Road to Next

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Deloitte.

Data provided by PitchBook

Executive summary

Amid market turmoil, exit activity slows down.

Themes & key findings for this issue:

After 2021's record-breaking heights, 2022 is off to a slow start for exits: 2021 saw $1.2 trillion in exit value achieved by expansion-stage companies in the US, across well over 1,800 liquidity events. After such a peak, a cyclical pullback could have been anticipated.

While most sectors will eventually be affected, some could exhibit more resilience: Healthtech is still poised to see innovation and strong demand based on macro factors, while fintech could experience consolidation.

Thanks to record financing levels, many companies are well-positioned: Proven businesses that recently raised hundreds of millions in investment capital can retool plans to weather current market volatility and impacts to their business.

Deloitte and PitchBook have collaborated to produce a unique methodology for the *Road to Next* series, in order to better analyze a new segment of companies that emerged in the 2010s. Dubbing this segment the expansion stage, the methodology uses investment data restricted to late-stage VC, PE growth, and private corporate financing. In addition, companies must still be privately held by aforementioned investment firms.

The first several months of 2022 have seen a seemingly endless slew of shocks, from geopolitical uncertainty to volatility in financial markets. While many of these trends are intertwined, the current market environment poses significant challenges for many expansion-stage companies that were preparing for exits or other major liquidity events. While opinions differ on the length and severity of obstacles in the current macro environment, there are also hidden nuances that point toward paths forward. In this edition of *Road to Next*, we provide an in-depth review of extensive PitchBook datasets on liquidity for expansion-stage companies to provide historical context and showcase how mature private businesses are navigating the current scene.

Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

With more than 30 years of financial services experience, Heather serves as the national Private Growth leader with oversight of the Deloitte Private, Emerging Growth Company, and Private Equity businesses within Audit & Assurance.

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

National Capital Markets Transactions Leader for the Accounting & Reporting Advisory practice with extensive experience leading IPO/SPAC engagements including reverse mergers, special purpose acquisition companies, recapitalizations, Up-C Structures, predecessor accounting, and SEC pre-clearance filings.

Amy J. Park
Audit & Assurance Blockchain & Digital Assets Partner
Deloitte & Touche LLP

Amy has more than 16 years of experience in public accounting, including a practice fellowship at the Financial Accounting Standards Board. She leads Deloitte's Blockchain & Digital Assets services for the Accounting, Advisory and Transformation practice with a focus on technical accounting related to digital asset transactions. She also serves on the AICPA Digital Assets Working Group.

"No one likes to catch a falling knife. Some caution prior to a buying spree is likely—we anticipate PE shops waiting for a bottom instead of hastily buying only to see further declines in valuations."

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

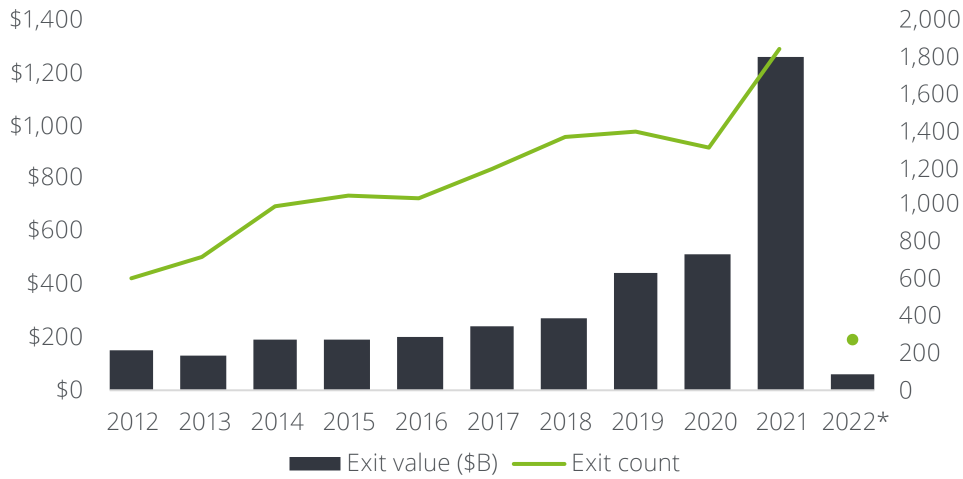
Market trends

In terms of liquidity, 2021 was an outlier in many ways.

In the US, expansion-stage companies enjoyed unprecedented levels of liquidity events in 2021. More than 1,800 transactions closed, for over $1.2 trillion in combined deal value. Although the prior decade saw robust figures for exits, the upward surge in both value and volume for expansion-stage exit activity in 2021 is still striking. Against that backdrop, the slower start to 2022 looks like a marked decline. However, when analyzing quarterly tallies, Q1 2022's exit figures resemble much of their 2010's counterparts and are slightly above the quarterly dip induced by the onset of the COVID-19 pandemic reflected in Q2 2020. While there is significant volatility in current financial markets—particularly in crypto assets—exit rates have not plunged to atypical levels.

Examining average and median exit metrics by type, the historic rise in public equities drove much of the record levels of expansion-stage liquidity. 2021 alone saw close to $900 billion in exit value generated by 335 public listings (which include direct, traditional, and SPAC listings). An interesting divergence did arise between average and median expansion-stage exit sizes between 2020 and the present, with the latter figure declining sharply after consistent highs, while the former stayed elevated until a precipitous drop between 2021 and 2022 to date. The surge in listing volume likely drove down the median substantially in the past couple years, while a number of expansion-stage businesses debuted at high levels, which kept the average inflated. Post-money valuations remained high until markets began a sharp decline in early 2022.

