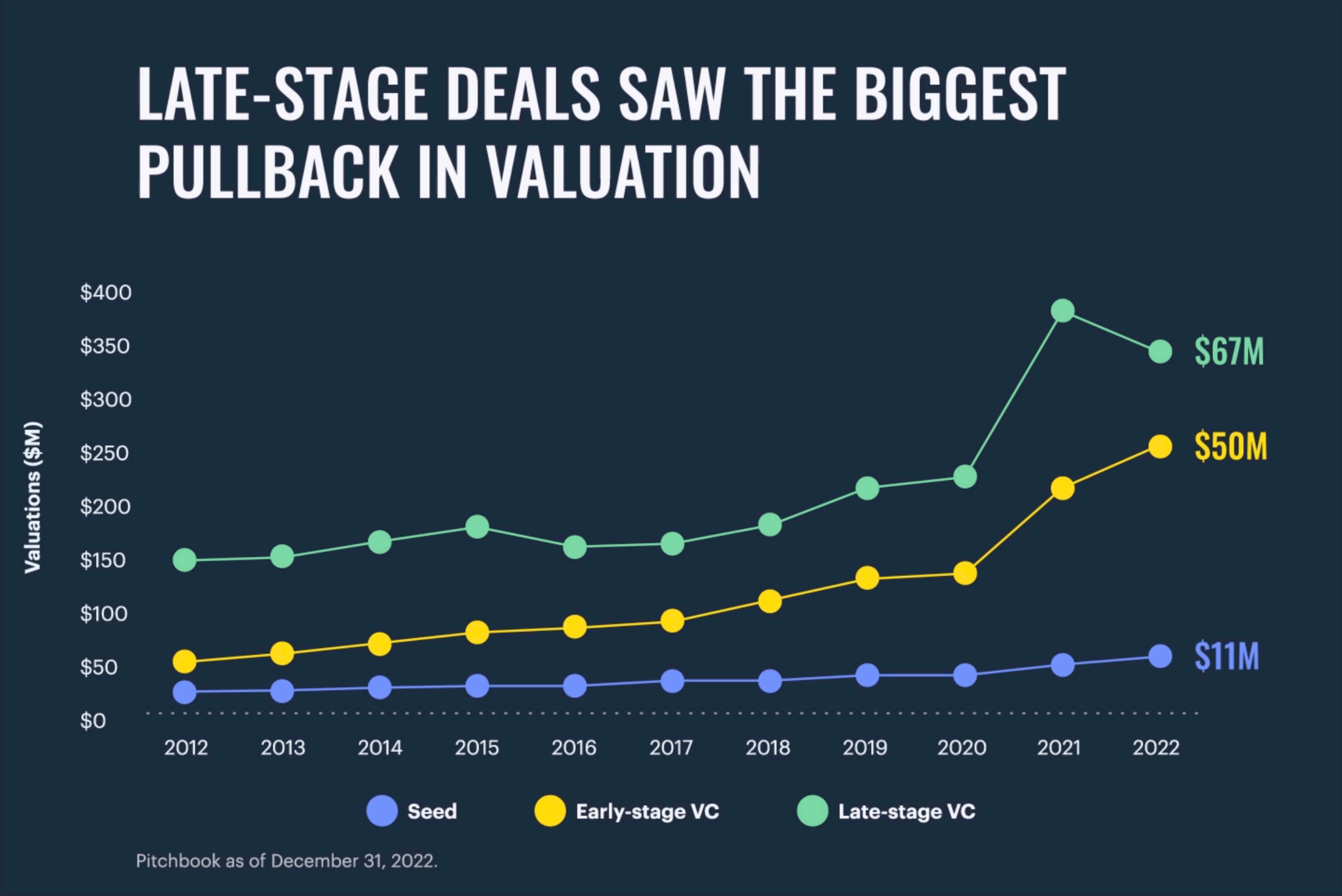
As market caps for public companies were incredibly challenged in 2022, investors were less willing to pay high revenue multiples for high-growth, late-stage private companies. Time will tell if this trend bleeds into earlier-stage companies.

