First Republic

Great Expectations: Why venture investors will plant more seeds than hunt unicorns

Presentation to NuFund

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Venture reached new peaks during the last venture cycle

However, the era of cheap money is over

Explosion of investment

$90B in 2017 to **$344B** in 2021

Unicorn creation jumped from 88 in 2017 to **596** in 2021; Fell to 308 in 2022

Non-traditional investors participated in 6,802 deals at **$278B** in 2021, compared to 3,346 deals at $60B in 2017;

- Fell to 5,229 deals, **$177B** in value in 2022

Tiger, Softbank, Hedge funds, SWFs

Robust exits

Total exit value = **$753B** in 2021

- Fell 90.5% in 2022 to $71B in total exit value

181 exits via **IPO** with agg'd exit size of **$512B** in 2021

- 965 IPOs in 2021

SPACs was viable exit strategy in 2021

Record fundraising

$44B by 643 funds in 2017 to **$131B** by 771 funds in 2021

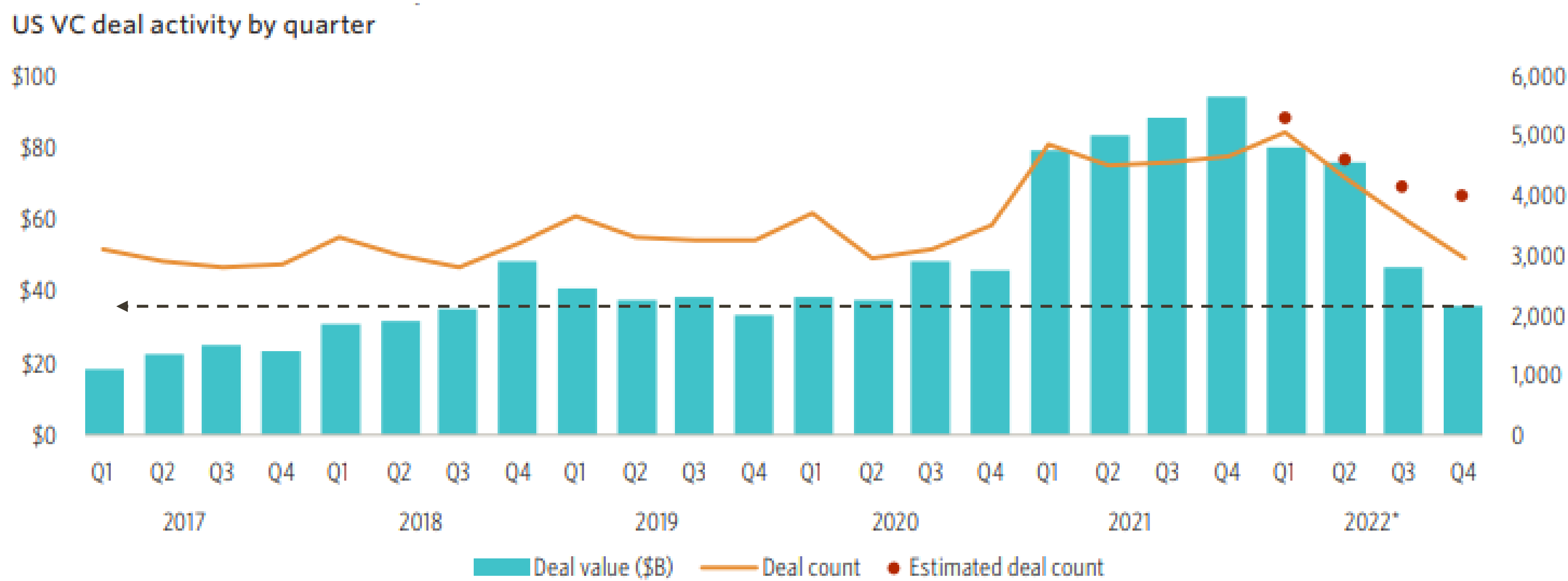
Last peak was in 2007 at $33B by 201 funds.

High interest rates and threats of recession dampened the exuberance, starting in Q3 2022

Source: PitchBook, US venture funds.

