

State of the Venture Capital Industry

MARKET ANALYSIS

Spring 2017



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Introduction

2016: A Return to The New Normal

At the conclusion of our 2016 State of the Venture Capital Industry report, we observed that the venture capital party that raged during 2014 and the first half of 2015 had died down, and that 2015 ended with dampened statistics and a more cautious, uncertain tenor. We also noted that there were certain aspects to the party's hangover that were welcome, including a slower deal pace, more rational valuations, and a renewed focus on operating metrics and profitability.

In many ways, 2016 played out as expected and in line with how 2015 ended – the industry remained at its new normal.

A return to the new normal

“While the venture industry doesn’t seem headed for the plunge it took 16 years ago, there certainly are similarities. The bloom is off the unicorns. Investors are more cautious and looking for solid business models. Venture firms, on the other hand, continue to rake in money, as they did in 2001, even after the tech bubble burst.”

- Russ Garland (WSJ Pro Venture Capital)

In 2016, venture capitalists completed fewer deals, and valuations declined at the early, mid and late stages. As a result, there were fewer new unicorns, more down-rounds, and noteworthy exits at valuations below prior financing rounds. And while the IPO market showed some signs of life, the window never opened as industry participants had hoped, contributing to a stifled exit environment. The headlines in 2016 also included some high-profile scandals – from insurance violations at the human resource startup Zenefits to failed testing technology at the health IT company Theranos – as well as year-end layoffs at some notable venture-backed companies.

These storylines – combined with the political narratives around the new US administration and Brexit – evoked words such as PULLBACK, RESET, CAUTION and PRUDENCE to describe the venture market in 2016. As 2016 ended with an air of uncertainty, it marked a dramatic change from the environment 18 months prior.

Yet amidst the changes and uncertainties in 2016, there were definite bright spots in the venture industry. At a high level, there were plenty of reasons to be excited about opportunities in emerging technologies such as artificial intelligence, virtual reality, and autonomous technology, as we considered where we were in the cycle and the industries that were undergoing disruption. Many good companies stood on solid ground, continuing on impressive growth trajectories and successfully raising capital. On the exit front, a handful of unicorns made their public debut, and we saw several companies get acquired at multi-billion dollar valuations. Finally, contrary to the other declining statistics, 2016 was a record year for fundraising. So let’s start there as we review and assess the state of the venture capital industry.

Fundraising

A banner year for VC fundraising

In recent years, investors have been drawn to the asset class as a result of historically low interest rates, a search for return, and growing interest in high-profile, not-yet-public companies such as Uber and Airbnb. Last year was no exception. Even with a slower deal pace and declining valuations, capital sources remained abundant in 2016 – VC funds raised more capital than in any year since 2000, driven by later stage funds, although capital remained concentrated in relatively few firms.

Fundraising

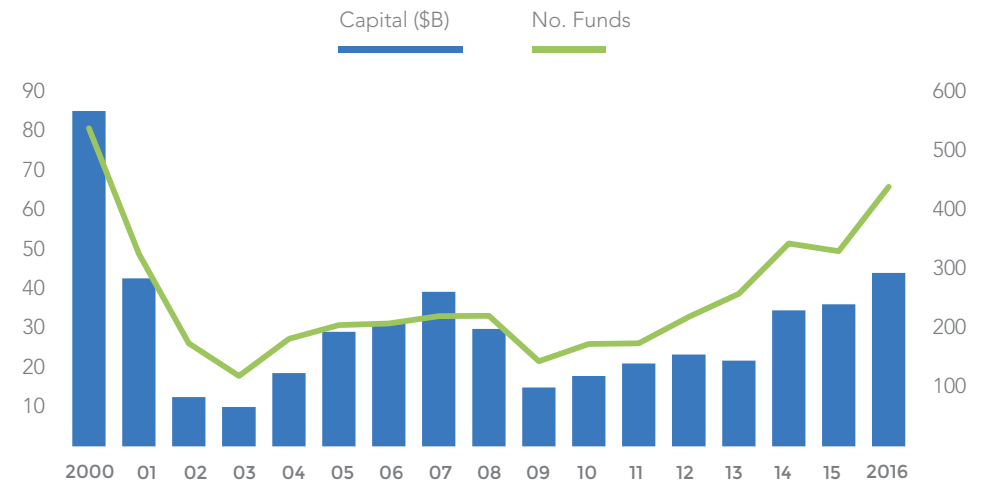
Fundraising reached post-bubble high



According to Pitchbook, 86% of venture capital funds in North America and Europe hit their fundraising targets; this percentage has increased steadily in recent years from less than 50% in 2007 and 2008. Compared to 2015, 33% more funds by number raised 22% more capital in the US in 2016. And compared to a recession low point in 2009, 205% more funds raised 195% more capital. In fact, more capital was raised in 2016 than in any year since 2000.

During a year when deal pace slowed and valuations at most stages declined, it is notable that the fundraising tally surged to a 16-year high. That said, the 2016 total remained well below – 48% below – the all-time record in 2000. After the Internet bubble burst in 2000, venture capitalists continued to raise significant capital in 2001, until fundraising sharply declined a year later. While we expect 2017 to be a more moderate year for fundraising, we do not expect it to drop to post-bubble or post-recession levels given how different the current venture landscape is from 16 years ago.

Total US Venture Capital Raised



Dow Jones LP Source as of December 31, 2016.

Fundraising

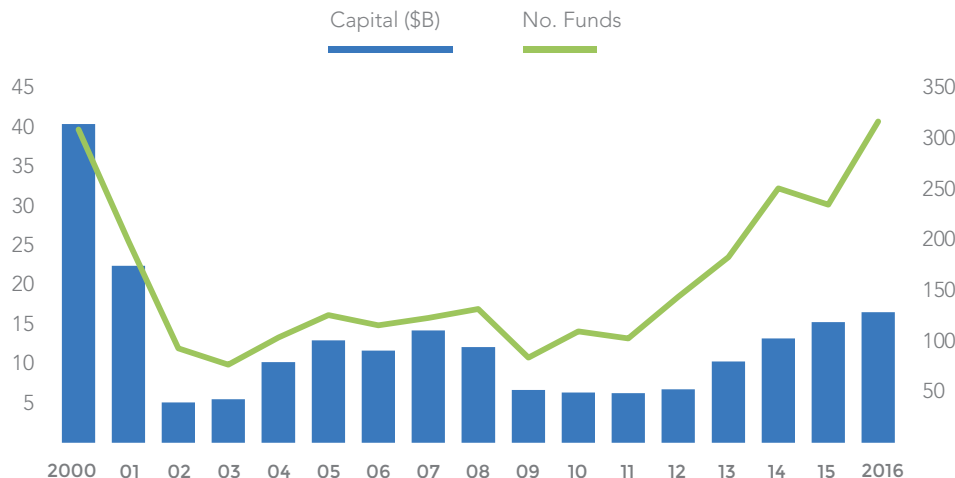
Early stage fundraising crept higher

Similar to the overall venture market, seed/early stage capital raised in 2016 reached a post-bubble high.

