

Back to reality

EY global venture capital
trends 2015



Building a better
working world

Back to reality: VC focus on the fundamentals in 2016

2016 looks set to be the year in which companies will be expected to prove they can execute after what can only be described as an exceptional 2015.

2015 saw US\$148b invested through 8,381 deals – the highest venture capital (VC) activity in nearly two decades. On a yearly basis, funding grew at 54% while deal volumes rose 10%, reflecting global investor preference for making fewer, bigger bets on established businesses that are in the later rounds of their fundraising journey and potentially closer to VC nirvana: superior returns. This flight of capital to later-stage funding rounds may also reflect the growing range of early-stage options open to start-ups looking for modest capital – from crowdfunding to angel finance.

Investment levels were high across the key VC hotbeds – the US, Europe and China – with the majority of activity focused on the first three-quarters of the year. Investments, however, fell back in the last quarter (12% q-o-q decline) as overall market concerns around public market conditions, valuations, burn rates and overfunding put the brakes on investment.

With global economic growth dogged by concerns regarding the strength of the US economic recovery, stalling Chinese growth and political and economic stress in Europe, it is predicted that stock markets are likely to remain volatile and greater investor caution is inevitable. Global VC-backed exit activity was soft during 2015 compared to 2014 with M&A value down by 10% y-o-y and the amount raised through VC-backed IPOs falling by almost 20% during the same period. However, it should be noted that 2015 exit levels remained relatively robust compared with recent years, albeit down on what was a stellar 2014 for both measures.

In our view, the 4Q15 downward trend is likely to persist, reflecting a healthy market rebalancing on the back of more careful decision-making. In an era of moderate economic growth and perpetually low interest rates, investors will still be as keen to find growth opportunities as investees are to secure funds; they will just get there more slowly.

“Tension between caution and the ongoing quest for return will be finely balanced.”

**Bryan Pearce, Global VC Leader,
Strategic Growth Markets, EY**

So what do we anticipate for 2016?

As we move on from the outstanding megafunding environment of 2015, we expect that focus will be on companies' proven ability to execute. Alternative investors such as hedge and mutual funds who invested heavily in the VC industry across a range of subsectors and helped drive up prices will now be focusing on the growth/burn ratio and downside protection as we move into an era of price correction and greater competition for cash.

Against this backdrop we anticipate a number of trends for 2016:

- ▶ Ongoing steady price correction
- ▶ Greater investor scrutiny and a clear focus on execution
- ▶ Flat funding rounds (in later-stage investment)
- ▶ Rising interest in early-stage, lower-cost investments
- ▶ More cross-border investment
- ▶ Experimentation with models
- ▶ Increasing sector specialization
- ▶ China will grow in significance vs. US and Europe
- ▶ India still promising but not quite delivering

Ongoing steady price correction

Despite the increased caution we do not expect this is going to be a rerun of 2001, when the NASDAQ Composite Index fell 59% on the year. The macroeconomic environment may not be as strong as anticipated, but a sudden reset is not in the cards. Price corrections of up to circa 25% across a range of mature unicorns in the last four months,

“2015 will be remembered as the year when an oversupply of capital came to an end, and with it the high – in many cases irrational – valuations of later-stage companies.”

**Dana Stalder, General Partner,
Matrix Partners**

by investors including Fidelity and Blackrock, have already started as investors take a more pragmatic approach to valuations across the board.

Greater investor scrutiny and a clear focus on execution

A more disciplined approach to investment as we move into 2016 means that companies already in the VC pipeline are going to take longer to raise a new round and can expect more demanding milestones, and are going to face hard questions around the path to breakeven, profitability and positive cash flow. Entrepreneurs will need to demonstrate prudence, pursue slow-burn growth and learn to execute as VC moves out of the competitive heat of an auction environment and into a more disciplined sale environment.

Of course for many start-up leaders the change in sentiment may come as something of a shock. Most have not been through any kind of slowdown and for some, greater scrutiny is going to feel painful. However, the secret to being a great entrepreneur is being able to navigate rougher waters.

Companies may also look to add older, serial entrepreneurs to their teams to bring in experience of working through a down cycle.

Flat funding rounds will continue

Against this backdrop we expect to see more flat and down rounds. Recent pricing corrections among well-backed tech unicorns are a signal of a new valuation environment. These market corrections will be an ongoing feature of 2016, particularly among mature VC-backed technology companies.

Rising interest in early-stage, lower-cost investments

We are already seeing evidence that some firms that had been backing late-stage deals are now scaling back or avoiding these deals, focusing instead on younger start-ups at lower values.

In 2015, first-round funding secured the highest volume of deals accounting for 45% of the global deal share. With the annual number of VC-backed exits with valuations of US\$1b or more averaging around 65 over the past two years, unicorns only account for a small minority of the market in terms of volume, even if they dominate in value terms. We expect greater interest in early-stage investing through 2016, in part because of belief that when these companies mature the capital markets may be more receptive.

More cross-border investment

Capital will always seek the best opportunities, wherever in the world they exist. In 2014, US technology investors accounted for more than half of all the money raised by London start-ups for example, and this pattern is continuing.

Experimentation with models

Some in the industry are starting to form the view that investment periods will extend somewhat as the economy slows. In London, for example, press reports talk of the rise of so-called "patient capital" – provided by VCs that are prepared to invest significant sums over a longer term. According to EY research, this has become the main source of funding for UK tech companies.

"You're not always going to have the wind at your back and the sun on your shoulder."

Jeff Grabow, US Venture Capital Leader, EY

"The M&A market is highly correlated to the public equity market and we are off to a disastrous start in 2016, so I think this year it will be a very weak exit market."

Dana Stalder, General Partner, Matrix Partners

"The world is much flatter. If you raise a billion dollar fund, you have to leave your backyard. You can't invest it all in Silicon Valley. You have to take a broader view to generate positive returns."

Jeff Grabow, US Venture Capital Leader, EY

"I believe investment periods will extend a little. Some VCs have invested too fast in too many companies. In early-stage investing if you are moving too fast you create too great a load on the portfolio to be managed. To do the right thing, you need to spend time with the portfolio companies. Generating too big of a portfolio is counter-productive and time frames of four to five years are better than three years.

**Avi Zeevi, General Partner,
Carmel Ventures**

"European investors are unencumbered by the fixed-model baggage so they're looking for new models. ... There is more open-mindedness towards different models and less of a fixation on 10-year limited partnerships."

Simon Cook, CEO, Draper Esprit

"What we are seeing is not the bursting of a bubble, but more a tighter focus on the maturation process."

**Bryan Pearce, Global VC Leader,
Strategic Growth Markets, EY**

Increasing sector specialization

As blockbuster deals become harder to execute, specialization gains fresh appeal as investors focus on what they know, a preference that is reflected in ongoing enthusiasm for consumer services and its many subsectors.

Annual funding growth in travel and leisure and consumer information services stood at 126% and 71% respectively in 2015. With US\$32.1b in funding, the consumer information services subsector led the way in terms of amount raised and the top deal of the year (China Internet Plus Holding Ltd. also came from this sector. By contrast, the household and office goods subsector and renewable energy subsector saw the biggest fall, seeing declines of 43% and 15% in funding, respectively.

