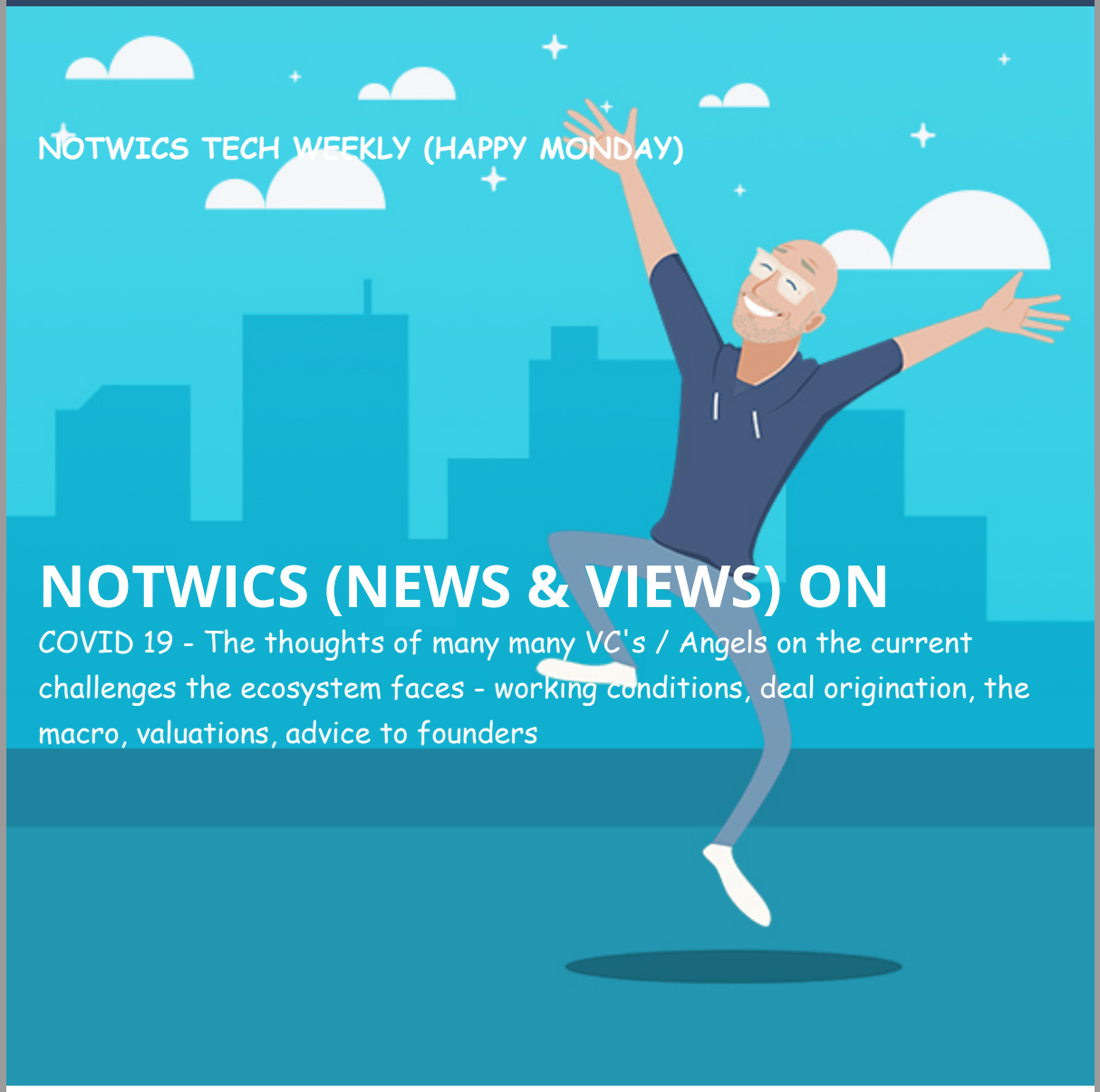
NOTWICS

23.3.2020

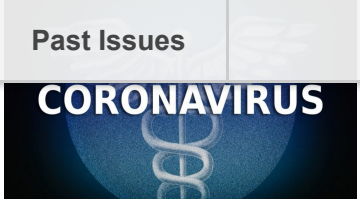


GOOD MORNING,

Here's the recent TECH News & Views opinions from NOTWICS

COVID 19 CRISIS

COVID 19 - EARLY REACTIONS FROM FUNDS & ANGELS.