While the total amount raised still paled in comparison to 2000, an all-time record number of funds raised capital last year.



Seed/Early Stage US Venture Capital Raised



Dow Jones LP Source as of December 31, 2016.

Over the past several years, the amount of capital raised has increased in a step-like function. While 8% more capital was raised for seed/early stage funds in 2016 compared to 2015, the year-over-year increase was not as stark as in the overall market. Compared to the prior year, 35% more funds raised capital in 2016, which closely mirrored the overall market. These data points suggest that the year-over-year increase in capital raised was driven by later stage funds.

If you look at micro funds, or those less than \$50 million, in particular, you see that the number of funds closed in 2016 fell to a nine-year low, according to Pitchbook. Yet more funds were closed between \$50 million and \$100 million than had been raised in any other year during the past decade. This fundraising evolution is not surprising – as startups have raised larger or even multiple seed rounds, managers have needed to raise larger funds to compete for and participate in these financings.

Capital continued to consolidate

More venture funds closed on at least \$500 million in commitments last year than in any other year during the past decade. (Pitchbook)

During 2016, we continued to see fundraising dominated by a relatively small number of firms. In fact, approximately 3% of the funds that raised capital in 2016 accounted for 29% of the capital raised. While capital was not as concentrated as it was in 2015, the data reinforced a “flight to quality” – a long-term trend in the venture market that we have highlighted in previous reports. By and large, the experienced investors with unique and sustainable competitive advantages, strong track records, and excellent reputations among entrepreneurs and limited partners continue to raise sizable pools of capital today.

Whereas six firms closed on pools of capital greater than \$1 billion in 2015, nine firms hit this mark in 2016.

VCs with \$1B+ Funds

Accel

ANDREESSEN
HOROWITZ

FOUNDERS FUND

greylockpartners.

KPCB | KLEINER
PERKINS
CAUFIELD
BYERS

LIGHTSPEED
VENTURE PARTNERS

NORWEST
VENTURE PARTNERS

SPARK
CAPITAL

TCV

Fundraising

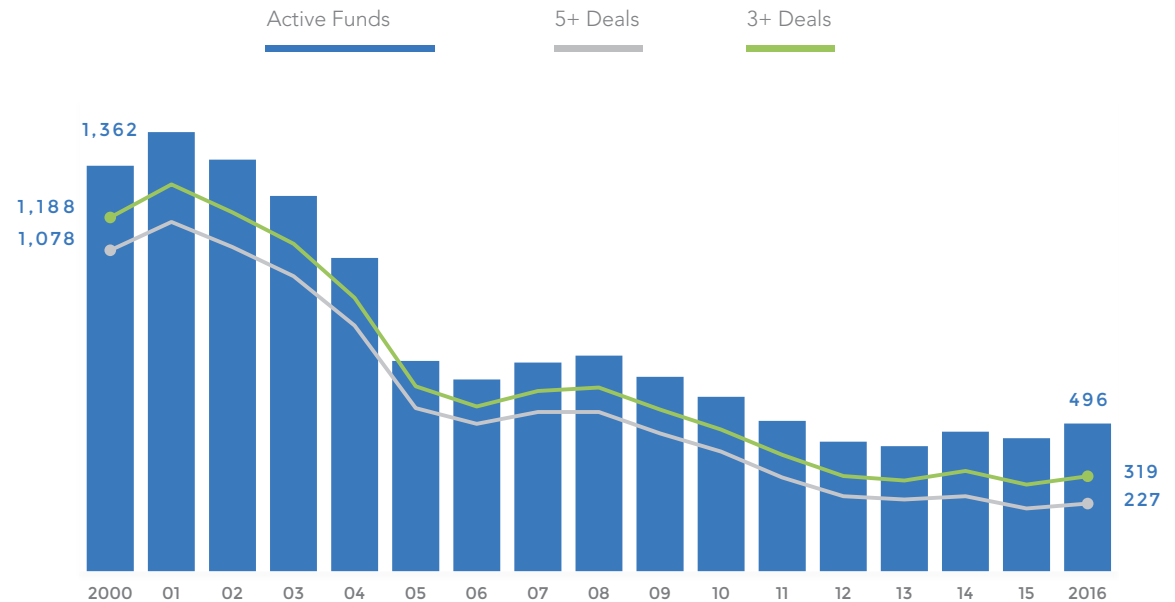
Active VCs nudged higher

To estimate the number of active firms in the market over time, we first analyzed the number of firms that raised capital in 2016 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, 496 funds were within their investment periods during 2016. While the number of active funds has fluctuated on a yearly basis over time, the 2016 tally is notably 66% 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 2016, 319 funds invested in three or more deals, an increase of 10% year-over-year and 75% less than in 2001. Similarly, 227 funds invested in five or more deals in 2016, 6% more than in 2015 and 81% fewer than in 2001.

While the long-term trend is clear and the industry has certainly right-sized since the Internet bubble, there has been an increase in active funds since 2013, which is consistent with the strong fundraising statistics from 2014, 2015 and 2016. We will continue to monitor future data in order to evaluate whether the long-term trend could be stabilizing or reversing.

Active VCs



Thomson Reuters as of December 31, 2016. Includes all US venture capital funds greater than \$10 million that raised capital in 2016 and the previous four vintage years.

TREND: AI IS THE NEW MOBILE

"If software is eating the world, artificial intelligence is serving it up on a silver platter indeed!"

- Zavaian Dar, Lux Capital (Wall Street Journal)

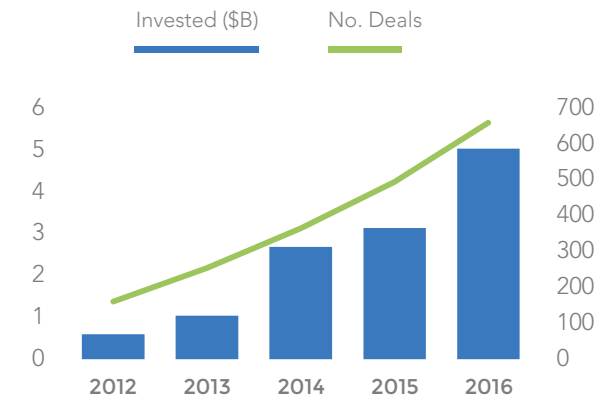
Artificial Intelligence (AI) was a bright spot and popular investment theme in 2016, with venture capitalists commonly describing AI as "the new mobile" – referring to how common it is becoming for companies to have an AI strategy or component to their business, just as they have for mobile. Deal count and capital invested trended up, and AI algorithms are now being applied to companies operating in industries ranging from healthcare and financial services, to automobiles and security.