There is no question that leveraging technology has shortened the runway for a number of companies but also enabled fiercer competition. However, we believe that one side effect of a reduction in the supply of capital may be to remove some of the "me-too" copycat start-ups from popular subsectors, as capital focuses on fewer, higher quality investments.

It is noteworthy that technology-enabled consumer companies dominate among the larger unicorns.

China's growing significance compared to US and Europe

With US\$72.3b investment through 3,916 deals, the US continued to dominate the global VC landscape despite a strong dollar and Federal Reserve rate hike in December 2015. However, for the first time ever, three of the year's top five VC deals were outside the US and all were in China.

China now accounts for three times more investment than all the countries of Europe put together, raising total funding of US\$49b through 1,635 deals in 2015 including several billion-dollar-plus deals and the top deal of the year, China Internet Plus Holding Ltd., worth US\$3.3b. We note that VC funding in China has grown seven-fold in the last five years, from US\$7b in 2010 to US\$49b in 2015. At the same time, deal size has doubled from US\$15m in 2010 to US\$30m in 2015. Although China may dominate in terms of investees, the top investors in 2015 remained US.

India still promising but not quite delivering

India raised US\$8.0b through 528 deals in 2015, representing annual increases of 43% and 89% respectively. If India could combine the undoubted advantage of its highly trained computer scientists within a more stable economy and a strong emerging middle class (as we see in China) it would be a powerhouse economy. However, without those drivers the market remains challenging for entrepreneurs and investors.

Despite these structural disadvantages, the technological innovation coming out of India in 2015 was probably the strongest it has ever been and while it is harder to scale in India than China, innovative companies focused on domestic growth is a trend we expect to see more of moving forward.

New year, new VC?

The venture capital business is a marathon, not a sprint and we expect 2016 will be the year of the mature, sophisticated investor identifying the better long-term bets. If that means that 2016 ends up being a down year on the back of a record US\$148b of global investment in 2015, that in itself would not be concerning. In our view, the better deals and their leadership teams will continue to attract funding – and those investors may, in fact, have more time to devote to the "care and feeding" of their portfolio. We also know the intense interest that larger corporates have in sourcing disruptive innovation from venture capital-backed companies in order to sustain their growth.

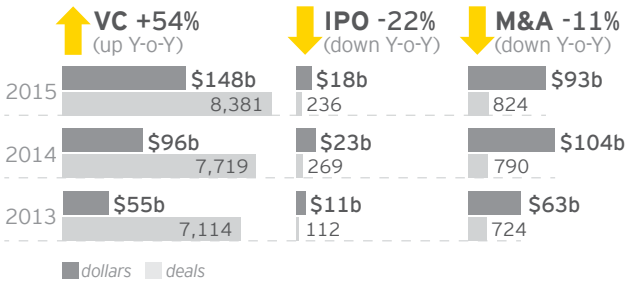
²Source: *CB Insights*

Global venture capital highlights 2015

Deal activity at a 10-year high

VC activity has grown steadily

while exit activity saw a decline on a Y-o-Y basis



Investors make bigger bets

on established businesses through later rounds

58%

of the total value was captured by later-round class



>45%

of the total deal volume was captured by first-round class

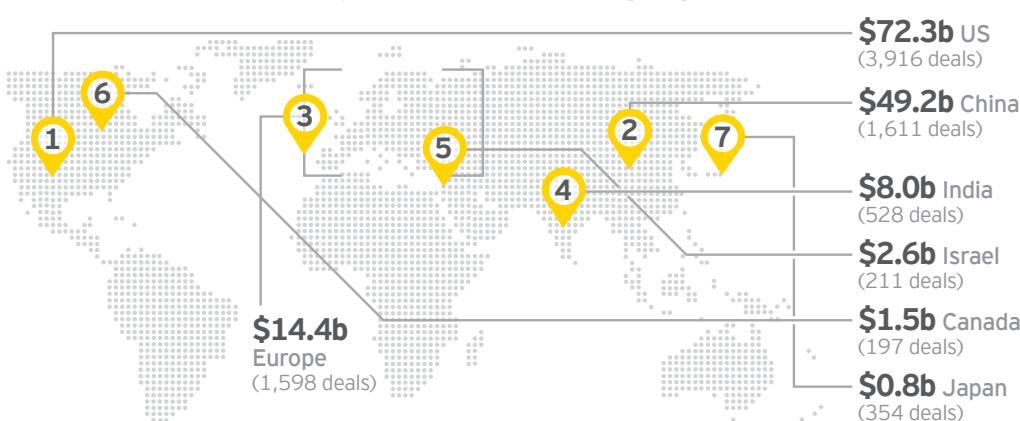


~80%

of the total VC deals and value were recorded by companies in the generating revenue stage



The US dominates global VC activity by deals and value



Two out of three top deals were China-based

\$3.3b Beijing
China Internet Plus Holding Ltd.

\$3.0b Beijing
Beijing XiaoJu Technology Co. Ltd.

\$2.1b California
Uber Technologies Inc.

Tech-enabled models prominent among new entrants entering unicorn club

*Top two new entrants from key regions based on funding raised

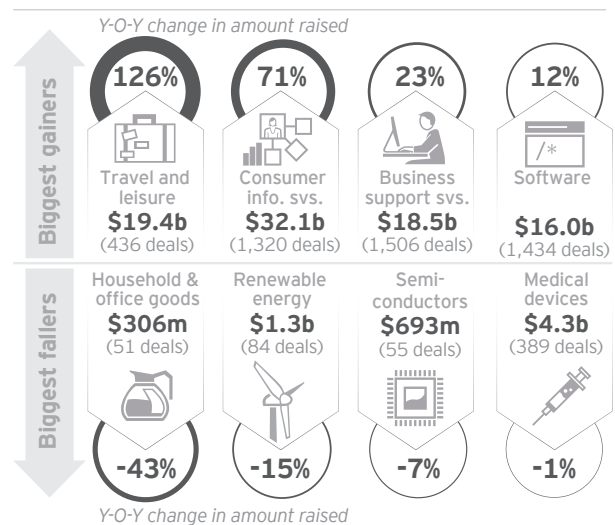
US*	Europe*	China*
Zenefits: US\$500m Series C (May 2015)	BlaBlaCar: US\$200m Series D (Sep. 2015)	Dada: US\$300m Series D (Dec. 2015)
ContextLogic: US\$500m Series C (May 2015)	Funding Circle: US\$150m Series E (Sep. 2015)	TuJia Online IT: US\$300m Series D (Jun. 2015)

Source: CB Insights

Top 5 Global VC investors by number of deals

- | | |
|------------------------------------|---------------------------------|
| 1) New Enterprise Associates (113) | 4) Matrix Management Corp. (71) |
| 2) Sequoia Capital (82) | 5) Andreessen Horowitz (70) |
| 3) IDG Capital Partners (82) | |

Investors skew toward consumer services sector



All data is in US dollars. Figures may not appear to sum due to rounding. Source: Dow Jones VentureSource unless otherwise noted.