After peaking in Q4 '21, VC deal volume dropped to 2018 levels

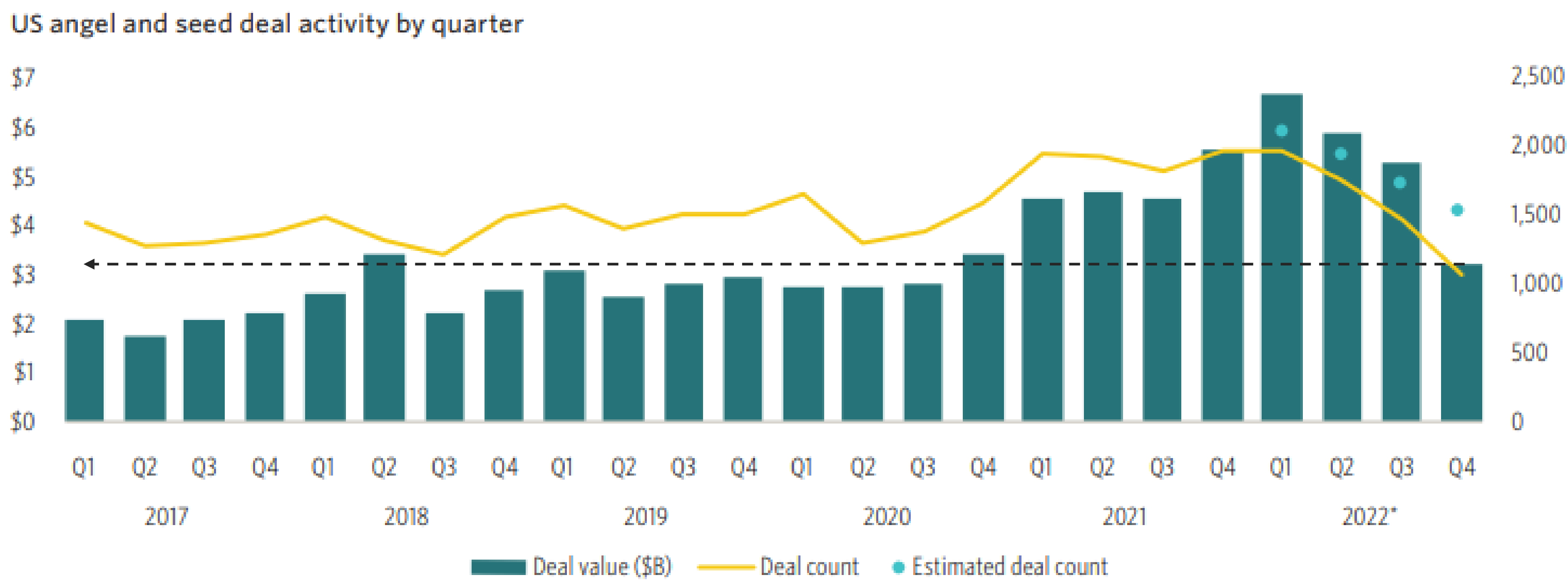
Fund managers have ample dry powder but are focused on current portfolios