Expansion-stage exit activity



Source: PitchBook | Geography: US | *As of March 31, 2022

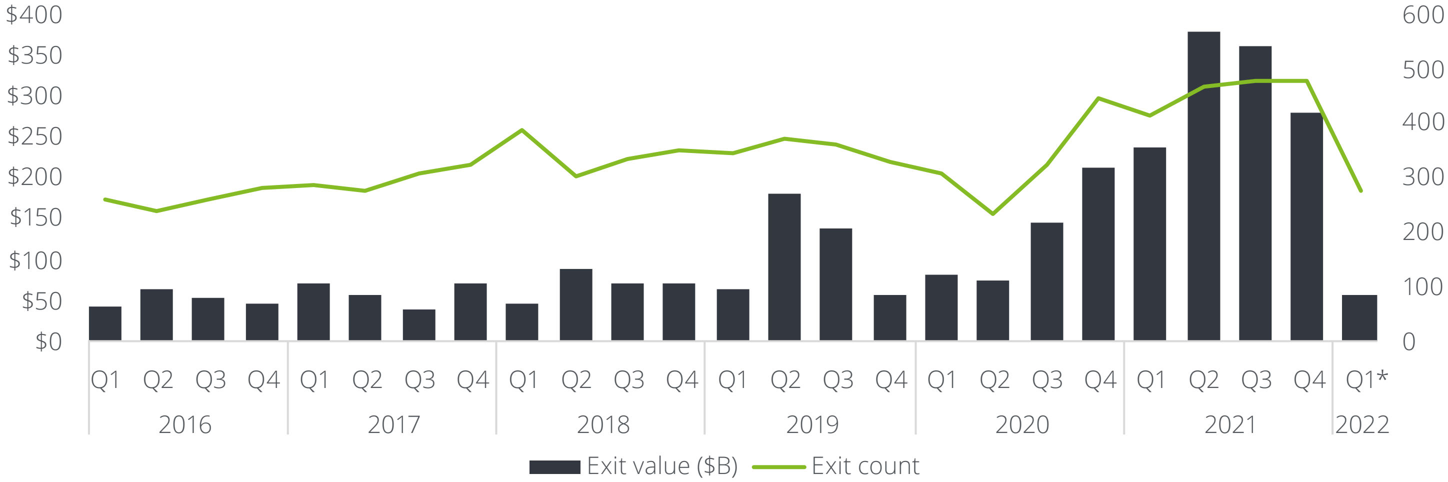
"We started seeing significant declines on IPO pricing just days before close in the final quarter of 2021. Given how heady the environment had gotten, there was a sense of exhaustion heading into 2022, exacerbated by inflation and a significant uptick in volatility."

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

"Post-debut performance for companies that listed in the past several months has not been as encouraging, which has contributed to the slowdown in both offerings and SPACs."

Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

Expansion-stage exit activity by quarter



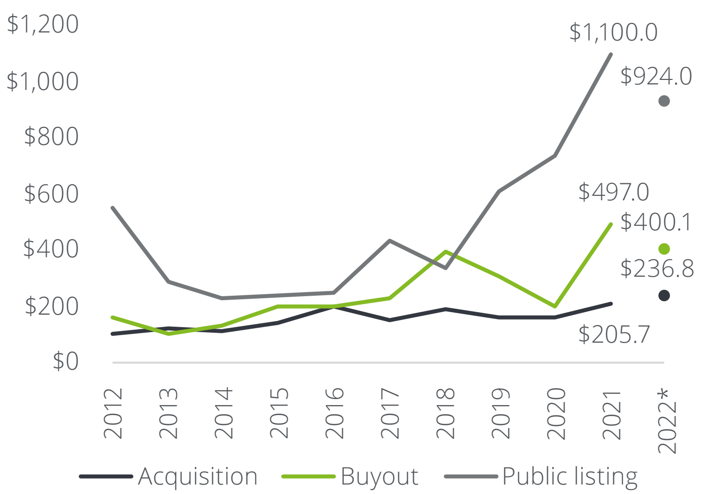
Source: PitchBook | Geography: US | *As of March 31, 2022

Although public stocks and listings dominated headlines, acquisitions remain critical for liquidity.

Buyout firms did grow far more active even at the higher end of the exit market in terms of size. The median buyout post-money valuation jumped to a record $1 billion in 2021 and remained strong in Q1 2022 at just over $300 million. As handfuls of expansion-stage companies began to face consequences of overly rapid growth catalyzed by easy access to large sums of investment capital, private equity buyers likely sensed opportunities and snapped up formerly high-growth tech businesses.

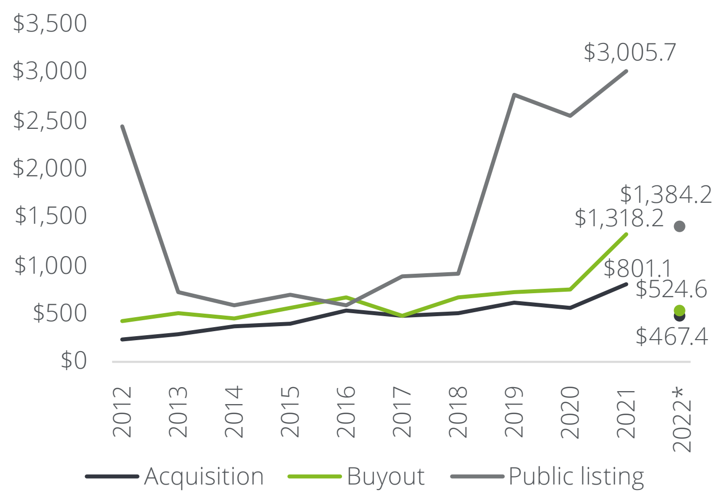
Financial acquisitions and strategic M&A by incumbents remain critical to the expansion-stage ecosystem for liquidity, even if most attention across financial markets has been devoted to analysis of the records set by public markets in the past several years. Just over 700 strategic acquisitions closed in 2021, while nearly 140 closed in Q1 2022. Moreover, acquisitions' proportion of exit value so far in 2022 has shifted back to historical norms, with just over half of all exit value for expansion-stage companies coming via that exit route in the first quarter.