TO SAY LAST WEEK WAS TUMULTUOUS FOR ALL WOULD BE SOMEWHAT OF AN UNDERSTATEMENT

WE DECIDED TO DO A CALL TO ARMS & ASCERTAIN CURRENT THOUGHTS ON THE SITUATION THE LONDON & UK ECOSYSTEM NOW FINDS ITSELF IN

WE'D LIKE TO THANK MANY VC'S & ANGELS WHO RALLIED TO THIS REQUEST S & WE'VE WORKED HARD TO SUMMARISE THE MOST SALIENT POINTS IN THIS WRAP

WE'VE GROUPED THE KEY RESPONSES TO THE KEY THEMES & WITH A-LOT OF FUNDS & ANGELS WITH OPINIONS TO SHARE

SO THE WRAP IS SOMEWHAT LONGER THIS WEEK BUT WE HOPE YOU APPRECIATE THE VITAL INFORMATION THE NOTWICS COMMUNITY HAS SHARED & IS SHOWING A STRONG WILL TO CONTINUE TO

WE WELCOME REPLIES - SPEAK AGAIN SOON

1/ TIME TO NORMALISATION

FROM VC'S

The Knee Jerk ..

The basic message has been this from the many kind investors we've talked to in the last 4 days ..has been pretty mixed:

===> On an encouraging note, about 40% of funds stated that it was business as usual - they are still open, looking at origination, have capital to deploy, are using exactly the same working practices and have a strong pipeline of deals to get done in 2020

===> A further 40% stated they are re-adjusting to the new normal and this will take a bit of time. The first week of Covid 19 had been a tremendous shock and jolted them, to actually just focus on the existing, rather than the new. As things calm down, into the new normal, these funds expected the next couple of weeks to not be such write offs

===> They accepted it would still be tough, but this time line would see them correct back to normal working practices of investment, origination and support for the existing portfolio. "Back to normal" working practices were estimated to be the 1st April, a point would start seriously considering deal origination again

===> About 20% of funds felt completely "hammered" by this news, akin to a "Lehman moment". Some admitted that the internal mountain of existing investments, setting up new working practices, procedures, damage limiting existing rounds and managing moral and staff was a challenge. WFH made this even tougher for the management teams to lead by example, This was, more than ever, a time when they needed to pull together and talk more. Most of these respondents felt that they'd only really be able to action new ideas by early May !!

Other key trends:

Portfolio guidance is critical for all funds at the moment - most of funds are focusing on getting their current portfolio of investment better positioned to whether the storm, preserve as much cash as possible, cut back on unnecessary spend and focus on calling upon existing customers for monies owed

An over-riding message was all founders should have amended expectations to reflect the current environment, both in terms of their response rate (likely to be slower than normal), but also any material founders intend to disclose, should have modelled the impact of this downturn on the Scale - Up or Start - Up, rather than just ignoring it

Some of the bigger funds highlighted that the sheer size of their portfolio's mean't they were still reeling from the impacts and couldn't give a timeline where they would realistically take a look at new stuff in real detail

Several commented that they still need deals & high quality flow. If there are no deals, they will struggle even more. The funds want deals, as one quite clearly wrote, no deals mean they die

A couple did warn that in the next month, they'd expect to hear about term sheets will be pulled last minute, something that is not unusual for the times we are in now

On dealflow ..

Most funds highlighted that they still had strong pipelines for the year ahead and this had not changed

All recognised that some of their traditional supply lines have dried up with no events / accelerator programmes / other sources

Again, bespoke introductions virtually by trusted sources, was emphasised as a good way of moving forward

70% of funds stated that they were focused on the same investment perspectives they had pre Covid 19, but a few were adapting to consider new areas of opportunity too

Founders were encouraged to approach them with strong ideas that fit their investment focus, with some VC's stating they were also broadening out their horizons to to accept other ideas that had been provoked by the pandemic (See section 5)

On capital ..