Venture capitalists invested a record \$5.0 billion in 658 AI companies in 2016, a 61% year-over-year increase according to CB Insights. As of March 2017, there were five unicorn startups in the AI space: automobile technology company Zoox (the most well-funded AI company, with total funding of \$290 million), robotics startup UBTECH, healthcare companies Benevolent.ai and iCarbonX, and sales technology startup Insidesales.com.

Even though the promises of AI are just beginning to come to fruition after decades of research, we have already seen robust M&A activity among technology giants, with Amazon, Apple, Facebook, Google, IBM, Microsoft and others scooping up handfuls of AI companies. Fueling the M&A environment are the beliefs by corporate acquirers that business fundamentals and valuation are not all that matter, when compared to the potential of AI technology and talent. For example, in an interview with Fortune, Google's head of corporate development stated that when it comes to investing in AI, "we pay attention to [valuation] but don't necessarily worry about it."

As AI technology continues to advance, and devices continue to connect more seamlessly, AI no longer appears to be a big-picture theme but instead something with a measurable impact on our lives at work and at home. Companies are increasingly incorporating AI technology into actual products and services across a range of applications, a trend that we expect to continue in the coming years.

Capital Invested in AI Companies



CB Insights as of December 31, 2016.

Most Active VCs in AI

data collective

intel capital

khosla ventures

NEA

G/

Investing

A relatively active year for VC investing

Compared to the prior two years, investing activity in 2016 subsided, and perhaps represented a step toward regression to the long-term mean. Most dramatic was the year-over-year change in invested capital, as VCs invested \$52.4 billion across all stages of venture in 2016 – 32% less than the \$77.3 billion invested in 2015. The financial technology and consumer service sectors were hit particularly hard.

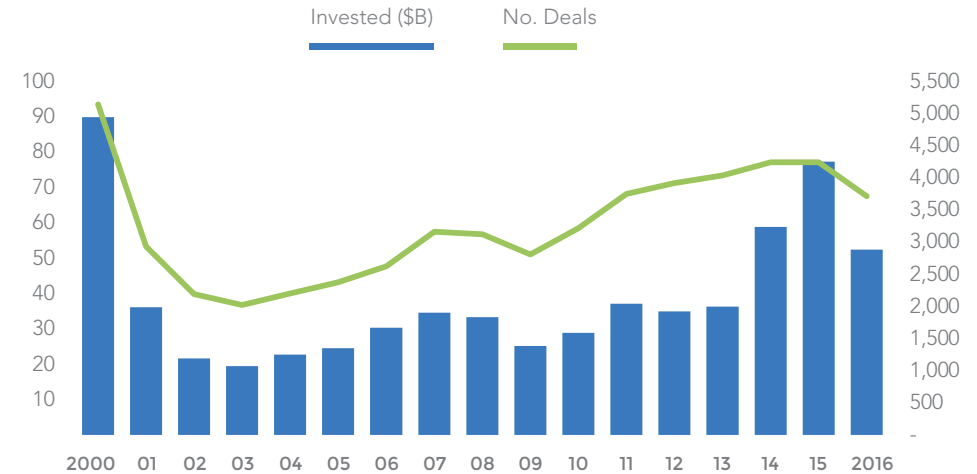
Investing

Investing activity receded



It's not surprising that fewer companies received funding in 2016. But the decrease in companies (12%) was less than the decrease in capital invested (32%), indicating a pullback in the later stage mega rounds that had become commonplace in 2014 and 2015. With pronounced public market volatility during the first half of 2016 and the uncertainty before and after the US presidential election, venture capitalists focused on ensuring their existing portfolio companies were positioned operationally to weather a tougher financing environment. The industry's funding pullback was also attributable to non-traditional investors, which have become increasingly active in recent years. According to CB Insights, first time US technology investments by hedge funds fell by 71% year-over-year, and participation by mutual funds (including T. Rowe Price, Fidelity, Wellington, BlackRock, and Hartford) in US technology deals also slowed meaningfully.

Total US Venture Capital Invested



Dow Jones VentureSource as of December 31, 2016.

↓ **32%**

DECREASE IN CAPITAL
INVESTED

↓ **12%**

DECREASE IN COMPANIES
FUNDED

Investing

Late stage investors retrenched



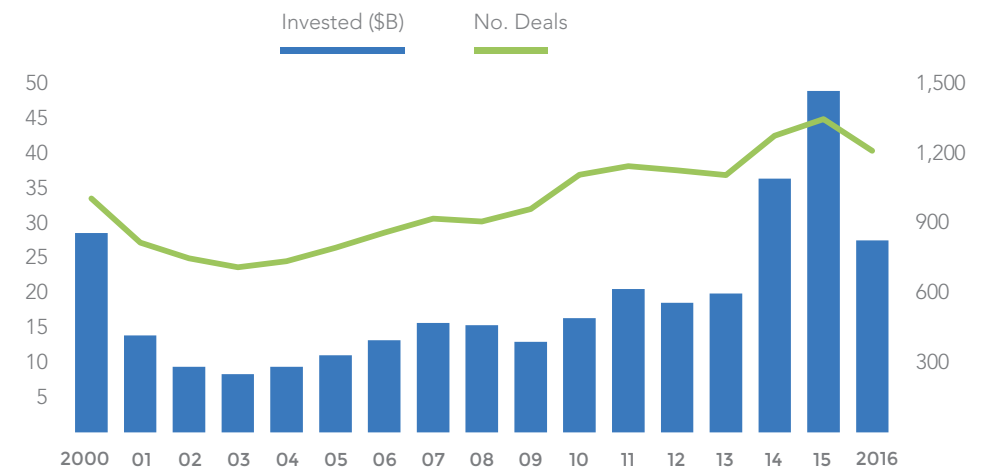
After two years of record setting investment activity, late stage investing retrenched in 2016, albeit to levels that were still high on a historical basis. Late stage capital invested fell by 44% in 2016, while companies funded fell by only 10%. As a result, the average amount invested in late stage rounds decreased by 37% to \$22.7 million. Much of the pullback in late stage funding was attributable to a decrease in mega rounds, or financings of \$100 million or more. According to CB Insights, the number of mega rounds was down 47% year-over-year, with Uber alone garnering \$3.5 billion of the \$16.1 billion raised in these rounds.

\$100M+ Financings (CB Insights)

| 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|------|------|------|------|------|------|
| 4 | 5 | 8 | 38 | 77 | 41 |

Despite this general retrenchment, highly valued companies with momentum – such as Airbnb, Uber, SoFi, Snap, Magic Leap, Wish, Oscar and WeWork – still managed to complete large financings.