Median expansion-stage exit value ($M) by type



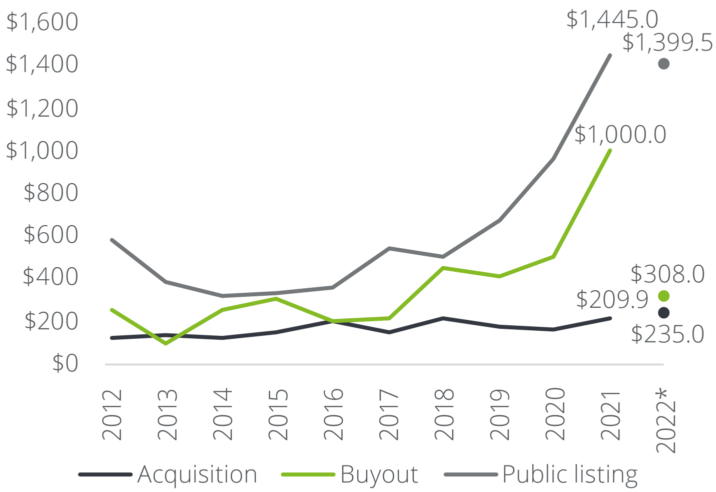
Source: PitchBook | Geography: US | *As of March 31, 2022

Average expansion-stage exit value ($M) by type



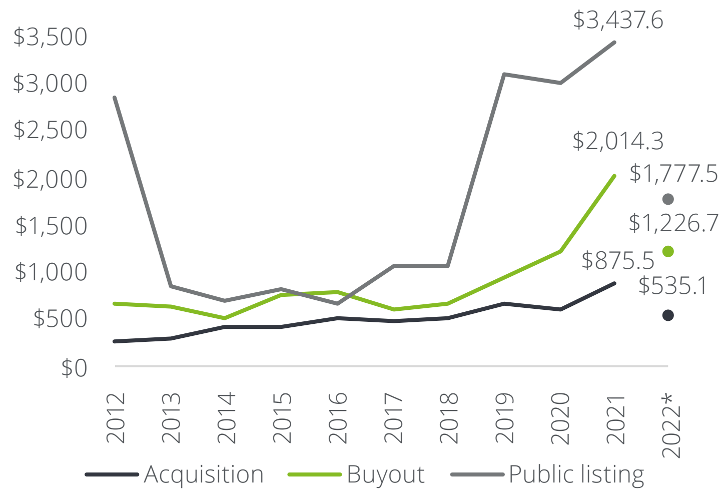
Source: PitchBook | Geography: US | *As of March 31, 2022

Median expansion-stage post-money valuation ($M) by exit type



Source: PitchBook | Geography: US | *As of March 31, 2022

Average expansion-stage post-money valuation ($M) by exit type

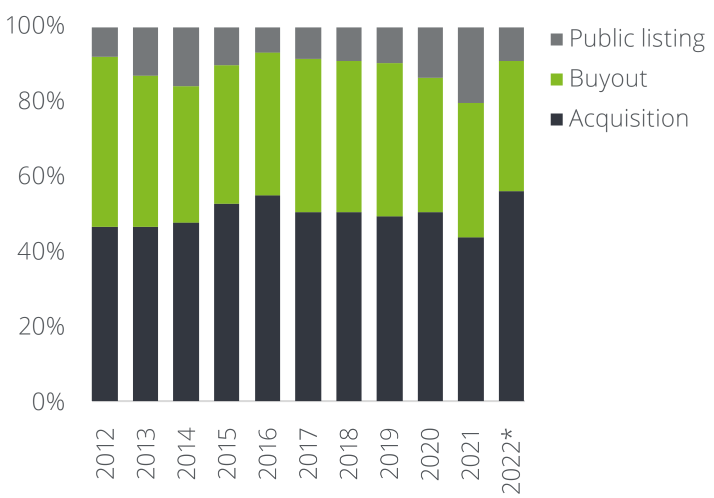


Source: PitchBook | Geography: US | *As of March 31, 2022

"Whenever you see the IPO market cool, strategic players often can take the view that it is an opportune time to add value via acquisitions. Especially in fintech, there could be consolidation as well as M&A of crypto entities by fintechs or incumbent financial services companies."

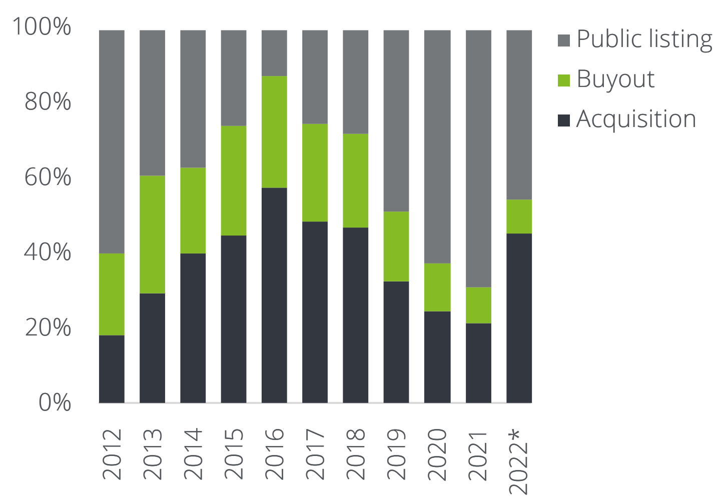
Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

Share of expansion-stage exit count by type



Source: PitchBook | Geography: US | *As of March 31, 2022

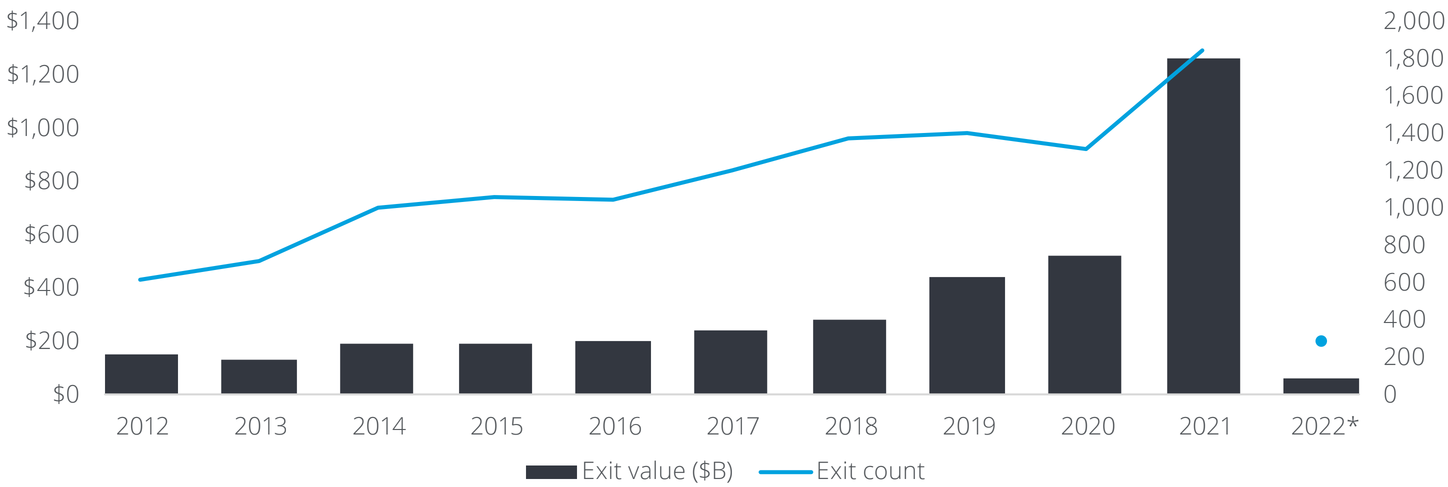
Share of expansion-stage exit value by type