There is still a lot of capital to be deployed over the next 12-18 months & very vibrant capital pipeline

The allocation of this will be much more polarised with a flight to quality, with the better founders and quality businesses receiving the lion's share

No bad deals will get away, which has happened on occasion in the last 5 years, as funds just had to deploy capital

Most VC's commented there could be a few funds that become snowflakes & go into hiding for the next 6-9 months, but they will be will have to come back to the market eventually by Q3 !!

This was contrasted by a few "HERO's & HEROINES" who proclaimed they would try and step into some deals where the founders need help, something we thought was admirable

On timing - it's assumed that the average time length for a Series A would be 8 months rather than 6 months

NET/NET

The overall message from funds was be patient for the rest of the month in terms of responses to deal origination

Remember VC's are human, they also can get ill & have friends and family in need, so if this gets worse, responding quickly to founders falls down the list of priorities & best quote in regard of origination - "Schools out - so take your Easter holiday now instead of when it was mean't to be "

BEST QUOTES:

> *"This week was all about adjusting to the 'new reality' so fundraising will have temporarily slowed/conversations will have been delayed as investors prioritize sorting portfolio companies out. Suspect next week will still be the same but week after next people should have found their groove. I suspect investors will also realize their pipeline thinned out and will start to proactively source more aggressively again"*

> *"Sorry for the slow – reply. We're firefighting on a few fronts so haven't had time for much outside the core business right now. And that is probably going to be the theme for the next period – an absolute focus on the core business, whether you're an FMCG, Mining company or VC. We're still assessing the situation so can't give you a view on our own position right now"*

> *"At the moment, more focus is on the existing portfolio. This was a large shock to the ecosystem, but we expect to re-orient towards our old patterns of working and focus as soon as possible"*

FROM ANGELS

The Knee Jerk

Its fair to say, that the majority of casual angels have disappeared from origination currently - some have witnessed a dent to their personal wealth by the implosion of the public stock markets. This has been either the result of the decline of their wealth from the options of their listed parent company which have gone into a a tailspin. Or its a consequence of the hit from their own public market exposure, with the overall implosion of the financial markets

On a more positive note,

Some with money in the bank, from previous exits & fuel from the past will return more quickly, as they realise this situation could create great opportunities

The seasoned pro's or Super Angels are still there - but are being very, very selective and reading around what would be the next spaces to look at in the next 3-6 months

Of those angel that are currently active - they have decided to concentrate on closing the existing SEIS & EIS deals, they've been working with founders on & then take a break
These are businesses research hours have been completed, due diligence instigated, commitments made, which the best angels feel duty bound to honour
It would be fair to assume that most Angels are potentially now off piste to new ideas until post the SEIS / EIS window closes (early April) & the shock factor of where we are goes away

On future dealflow ..
Several of the Angels highlighted that the need to get back into the market wasn't that great and that they will wait to the summer to look in earnest at new businesses - when the founders will have had to have taken their medicine and undertaken a valuation reset
If anything, Angels are the most sensitive of any investor class to any valuation reset - so they asked me a-lot of questions on where the market was trying to find the range, to which we replied - for new rounds, 25% - 60% lower

On Capital ..
The very best seed stage names with great traction and/or a relevancy to the current new world will get funded, but irrelevant ideas will not
On average a Seed Round or Early Round is now expected to take 6 months rather than 4 months

NET/NET
It was widely agreed that seed would now struggle until the summer
The over-riding advice from Angels was for founders to reduce their current valuation - in line with what's happening with the valuations in public market
One rule of thought was to look at the public markets and then do the math ===> If you look at SAAS listed business - pre-Covid crisis - they were trading @ 8x to 12x earnings. Now they are 6x

BEST QUOTES

"WITH VIDEO MEETS HOME WORKING IS EASY MORE PRODUCTIVE BUT BORING AS _ _ _ _ ! so could make response times and meets quicker ...."

"Yes, still happy to look at opportunities. The challenge is the time required to research and understand the company, their vision and strategy. There is definite focus on short-term evaluation of current investments portfolio, particularly around cash flows. The next 6 weeks will likely be quiet as everything stabilises. Hopefully we can come through this phase and accelerate out in the summer. Still makes it

interesting to look at interesting business opportunities, with well prepared decks as a pre-read"

"I might also start to deploy some capital in the public markets as some of the declines in quality TMT names are once in a lifetime opportunities. I'd rather wait for the private market to stabilise over time"

2/ THE CHANGE TO THE INVESTMENT PROCESS

In general ..

