MERCER CAPITAL

VALUE FOCUS
Venture Capital

Mid-Year 2015

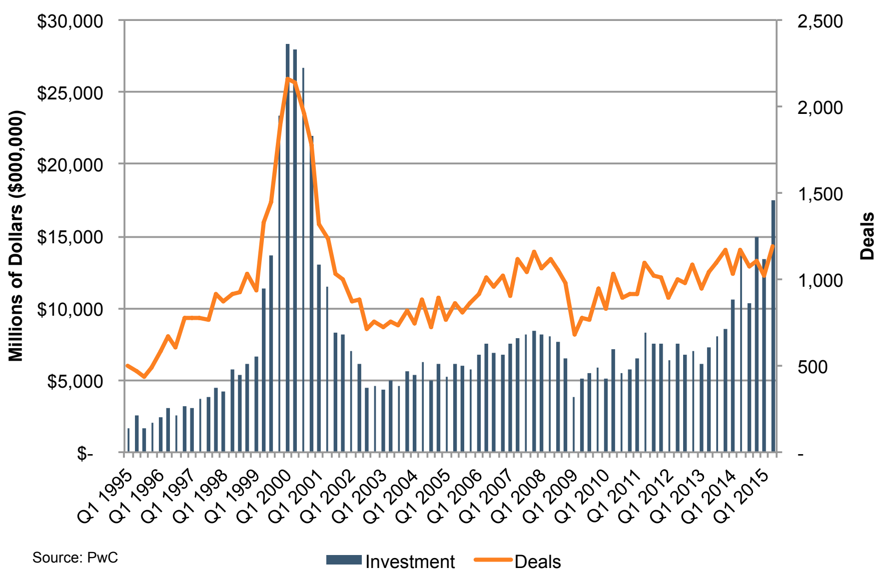
www.mercercapital.com

Mid-Year Market Perspective

Venture Capital Overview

The venture industry continues to be marked by rising valuations and steadily increasing levels of investments, a pattern almost uninterrupted since the tech boom of 2000. As of year-end 2014, total investments topped out at a staggering $49.5 billion, while deal volume has fallen to its lowest level since 2012.[1] The trending of a diminishing number of rounds occurring at ever larger dollar amounts has continued into the first half of 2015. In the first quarter of 2015 alone, total investments hit $13.4 billion, representing a $200 million increase over the first quarter of 2014.[2] Median valuations across all stages of funding have risen to historic levels, spurring investors towards either end of the market in the hopes of finding a breakout startup in the early rounds, or catching a piece of a so-called unicorn before a lucrative IPO.[3] As a result, the majority of investments made in the first half of 2015 were made in only a few large rounds.