Source: PitchBook | Geography: US | *As of March 31, 2022

Highlights across investment trends

Expansion-stage exit activity



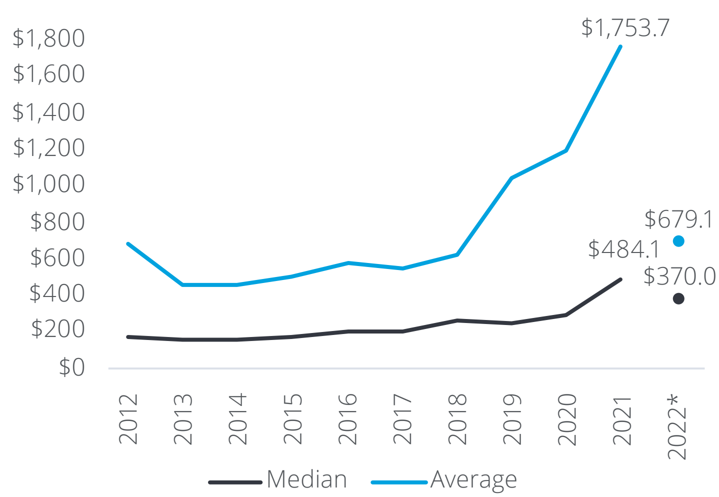
Source: PitchBook | Geography: US | *As of March 31, 2022

This edition of *Road to Next* breaks down key trends spanning liquidity across the expansion-stage ecosystem, particularly in light of recent market volatility and how it may affect the plans and prospects for late-stage companies looking to exit.

"As history has shown, it was inevitable that a market correction would occur at some point. Valuations returning to more reasonable levels is a necessary part of any market cycle."

Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

Median and average expansion-stage exit value ($M)



Source: PitchBook | Geography: US | *As of March 31, 2022

$57.7B

2022 is off to a slower start for expansion-stage exits, but historically robust figures still occurred in Q1.

45

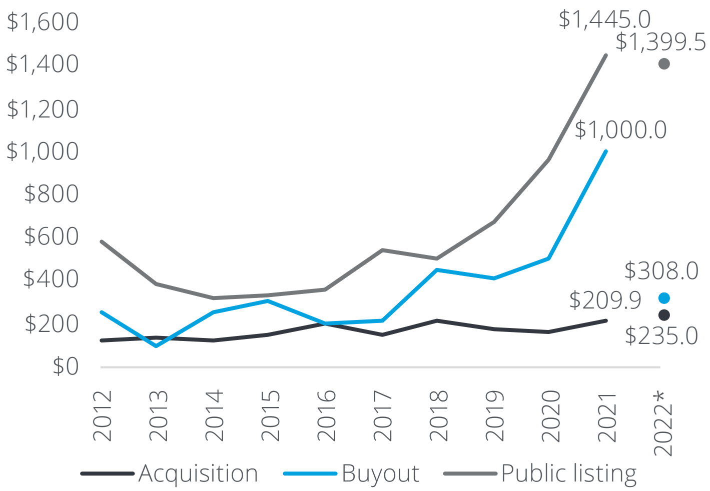
Although behind 2021's blistering pace, Q1 2022 saw SPAC mergers proceed at a faster clip than nearly any other full year prior.

$236.8M

The median acquisition valuation of an expansion-stage company remained elevated in Q1 2022.

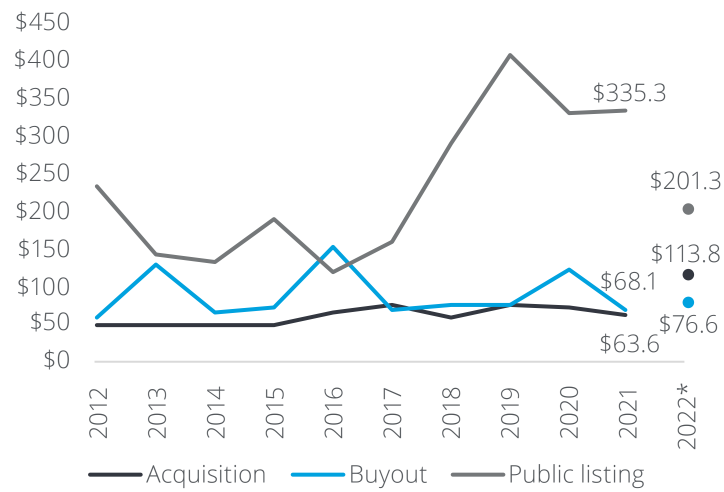
All callouts | Source: PitchBook | Geography: US