+ 10%
Angel

+ 17%
Seed

+ 19%
Early

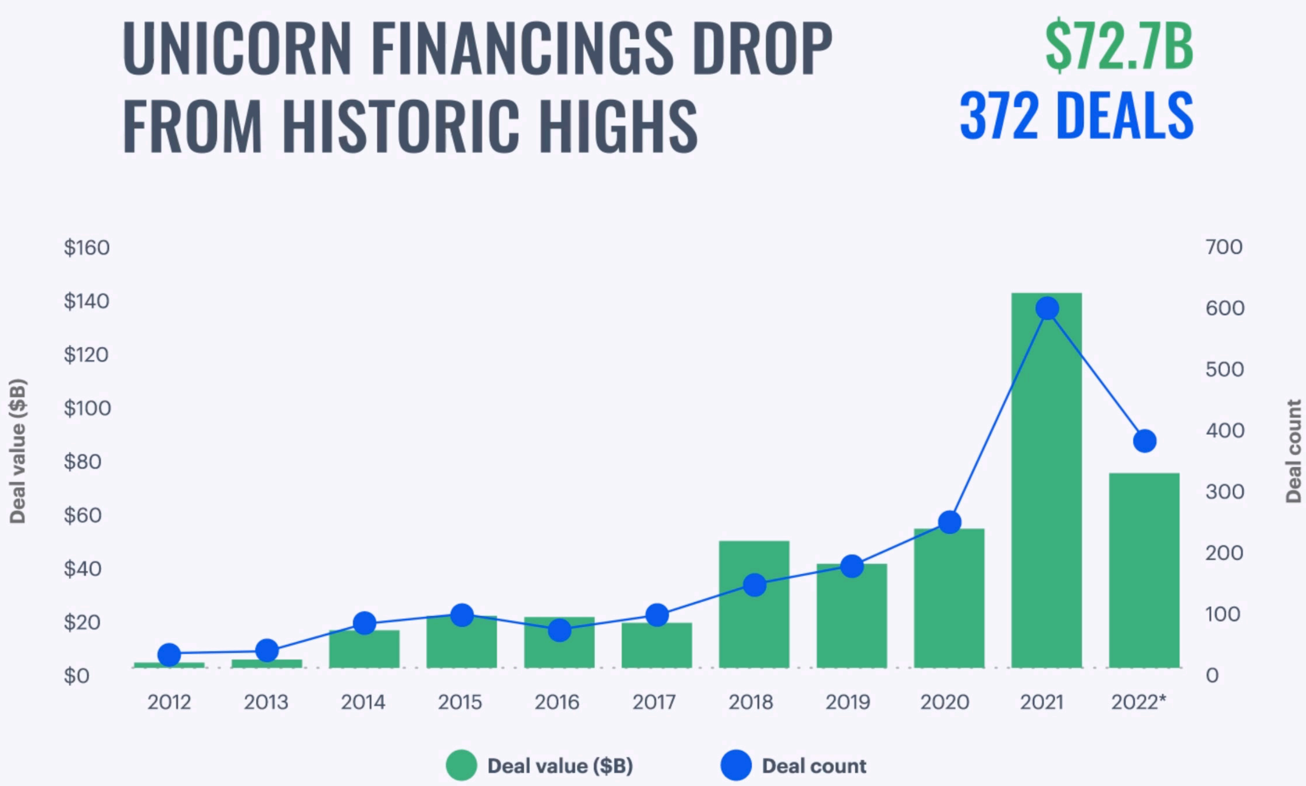
- 10%
Later



Seed and early-stage valuations were surprisingly resilient in 2022 as they rose slightly despite pricing pressure at later stages.

While there is some evidence that investors are reducing round sizes as capital becomes more expensive, there has not been a meaningful impact on valuations at these stages. Early-stage valuations have arguably been supported by increased competition, as sizable seed-focused funds were raised in recent years by notable firms such as Sequoia, Andreessen Horowitz, Index, and Khosla.

In lockstep with pressure on late-stage valuations, the number of deals funding unicorn companies (private companies valued over $1 billion) was significantly lower in 2022. After a record 584 unicorn deals in 2021, there were only 372 in 2022 — a drop of 36%.



Pitchbook as of December 31, 2022.

EXITS

NEARING ZERO ACTIVITY

Investors and analysts alike expected exit events to slow in 2022, but few foresaw the near-complete shutdown.

