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Later-Stage Valuations Tumble As Venture Investors Reset Expectations

by Russell Garland

The financial crisis drove down the median valuation for U.S. later-stage deals by 43% in the first quarter, according to the latest VentureSource data.

The sharp decline is another indication that venture investors are finally adjusting the values they place on their portfolio companies to reflect the public markets, which tumbled last year. Other signs are that investors in venture funds are seeing writedowns in portfolio values and law firms that track venture finances report increases in the rate of down rounds -- deals done at a lower valuation than the prior financing.

The median pre-money valuation for later rounds in the first quarter of this year was $32 million compared with $56.1 million in the fourth period of 2008, according to industry tracker VentureSource, a unit of VentureWire publisher Dow Jones & Co. The median hit a peak of $64 million in the third quarter, the highest since $81 million in the fourth quarter of 2000.

Also falling was the median valuation for second rounds, going from $16.1 million in the fourth quarter to $10 million in the first quarter. First rounds, which typically show much less volatility, rose from a median of $6.6 million in the final three months of last year to $7 million in the first quarter of 2009.

The median valuation for all venture rounds was $20.5 million in the first quarter. This was an increase from $18 million in the prior quarter. VentureSource attributed this rise to an increase in the percentage of later rounds, which have higher valuations. In the first quarter 41% of venture financings were later rounds versus 37% in the prior quarter.

The tough investment climate has resulted in an increased rate of rounds done entirely by prior investors. In the first quarter, 57% of all venture rounds in the U.S. were done by insiders only, according to VentureSource. The prevalence of such financings has raised concerns that venture firms are propping up valuations to avoid write downs that would affect fund performance. A new investor is more likely to question whether a company is over-valued.

The latest valuation statistics, however, indicate that those fears could be overblown. Steven Bird, a general partner at later-stage investor Focus Ventures, said his firm is seeing plenty of valuations being propped up by insider rounds, but "also some realistic valuations, even on some inside rounds."

"There's a long lag effect where the public market stocks were down significantly and yet privates hadn't come down, at the late stage at least, anywhere near as much," said J. Sanford "Sandy" Miller, a general partner at later-stage firm Institutional Venture Partners. "I think we're beginning to see that correction now.

"I think it also reflects the fact that a number of private companies who had waited to come to the private market because they had stretched their capital finally do need to come and just take what terms are in the market," Miller said.

Limited partners in venture funds say they are starting to see portfolios written down by as much as 30% or 40%, although year-end writedowns seemed to be largely in the 10% to 15% range.

Another sign that the venture industry is swallowing its valuation medicine comes from the legal industry. Fenwick & West said 46% of the Silicon Valley financings it analyzed in the first quarter were down rounds, the first time since 2003 that down rounds exceeded up rounds.