VENTURE

VCs Share Thoughts, Advice On State Of The Market During COVID Restrictions

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The COVID-19 pandemic has upended life as we know it, and the world of venture capital and startups is in the process of trying to figure out its new normal.

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Between how sudden everything changed and the uncertainty of when it will all end, there have been a lot of questions about what's going on in the market, best practices for companies and if deals are still happening.

I chatted with a few VCs to learn more about the state of the market and what they're advising their portfolio companies–especially the more mature ones–what they predict will happen in the near future, and what they're seeing and hearing about how deals are being made.

On IPOs

Companies looking to go public will just have to wait it out. The effects of COVID-19 on the IPO market is already showing–there were just two IPOs in the past two weeks, both pharmaceutical companies (Keros Therapeutics and Zentalis Pharmaceuticals).

Malcolm Thorne, a partner at 4490 Ventures, said he expects the IPO market to slow down, and if a company wants to go public, it's going to be very difficult.

"I think if it's an IPO, I think people need to be patient," Thorne said "I think there are still going to be strategic transactions that make sense during these times. The challenge is that valuations drop during these times."

So, that doesn't mean all exit opportunities are at a standstill. There are still other exits that make sense "in certain markets and certain applications," Thorne said.

"I do think that everything is sort of being exposed in this COVID crisis," Thorne said. "Because of this consumer behavior shift that's been exposed, I think a lot of firms are going to (make a strategic bet). They don't want to be left behind in these markets, not having a strategy, not having a solution."

On mergers and acquisitions

While the prospect of an IPO in the near future may not be likely, Andy Lerner of IA Capital agrees with Thorne, saying mergers and acquisitions are expected to continue.

"I think there's money for exits, currently, it's not as robust as it was a month or two ago. Especially financial sponsors, [private equity] firms will continue to be buying companies in this environment," Lerner said. "I wouldn't rule out exits in particular. In some ways exit might be an option for a company that doesn't want to raise new capital at a lower valuation."

Lerner said he thinks private equity buyers will be more nimble than corporate buyers, and there will continue to be activity on the M&A side, but not the IPO side.

The shift in human behavior caused by the COVID-19 pandemic (think an increase in use of telehealth services, distance learning and video communication), will translate into more M&A activity for companies in those sectors, Thorne said.

"I think we're going to see increased adoption of many of the things we're utilizing in this crisis and I think that's going to lead to increased M&A," he said.

On raising money

The general consensus for companies of all stages looking for new funding was to turn to existing investors rather than seeking out new ones. The people who know you and are (literally) more invested in you will be more likely to help you out.

For late-stage companies, the good news of the situation is that there's a huge amount of capital allocated to the asset class, Next Coast Ventures co-founder Mike Smerklo said. But the bad news is that it's hard to make assessments of the future of a company, which makes coming up with a valuation much tougher.

"The good news is there's a lot of dry powder, the bad news is it's hard to determine valuation," he said.

It's a seller's market, not a buyer's market right now, so for companies who need capital, they can't be picky about where it comes from.

"If you're in a situation where you're going to run out of capital, take what you can get and live to see another day," Smerklo said, adding that if a company can wait, it should.

Funding slowdown?

One of the biggest questions up in the air is if there will be a funding slowdown because of the lack of in-person interaction during the pandemic. Investing in a company usually requires meeting in-person and getting to know the company and the people behind it.

“I think people will continue working on investments they’ve engaged with prior to the ciris, but it’s just outside of people’s comfort zone to make an investment on a company they have not met in person,” Lerner said, noting that the possible exception to this would be for companies in the telehealth, insurance tech and fintech spaces.

Investors are moving forward on deals they already had in the pipeline and done site visits for, met the team and done due diligence, he said, though there are adjustments being made on pricing and valuations.

Lerner expects that over the next couple of months new deals will slow down. But, there’s a chance that if the pandemic continues for several months, people will start making deals over Zoom.

Smerklo said he expects a funding slowdown in the second and third quarter, but that specific areas (like video communications) will be “robust.”

“I think in the short term, [the slowdown] will be pronounced but I think as the year progresses … I’m optimistic, I think activity will pick back up,” he said.

There’s two ends of the spectrum, with some VC firms actively looking for new opportunities and others heavily focused on helping their portfolio companies navigate the COVID-19 situation, according to Thorne.

“We are continuing to meet with people, obviously we don’t know when this ends,” Thorne said. “Ultimately we hope we meet with these people face-to-face but we’re not stopping taking new meetings just because it has to be done remotely at this point.”

Illustration Credit: Li-Anne Dias