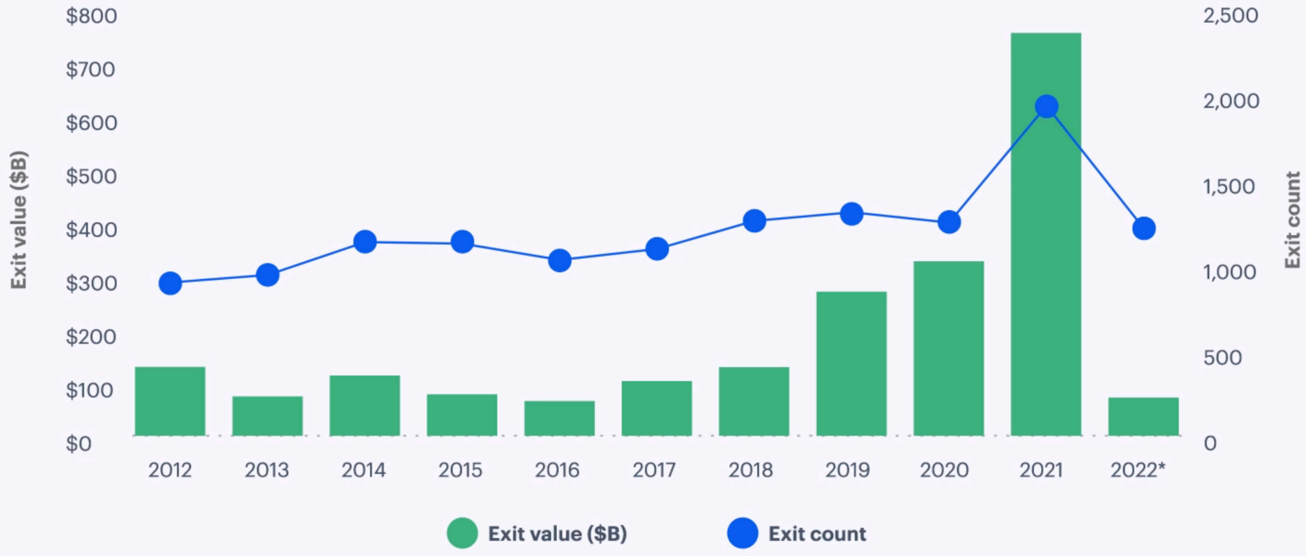
90%↓
Year-over-year exit activity

$71B
Total value realized

One of the biggest stories of the year for the broad venture industry was the near-complete lack of exit activity. Total exit activity, including IPOs, direct listings, mergers and acquisitions, and buyouts, was down over 90% from 2021. There was only approximately $71 billion of total value realized through exits in 2022, the lowest annual figure since 2016. Not a single company raised over $1 billion in an IPO in 2022, after 15 such IPOs raised that amount or more in 2021.

THE IPO WINDOW EFFECTIVELY CLOSED

$71.4B
1,208 EXITS



Pitchbook as of December 31, 2022.

The large drop in activity can be largely attributed to two factors:

- Public market investors shifted their focus to de-prioritize promises of future growth and re-prioritize profitability
- Pre-IPO companies altered their plans after seeing many of their public market peers' valuations plunge by well over 50% — and in some cases over 90%.

Many of the recently high-flying venture-backed IPOs of 2021 saw challenging price action in the year following their debuts.

US crypto exchange Coinbase, which made a big splash with its April 2021 IPO that valued the company at $86 billion, had a market capitalization around $10 billion at the end of 2022, though it has since rebounded slightly. Other companies with large 2021 IPOs – including Robinhood, Toast, and UiPath – all saw similar weakness.

COINBASE

$86B
2021 value

$10B
2022 market cap

Investors and analysts alike expected exit events to slow in 2022, but few foresaw the near-complete shutdown. Some are hopeful, with equity markets starting to show signs of stability at the start of 2023, that the IPO window could soon reopen.

VENTURE-BACKED M&A

10%
2021 total exit value

50%
2022 total exit value

Fueled by dropping valuations, M&A activity did pick up: nearly 50% of venture-backed exit value in 2022 came from M&As, compared to just 10% in 2021. We can expect to see increasing M&A activity as companies look to take advantage of reasonable valuations and seek ways to fuel growth amidst a challenging market.

Truly disruptive, high-growth companies continue to be highly valued by incumbents.

In 2022, Adobe announced its acquisition of Figma, a powerful design system that is not only cloud-based, but fully built on the power of the cloud. Focused on transitioning from their current desktop model, Adobe agreed to pay 50x top-line revenue, doubling Figma's 2021 valuation in a heated market. Set against the stark exit environment, the acquisition announcement captured headlines globally and stood as a highlight for 2022 exit news.