Soft landing concludes an outstanding 2015 for US VC

2015 was a standout year for the VC industry in the US. At US\$72b, funding hit its highest point since 1992, rising 24% on the prior year, despite a marginal (4%) decline in deal numbers to 3,916, a pattern reflected in the 18% increase in median deal value from US\$5m to US\$6m. The year also saw more companies achieve unicorn status than in any previous year. Investment volumes would have been even higher had it not been for a marked falling off during the last quarter of the year of 4% compared to 3Q15, reflecting concerns around valuations, investment overload and the rate of capital depletion by investees.

Economic swings and roundabouts

The US economy grew at an annualized rate of 0.7% in the final three months of the 2015, a sharp slowdown from 2% in the previous three months. Although growth had been steady throughout the first half of the year and employment levels were rising, weakening oil prices and a strong dollar, combined with poor growth in other parts of the world, all took their toll on consumer and market confidence.

Against this mixed economic backdrop, investors were keen to direct the majority of their cash (75% in terms of both deals and value) toward what many would perceive to be safer, well established, revenue-generating businesses with proven business models, reserving just over one-third (35%) for riskier first-round deals. The shift in preference toward more established companies was particularly marked – up 30% on 2014. As has often been the case, businesses in the middle funding rounds were not spoiled for choice.

Technology once more shortened the runway for many businesses, underpinning strong fundraising in the business support services, software and biopharmaceuticals subsectors in 2015. In terms of value, the travel and leisure subsegment featured strongly, producing two megadeals in the year – Uber Technologies (raising US\$2.1b) and Lyft (US\$1b). In terms of deal count, information technology was the clear leader buoyed by a large number of deals in the software subsector.

Investors sticking by their investments

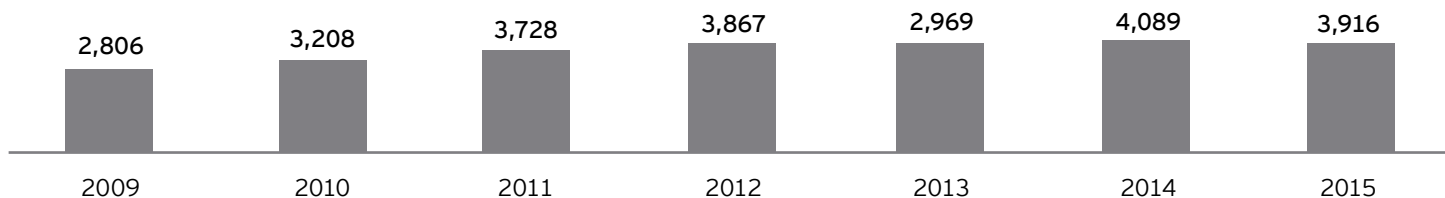
IPO activity in the US saw a sharp decline with volume down 38% on the prior year and capital raised fell by 32%. At the same time, M&A deal volume and value declined by 7% and 34% respectively compared to the prior year as venture-backed companies continued to prefer raising larger amounts and in later VC rounds for growth rather than to realize an exit via M&A.

With a portion of exits deferred in 2015, we anticipate that VC-backed assets are likely to account for a large portion of global IPO volume during 2016, particularly if economic growth steadies and equity markets become more resilient. There is a robust pipeline of companies waiting to go public, but with investors becoming wary of high valuations, companies will need to judge their pricing strategies carefully. Alternatively, some businesses may prefer to review their options with potential acquirers, including strategic rivals and financial firms, opting for a trade sale or merger rather than a public listing.

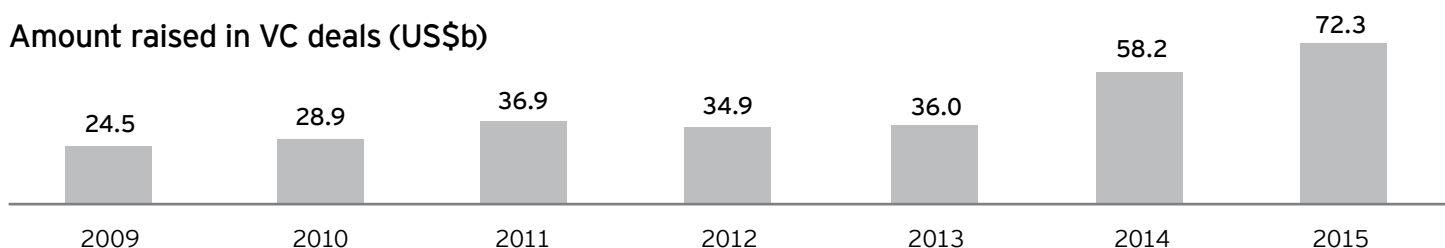
Caution ahead

Looking ahead to 2016, Janet Yellen, Federal Reserve Chair acknowledged to Congress in February: “Financial conditions in the United States have recently become less supportive of growth” making pressure on valuations more likely. To help manage employee morale in this cooler exit environment, we anticipate that more unicorns will be allowing staff to take money off the table facilitated by share buy-back schemes.

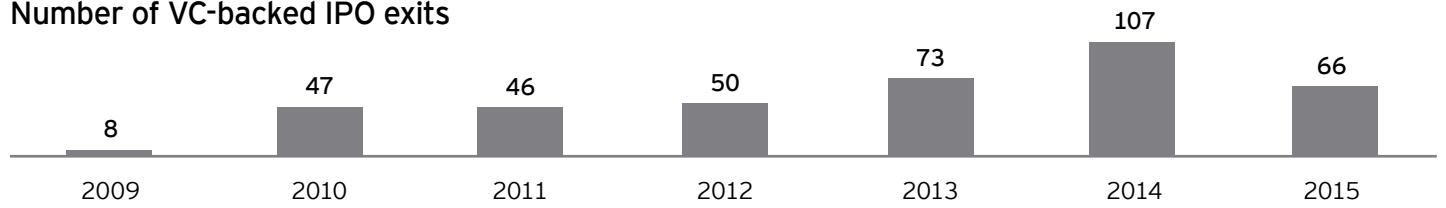
Number of VC deals



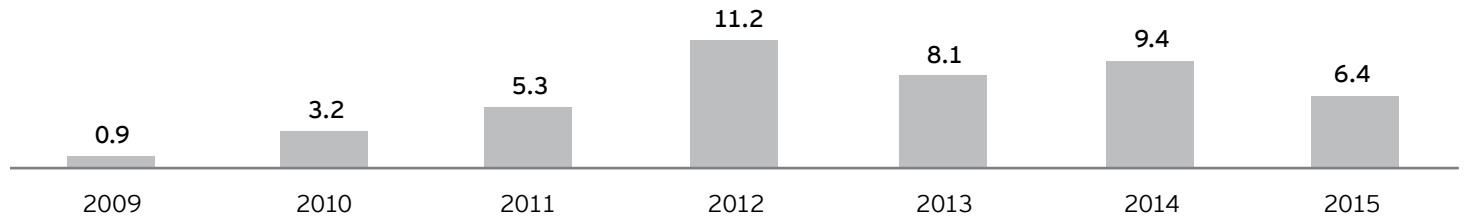
Amount raised in VC deals (US\$b)