Venture Capital Overview



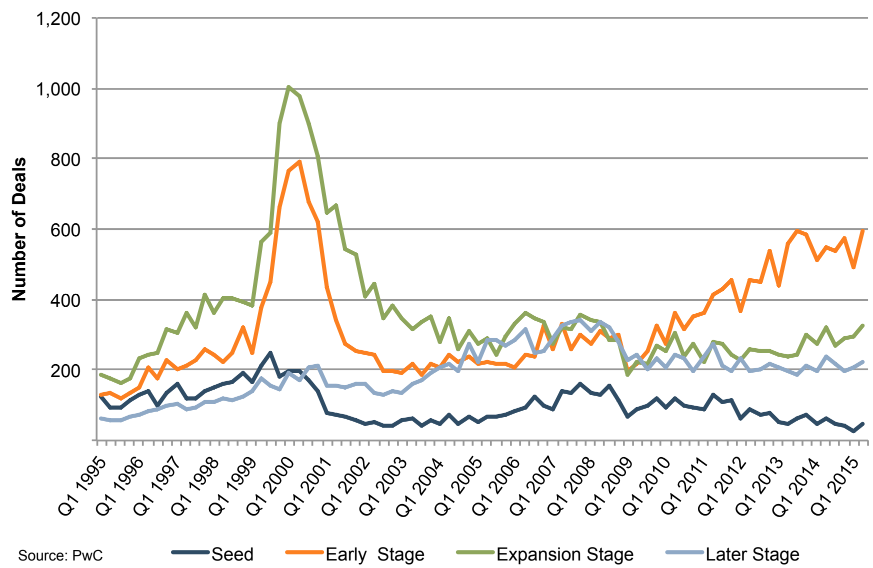
Source: PwC

Venture Capital Activity by Stage & Quarter

The growth in the median value of funding rounds over the period is most evident in the pattern shown by later rounds. Over 80% of Series C and D+ rounds topped $25 million in value in the first half of 2015, despite a 28% drop in the number of $25M+ rounds over the same period. The growing amount of late stage capital has created a sort of "private IPO" market, with startups choosing to continue raising private capital in later rounds in order to delay their exits into the more volatile public markets. Year over year, the number of exits in the first half of 2015 was 23% lower than 2014, which has led to an explosion of pre-IPO companies reaching the billion dollar mark. As of the second quarter of 2015, there were 24 of these unicorns, compared to only 9 in the same quarter last year.[4]

Concern has grown on the sustainability of rising valuations, but the industry as a whole has grown consistently since the mid-2000s. Over 60% of financings in 2014 attracted higher valuations in subsequent rounds, buoyed by a recovering economy, higher performance in the public markets, and solid growth and revenue amongst startups. Although industry activity has slowed to levels comparable to 2012 in the first half of 2015, venture capital activity has been historically slow in the first quarter of the year in relation to the remainder of the year.[5]

Venture Capital Activity By Stage and Quarter

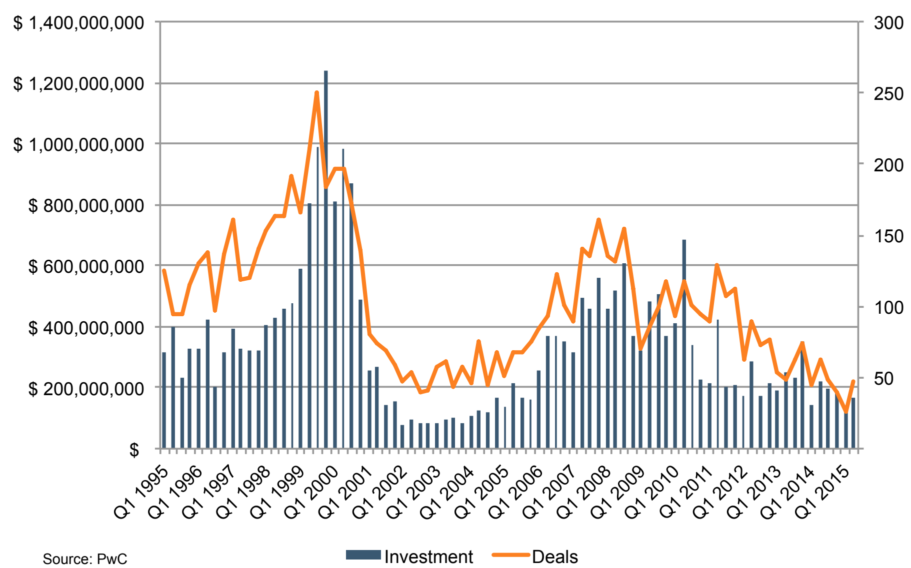


Source: PwC

Seed Activity

The recent slowdown may also be partially due to a change in investment strategy and variations in reporting. Many companies with exceptional founders and prior venture success are skipping the traditional "Seed" round for a "Straight to A" round, in which start-ups are able to raise $5 to $10 million from the outset. The falling costs of startups and the democratization of funding from newer types of sources like Reg A+ or crowdfunding has expanded the traditional means and volume of capital available to founders.[6] CB Insights also maintains that the seed stage market may not be as sluggish as it appears in the PwC data. However, this discrepancy may result from differences in data collection methods, as CB Insights collects data through direct submissions from companies as well as an algorithm that searches regulatory filings, blogs, and news sources, and programmatically extracts data deemed relevant. And there may be a tradeoff between the quantity of data extracted by CB Insights' web-crawler, and the practitioner survey data collected by PwC via their access to Thomson Reuters Private Company Data.[7]