Late Stage Capital Invested



Dow Jones VentureSource as of December 31, 2016.

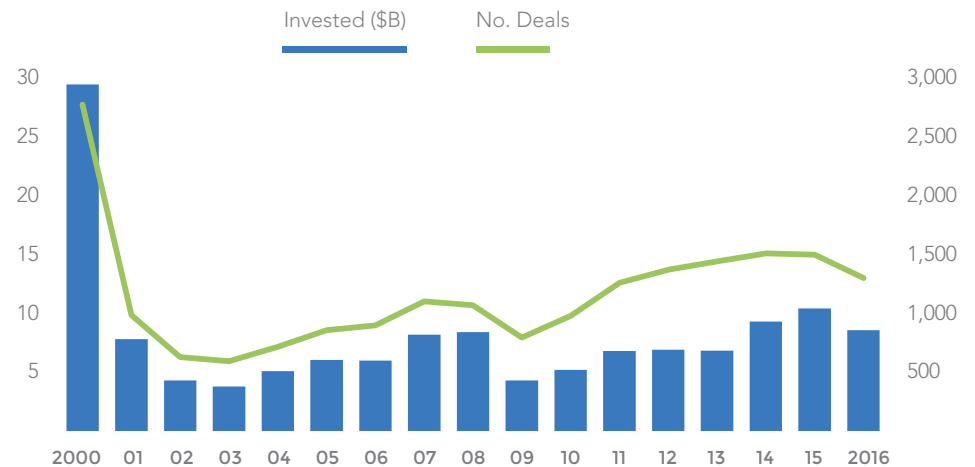
Early stage activity cooled



After six years of steadily increasing early stage investment activity, the number of companies funded and the amount of capital invested at the early stage in 2016 dipped, although the reduction was not as glaring as in the late stage and overall markets. The number of early stage companies funded decreased by 13% year-over-year, while early stage capital invested fell by 18%. Since the Internet bubble, early stage invested capital has remained well below the record high in 2000; this is in contrast to late stage capital invested, which surpassed the 2000 level in both 2014 and 2015, then in 2016 dropped back to a level in line with 2000.

Notably, the average round size for early stage companies in 2016 fell by 5%, after having crept higher in 2014 and 2015. Series A rounds had grown in size as a result of a competitive marketplace and the maturity of Series A companies. Since seed rounds had become similar to historical Series A rounds in terms of size, participants, and pre-money valuation, companies were waiting to raise Series A rounds until certain user and/or revenue metrics were established. Although it is too early to say whether the data in 2016 reflects a changing trend, we will monitor closely the seed and early stage landscape as it continues to evolve.

Early Stage Capital Invested



Dow Jones VentureSource as of December 31, 2016.

Investing

Seed stage activity continued to moderate

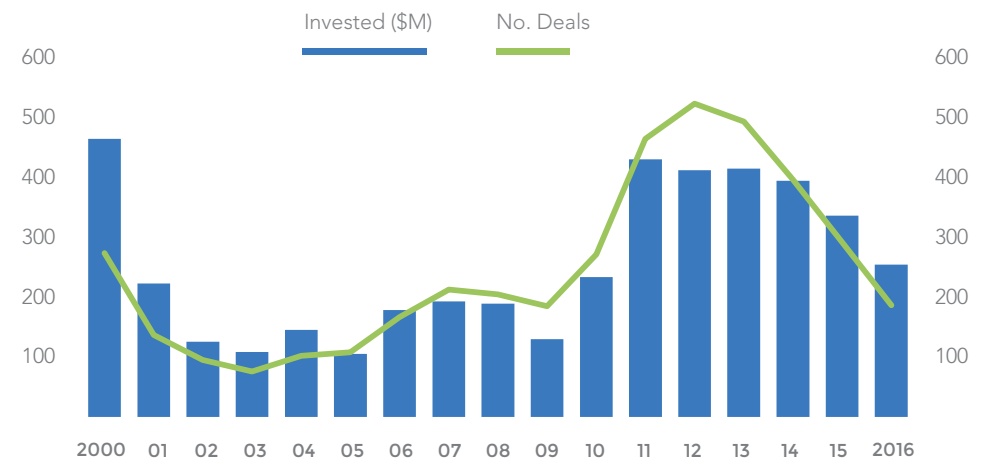


Seed stage activity in 2016 decreased both in terms of companies formed and capital invested; this statistical moderation – which interestingly does not reflect anecdotal experience – has been fairly steady over the last five years as the seed landscape has matured.

Starting in 2010, new micro VCs began to spring up as the industry embraced a new paradigm in company formation. This shift, driven by the emergence of cloud computing, software-as-a-service (SaaS) business models, and viral marketing, brought the cost to start an Internet technology company well below what it cost in 2000, letting companies effectively prove their products and services using far less capital.

The onset of new seed investors led to increased competition and larger, more institutional pools of capital. As a result, seed rounds of financing became larger than in the past, such that they looked more like Series A rounds. In fact, according to Dow Jones Venture Source data, the average seed stage investment grew by 94%, from \$700,000 in 2009 to \$1.4 million in 2016.

Seed Stage Capital Invested



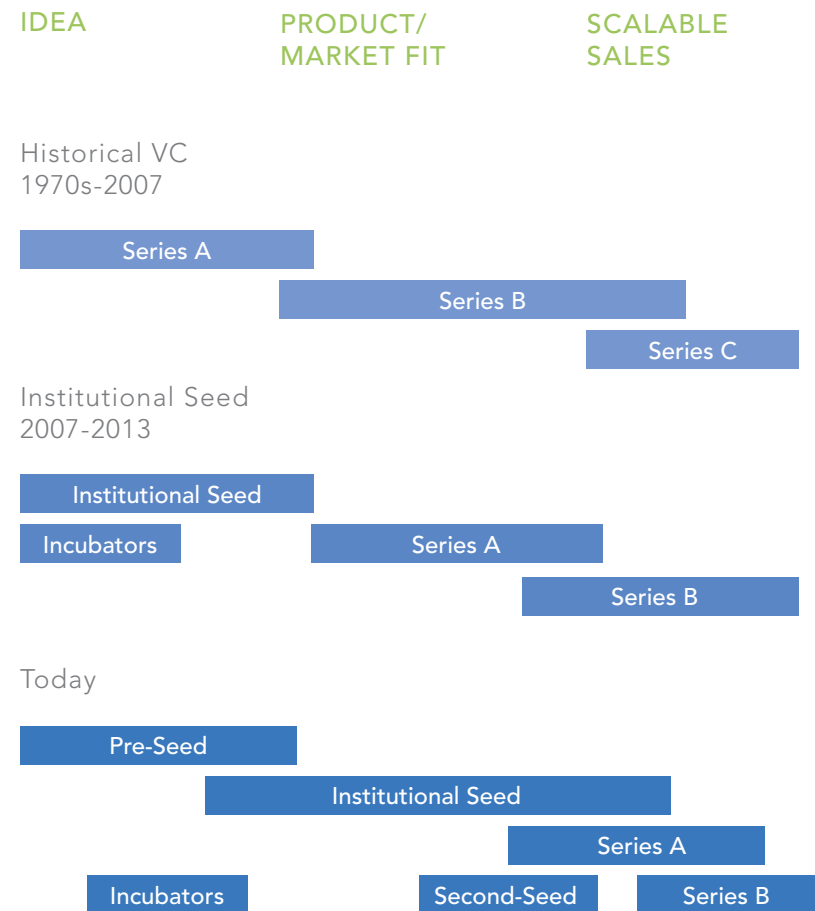
Dow Jones VentureSource as of December 31, 2016.