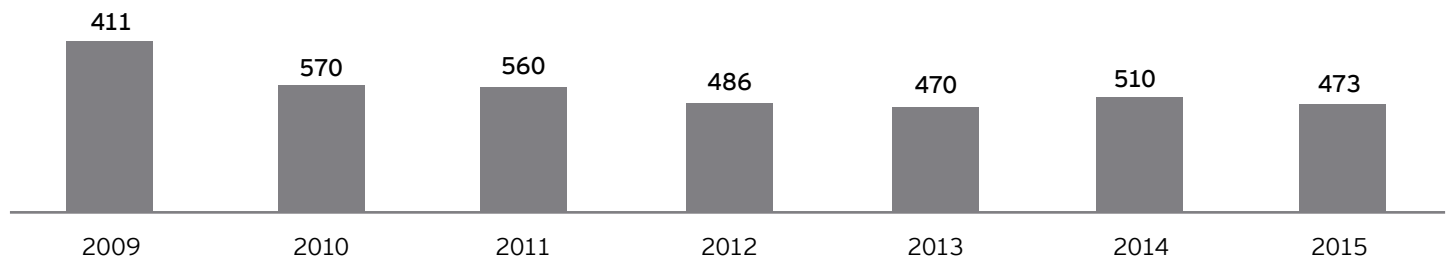
Number of VC-backed IPO exits



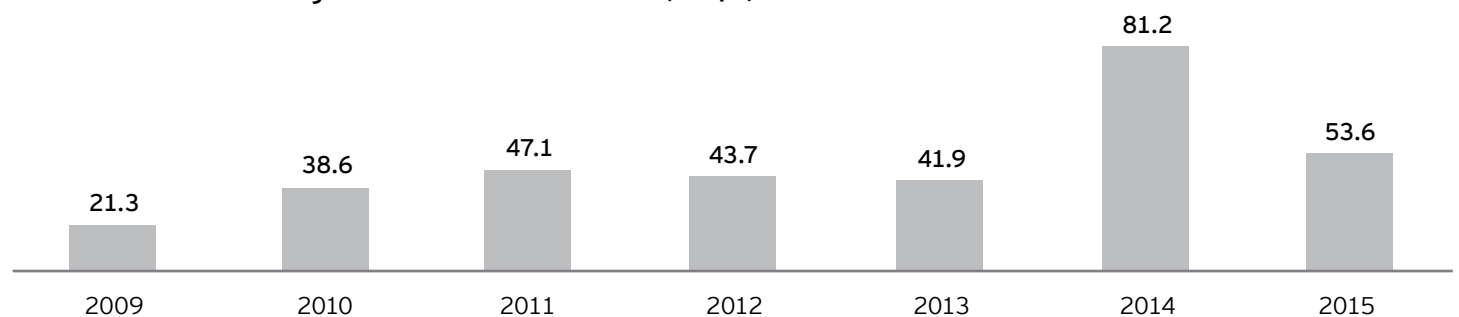
Amount raised through VC-backed IPO exits (US\$b)



Number of VC-backed M&A exits

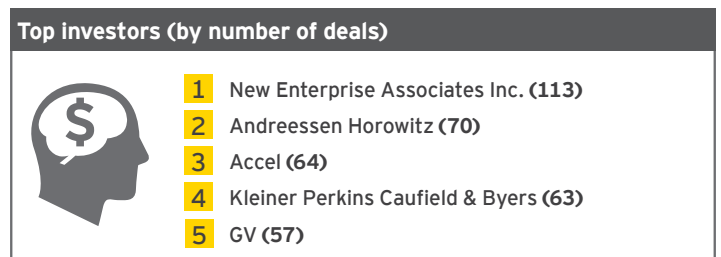
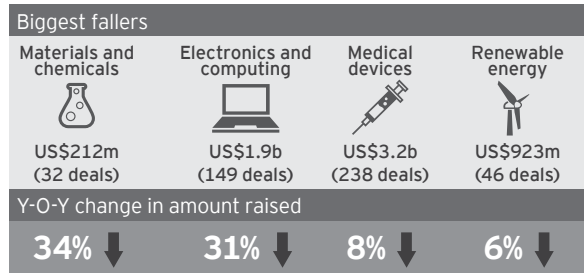
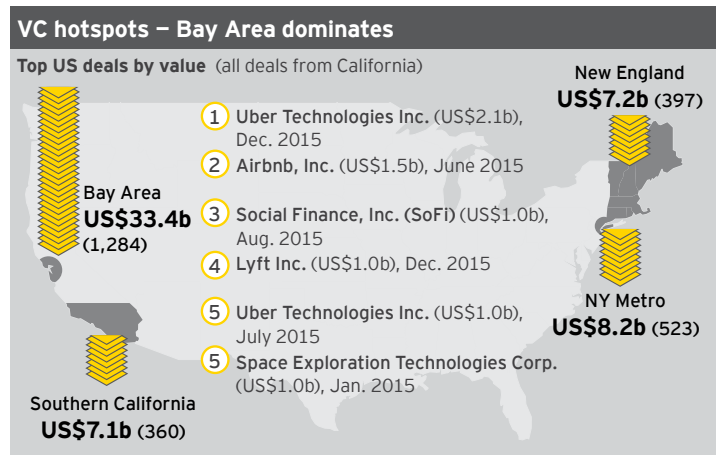
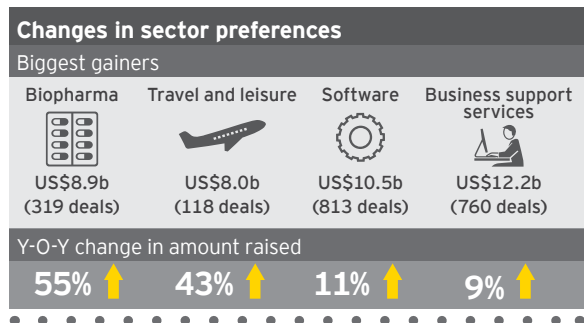
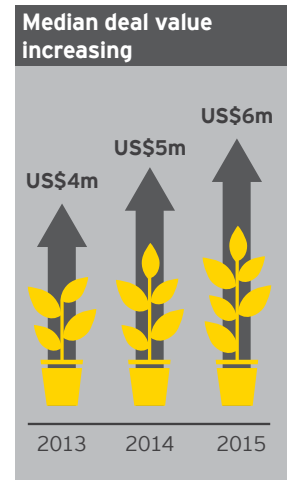
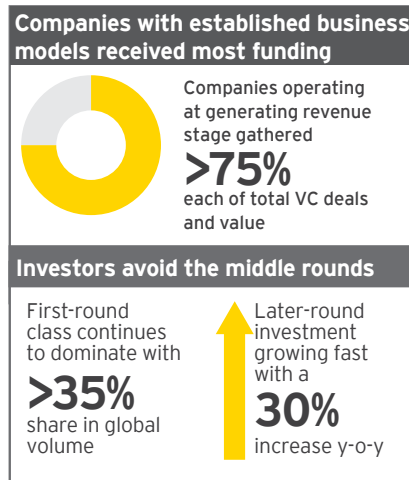
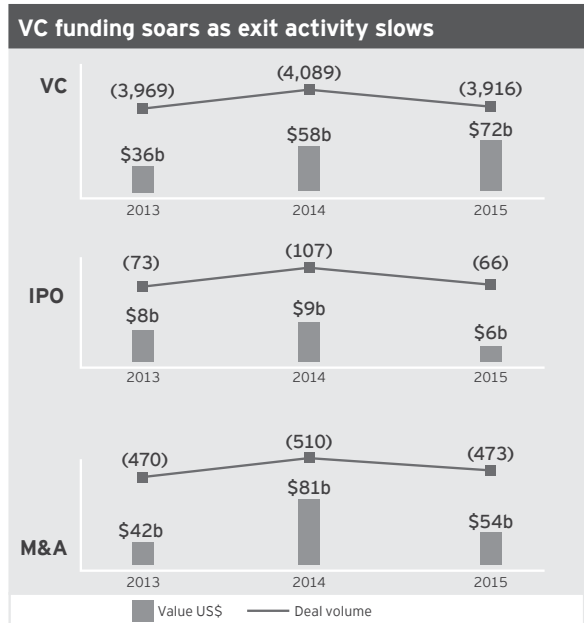