It was agreed that decision making has been pushed out by logistical barriers in the short term

Most felt these would rectify in the next couple of weeks

Most of the bigger investors spent the first week adjusting to a new way of working, meaning WFH or work from home which, for some, temporarily has slowed things

Deal Decision - Making ..

Some investors said its business as usual, that this is the way they have worked normally, for many years, so its not such a big deal

For those funds that are new to remote working, highlighted it was still too early to determine how the actual new decision making process will take shape

Many of the more international funds, that have partners in London, as well as around Europe and the US, highlighted that this was to not different to how they normally operate

It was suggested that there maybe a flurry of Zoom based deal announcements in April, which could signal the new normal

For once, the traditionalists, bent on seeing the whites of the eyes - may have to be sacrificed

Others accepted that the virtual way of working could maybe not give them enough conviction to pull the trigger, but they would line up a shortlist to get close to finalising and then pull the trigger on them when the window to meet face to face, opens again

On the suppliers ..

The only drag - was suppliers work - lawyers / accountants and others are seeing workflow here pushed out by 1-2 weeks

They expect continued delays in the short term, in the next couple of weeks, as people grapple with ever changing personal/professional surroundings

BEST QUOTES

"Surprised how well internal discussions have worked despite WFH. Fewer distractions promoting some great insights and analysis from the team. Huge question on people and presentations – we find it hard to synthesise this. Video etc. just not the same, and especially for deeper discussions and DD work…!"

"Initially: i) some funds may be quick to announce their first "zoom based deal", and then go "what have I done", then eventually get comfortable again. (ii) those that just need time to get comfortable with decision making remotely"

3/ THE MACRO - ITS CHANGING & COULD MAKE THINGS WORSE

The bigger picture..Scenario's

Most funds and angels are basing their current thoughts on a world that comes out of lock down at the end of June

Its fair to say that Q2 2020 will be the worst quarter ever in world GDP & these VC's are making the majority of the predictions in this note on the basis that this is the background to the world at large, a world that has a deep recession in 2020

If lock-down persists until September 2020, they will start to revisit their expectations in May and further haircuts to expectations maybe necessary as we, will be looking at a depression, similar to the great depression in the United States, where the impact lasted 10 years

Most funds highlighted they hadn't modelled this outcome yet & positively, were not expecting this to occur

I HAVE TO ADMIT THIS IS THE STUFF OF CHIEF ECONOMISTS - SO I MOVED ON FAIRLY QUICKLY WHEN INDIVIDUAL MANAGERS WANTED TO DISCUSS THIS IN DETAIL - TAXI PLEASE MR DE NIRO !!

BEST QUOTE

"However we have a specific investment focus in European deep technology (see our website for details). This approach is not changing as a result of Covid19. The largely compute and telecom technology that we invest in is supporting much of the home-working technology being used today.

We receive about 40 applications a month from founders, and typically 60% of these are turned down because they are outside our investment

focus. We typically make 2-4 investments a year. Right now we have a very full deal flow pipeline through 2020.

We don't have a clearer view than anyone else yet on the general impact on funding for seed and scale-ups. We would expect that larger later stage VC funded companies negatively affected by Covid19 will be seeking unplanned additional funding which could cap new investments. This would put pressure on availability of seed and scale-up funding. We ourselves are equity funded and so adjust our rate of new investment to our own equity funding activity. Our shareholders are being very supportive".

4/ VALUATION IMPACT - BUT WHERE ARE WE NOW WITH THIS

IN GENERAL Valuations ..Created a large amount of debate and variety in responses. We've done our best to summarise these views of both funds and angels here:

All mentioned these need a reset in future

The cost of capital has been lower than opportunity for far too long, now this is equal and means better opportunities for funds & angels with new deals

The initial pressure will be for 25% - 30% lower in the next 2/3 weeks, but this could extend to being 50% by June

Some argued that expectation valuations will revert to 2014/2015 levels

Other felt that as the supply of capital reduces then valuations are likely to be hit

Some Founders may have to be satisfied with raising rounds at a flat valuation which we haven't seen in the market for a number of years

The most bearish angels and funds highlighted some founders may see a retraction of 60-70% for businesses that are just not relevant now !!!