Amidst a different macroeconomic backdrop in 2023, many late-stage companies have shifted their focus to profitability and strengthening their bottom lines, delaying their IPO ambitions. Many investors see companies like Databricks, Reddit, and Instacart as potentially good candidates for public listing when the market is ready, though for some, that could come at lower valuations than they have previously enjoyed.

"During a down-market, young startups who face a radically more challenging fundraising market than six months ago more often choose a quick sale. M&A secures the team greater financial certainty within a more established & better capitalized business."

Tomasz Tunguz, Theory VC

PERFORMANCE DIPS AFTER HISTORICAL HIGHS

Following a year of historical strong performance in 2021, venture capital broadly saw a slow, then sudden, decline in 2022.

Fundraising trends and valuations were largely business as usual for the first two quarters of the year, with early-stage venture performing reasonably well relative to the broader market.

As the second half of the year approached, public market turbulence trickled down to late-stage companies, then eventually to early-stage companies. Widespread reports of valuation cuts, layoffs, and down rounds weighed on the strong returns that investors enjoyed in 2021.

Despite a pullback in 2022, venture remains the top-performing asset class over three-, five-, and 10-year time horizons.

There was a dearth of IPO and M&A activity as 2022 played out. According to research conducted by Pitchbook, venture was the worst performing private capital strategy for 2022, but an analysis of multi-year internal rates of return shows that, despite this one-year pullback, venture capital remains the top-performing private asset class over three-, five-, and 10-year time horizons.

PRIVATE CAPITAL

+ 1%
Q3 2022

+ 19.1%
1 year

+ 19%
3 year

+ 16.2%
5 year

+ 14.4%
10 year

VENTURE CAPITAL

- 4.8%
Q3 2022

+ 2.8%
1 year

+ 26.8%
3 year

+ 22.8%
5 year

+ 16.6%
10 year

80%

LPs maintain their commitment to VC

According to a Venture Capital Journal survey, roughly 80% of institutional investors intend to maintain or increase their exposure to the venture asset class in 2023.

While an impressive figure, the 20% who plan to invest less capital is nearly double that of the prior year. This increase in LPs who say they will pull back on their venture investing is not surprising, given that many have seen a deterioration in performance over the last year for the first time in nearly a decade.

"The rolling one-year IRR for VC dropped to 2.8% in Q2 2022 - its lowest level since Q4 2016 - as returns regressed from 2021 peaks. The wider macroeconomic picture remains unclear, and we could see further declines to returns in coming quarters."

Pitchbook, 2022 Global Fund Performance Report

CONCLUSION

WE'LL KEEP ON KEEPIN' ON

The relentless optimism that characterized the venture industry over the last several years was ushered out in 2022 by rising interest rates to combat climbing inflation, geopolitical conflicts, tightening corporate budgets, and an impending recession.

The year was undeniably challenging, and the first bear market that many investors and founders had encountered in their careers.

While parts of the venture market have corrected, others likely need more time to reset and settle into a new normal. Because so many startups raised ample cash in 2021, only time will determine the full effect of this difficult environment on valuations and survival rates.

We expect 2023 to look and feel like more of the same, as the downturn is still playing out and the road to recovery is still being assessed. Patience is needed and will be rewarded. While there is likely more short-term pain to endure, the long-term positives should not be overlooked.

“We haven’t seen many collapses yet because companies still have cash. The next stage will arrive when the cash runs out in two to three years. We will then discover which companies are doing something which is a ‘must have’ and won’t be hit by the recession and which companies are doing something that is not as necessary. Good companies will be stronger at the end of the crisis. In order to be efficient and stronger at the end of the crisis you have to get rid of all excess weight.”

Oren Zeev, Zeev Ventures

WE HAVE REASONS FOR OPTIMISM

The market is more rational.

Valuations have come down.

Tourist investors are taking a hiatus.

The IPO window will reopen, eventually.

Innovation never stops.

"2022 was a year of transition. The year began amid the ongoing frenzy of rising valuations and rapid financing rounds, with unicorns being minted every day. By now, the great tech slowdown is upon us and many expect a broader economic recession to continue well into 2023 and perhaps beyond. We entered with talk of NFTs, web3, and metaverses. We are exiting with excitement (and some hand-wringing) about ChatGPT, DALL-E 2, and what they might mean for the future of work, software, and creativity."

Gil Dibner, Angular Ventures

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