Seed Trends



Source: PwC

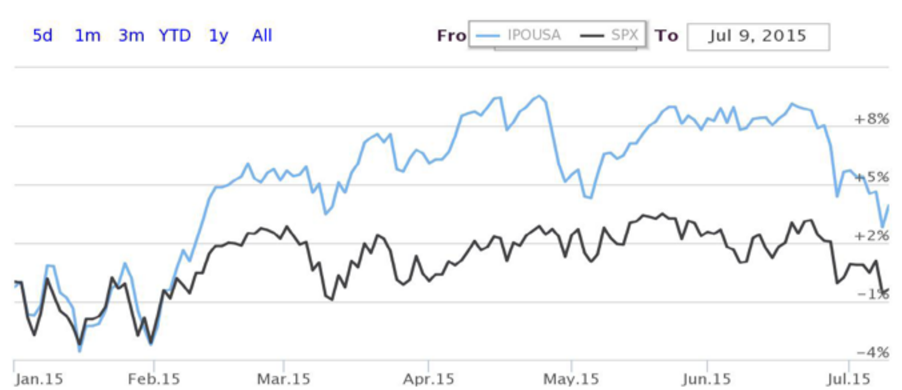
Exits Overview

With so many VC-backed tech companies valued over $1 billion, many predicted that 2015 would be a banner year for tech exits. However, as of the first quarter of 2015, only three tech companies (excluding biotech) had gone public: Box, Inovalon Holdings, and MaxPoint Interactive.[8] Unlike in years past, large financing rounds in the tech industry are no longer indications of companies nearing "late-stage", pre-IPO funding. Many of the business plans and strategies of these companies in these high priced private rounds are still under development, and have not undergone the same level of scrutiny historically expected of a company nearing an IPO. As late-stage funding has grown more competitive, investors have in many cases thrown caution to the wind in order to secure a stake in a potential unicorn.[9]

According to Renaissance Capital, an IPO research and investment-management firm, IPO activity in the first quarter of 2015 was half the level of the first quarter of 2014. The most significant drop occurred in technology, with only four deals in this quarter as compared to 11 in the previous quarter. This drop may be the result of the recent IPOs of several high profile tech companies, including Box and New Relic, which priced below their most recent private financing rounds. Over the first quarter of 2015, it appeared that funding was once again favoring the private market. This presents a logical dichotomy, however, as funding for development in private companies is ultimately contingent on some kind of public exit. So when the equation is lopsided, and the private market is favored at the expense of public investment, pressure builds.

IPO activity rebounded in the second quarter of 2015, with 70 IPOs raising almost $13 billion. Although tech continued to have weaker than historical performance, the health care sector was bolstered by a growth in biotech companies, with 34 venture backed IPOs in the second quarter. With an 88% increase in the number of IPOs from first to second quarter of 2015, momentum appears to be building in the third quarter. The Greek crisis has led to some caution in the equity markets, but the number of companies poised for IPOs has increased, and many companies are hoping to beat a potential Fed rate hike or other unforeseen market disruption / strain on liquidity.[10]