All funds and angels agreed that the valuation reset was long over due & 11 years of bull markets has made things very fluffy

However, most were concerned that rounds will be harder to close this year, that some co-investors may withdraw from the market and that valuations will be lower. This applies equally to seed and scale-up rounds

The market will become merciless and mis-execution will immediately lead to a down round

But on a positive note ..

It's all about valuation in a bear market & good companies can still attract investment

Scarcity of capital would put downward pressure on valuations, though in the early stage world, data on valuation metrics have always been somewhat opaque, which could save many names

Most agreed the real hit is likely to be felt visible in the later stage funding rounds where the size of series-B and beyond has been escalating in recent years

So act now founders ..

This valuation reset for some businesses mainly will reflect lengthening lead times and increased churn from existing customers, as bigger companies re-trench - so the founder must take there medicine now and reset to match this as quickly as possible

The founders that don't and walk around with their "heads up their arses" said one northern fund - will see their funding balloon pop very quickly indeed

Some investors fear - the longer we stay in lock down the lower valuations will fall

Adding to this, Its fair to say the assumption of a significant valuation re-set, is based on us coming out of lock-down in the UK - 3 months from now, in Mid June

LOTS OF GREAT QUOTES & INSIGHT HERE

"We will look back at WeWork in a few years' time and associate that failed round with the top of the market. I imagine seed being particularly badly impacted"

"We would certainly hope to see them come down, difficult to put a pin in, but 30% declines would seem more "realistic" in any case. Would imagine the secondaries market is going to be harder hit in that respect".

"Any founders that don't recognise that the macro could lead to valuations halving at worst- need their heads examining.
"Valuations will fall, people with cash will have a high bar & lower valuation & less money will be chucked around. Companies that are high quality, have solid cost control & good revenue growth - I forecast these deals will be extremely competitive. That dry powder will be more focused on targeting them. They won't have too much valuation downward pressure"

"Great businesses even in today's market will stay resilient and wont see valuation impact – we are already seeing this in our portfolio. It will be company specific, in the past 8 years there has been a lot of easy money that allowed firms to put money in burn rate and replace the underlying structural economics to prop up growth – some will fail, some will see significant valuation declines. There are many firms out there swimming naked"

"Yes, they will probably decline overall in the market as there is a market

correction happening. BUT, we do NOT change our approach to valuations, as we don't need to. We have been disciplined over the bull period and will continue to apply a fair approach, as we did during previous bull and bear periods, for all parties involved"

"Regarding valuation there's clearly going to be an impact from losing maybe as much of 15% of GDP globally. But when we come out of the other side (3m, 6m, 12m?) people will still need to fly around and stay in hotels, though obvilusy growth won't be at the same rate, and we all may be burdened by the costs of dealing with this crisis for some time to come. The FTSE is only down to where it was at Jan 18! So 25% down on average feels like it could be right, though clearly not all companies will fare the same"

5/ THE VERTICALS IN DEMAND / BUSINESSES THEY'LL WELCOME APPROACHES FROM

Generally, on asset allocation in the next 3 - 6 months

It was relatively normal for most funds to state they will stick to their areas of expertise, as this is what they know best. However - it was also hinted at they they may deploy other capital to areas of opportunity that arise from the crisis in the next 3-6 months

None stated they were going to SUDDENLY change focus completely and look at completely different areas for funding

A few hinted that they did intend on shifting some capital towards some newer trending verticals, to support & take advantage

On the angels and seed funds side..

With their greater propensity to change more, would hunt the more crisis orientated opportunities, because of the flexibility they have

Here are the key themes ...

The key new areas of focus ..

For Lockdown:

Digital Health Tech. Accelerated shift to digital healthcare adoption and home testing

Online ordering / delivery systems, with an upswing in later and last mile technologies

Online learning ED-Tech solutions for not just children, but to re-skill adults, at scale

Expert Tech - for online creativity - speak with an expert

Tools/Platforms that empower people to start and monetise side-hustles/passion projects

Home Fitness/ lifestyle. With gyms being closed globally, think these type of coaches to keep us healthy will surge in popularity

Audio Entertainment
IOT & Data

VR / AR - too extract people from the fact that they have a lot of time on their hands. Also include Virtual Beings and tools / platforms that enable new forms of content production

For Lockdown & beyond ..