Median expansion-stage post-money valuation ($M) by exit type



Source: PitchBook | Geography: US | *As of March 31, 2022

Average total VC raised ($M) by expansion-stage companies by exit type

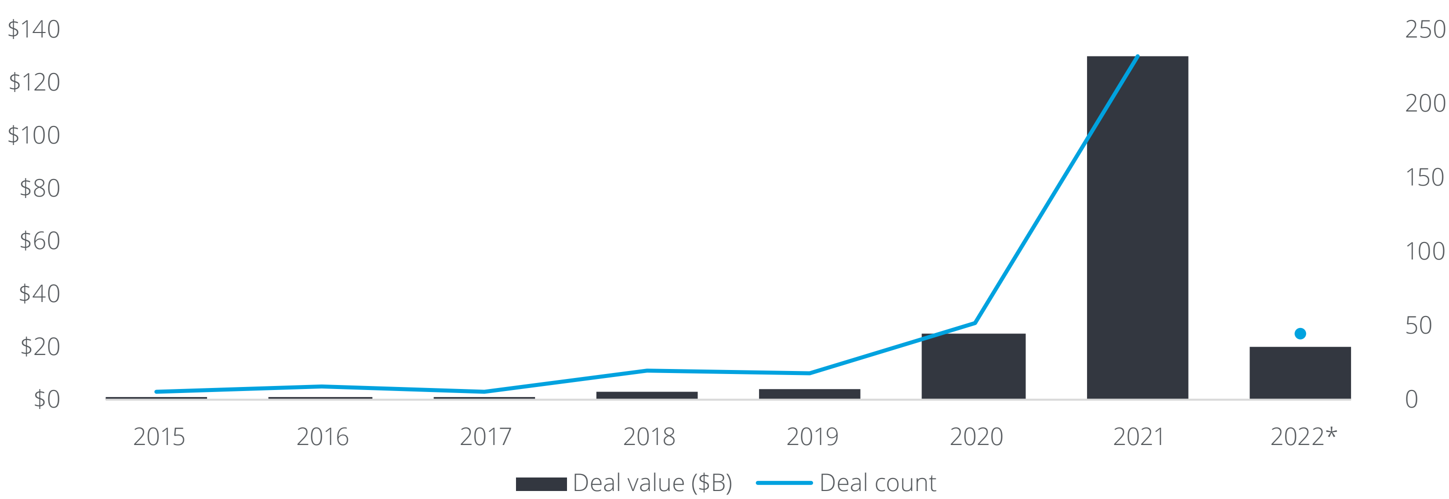


Source: PitchBook | Geography: US | *As of March 31, 2022

"In the SPAC space, there has been a healthier pipeline of recent merger announcements. Valuations have continued to come down, but targets are still seeking capital to expand their businesses. These are a new breed of targets, of which many have met key commercialization thresholds. As volatility increases and the IPO window closes, we continue to see the need for a vehicle that provides alternative financing and access to the public markets and targets continue to evaluate SPACs as a possible vehicle."

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

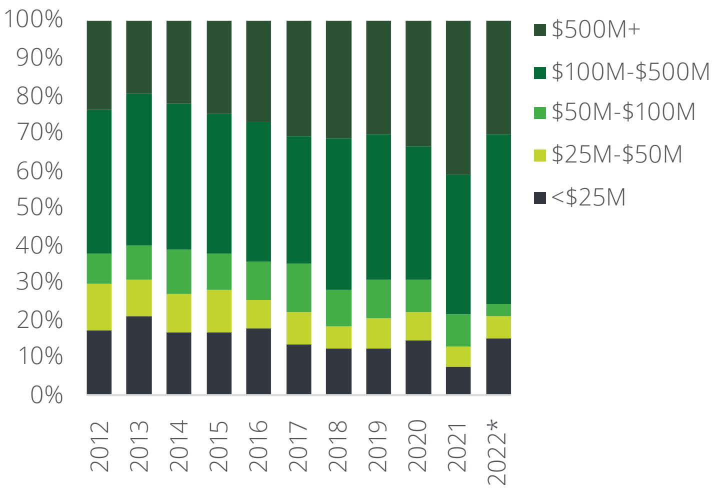
Expansion-stage SPAC activity



Source: PitchBook | Geography: US | *As of March 31, 2022

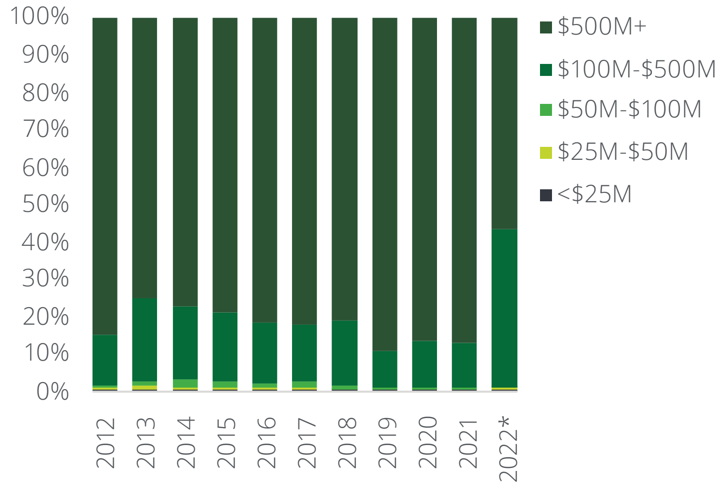
Note: The count of listings includes both SPAC launches and private investment in public entities (PIPEs).

Share of expansion-stage exit count by size bucket



Source: PitchBook | Geography: US | *As of March 31, 2022

Share of expansion-stage exit value by size bucket



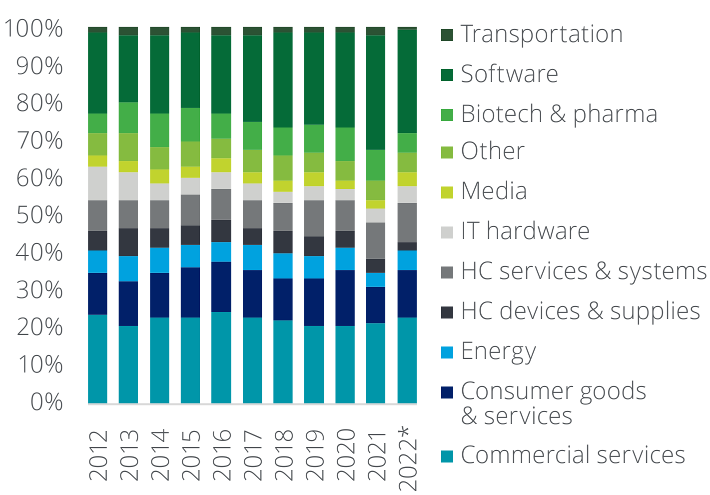
Source: PitchBook | Geography: US | *As of March 31, 2022

296 exits of $500 million or more occurred in 2021, far and away the highest such tally.

After a boom in business software exits, trends revert to historical patterns.

