VC Dealmaking Remains Strong Despite Public Market Volatility

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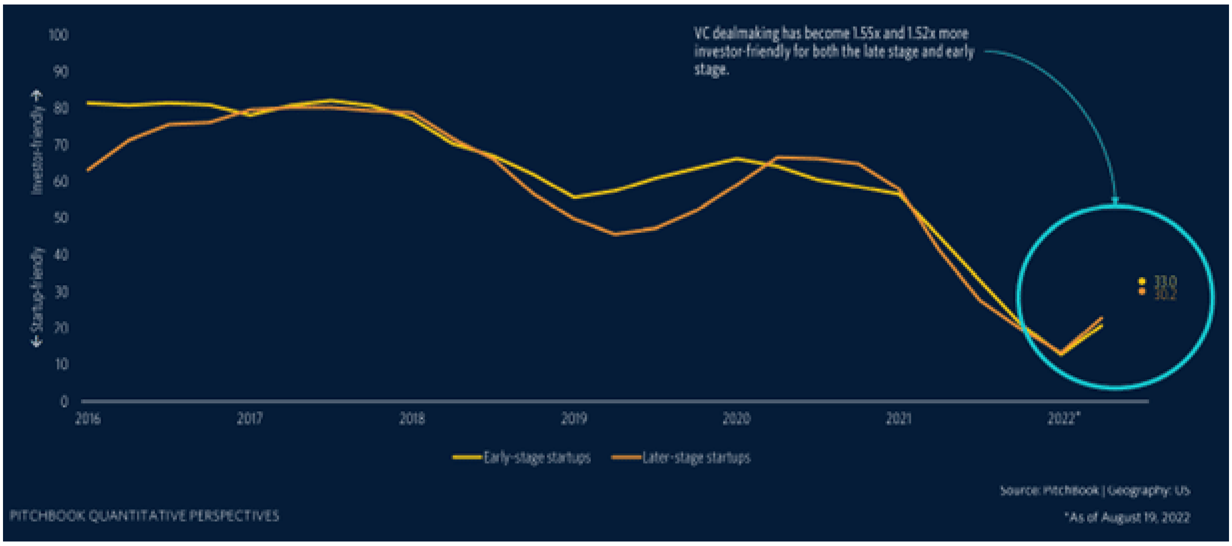
Private and public markets are inextricably linked. This crystalized in the first quarter of 2022 as public market volatility and falling valuations altered the VC landscape. For some, memories of 1999 and 2007 heightened fears that dry powder would evaporate and unleash a devastating blow to early-stage companies. After all, both rising rates and market declines tend to reduce VC activity.

However, so far in 2022, the VC landscape has remained exceptionally resilient. Ample deal activity has carried the industry above its long-term trend and, despite a recent sell-off in public markets, an early Q3 rebound provided optimism that dealmaking activity will continue to remain strong.

One of the primary reasons that dealmaking has persisted despite volatile public markets is a swing towards investor-friendly terms. According to PitchBook's [US VC Dealmaking Indicator], "VC dealmaking has become 1.55x and 1.52x more investor-friendly for both the late stage and early stage."



This can take several forms including discounted valuations, liquidity preferences, redemption rights, and even the reemergence of ratchets — an anti-dilution provision used by early investors to protect their stakes — to hedge against future declines.

Another related factor is that there has been an exponential rise in demand for capital from early-stage and late-stage companies since early-2021. On the flip side, the amount of dry powder – or the supply of capital to meet demand –increased from $234B in 2021 to $290B in 2022, according to Pitchbook. This further shifts the power balance towards traditional VCs with plenty of dry powder that are looking to capitalize on investor-friendly terms and cash-hungry founders.

As a result, while public market volatility, inflation, and rate hikes will continue to temper the uncontrolled animal spirits of yesteryear, well-run and innovative companies should have plenty of opportunities to fuel growth. Further, this "market reset" should create better and more resilient businesses in the long run, meaning investors will likely benefit from more favorable entry points and companies that are focused on growth, profit margins, self-sustainability, and the bottom line, rather than growth-at-all costs.

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Michael Johnston
Tech Contributor