Seed landscape matured and evolved

At the same time, the average age of seed funded companies increased from 1.6 years in 2011 to 2.4 years, according to Pitchbook. Similarly, the average age of Series A funded companies increased over time, and with it the milestone expectations and metrics that venture investors wanted to see before funding Series A companies. With these changes came the entrance of seed extensions (also referred to as second-seed rounds or mini-A rounds) to help companies bridge the gap to Series A rounds, as well as pre-seed rounds to fill the void at the earliest stages of company formation. In fact, notable companies like WhatsApp, Uber, Airbnb, Instagram, Facebook, and Snap all raised what today would be called pre-seed rounds before raising large Series A rounds. The proliferation of incubators and accelerators has also played a large role in pre-seed funding in recent years. As a result, it is fair to say that the seed landscape has become increasingly segmented and nuanced, and that not all seed rounds are created equal.

While the uncertainty of 2016 likely helped limit the number of “me-too” companies, the reasons to start companies today continue to be compelling. And the industries that are undergoing disruption, or that have yet to be disrupted, are many. Despite higher valuations, the attractive economics of startup formation, and the talented seed stage investors who are backing the best ideas and entrepreneurs, continue to make the seed space an attractive one in which to selectively invest.

While seed stage activity has statistically declined in recent years, company formation and seed stage funding remain at historically healthy levels.



Source: Pear VC.

TREND: CORPORATE VC ON THE RISE

Over the last several years, the participation of corporations in funding startups alongside traditional venture firms has marked a dynamic shift in the venture landscape.

For corporations of varying size and sector, investing in venture deals has become a popular way to innovate externally and improve operations internally. In fact, the number of corporate venture capital (CVC) groups making private investments has nearly tripled since 2010, according to Global Corporate Venturing.

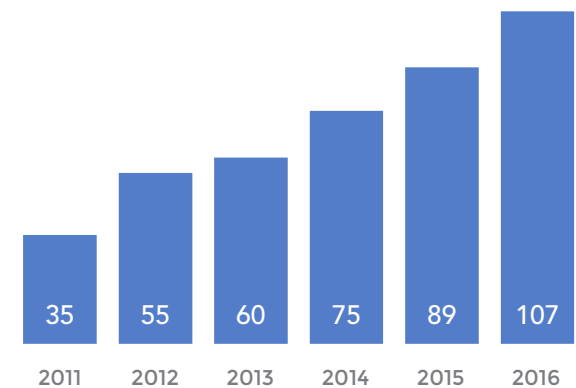
In 2016, both capital invested and companies funded by US CVCs declined – the same trend observed in the broader venture market. According to CB Insights, US CVCs invested \$16.1 billion in 752 deals in 2016, a year-over-year decline of 10% by capital and 12% by deal count. While the percentage decline in deal count was in line with the broader market, the decline in capital invested was much less dramatic. As traditional venture investors retreated in 2016, CVCs retreated to a lesser extent and thus helped to fill the funding gap.

Despite the decreasing statistics, CVCs continued to play a meaningful role in the venture capital ecosystem by participating in 21% of all venture financings in 2016. And the number of new CVCs has steadily increased in recent years, with Campbell Soup Company, JetBlue and Sesame Street among the 107 debut CVCs in 2016.

2016 also marked a year of active M&A by corporates, particularly non-technology incumbents such as GM, Unilever, and Walmart, which each acquired an angel- or venture-backed technology company for over \$1.0 billion last year. Because only a single non-technology incumbent had made a \$1.0+ billion acquisition over the preceding three years, CB Insights suggested that the profile of buyers in the biggest venture-backed M&A exits could be shifting.

As technology and non-technology corporations alike endeavor to innovate and stay ahead in their respective industries, we expect CVCs to continue to participate actively as investors and acquirers over the coming years.

Rising Number of New CVC Groups



CB Insights as of December 31, 2016.

Most Active US in CVCs



Valuations

A welcome reset for VC valuations

After running up in 2014 and 2015, valuations fell almost across the board in 2016 – a welcome change for many industry participants, even as some companies scrambled to accommodate investors' heightened focus on business fundamentals and avoid having their reputations tarnished by down-rounds. Fewer unicorns emerged as a result, but that didn't stop a number of high-profile, high-performing companies like Airbnb, Uber, SoFi and Snap from drawing the attention of investors.

Valuations

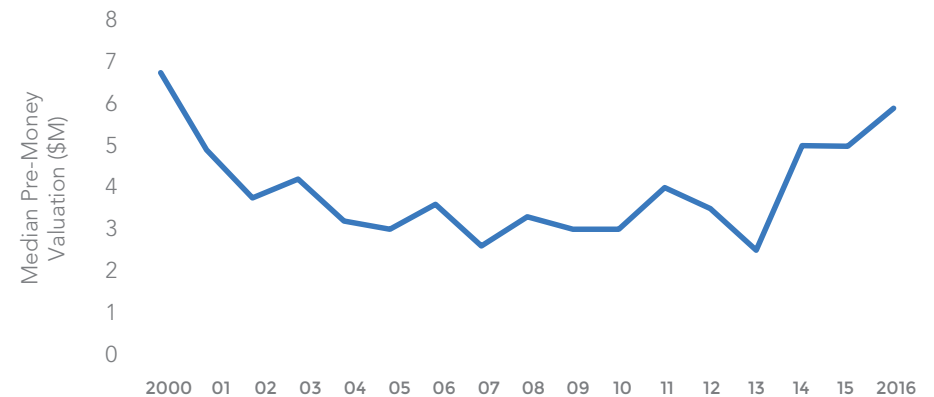
Seed stage valuations rose as early stage fell

Seed valuations in 2016 increased 18% year-over-year, reaching a post bubble high of \$5.9 million.