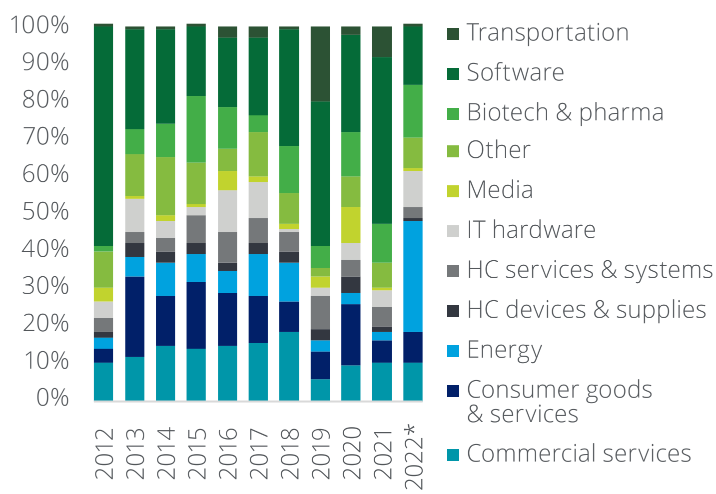
From a sector standpoint, business software expansion-stage players saw significant exit tallies in 2021, with $128.0 billion in exit value occurring across nearly 400 transactions. However, Q1 2022 saw these trends revert, with other sectors seeing a greater proportion of exit volume and value. For example, IT hardware players have already notched $5.4 billion in exit value, relative to $49.4 billion in 2021. It remains to be seen how these shifts may play out in the remainder of 2022, but as in any period of significant market tumult, investors and acquirers tend to prioritize not just company-specific dynamics but also sectors that are perceived to be somewhat more volatility-proof thanks to long-running factors such as demographics, access to natural resources, government affiliation, and more. Given that, biotech, healthcare, and IT hardware could continue to see significant interest, even if not at record levels, due to current geopolitical and economic concerns.

Share of expansion-stage exit count by sector



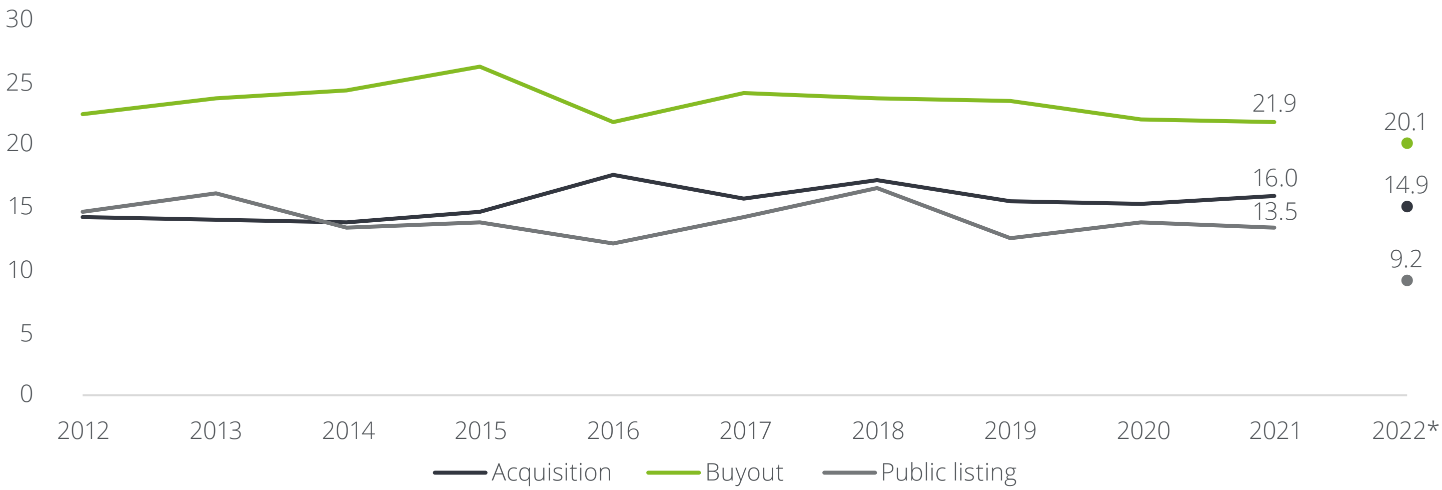
Source: PitchBook | Geography: US | *As of March 31, 2022

Share of expansion-stage exit value by sector



Source: PitchBook | Geography: US | *As of March 31, 2022

Average time (years) between founding and expansion-stage exit by type



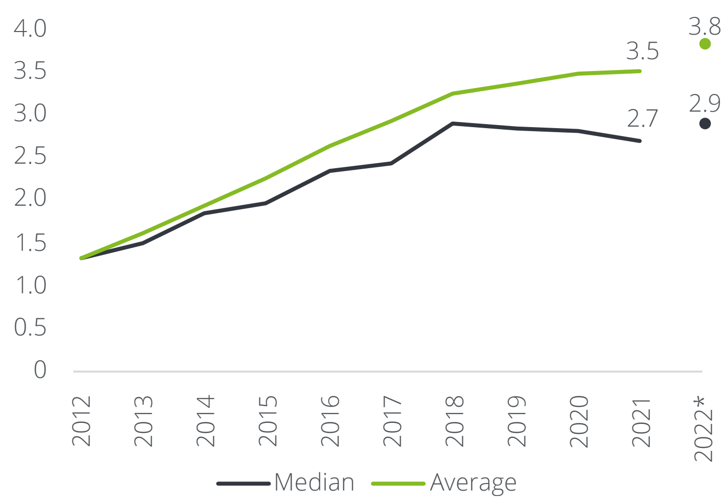
Source: PitchBook | Geography: US | *As of March 31, 2022

Are all the hottest trends of 2021 winding down, or are they evolving?

As of the time of this writing, these concerns seem to only be intensifying, throwing into question the durability of some of the most-discussed, hottest areas of innovation within the expansion-stage ecosystem of the past few years. Crypto assets, for example, are generally in freefall, which threatens the financial health of many blockchain-focused enterprises. Inflation-affected areas, such as food delivery, are also seeing impacts to their business lines.

However, expansion-stage companies' ability to achieve liquidity seems unharmed by these trends so far. Since 2017, the average time from founding to public listing for expansion-stage companies has steadily declined, even though most of these companies take the same amount of time to be bought by financial or strategic players. (Given that this metric is the average, there is likely significant skew by aging software companies.) In Q1 2022, that average only declined further, with expansion-stage companies going public just over nine years since founding. This trend is undoubtedly aided by the unprecedented access to private capital that characterized the expansion-stage ecosystem in the second half of the 2010s, which enabled companies to ramp up faster and go public if they desired to. Many did not and instead remained private. But even in the face of market volatility in Q1 2022, expansion-stage companies still went public at a fair clip—and early in their lifecycle, on average. It remains to be seen if this trend will hold, given that financial indexes keep declining and forecasts for economic growth are becoming increasingly bearish.