Amount raised through VC-backed M&A exits (US\$b)



US venture capital highlights 2015

Deal activity at a 10-year high



Software dominates larger unicorns

Top five deals* that entered unicorn club based on latest funding round in 2015

Company	Latest valuation	Last funding round
Zenefits	US\$4.5b	US\$500m Series C (May 2015)
Context Logic	US\$3b	US\$500m Series C (May 2015)
Jet.com	US\$1b–1.5b	US\$500m Series B (Nov. 2015)
Avant	US\$2b	US\$325m Series E (Sept. 2015)
DraftKings	US\$1.4b	US\$300m Series D (July 2015)

*Source: CB Insights

Figures may not appear to sum due to rounding.
Source: Dow Jones VentureSource unless otherwise noted.

Europe surges on the back of fewer, bigger bets

Funding levels in Europe in 2015 reached their highest levels since 2001 as VC investment rose for the third straight year – reaching US\$14.4b, up from \$US11.3 in 2014. Meanwhile, the region saw a slight drop in deal volume, to 1,598 compared to 1,634 in the previous year.

While other VC hotbeds – most notably China and the US – saw a marked slowdown in activity on 4Q15, Europe held its own with US\$3.6b invested through 426 deals, an increase of 14% in terms of deal numbers and a marginal decline of 3% in terms of deal value compared to the prior quarter.

UK leads the way

The UK led VC activity in Europe in 2015 in terms of both volume and capital with US\$4.8b invested through 405 deals. The country bagged four of Europe's top ten deals of 2015: O3b Networks (worth US\$460m), Immunocore (US\$320m), Skyscanner (US\$193m) and Funding Circle (US\$150m). Germany also performed well with 272 deals generating funding of US\$2.9b in 2015. Both countries saw a quarterly increase in number of deals in 4Q and the UK also saw a 7% increase in funding, reflecting the relatively strong performance of the UK VC ecosystem relative to its peers and boding well for 2016.

Consumer services sector attracts most interest

In line with the global trend, consumer services companies were most attractive to investors in Europe in 2015. The sector raised funding of US\$5b through 445 deals, accounting for 35% of the total amount invested in the region during the year. The amount invested in the sector grew by 57% in 2015 compared to 2014 despite a 10% decline in deal count. Other sectors that attracted investor interest were health care, raising US\$3.6b through 262 deals and business and financial services, which saw 415 deals attracting investment of US\$2.9b.

The rise of patient capital

In 2015, investor preference in Europe was evenly split. First-round funding accounted for 52% of total deal volume, while in terms of deal value, later-round classes accounted for 57% of the total amount raised.

In terms of stage of development, the greatest amount of VC activity took place at the generating revenue stage, with US\$10b invested in 1,262 deals. The amount invested at this stage in 2015 grew by 22% with deal volume similar with 2014, reflecting investor preference for mature business models with a stronger expectation of higher future gains.

However, there are signs that this pattern could be set to shift as European investors seek out new models. Reports in London point to the rise of patient capital – provided by VCs prepared to invest significant sums over a longer term in the hope of generating superior returns. According to research by Draper Esprit, the pan-European venture capital firm, this has become the main source of funding for UK tech companies.

Exit volume down but returns up

M&A activity in 2015 raised US\$23b through 183 deals, the highest annual amount since 2000. The return of more stable growth in the EU and continuing quantitative easing by the European Central Bank (ECB) should support deal-making in the region.

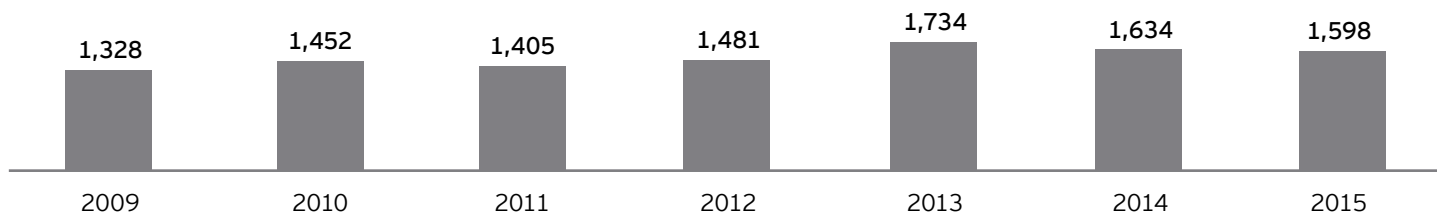
In contrast, the amount raised through IPO exits declined by 50% with a 13% drop in the number of VC-backed new listings compared to 2014. European IPO activity should pick up pace from the second quarter of the year, with greater clarity on the ECB's monetary policy announced in March 2016. The European IPO pipeline is also strong, but we are unlikely to see a significant pick up until current market volatility begins to subside.

Uncertain outlook

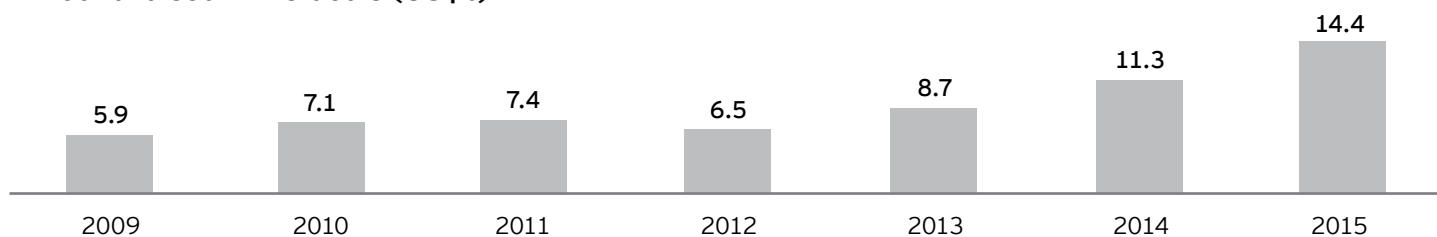
Despite market uncertainty resulting from a number of geopolitical factors including the ongoing refugee crisis, remaining challenges around the Greek economy and the UK referendum on the European Union, VC sentiment remains positive.