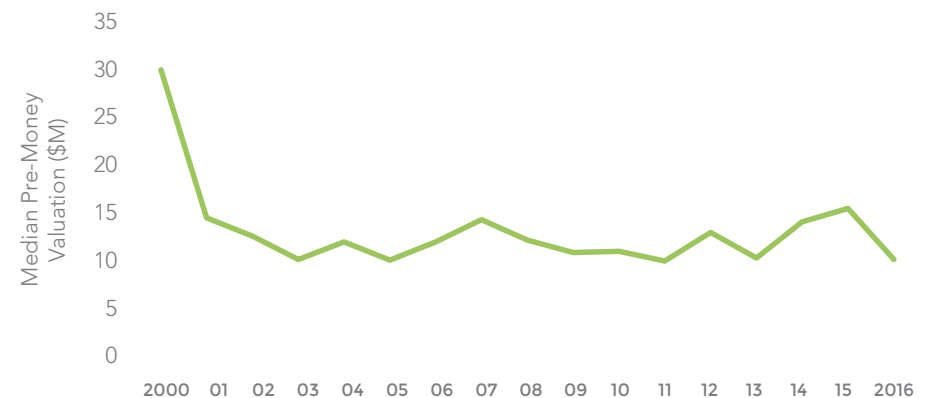
Conversely, early stage valuations fell rather sharply to \$10.1 million, 35% lower than in 2015.

Generally speaking, valuations fell across most stages, sectors, and geographies in 2016. Venture capitalists leading financing rounds were more focused on revenue and profit growth, not just customer and user growth, and thus demanded lower valuations. At the same time, companies tried hard to avoid down-rounds because of the potential negative effects on recruiting, employee morale and customers. To avoid down-rounds, companies may have offered generous terms to new investors (such as ratchets that provided downside protection for investors) or delayed raising new capital at all. Overall, the valuation reset in 2016 was welcomed by industry participants after the frenzied environment in 2014 and 2015, but there were still high-performing, highly sought after companies that commanded high valuations and FOMO (“fear of missing out”) behavior by some investors.

Seed Stage Pre-money Valuations



Early Stage Pre-money Valuations



Dow Jones VentureSource as of December 31, 2016.

Valuations

Mid and late stage valuations declined

"Pre-IPO late stage private startups that could survive without new funding resisted down rounds. The market was in a stalemate."

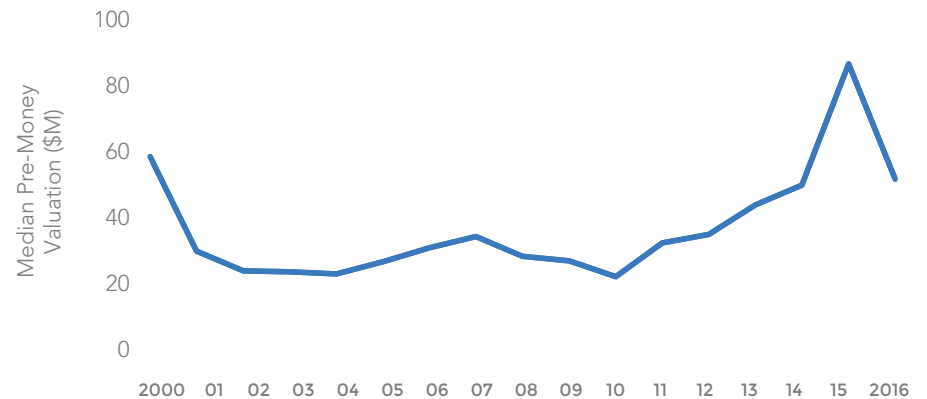
- Byron Deeter, Bessemer Venture Partners (WSJ Pro Venture Capital)

Mid stage valuations, typically represented by Series B and C financings, decreased substantially in 2016; the median pre-money valuation for mid stage financings was \$51.8 million, 40% below the all-time high reached in 2015. Likewise, late stage valuations (Series D rounds and later), which since 2003 had been on a steady and steep climb, fell to \$300.0 million. While the magnitude of the 33% drop was significant, late stage valuations still ended the year relatively high on a historical basis.

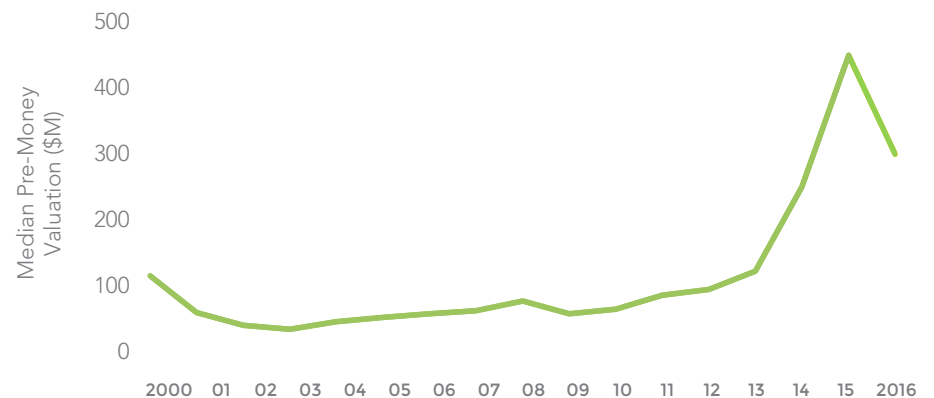
The rise in late stage valuations over the past several years was discussed in prior reports, and many of the key factors driving the trend remain in place today:

- Companies have delayed public offerings and are staying private longer, giving private investors more opportunity to invest and participate in the steep portion of companies' value creation curves.
- A new generation of technology companies, born out of advances in cloud and mobile computing, is disrupting new industries – naturally attracting investors to the sector.
- Investors behaved aggressively, driven by FOMO, although this behavior diminished in 2016.
- A record amount of late stage capital was invested over the past three years.

Mid Stage Pre-money Valuations



Late Stage Pre-money Valuations



Dow Jones VentureSource as of December 31, 2016.

TREND: UNICORN STAMPEDE SLOWED

While 76 companies globally joined the unicorn club in 2015, only 41 were granted this distinction in 2016. (CB Insights)

Unicorns, or the 182 global, venture-backed companies with valuations of \$1.0 billion or greater, remained in the spotlight in 2016, but not all the attention was as positive as in 2015. Instead of the unicorn rush that occurred in 2015, when an average of 1.5 new unicorns were “born” each week, 2016 saw fewer new unicorns, as well as unicorns “wounded” after flat or down financings or exits. Some of the headline-grabbing “wounded” unicorns in 2016 included Jawbone, Zenefits and Doordash, all impacted by down rounds, and Gilt Groupe, Living Social, and One Kings Lane, which were acquired well below their valuation peaks. The industry also saw a few unicorns – such as Mode Media and Powa Technologies – become “unicorpses” as they shut down operations in 2016.