Median and average time (years) between last expansion-stage financing and exit



Source: PitchBook | Geography: US | *As of March 31, 2022

> "With regard to SPACs, the SEC seems to be more favorably inclined in scenarios wherein SPAC sponsors and the retail investor are more aligned in the risks of the SPAC merger."

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

Regional trends

Coastal hubs still see the most exits.

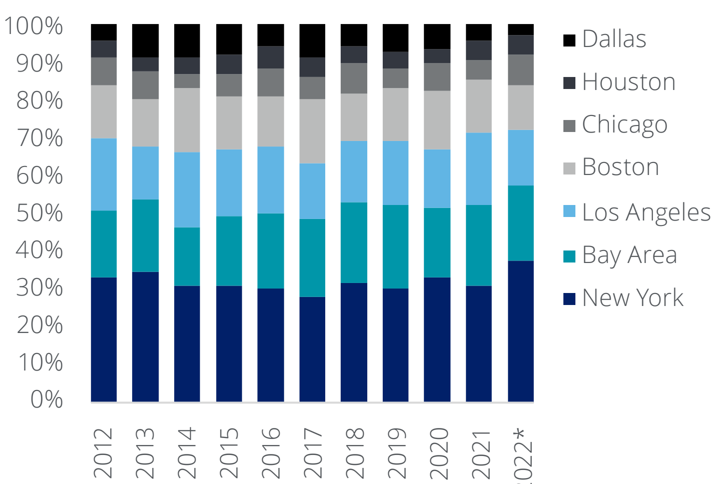
In terms of exit volume, proportions held consistently across the seven most active US metro areas over the past decade. There were some minor fluctuations, but the two prime California hubs for expansion-stage companies—Southern California and the Bay Area—accounted for a plurality of expansion-stage exits in that timeframe. The New York metro area remained a close third, notching well over 200 completed expansion-stage exits in 2021. In terms of exit values, however, the past few years saw a decided uptick in Bay Area-based unicorns driving the bulk of expansion-stage exit value, culminating in close to $500 billion in exits in 2021 alone. Q1 2022 saw a similar occurrence, with just over $18 billion. Exit value tallies remain much more volatile than volumes, thanks to blockbuster debuts and acquisitions. For example, the Boston ecosystem notched just over $100 billion in exit value for the entirety of 2021, but saw $6.1 billion in Q1 2022 alone, driven primarily by a slew of biotech & pharma exits. Given the slow but steady proliferation of venture activity in noncoast metros, the 2020s could eventually see US metros outside the coasts and Chicago boost their expansion-stage ecosystems to such an extent that their proportions of exit tallies will rise, but that has not yet occurred.

"We have continued to see steady deal flow in venture funding on the coasts. As fundings and valuations level out in this environment, it's likely we will see companies gain investor attention when they can maintain sustainable growth and display a path to profitability."

Kelly Borland
Market Development Leader, Emerging Growth Company Practice
Deloitte Service LP

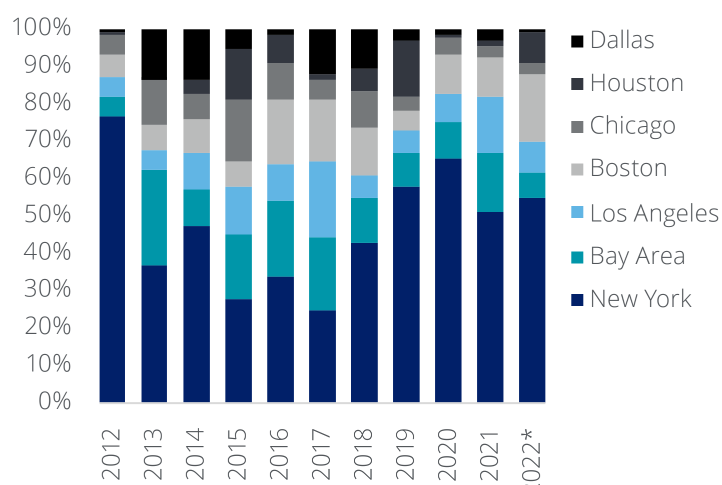
New York's financing volume jumps to all-time high.

Share of expansion-stage exit count by CSA



Source: PitchBook | Geography: US | *As of March 31, 2022
Note: Only the top seven CSAs by volume were included.

Share of expansion-stage exit value by CSA



Source: PitchBook | Geography: US | *As of March 31, 2022
Note: Only the top seven CSAs by volume were included.

Spotlight: The evolution of SPACs & intersection with crypto

How will the SPAC trend fare in the face of growing market volatility?

The SPAC phenomenon has been widely discussed, given its remarkable rise over the past few years. 2021 saw no fewer than 233 SPACs completed in the US for a total of just under $130 billion. Now, the onset of market volatility calls the continuation of this trend into question. However, the first quarter of 2022 has seen $20.6 billion in value across 45 completed SPACs, more than the first quarter of any other year in the last decade. Given the number of SPAC entities launched in the last year or so and investors' and sponsors' demand for exposure to the expansion-stage ecosystem, there is still significant potential for SPACs to keep closing. Broadening market turbulence and increasing pressure on many fast-growing companies could make SPACs even more popular, especially for the most pressured businesses.

SPACs' unique features do not necessarily render them more alluring than other routes to liquidity, but depending on the sponsors and affiliated advisors, they can provide greater certainty of exit valuation and close, as outlined Deloitte's recent SPAC primer.

"After a record year, SPACs aren't going to go away, especially for novel companies like digital asset players. Given current market turbulence, there is plenty of potential for the most robust crypto companies to prove their intrinsic value and model by weathering the storm."

Amy Park
Audit & Assurance Blockchain & Digital Assets Partner
Deloitte & Touche LLP

"Crypto companies largely correlate with crypto markets' performance. So, currently, many are facing significant volatility. Many companies in this sector still want to go public and are engaging with regulators to embark on registration processes, but unfortunately, the current level of unpredicability may delay that process."