The recovery in the Eurozone is likely to continue at a steady pace, supported by low oil prices, continued loose monetary policy and the strong euro. The ECB recently reduced its deposit facility rate and extended the quantitative easing program to March 2017, to counter the effects of uncertainties in global markets. With Eurozone economic sentiment in November 2015 at its highest in four years, according to the European Commission, we expect VC investors will continue to look to the region in anticipation of healthy returns.

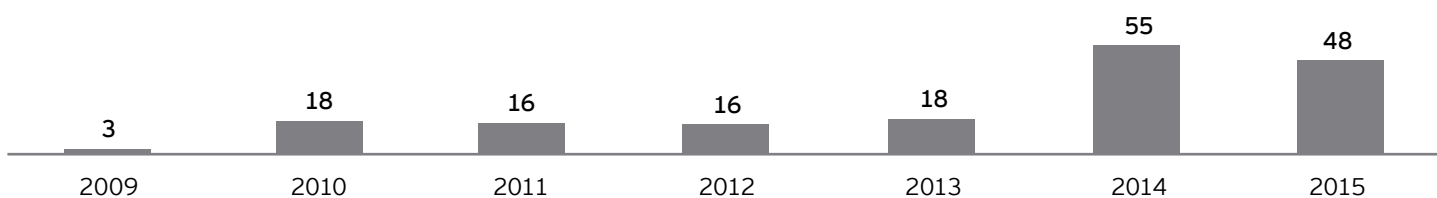
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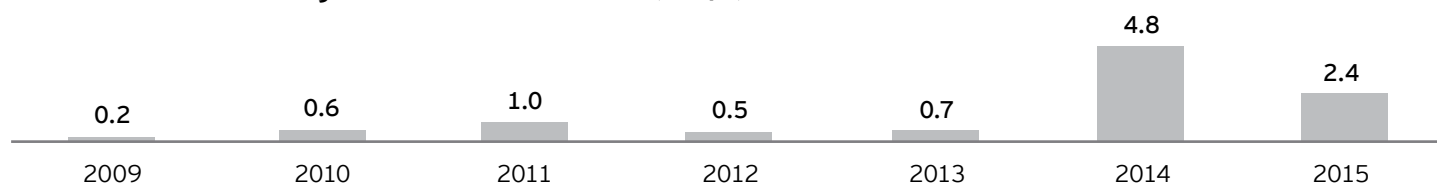
Amount raised in VC deals (US\$b)



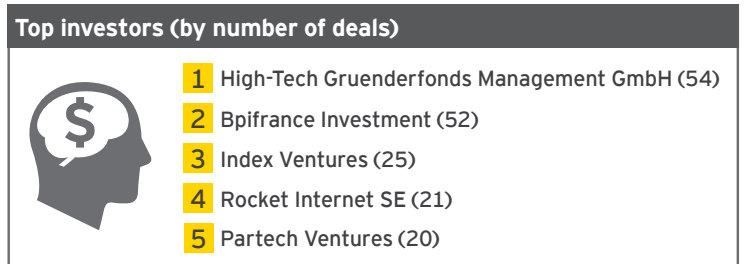
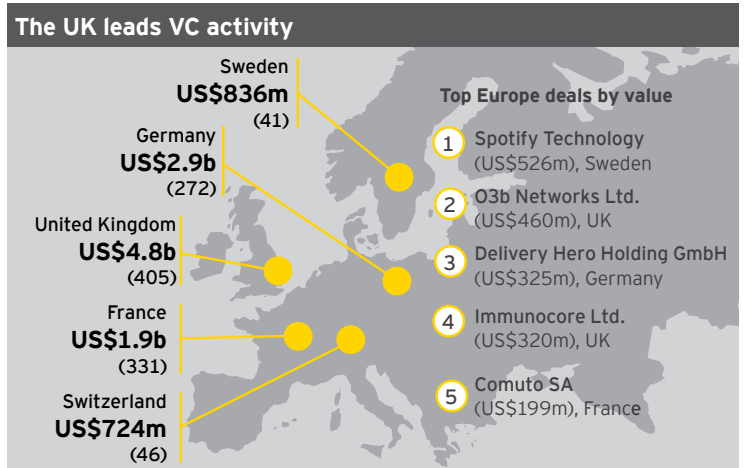
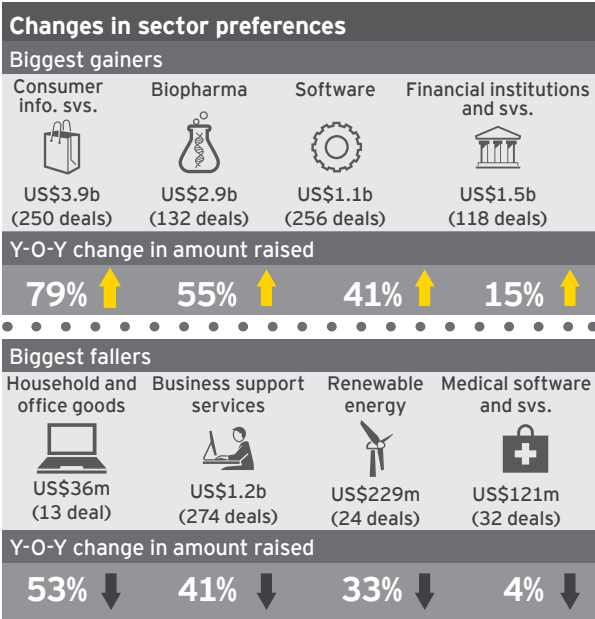
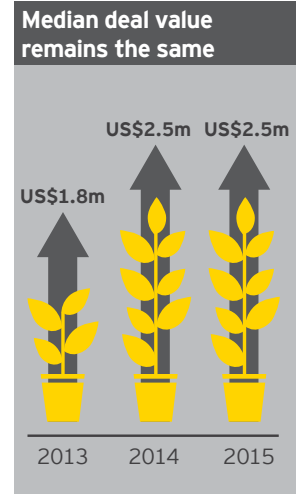
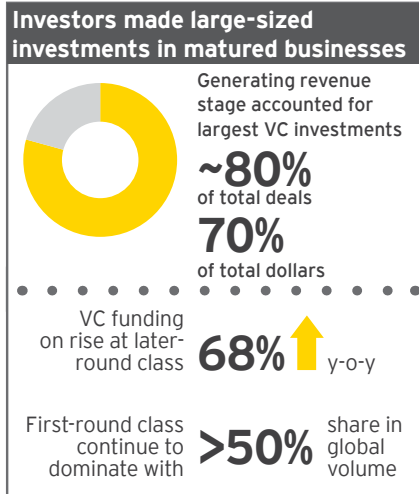
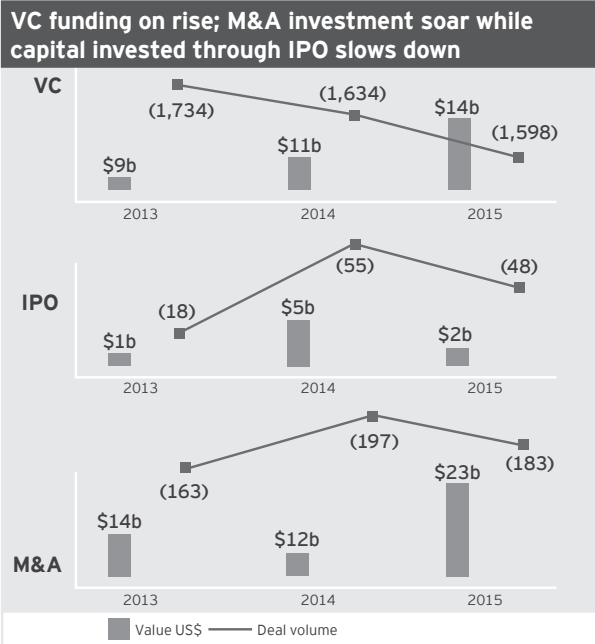
Number of VC-backed IPO exits