Investor Index



Source: Renaissancecapital.com

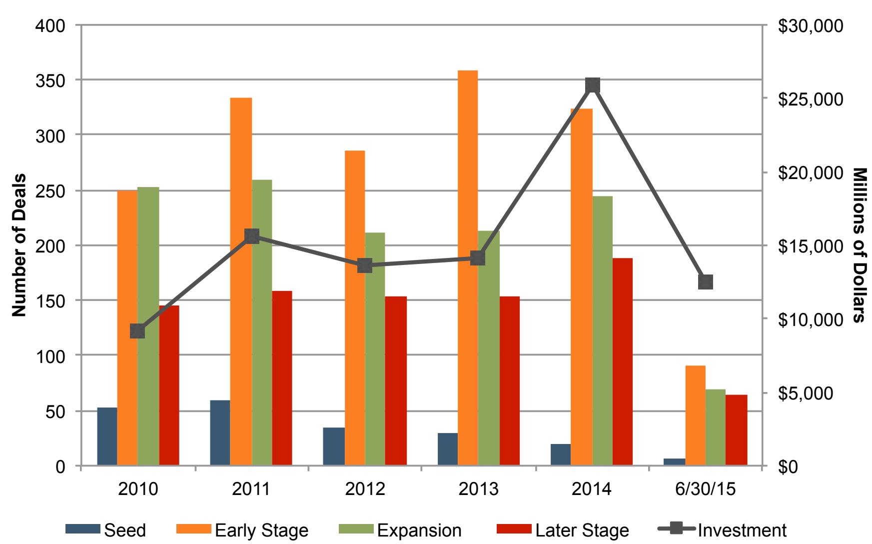
Firm Focus

New Enterprise Associates (NEA)

In order to narrow down the wide landscape of the venture capital industry, we selected 15 of the largest, most active venture capital firms involved in high profile deals in the United States. Of these investors, New Enterprise Associates ("NEA") had the largest number of deals in the first half of 2015, with a total of 45 investments.[11] NEA is a multistage investor that has historically focused on healthcare and technology investments in the U.S., China, and India. Led by managing partners Scott Sandell and Peter Barris, NEA announced that it has closed its 15th investment fund at $2.8 billion on April 15th, the largest single pool in the Company's history. Alongside an additional $350 million investment, the two pools total $3.15 billion and exceed the largest single venture fund ever raised in the history of venture capital.[12] NEA's huge investments demonstrate the firm's confidence in the existence of investment opportunities, despite concerns of overheating in the tech world. Top investments for 2015 include a $140 million investment in Jet.com in the first quarter, and a $128 million investment in MuleSoft Inc. in the second quarter.[13]

The graph below shows the number of deals by round and the total number of dollars invested by the 15 selected investor firms from 2010 to the second quarter of 2015. Fiscal 2014 saw a 5 year high for dollars invested, and was led by a number of extremely large later stage rounds within the industry and among our top 15 firms.

Investor Index



Source: VC Experts

VC Bubble?

If every bull market climbs a wall of worry, every venture capital expansion happens in a bubble. Over 2014, the industry saw some of the highest valuations on record, a trend that has continued well into the first half of 2015 and shows no sign of stopping. Mega-deals are on the rise, with higher dollars in fewer rounds, and a longer wait-time before companies go public. Although current trends certainly denote some froth in the market, industry leaders such as Marc Andreessen continue to assert otherwise.

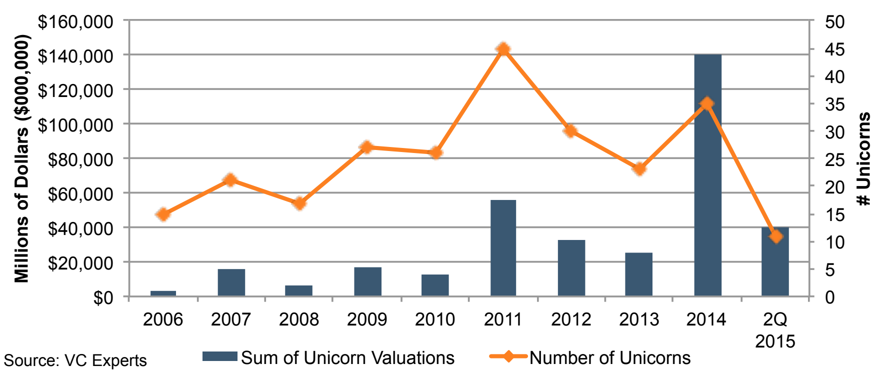
Per Andreessen, the rise of the mobile phone and the online consumer justifies the growth in industry valuations, especially tech, since early 2014. The rapid rise of valuable new software companies is not a bubble, but a fundamental shift in the economy that is centered on the smartphone.[14] With over four billion people online and e-commerce encompassing only 6% of U.S. retail revenue, the sphere has room to grow. In addition, the rise of mega-rounds in the tech industry has come hand in glove with the fall in IPO activity. Companies are taking longer to exit and experiencing higher late-stage rounds as traditional public market investors are increasingly investing in private rounds. However, in contrast to the unsustainable market in 2000, the growth in funding is in predominantly late-stage companies, not younger startups.