Amy Park
Audit & Assurance Blockchain & Digital Assets Partner
Deloitte & Touche LLP

If more expansion-stage companies see their private valuations marked down due to market conditions or economic pressures, SPAC sponsors could still conclude that it is worth offering an avenue to greater liquidity—betting that, in the longer run, the fundamentals of a given business are more sound than current market pressures indicate. This is particularly crucial for crypto companies. Such enterprises face unique challenges that could align with SPAC pros, such as dedicated sponsors, timelines, and target valuations. As outlined in this Deloitte guide for digital asset companies embarking on a SPAC, digital asset companies may need to have even more robust disclosures to clarify any volatility in their assets, especially if they were due primarily to overall market volatility. Relevant SEC guidance has recently become available, especially Staff Accounting Bulletin (SAB) No. 121. However, such strictures are where the right SPAC sponsors and advisors come into play; with the right expertise and experience, digital asset companies could benefit from finding the right set of SPAC sponsors.

From a tax perspective, recent guidance from the IRS—Rev. Rul. 2019-24—is helpful but not fully comprehensive. Therefore, additional consideration will likely be required of digital asset players as they look to go public. Again, finding the right SPAC sponsor team with expertise and resources may be the only avenue forward for crypto players to go public, especially in the current market environment.

Perhaps the most difficult hurdle for crypto players looking to tap capital markets is that of appropriate valuations. Per current regulations and guidance, digital asset businesses must list their crypto asset holdings as intangible assets, meaning if they then decline in value, that decrease is an impairment. At the same time, issuers that hold crypto assets as custodians must record those holdings as liabilities. Overall, valuations for crypto companies that become the targets of SPACs remain complex and could dissuade some investors from signing on, even leading to redemptions. With that said, SPACs' demand for attractive acquisition targets remains strong, given how much capital has been raised and is ready to deploy. While recent market volatility has led to significant downturns in indexes and crypto assets, the best-positioned digital asset companies that may see a temporary reduction in value could theoretically still embark on SPACs with willing partners—ideally those that have more experience in the crypto realm.

An uptick in SPAC activity has yet to fully materialize, but we will be watching the space, given the raft of current SPAC entities still looking for worthwhile targets. Accounting and regulatory risks for SPACs still exist, but developments from regulatory bodies, such as the SEC, are occurring as players acknowledge that novel digital enterprises will require unique guidance due to their underlying technologies and business models.

> "SPACs are generally not faster, easier, or cheaper than an IPO. Reporting requirements are often more complex, there is less time to prepare for complicated deals, and they can oftentimes be more costly. However, targets are still engaging with SPACs to avoid volatility or pricing risk and are seeking public capital when other avenues are unavailable."

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

> "Given fluctuations in accounting and regulatory guidance for digital asset companies, going public will necessitate significant preparation and constant monitoring to stay up to date. To some degree, that can be onerous—but ultimately worthwhile—for players in the long run, as they invest in the resources and time required to attain public markets' level of hygiene."

Amy Park
Audit & Assurance Blockchain & Digital Assets Partner
Deloitte & Touche LLP

Looking forward

How will exits for expansion-stage companies hold up under increasingly bearish conditions?

The market environment in early 2022 is remarkably complex. On the macro financial side, government agencies worldwide either seem determined to balance accommodative monetary policies and foster economic growth while ignoring mounting inflation, or they are seeking to curb inflation without causing panic in markets or undue economic pressure. There is no panacea in situations such as this, hence the decline in most major market indexes and drops in valuations for many expansion-stage businesses as monetary conditions tighten even slightly. It is important to note that markets are not whipsawing solely due to rises in interest rates, but also due to economic contractions worldwide and the exacerbation of supply chain and natural resource issues by the war in Ukraine. In short, there seems to be no easy or swift resolution of the pressures that have intensified in the past few months.

What this entails for the expansion-stage ecosystem, particularly regarding exits, is nuanced. Some companies will have to make difficult choices as challenges persist, looking to shrewdly deploy their recently raised capital to recession-proof their core business lines. Crypto companies are likely chief among such businesses due to the degree of volatility in their financing models. Some expansion-stage companies may still experience upticks in business fortunes due to macro factors, such as national onshoring, increasing cybersecurity spend by major tech corporations, and more.

When it comes to liquidity, exit prospects are not necessarily dimmed. Choppy equity markets require greater preparation to go public, for example, yet investor demand remains for solid businesses. Stockpiles of private capital dry powder in the market could lead to additional fundraising efforts to shore up business lines. And while acquisitive enthusiasm may be tempered temporarily, PE fund managers and corporate development teams are unlikely to stay on the sidelines for long, as any depression in formerly record-breaking market valuations can render many companies even more attractive for acquisition. Thus, an uptick in both financial and strategic M&A seems probable, even in the remainder of 2022.

"A slowdown in the pace of listings due to market volatility can allow more time for a company to prepare even more thoroughly and focus on operating efficiency. In the past several quarters, more companies were overly concerned with building infrastructure post-listing, as opposed to what public companies should be doing, especially in today's market environment, which is operational finesse."

Will Braeutigam
Audit & Assurance National Capital Markets Transactions Leader
Deloitte & Touche LLP

"For crypto, volatility may always be a key factor to consider, albeit in a unique way relative to the types of volatility that other sectors experience. However, as digital assets continue to diversify and proliferate, there could be further evolution and maturation into stability."

Amy Park
Audit & Assurance Blockchain & Digital Assets Partner
Deloitte & Touche LLP

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Methodology

Geographical region: United States

Active investors: The number of active investors is calculated by including either investors that have raised a venture or growth fund in the trailing five years or those that have made four or more VC or PE growth investments in the past three years. There is no exclusion on investor type, apart from angel investors. All investment data is restricted to late-stage VC, PE growth, or corporate financing types as defined by PitchBook.

Nontraditional investors are defined as hedge, mutual, or sovereign wealth funds.

All exits are defined by PitchBook's primary exit types: buyouts, acquisitions, or public listings, which include direct listings, traditional public listings, and special purpose acquisition companies (SPACs). The underlying companies are those that have, at minimum, achieved any of the investment data under restrictions.

Company inventory is calculated by tallying the number of companies that achieve either late-stage VC, PE growth, or corporate financing by year and have not recorded an exit event as of the year in question.

All exits unless otherwise noted were made by companies that fall under the aforementioned criteria for expansion-stage companies. The number of sellers was based on the count of investors classified as PE by PitchBook within the IPO event.
This report was written in mid-May 2022. All data is as of March 31, 2022.

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