Amount raised through VC-backed IPO exits (US\$b)



Europe venture capital highlights 2015



Software dominates larger unicorns

Top five deals* that entered unicorn club based on latest funding round in 2015

Company	Latest valuation	Last funding round
BlaBlaCar	US\$1.4b–US\$1.6b	US\$200m (Series D, Dec. 2015)
Funding Circle	US\$1b	US\$150m (Series E, Apr. 2015)
Farfetch	US\$1b	US\$86m (Series E, Mar. 2015)
HelloFresh	US\$2.9b	US\$85m (Series F, Sept. 2015)
TransferWise	US\$1.0b	US\$58m (Series C, Jan. 2015)

*Source: CB Insights

Figures may not appear to sum due to rounding.
Source: Dow Jones VentureSource unless otherwise noted.

Standout year in China but outlook tempered

“There’s no question that tech has shortened the runway for a number of companies but also enabled a lot of competition – brutal competition.”

Dr. Rama Velamuri, Professor of Entrepreneurship at China Europe International Business School

In its strongest year since 2000, when VC investing started to take off on a global basis, China almost tripled VC investments from US\$17.3b (in 2014) to reach US\$48.9b in 2015. Over the same period, deal volume rose by almost 50% and average deal size more than doubled. Three of the year’s top five VC deals worldwide were in China and the country accounted for three times more VC investment than the whole of Europe put together.

However, there are signs that investors may be beginning to apply the brakes. After a robust performance in the first three quarters of 2015, there was a slowdown in VC activity in 4Q as financial market turbulence and concerns about macroeconomic growth impacted investor sentiment.

Consumer services leads the way

In line with the global trend, China saw strong investor preference for the consumer services sector in 2015. With US\$32b in funding through 777 deals, the sector accounted for almost two-thirds (65%) of VC-backed investment during the year. The amount of money invested grew more than three times with close to 50% growth in deal count compared to 2014.

Notably, nine out of the top ten VC deals in 2015 involved consumer services companies including the year’s largest deal, the US\$3.3b investment into China Internet Plus Holding Ltd. In addition, there were five other blockbuster deals in the sector that crossed the US\$1b mark, particularly in the consumer information services and travel and leisure subsectors.

Emphasis on later-stage investing

Although first-round investing accounted for 56% of total deal volume in 2015, in terms of deal value later-round classes saw the highest level of funding (US\$24b), driven by a strong investor focus on securing higher returns from more mature businesses. The average deal size at the later-round class stood at US\$121m in 2015, more than double the US\$67m average in 2014.

In terms of stage of development, VC investors preferred making sizable investments in Chinese companies already generating revenue. Companies at this stage of development attracted both the highest deal proceeds (US\$42b) and deal volume (1,375) in 2015. Compared to the previous year, the deal volume at this stage doubled while proceeds tripled during 2015, suggesting continued investor preference for companies with proven business models.

Positive exit environment

Levels of both VC-backed M&A and IPO were up in 2015, compared to the prior year. Exit via M&A saw an 80% increase in amount raised and close to a 40% increase in deal volume. Travel and leisure and business support services companies accounted for the bulk of M&A activity.

Meanwhile, IPO activity saw lower levels of growth as global investors seemed to be taking a less bullish view of the Chinese market. The number of deals was up to 81 from 62 in 2014, and the amount raised at US\$8.2b, compared to US\$7.3b the year before. Once the market stabilizes, we expect a pickup in exits via IPO as investor sentiment should be steadied by reforms within the IPO system and a significant pipeline of companies looking to go public.

“The first stage of tech investing in China has been about the consumer and in many cases copycats of Western business models. Now we are seeing businesses that are uniquely focused on the Chinese market that are truly differentiated.”

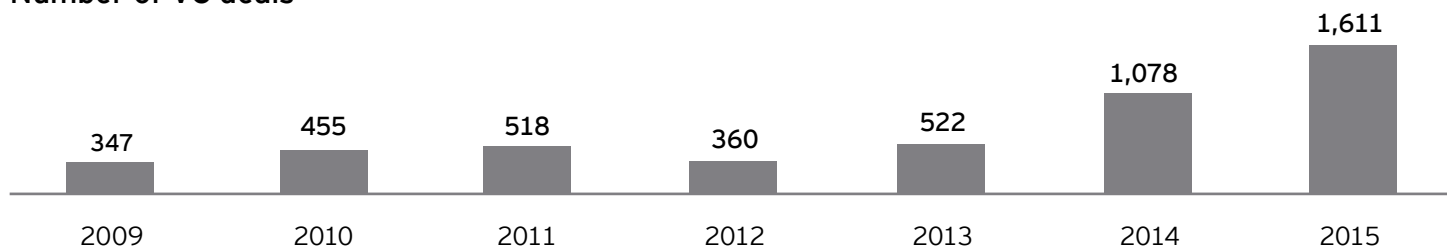
Dana Stalder, General Partner, Matrix Partners

Upbeat outlook

Despite a drop in VC funding in 4Q15 – after a standout third quarter – there is still considerable appetite in the market. There are some downside risks including ongoing stock market volatility and a weakening currency, together with recent market concerns around valuations, burn rates and overfunding.

However, efforts by the Chinese Government in terms of monetary and fiscal policy including the recent announcement of the new five-year plan should continue to support VC fundraising and bolster investor confidence. There are signs that VCs may be starting to take a more rational and cautious approach than has been seen over the last 18 months, but as Chinese entrepreneurs continue to develop attractive businesses based on innovation and invention the VC market will continue to see impressive growth in 2016.