PitchBook-NVCA Venture Monitor
*As of December 31, 2022

Angel and seed deal activity also declined

Investment peaked in Q1 2023



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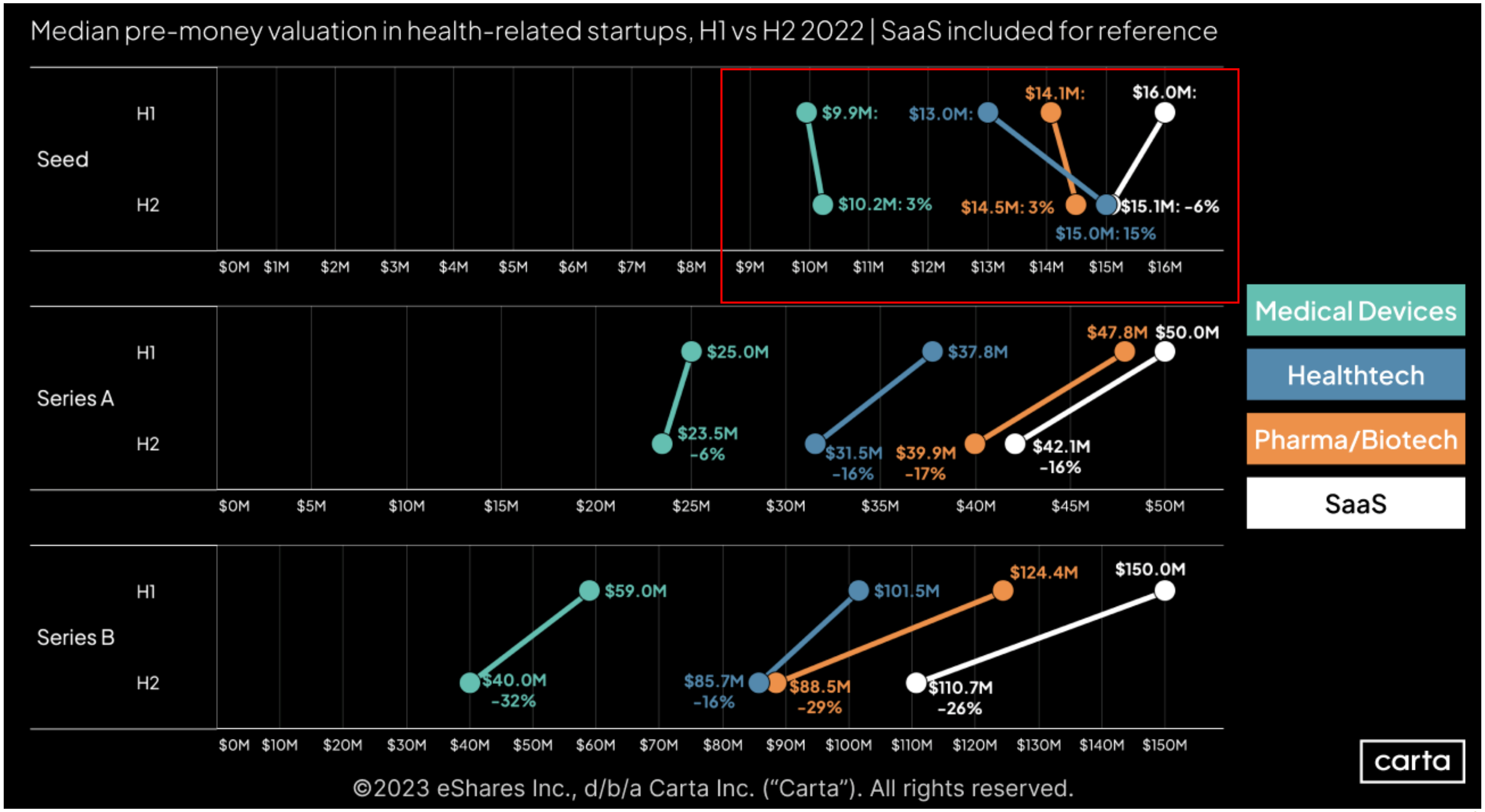
Seed stage valuations remain a bright spot

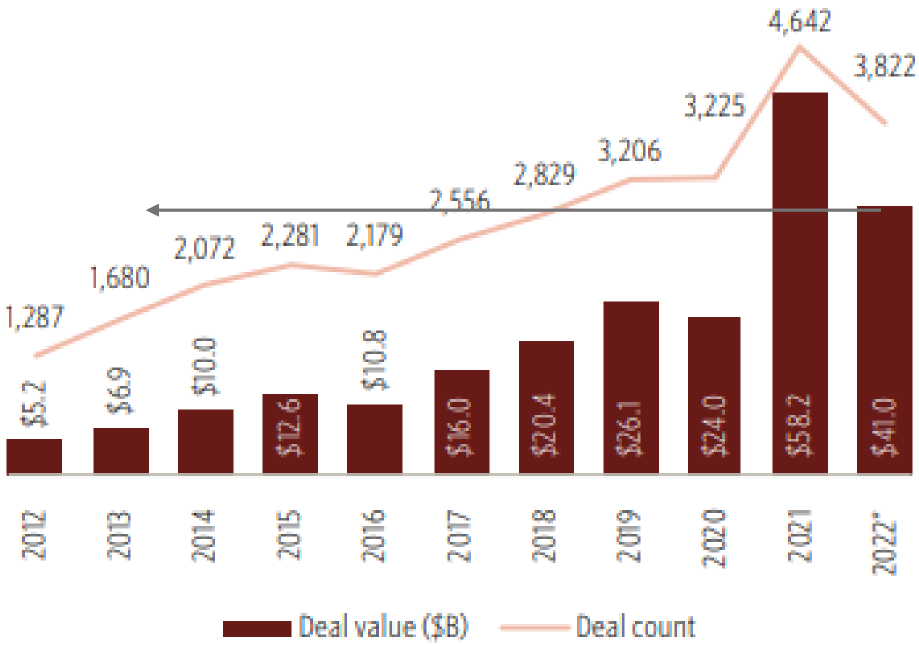
Valuations for H2 health-related seed deals were higher than H1 valuations



Women founders received record funding in 2021 and 2022

Will they continue to benefit in 2023 and beyond?