Med-Tech R&D - focused on solving disease
Fintech focused on financial wellbeing
Collaboration Software
Enterprise B2B solutions
Logistics - Supply Chain technology
Deep Tech will focus more on the unloved problems, providing solutions for Mental Health and loneliness
Caring in the community is a natural
Re-cyclables - planet love, carbon solutions, disease solutions, any ways to help

On the bigger pitcture ..

Centralised Systems / Systems analysis

There will be a lot of focus on centralised systems not scaling now. For instance, our kid's Firefly fell over globally today on day 1 of home-schooling !!
But also think of all the corporate systems which are failing under the demand right now: 5G, SaaS solutions etc,
The one's that which scale much better in a crisis will win
Plus infrastructure ideas like 5G, mesh networks, distributed cloud could rise again
Real AI needs to be prominent
Again technology that can scale globally into international markets will be essential too

Polarisarisation in Research R&D has to STOP argued a number

Things being done in Universities for the greater good of the world, should not have their growth stymied by local angels / funds trying to keep them stealth
These need to be opened up for wider investment earlier, especially if they have mass social, health & economic benefits for all
So the old Cambridge only invests in Cambridge, Oxford in Oxford nonsense needs to be consigned to the waste bin .. fast

VIEWS STILL CONTINUE TO FORM & I DIRECT YOU TO MANGROVE'S PIECE HERE TODAY

"Being honest, for me, it's a bit early to be calling long term shifts in behaviour. There will be a medium term spike for some of those (12-18 months), and others will lead to permanent shifts. Can tell the wood from the trees right now with that"

"Future of work / Productivity tools specifically designed for distributed teams that digitise some of the 'magic' of office life (more prescient than ever these days...Platforms like Bubble and Unqork that are creating low/no-code tools that enterprises can adopt to build their own custom tools [while limiting tech debt. Tools/platforms that facilitate high quality content production at scale".

"On the consumer side - Disruptive consumer brands targeting niche but highly engaged communities of customers.
Premium pricing (60% + product margins with long shelf-life (no perishable goods) and that lends itself to high repeat rates (which is why beauty, skincare, haircare & apparel. Category of product that people love to talk about [not a massive fan of kitchen/bathroom products]. Brand that is 'stretchy' (i.e the company can organically expand into adjacent categories). Selling into under-served target demographic with high disposable incomes who are more likely to stay brand loyal (silver economy; professional women/men"

"Supply chain / Supply chain flexibility. Might see a renewal in later and last mile – fulfilment and delivery solutions both B2B and B2C Open question – will the enforced drop in normal consumer behaviour accelerate the winds of change re: sustainability – e.g. circular economy models. Not a theme – but clearly for those scorched by B2C or certain sectoral challenges well capitalized funds are going to be in a much stronger position, whilst generalists under pressure may need to choose their favourite children...on the LP side we might see themes of "portfolio support" vehicles or maybe changes in how secondary funds engage (and price!)".

6/ GENERAL ADVICE TO ALL FOUNDERS - DOING A ROUND / OR ABOUT TO

GENERAL ADVICE TO FOUNDERS TO END ON AN OPTIMISTIC NOTE:

The bar is just a bit higher for new businesses + they need to be able to articulate how they leverage the consumer behaviour changes coming out of this period

If you believe in your product why not sit tight - be patient
Have a plan with sensible cash burn where the round you are raising gives you 18 months
There has never been a better time to prove you're actually selling something people NEED - nice to have's will just not get funded in the next 18 months
Its about timing - see this great advice from Mangrove on timing HERE
Get a strong lead investor and not to be exposed with cash.
To be prudent and clear on talent opportunities and how to capitalise on this un-predented situation we are in
Acknowledge that things are different and therefore to engage investors, needs to have a strong, compelling and eye catching message - the (new) world needs this because ....
Be positive and believe, share this energy and sense of community
None of us know how this will fully play out, and whilst resource constrained smaller companies are inherently more nimble.
Be flexible in thinking about the size and shape of rounds – which may have to change
Any market shakedown will test the balance sheets of the "weak" – so supporting yours at a reasonable price, and finding quality partners to support you (and be able to do so) will be key
More than ever make sure you have strong metrics & product market fit before talking to investors
Close all the capital you can as soon as possible & devise a war time budget and start implementing it
If you have customers, admit that your revenues are going to take a hit, but adjust your cost base to suit this (preferably already!)
If you are earlier and don't have customers, just accept the traction is going to take a lot longer than expected - add 3 to 6 months to these PC targets
There is lots of additional noise in the system at the moment, ignore it and stay focused on your business
For consumer models where acquisition costs have been a challenge we see the next 6-12 months as a real opportunity for founders who can work their way through the opportunities that present themselves