Still, there are detractors. Todd Dagres of Boston's Spark Capital, draws comparisons between Silicon Valley today and the 2000 bubble. With the number of unicorns on the rise, Dagres asserts, "If you wake up in a room full of unicorns, you are dreaming and you can't expect the dream to continue." Mark Cuban, who made his fortune founding and selling Broadcast.com, claims that the situation is even worse today than it was 15 years ago.[15] According to Cuban, the private nature of the current investment boom means that investors are in over their heads with no means of escape, effectively trapping them in an illiquid position should valuations collapse. A surge in M&A and an increase in IPO activity will have to counterbalance/justify the growth in valuations in order to sustain current investment sizes.

According to a Fenwick and West Survey, the dollar amount that venture capitalists invested in tech startups in 2014 reached its highest level since the tech bubble in 2000. As shown in the chart below, unicorns are on the rise, though total investments remain well below half of the dollar amount seen in 2000.[16]

Unicorn Valuation Trends

2Q 2005-2Q 2015



Source: VC Experts

Sector Focus

Event/Ticketing

Historically dominated by eBay's StubHub and LiveNation's TicketMaster, the event and ticketing industry has seen a recent upswing in startups and investor interest. As of the second quarter of 2015, startups in the event and ticketing industry have hit a five year quarterly high of north of $170 million, but like elsewhere in the VC space these days, the deals are few in number and large in size. In fact, this surge is primarily attributable to only two deals: a $62 million growth round to Accel-backed SeatGeek, and a $105 million financing to WePiao, a movie-ticketing app created as a spin-off of the popular messaging system WeChat by Beijing Weiye Technology. WeChat was established in 2011, with over 500 million monthly active users, primarily within China.[17]

SeatGeek is a mobile platform designed to help people find tickets to various entertainment events, from sports games to Broadway shows. The app provides users with a range of available tickets and no hidden pricing, as well as a means with which to sell unwanted tickets. With backers including Accel Partners, Causeway Media Partners, and Mousse Partners, SeatGeek hopes to utilize the current growth round to focus on its "customer-centric approach" to ticket sales, while investing in product innovation and brand building. WePiao sells movie tickets to local theaters, and has recently begun selling other sports and entertainment tickets. Demand for online ticketing is on the rise in China, with sales jumping from 8% in 2013 to over 30% by 2014. WePiao is driven through the WeChat app's "wallet" feature, and allows users to not only select which seats they will sit in, but even order soda and popcorn.[18]

Investors are hoping to determine public interest for ticketing services based on the looming IPO of Sequoia-backed company Eventbrite. Eventbrite is a platform that allows event organizers to plan, promote, and sell tickets to events across multiple social-media platforms. Reaching the $1 billion dollar valuation mark in 2014, Eventbrite's market traction and heavy funding has led many to speculate that it may soon go public.[19] However, like many companies in the industry, Eventbrite is in no rush to IPO, as the company has raised four out of the last ten largest funding rounds in the space over the last five years.[20] Starting out with smaller events, the company has begun to expand into larger events, and has recently managed ticketing sales for a 50,000 person concert in New York City. As shown in the capitalization table below, Eventbrite's funding has grown as the company continues to prove itself a worthy competitor in the ticketing industry.[21]