US VC deal activities in companies with at least one female founder



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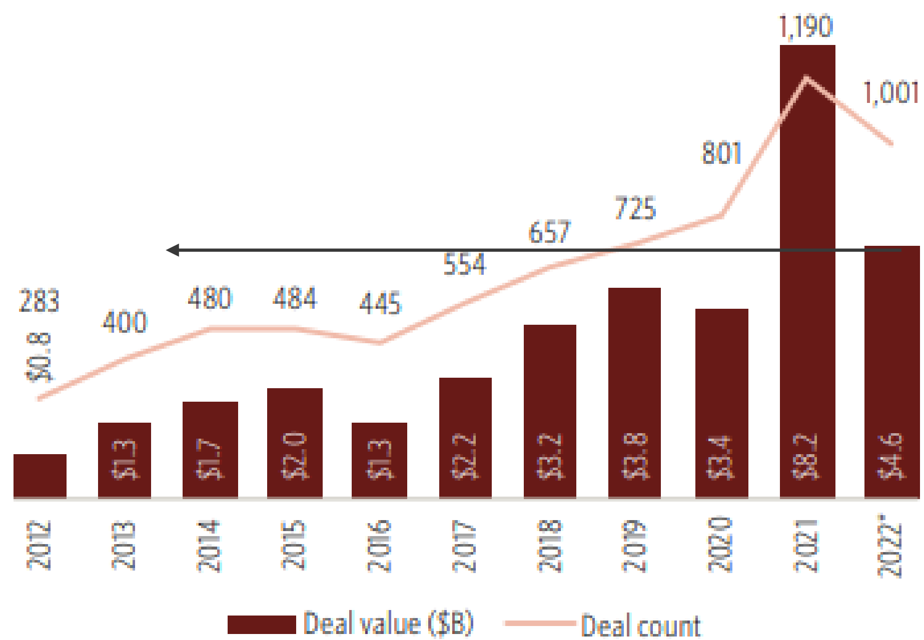
US VC deal activities in companies with all-female teams



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VCs predict that 2023 will usher a renewed focus on Seed Stage

When times are tough, only the strongest founders will prevail

D#uhvlolhqw#qhz#jhqhudwlrq#ri#irxqghuv#zloo#hphujh#– Sophia Bendz, Cherry Ventures

Startup founders will build painkillers, not vitamins – Mar Hershenson, Pear VC

Founders just starting out will be one of the best investment opportunities – Reshma Sohoni, Seedcamp

Bigger bets will be placed on women – Erin Harkless Moore, Pivotal Ventures

Source: "12 Predictions for Venture Capital in 2023," Forbes, Dec. 20, 2022.

In fact, many successful U.S. companies launched during a recession

Evidence or selection bias?

	Recession Years
hp	1937-39
Microsoft	1973-75
Electronic Arts	1981-82
mailchimp	2001 and 2009
Uber	2007-2009
airbnb	2007-2009
slack	2007-2009
WARBY PARKER	2007-2009
venmo	2007-2009

Source: Stephen Mugo Weru. "10 Successful Businesses That Were Started During Economic Downturns," Benzinga, May 4, 2020.

Market conditions may be ripe to encourage resilient startups

The era of chasing unicorns has ended

Supply:

- Layoffs at big tech firms will help to spur new founders, provide staff to startups
- Pandemic sparked entrepreneurship, boom in new companies
- Companies today are required to be more frugal with capital and produce revenue

Demand:

- Near record levels of dry powder by venture funds
- Later stage companies will look to combine with more innovative technologies and companies
- Belief that returns will come from early stage companies, rather than pre-IPO companies that will likely need years before going public
- Investing in seed stage at market rate, rather than in a down round