THE BEST QUOTES

"Strong founders and good biz models (ideally the two go hand in hand) will always attract capital"

"Make sure you are talking to firms that are open, now, to new investments. The fund structure of most VCs means you need to be sure they are in 'investing' mode. Firms that have a large proportion of

consumer driven portfolio companies will likely be focused internally and are less likely to look at new investments. If you are in a business that is negatively impacted by Coronovirus then you will find it very difficult to bring in new investors without substantial dilution. Turn to your existing investors, consider convertible debt or EIS eligible advanced subscription agreements if pricing is an issue. These set the valuation at a discount to your next raise and in the case of convertible debt provide higher security than ordinary shares. Make use of the many government initiatives to preserve your current cash reserves"

"In terms of tips for founders - add another 20% on your timing. Have a slide or at least mention that you have taken the public health crisis into consideration and how you are responding/what changes made to assumptions.
Go beyond crunchbase to find your investors- there is plenty of capital out there- look beyond the big names. Ask other founders and your peer what's app channels (which are on fire with activity currently!!) Strangely you may have more access to investors now then before via virtual office hours. Less travel = more time. So make the most of it and get in front of them 12-24 months before the round you need so you can update them with progress emails when we get back to new normal".

"Yes, there are always opportunities for smart founders with compelling vision and customer passion. If there is a compelling business opportunity and a gap in the market then Founders need to keep believing and follow their conviction. We will come out of this, so businesses need to demonstrate that they are going to contribute value to the customer and convince investors that there cash will work hard for the mission. Investors are undoubtedly going to be cautious".

"All the normal Q's but more acute ones: Reason to be live, be the winner in space , relevance to now, why/how they can survive 12-18m on funding. Those with real commercial traction now and demonstrably lower valuations will float to top with angels"

"I know it sounds simple but don't give up. There will be opportunities borne out of this current crisis. Still be confident and strong about your

business & that you will come out the other side stronger"

"Clear messaging at all times as there will be less face-to-face meetings. Run through your pitch with a friend on-line – can they understand your USP? Good data rooms with lots of info. Factor in more calls/on-line meetings to get to a term sheet. Be persistent with VCs – lots of events have been cancelled so VCs have time on their hands to take calls and conduct DD"

"Speak to founders who raised in 09! The rules are just different now and most importantly, re-calibrate expectations - time, valuation, how much capital you can raise etc.. I'd preempt going out for a round by convincing existing to give you a runway extension. Having cash in the bank will be your best shield, and could prove less dilutive after the round is done!"

"Delay if possible, cut costs and extend runway. Focus on fundamentals and business proof points to make the pitch ever more compelling. The world is going to change in a significant way, might be worthwhile to have a view on how your startup plays into this new world"

"Have a worst case scenario and plan to profitability scenario, many VCs will expect that. Make sure VCs you are speaking to have capital in the bank and don't have to go out and cash call their institutional investors – this might result in last minute pulled term sheet / reduced amount being funded. As cliché as it may sound but hope for the best and prepare for the worst"

"As for advice to founders – the finance industry hates uncertainty. If funding rounds can wait until we come out of lockdown and understand the economic impact and governmental response to the current then they will have a greater chance of success I think"

"Be prepared to bend over!"

!! THANKS TO THE MANY VC'S & ANGELS THAT CONTINUE TO WRITE IN WITH OPINIONS TO SHARE - I HAD TO STOP HERE TODAY.

PLEASE SHARE THIS TO YOUR COLLEAGUES AND FOUNDERS - BACK SOON WITH MORE !!

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