- Only 23% of the present-day unicorn club joined in 2016, compared to 42% that joined in 2015. (CB Insights)
- Unicorn financings were down 32% in 2016: 144 deals were completed, compared to 212 the year before. (CB Insights)
- Though nearly all US unicorn financing rounds were defined as up-rounds in 2014 and 2015, only 75% were up-rounds in 2016; the rest were flat (21%) or down (4%). (Fenwick & West)
- 40% of unicorns taken public or sold in 2016 occurred at a lower valuation than their last private financing round. (Fenwick & West)

Venture Firms with 20+ Unicorns

ANDREESSEN
HOROWITZ

SEQUOIA 


SVAngel

TIGER
Tiger Global Management, LLC

DST

 **Fidelity**
INVESTMENTS

Exits & Returns

IPO market takes a pause, a slight uptick in M&As

The IPO market during the first half of 2016, especially for technology companies, was by all accounts sluggish. 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.

While some sources claimed that 2016 was a lackluster year for venture-backed mergers & acquisitions, Dow Jones Venture Source data suggested that 2016 was a rather healthy year. In fact, the volume of M&A transactions has been more consistent than the volume of IPOs since 2009, and while the median market cap of IPOs has drifted lower since 2009, average M&A value has drifted higher over the same time period.

IPO market sputtered

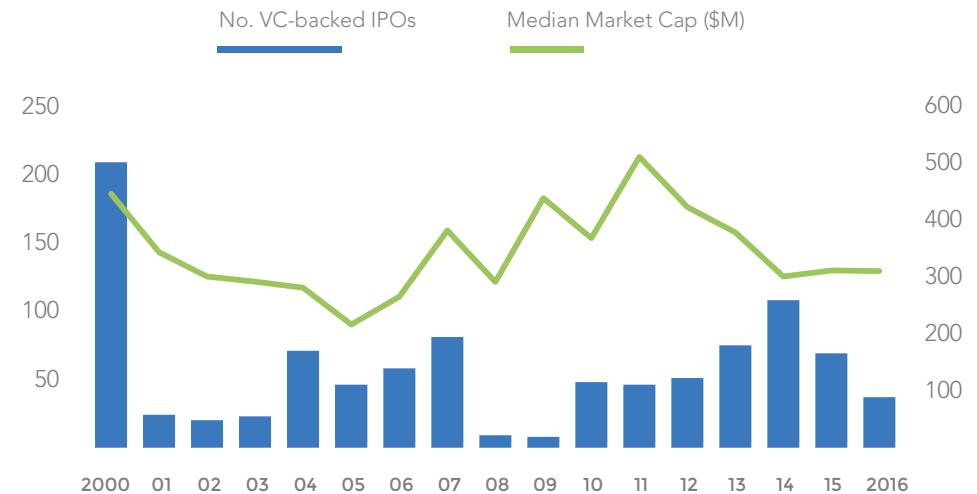
37 venture-backed companies went public in 2016, 46% fewer than in 2015, and the median market cap held steady at \$310 million. Over a two year period, volume fell by 66% as 2016 marked the worst year for IPOs since 2009.

The IPO market started to see signs of life in the second quarter of 2016 with the debut of Twilio, making it the first technology unicorn to go public since Square in November of 2015, followed by Nutanix and Coupa. With a resurgence in the broader market, and companies such as Snap and AppDynamics preparing to go public, investors had a cautiously positive outlook for IPOs for the remainder of the year. But the IPO window that cracked open seemed to close, as unicorn companies Blue Apron, SoFi, and Airbnb all delayed their plans to file.

There were numerous factors that contributed to the sluggish year for IPOs, including a market sell-off in January, the Brexit vote, and the US elections. But the biggest factor in the technology sector, according to Renaissance Capital, may have been the lowering of public valuations that made it harder to justify high pre-IPO valuations.

The performance of venture-backed IPOs was certainly a better story than the volume of IPOs in 2016. The successes of Twilio, Nutanix, and Coupa helped technology IPOs perform well on the year. Technology IPOs gained an average of 40% over their IPO price, much higher than the 23% average gain for IPOs overall, according to Renaissance Capital.

Number & Median Market Capitalization of IPOs

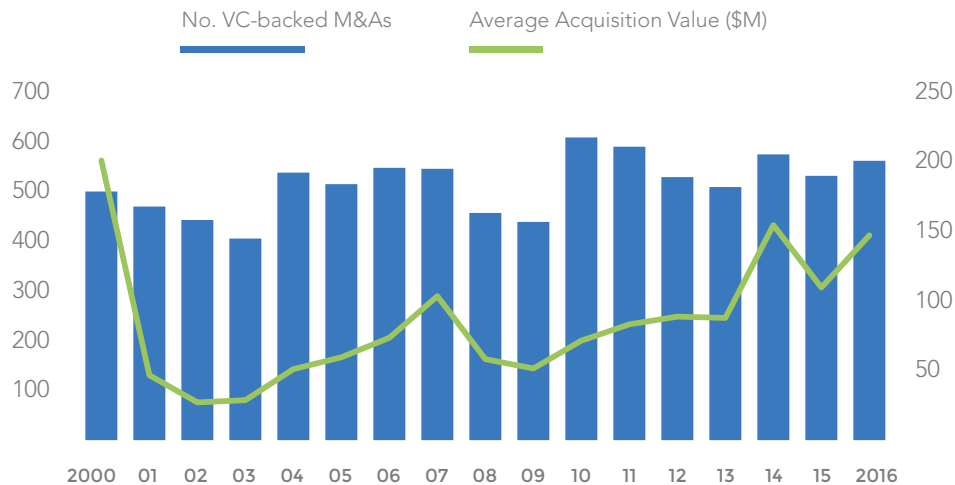


Dow Jones VentureSource as of December 31, 2016.

M&A activity remained healthy

561 venture-backed companies were acquired with an average acquisition value of \$147 million, resulting in a 6% year-over-year increase in volume and a 34% increase in valuation.

Number & Average Value of M&A Transactions



Dow Jones VentureSource as of December 31, 2016.

According to Pitchbook, the five largest venture exits in 2016 were a result of corporate acquisitions, three of which were life science companies. Stemcentrx was the largest deal of the year with its \$10 billion acquisition by AbbVie. The largest venture-backed technology deal was Walmart's \$3.3 billion acquisition of Jet.com. According to CB Insights, there were 18 \$1 billion+ technology exits in 2016, including The Dollar Shave Club (bought by Unilever for \$1.0 billion) and Cruise Automation (bought by General Motors for \$1.0 billion).