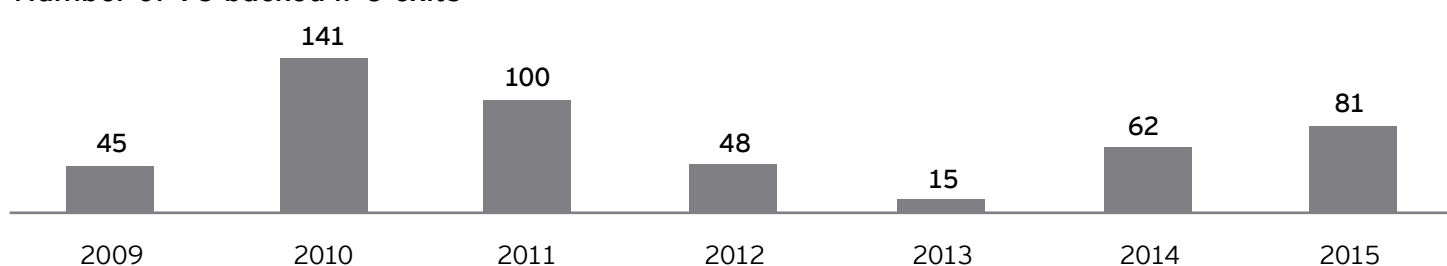
Number of VC deals



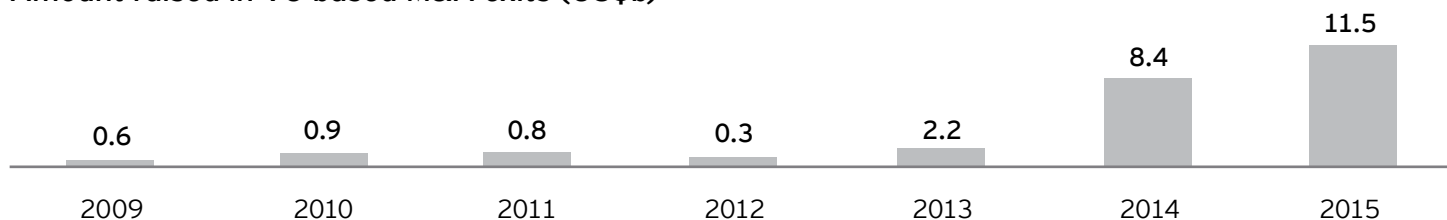
Amount raised in VC deals (US\$b)



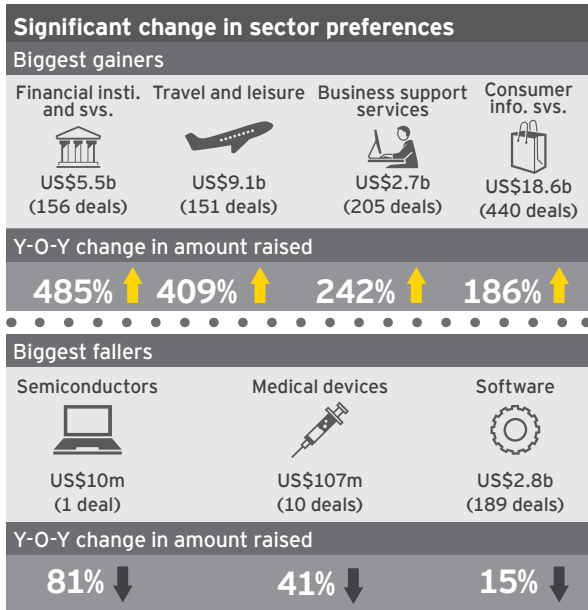
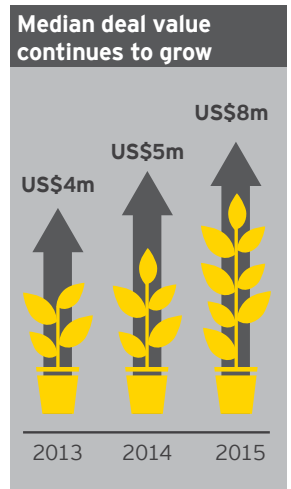
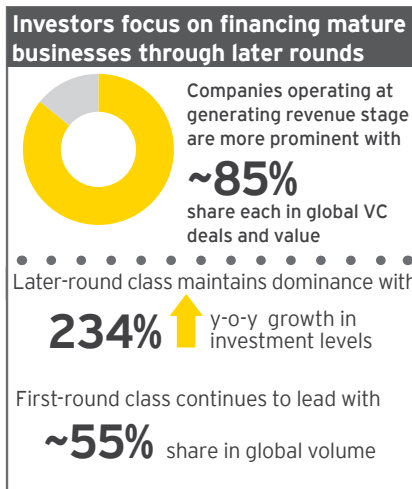
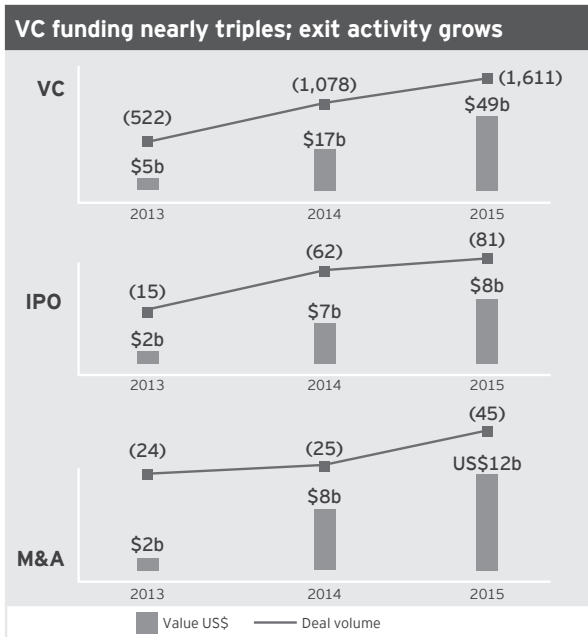
Number of VC-backed IPO exits



Amount raised in VC-based M&A exits (US\$b)



China venture capital highlights 2015



Software dominates larger unicorns

Top five deals* that entered unicorn club based on latest funding round in 2015

Company	Latest valuation (US\$)	Last funding round (US\$)
Dada	US\$1b	US\$300m (Series D, Dec. 2015)
TuJia Online	US\$1b	US\$300m (Series D, Jun. 2015)
Xuanyixia	US\$1b	US\$200m (Series D, Nov. 2015)
PanShi	US\$1b	US\$200m (Series B, May 2015)
TutorGroup	US\$1b	US\$200m (Series C, Nov. 2015)

*Source: CB Insights

Figures may not appear to sum due to rounding.
Source: Dow Jones VentureSource unless otherwise noted.

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Find out more about future VC prospects

For more information on global VC activity by quarter and year, and how the VC landscape looks set to develop in 2016, visit the EY Venture Capital Center of Excellence website: ey.com/vccoe

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