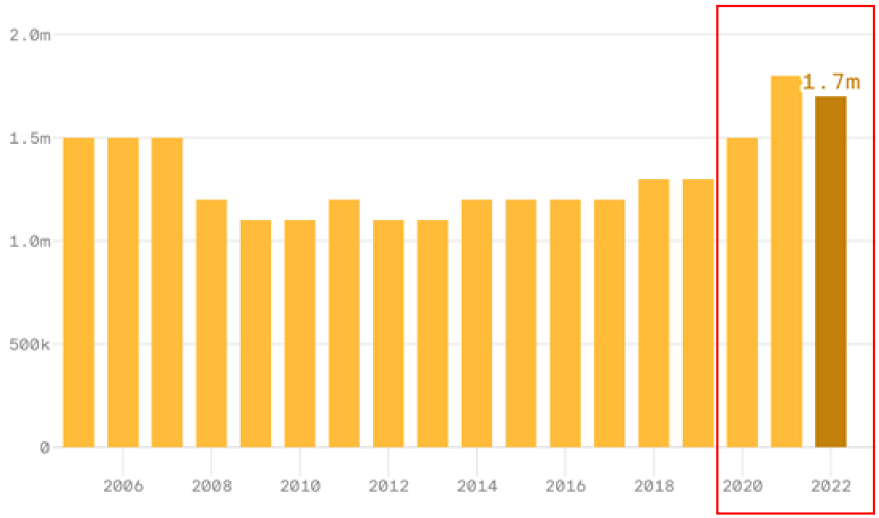
Sequoia's launch of a $195M seed fund portends the refocus on backing new companies

The launch of new businesses grew significantly since 2020

Entrepreneurship blossomed during the pandemic

Applications to start businesses likely to hire employees

In the U.S.; Annually; 2005–2022



Data: U.S. Census Bureau Business Formation Statistics via Economic Innovation Group; Chart: Axios Visuals

More new businesses

- 1.7M applications in 2022 for new businesses that were likely to hire employees
  - During economic uncertainty
  - Higher than pre-pandemic norms
- Pandemic as a positive shock to entrepreneurship?
- More new businesses started by women and people of color
  - In 2020, 11% of new business owners were Black and 49% were women

Source: Axios and Economic Innovation Group.

Prediction of hot seed sectors

Seed startups raising capital at the end of 2022 fell into sector clusters

Emerging Seed Themes

- Carbon capture
- AI productivity tools
- Women's health
- Hybrid workforce

The common denominator in these sectors is, they are B2B innovations that *enhance*, rather than replace, existing products and services.

Source: Crunchbase.

Also, the case for investing in women and minorities is strong

Numerous studies show similar results

Better Company Operations

Women entrepreneurs are more capital-efficient:

- 40% of new businesses last year started by women; 47% of these = minority women
- **Generate 20% more revenue** with half the money than male counterparts (Kauffman Foundation)
- Yet, women-only teams receive **2.6%** of VC dollars; all male teams receive 87% (U of Chicago Booth)

*Diverse management are **more innovative**:*

- Significant correlation between the diversity overall company innovation (BCG)
- Only 2.6% of venture dollars went to minority-led companies in 2020

Could AI be used to relieve unconscious bias?

Better Investment Returns

Investments into startups with at least 1 woman founder **outperformed all-male founding teams** by 63% (First Round Capital)

For every $1of funding, **a woman-led startup returns 78 cents** while male-founded startups generate only 31 cents (BCG)

Source: Valuer website and Forbes.

Sisters are doin' it for themselves (and brothers too)

Many seed stage funds – founded by women and minorities – invest in women and minority-led companies

Golden Seeds: Women-led companies

Astia: Women-led companies

How Women Invest: Women-led companies

Portfolia: Investing on behalf of women

Elevate Capital: Women and underrepresented

Backstage Capital: Underrepresented founders

Harlem Capital: Diverse Founders

And more...

By going out on your own,

- Reduce unconscious biases
- Enhanced deal flow through personal network
- Common understanding of founders and target markets

Food for thought:

- HBS's Josh Lerner found no statistical difference in performance of diverse-owned investment firms across asset classes.
- Knight Foundation found that diverse-owned firms were *overrepresented* in best performing mutual funds, hedge funds, and private equity.

What's next?

More seeds and fewer unicorns

- Expect more seed stage companies to form and operate at moderate growth pace
- Return to fundamentals - cash burn matters
- Longer time to exit; exit markets (IPO, M&A) will rebound when market volatility diminishes
- Dampening valuations at later stages; more resilience in seed and early stages
- Good time to be a fund with dry powder. They will take their time investing
  - Tending to current portfolio
  - Waiting for valuations to stabilize

Disclosures Slide

For use as an appendix slide

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