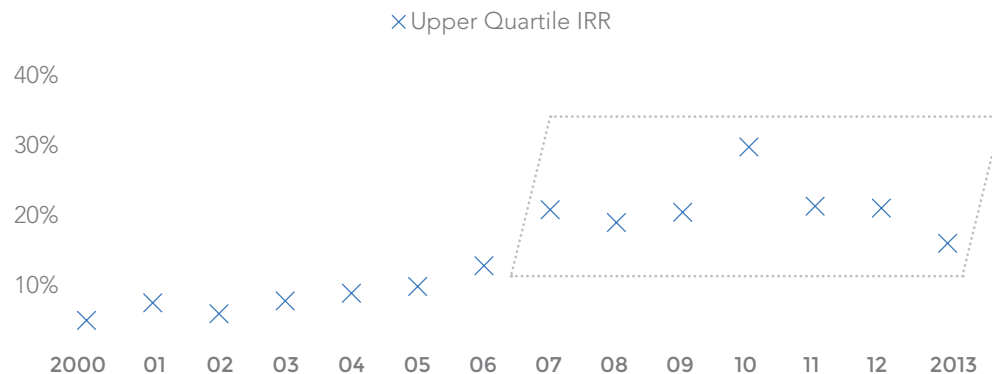
Although both public companies, Microsoft's \$26 billion acquisition of LinkedIn made quite a splash in 2016. Corporations proved they were willing to make big strategic bets and to acquire innovation. According to CB Insights, 2016 was the year of non-technology incumbent transactions; there were six non-technology buyers of \$1.0+ billion angel or venture-backed US technology companies including General Motors, Unilever, and Walmart. By comparison, there was only one technology buyer (Cisco) of a \$1.0 billion technology company in 2016. Other notable non-technology incumbent transactions include General Electric's \$915 million acquisition of ServiceMax and Ritchie Bros' \$758 million acquisition of IronPlanet.

But of course the M&A news in 2016 was not all rosy, as we previewed early in this report. Living Social, once valued at \$6.0 billion, was acquired by Groupon for literally nothing, while Gilt Group was acquired by the parent company of Saks Fifth Avenue for \$250 million, well below its prior \$1.0+ billion valuation.

Exits & Returns

Performance stayed strong

Upper Quartile Vintage Year IRRs



TOP QUARTILE RETURNS FOR EVERY MEANINGFUL VINTAGE YEAR SINCE 2007 ARE MORE THAN

16%
NET TO LPS

Cambridge Associates as of September 30, 2016.

It is now well understood that low absolute returns during the early 2000s were driven primarily by an overcapitalized venture industry, too many funds chasing too few compelling investments, and a dampened exit environment related to the financial crisis in 2008. As discussed earlier in this report, the industry has consolidated meaningfully when measured by the number of active venture firms; this consolidation, combined with a bull market over the last eight years, has contributed to improved returns.

While top quartile IRRs for vintage years since 2007 generally drifted lower compared to a year ago, they are all respectably above 16% net to LPs, according to Cambridge Associates. And the long-term venture capital index returns, particularly over 3, 10 and 20 year periods, continued to impress and outperform major public indices, even as the year-to-date index as of September 30, 2016 was only up 0.53%.

Not surprisingly, strong performance and robust net cash flows back to limited partners contributed to investors' enthusiasm for the venture asset class in recent years, as evidenced by the record fundraising levels between 2014 and 2016. But with the valuation correction, lackluster IPO market, and expected fewer distributions back to LPs in 2016, we will watch carefully whether top quartile IRRs will hold up and how well recent strong paper gains can be realized in the years to come.

Conclusion

What lies ahead?

While there are certainly reasons to be cautious about the current environment – including elevated fundraising levels, late stage valuations that remain high on a historical basis, and an IPO window that may or may not fully open – we believe, as do others, that there are plenty of reasons to be optimistic about the venture environment in 2017.

Conclusion

Expectations for 2017 and beyond

Fundraising levels should moderate this year. Deal pace has normalized, although there are exceptions to this rule as FOMO behavior still rears its head. Valuations have, on the whole, declined; and in the later stages, valuation resets may continue as many unicorns that raised capital at the peaks of 2014 and 2015 have yet to raise subsequent rounds, and may do so under higher scrutiny today. The IPO market is off to a healthier start compared to a year ago, with successful and highly anticipated public market debuts of Snap, Mulesoft and Okta, plus a large pipeline of companies poised to go public; in fact, CB Insights tracks 369 technology companies in its IPO Pipeline Report. Innovation is very much alive and well, and we are in the early innings of exploring the many applications of frontier technologies related to robotics, drones, autonomous vehicles, augmented reality, virtual reality, machine learning, and artificial intelligence.

There is a lot of capital that remains eager to invest in startups – including capital from traditional investors, corporates, and foreign entities – which could be either a positive or negative for the industry, depending on the sophistication and discipline of these investors, and the stage at which you are investing. But we continue to remind ourselves that despite the market cycles, and the near impossible task of timing the market, we must remain engaged, diligent, and mindful of the opportunities. It's worth remembering that some of today's most successful startups – Dropbox, Airbnb, Uber, Instagram, WhatsApp, LendingClub, AppDynamics – were started during or after the 2008 financial crisis. We eagerly await the next cohort of companies to emerge from these uncertain, yet compelling, times.

VC PREDICTIONS

"[Since the] second half of [2016], it's been what I would describe as a good market for good companies, meaning that deals were getting done. They're getting done at more rational prices, so on the whole prices are down from where they were in the peak of mid 2015. But it's a market that's actually working and functioning as opposed to the first half of the year which was kind of non-existent. And so I think 2017 will look a lot like 2016, which is good companies will get funded. People are back in the motion of doing deals, the IPO market is healthy."

- Scott Kupor, Andreessen Horowitz

"The IPO market, led by Snap, will be white hot. Look for entrepreneurs and the VCs that back them to have IPO fever in 2017. I expect we will see more tech IPOs in 2017 than we have since 2000."

- Fred Wilson, Union Square Ventures

Why it will likely be a great time to be a technology entrepreneur in the US in 2017–2018:

- foreign capital
- corporate investors
- increased LP distributions
- new VC funds, bigger funds
- repatriation of capital
- likely robust M&A and IPO markets

- Mark Suster, Upfront Ventures

Conclusion

Resources

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 Dow Jones LP Source for venture capital fundraising data and Dow Jones Venture Source for venture capital investing, valuation, and exit 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 2016 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 the Venture Capital Industry is an annual market analysis of key venture capital industry trends spanning fundraising, investments, valuations, exits, and returns.

Follow [@TrueBridgeCP](https://twitter.com/TrueBridgeCP) for the latest updates and insights.

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