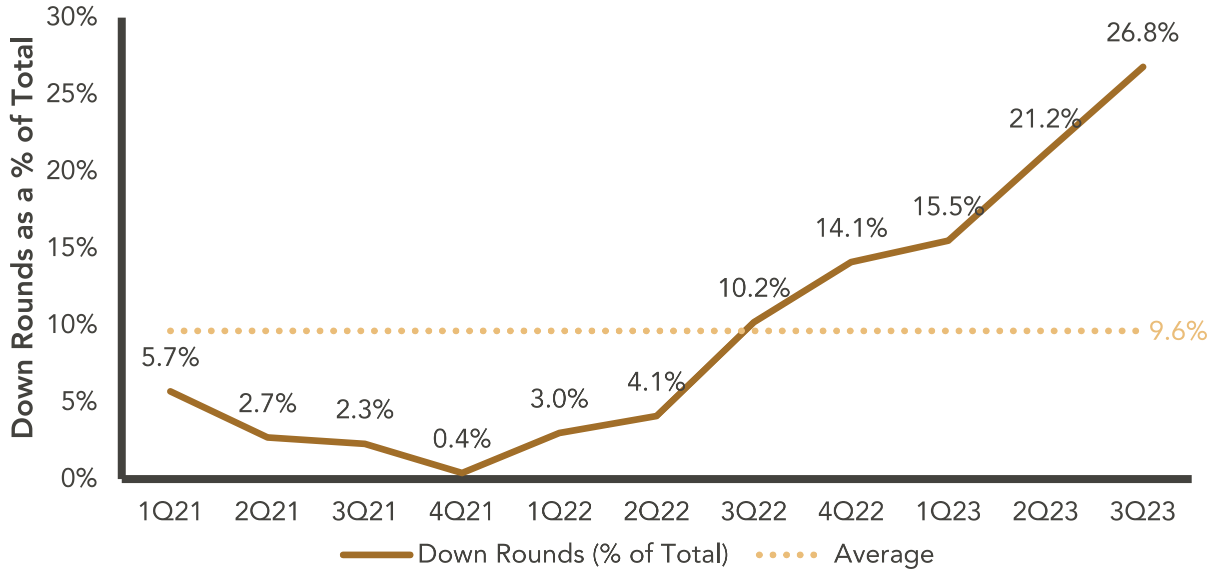
Chart of the Week

February 6, 2024

Another (Down) Round

NAT KELLOGG, CFA, PRESIDENT

Over the last two years, there has been a noticeable increase in down rounds for venture-backed companies



Source: Cooley GO as of September 30, 2023

Venture-backed companies tend to be nascent and typically deploy investment capital in an effort to drive revenue expansion, often to a point at which they are losing money. Given this profile, these businesses must raise new capital every few years to fund future growth. In normal circumstances, each capital raise is conducted at a higher valuation, assuming the company remains financially viable. That said, there are occasionally instances in which the market's perception of valuation has materially changed or the company is not achieving specific growth targets. Cases like these, which are referred to as down rounds, result in companies being forced to raise capital at lower valuations than the ones exhibited during the most recent fundraising period.

Many venture-backed companies raised capital in 2020 and 2021 at relatively high valuations. Since that time, a significant portion of those companies have seen cash levels depleted and are now returning to the market in order to fund operations for the next few years. However, today's market environment looks quite different from those of 2020 and 2021, which means these companies are being confronted with much lower valuations as they attempt to raise capital. As displayed in this week's chart, these dynamics have led to a steady increase in the number of down rounds over the last several quarters. To that point, down rounds (as a percentage of all fundraising rounds) hit a new high of nearly 27% in the third quarter, which is more than double the long-term average.

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The trends depicted in the chart above are likely to lead to some disappointing returns for venture capital funds with vintages from 2018 through 2021, as these funds deployed significant amounts of capital during those years and now face a more challenged valuation landscape. On the bright side, these dynamics may present an opportunity for funds with more recent vintages and fresh capital to invest at more attractive valuation levels. Marquette will continue to monitor developments within the venture capital space and provide recommendations to clients related to existing exposures and future commitments.

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