Event and Ticketing Startup Trends

Deal Date	Investment Amount	Valuation	Preferred PPS	Round
2/6/2014	60	$918,544,567	16.38	Series E or greater
4/22/2013	60	$639,051,942	12.35	Series E or greater
5/17/2011	50	$378,646,864	9.33	Series E or greater
10/4/2010	20	$176,169,641	5.14	Series D
10/29/2009	6.46	$23,611,810	0.80	Series C

Source: CB Insights Industry Analytics

Sources

[1] https://www.pwcmoneytree.com/HistoricTrends/CustomQueryHistoricTrend
[2] http://pitchbook.com/3Q2015_U.S._Venture_Industry_Report.html
[3] http://clients1.ibisworld.com/reports/us/industry/industryoutlook.aspx?indid=1314
[4] http://www.businessinsider.com/why-so-many-unicorn-tech-companies-cb-insight-unicorn-list-chart-explains-2015-7
[5] http://pitchbook.com/1H2015_VC_Valuations_and_Trends_Report.html
[6] http://mattturck.com/2015/04/02/the-straight-to-a-round/
[7] https://www.cbinsights.com/blog/seed-deal-activity-increasing/
[8] http://blogs.wsj.com/venturecapital/2015/04/06/first-quarter-drop-in-ipo-exits-could-spell-trouble-for-venture-capital-ists/?KEYWORDS=venture+capital
[9] http://abovethecrowd.com/2015/02/25/investors-beware/
[10] http://www.renaissancecapital.com/news/us-ipo-market-takes-off-again-in-the-second-quarter:-renaissance-capitals-2q-2015-review-33286.html
[11] VC Experts
[12] http://blogs.wsj.com/venturecapital/2015/04/15/new-enterprise-associates-cracks-3-billion-for-latest-funds
[13] VC Experts
[14] http://www.slideshare.net/a16z/state-of-49390473
[15] http://blogmaverick.com/2015/03/04/why-this-tech-bubble-is-worse-than-the-tech-bubble-of-2000/?utm_source=feedburner&utm_medium=twitter&utm_campaign=Feed%3A+blogmaverick%2FtyiP+%28blog+maverick%29
[16] http://www.bloomberg.com/news/articles/2015-03-05/this-venture-capitalist-is-willing-to-say-we-re-in-a-tech-bubble
[17] http://blogs.wsj.com/venturecapital/2015/04/02/seatgeek-scores-62-million-for-its-ticket-selling-app/
[18] https://www.techinasia.com/wechats-movie-ticketing-app-raises-105m-series-funding/
[19] http://fortune.com/2014/03/13/exclusive-eventbrite-joins-1-billion-club/
[20] http://www.forbes.com/sites/tomiogeron/2011/05/02/names-you-need-to-know-eventbrite/#more-851
[21] VC Experts

Mercer Capital

Venture Capital Services

Mercer Capital provides business valuation and financial advisory services to venture capital firms and other financial sponsors.

Our financial advisory services to the venture community include:

- Portfolio Valuation
- Solvency Opinions
- Fairness Opinions
- Purchase Price Allocations
- Goodwill Impairment
- Equity Compensation (409a)
- Personal Goodwill Valuation
- Dispute Resolution
- Buy-Sell Agreement Valuation
- Carried Interest Valuation

For more information about Mercer Capital, visit www.mercercapital.com.

Contact Us

Matthew R. Crow, ASA, CFA
901.685.2120
crowm@mercercapital.com

Travis W. Harms, CFA, CPA/ABV
901.322.9760
harmst@mercercapital.com

Madeleine L. Harrigan
901.322.9756
harriganm@mercercapital.com

MERCER CAPITAL

Memphis
5100 Poplar Avenue, Suite 2600
Memphis, Tennessee 38137
901.685.2120

Dallas
12201 Merit Drive, Suite 480
Dallas, Texas 75251
214.468.8400

Nashville
102 Woodmont Blvd., Suite 231
Nashville, Tennessee 37205
615.345.0350

www.mercercapital.com