

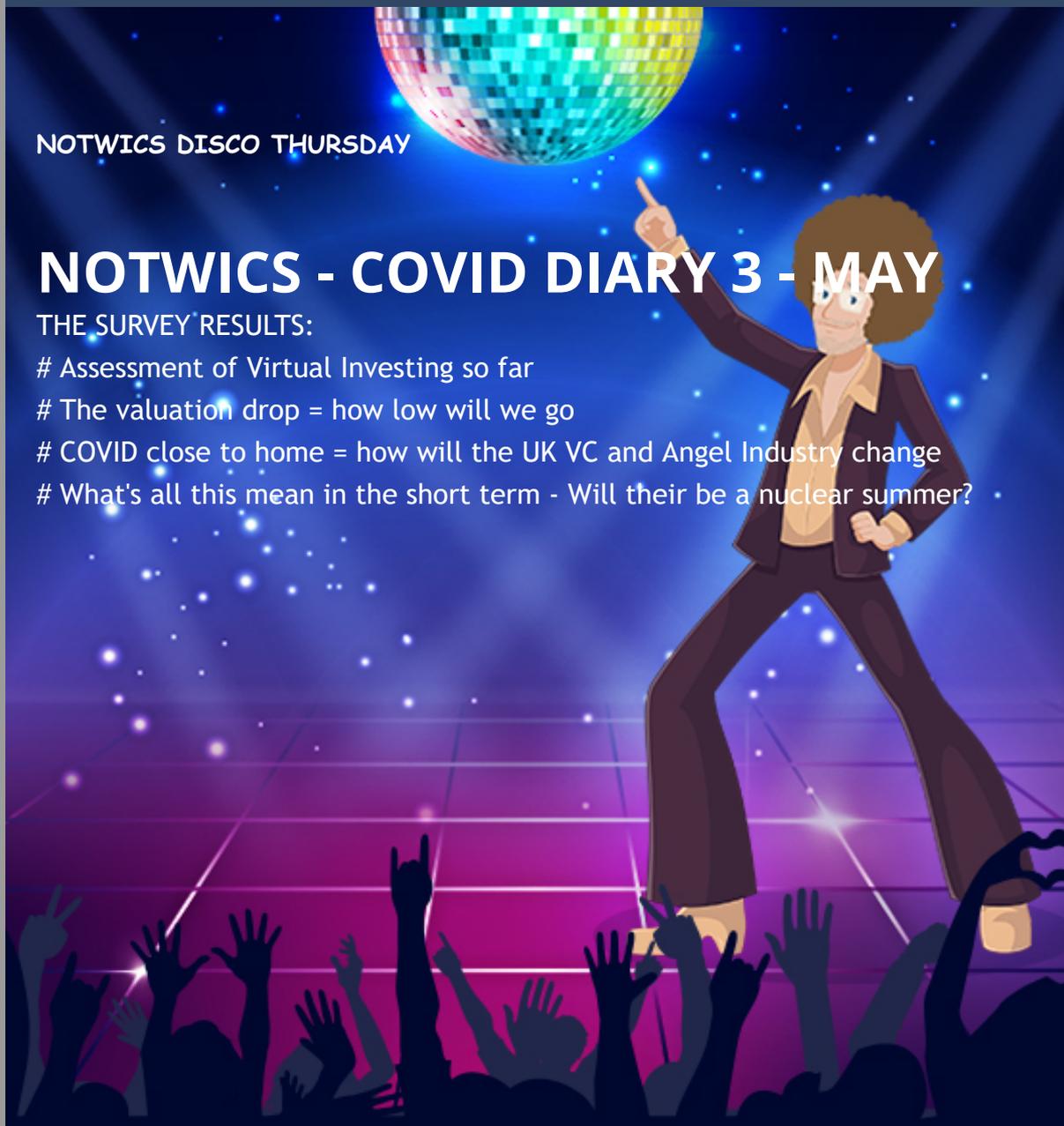


NOTWICS DISCO THURSDAY

NOTWICS - COVID DIARY 3 - MAY

THE SURVEY RESULTS:

- # Assessment of Virtual Investing so far
- # The valuation drop = how low will we go
- # COVID close to home = how will the UK VC and Angel Industry change
- # What's all this mean in the short term - Will there be a nuclear summer?



GOOD AFTERNOON,

Here's our current thoughts on the COVID impact on the world of Private Tech:

COVID IMPACT - MONTH 3: RESULTS OF OUR INVESTOR SURVEY OF INVESTMENT PROCESSES AND CLIMATE

THEME 1: PROCESS: "VIRTUAL" - THE NEW NORMAL / WILL THIS ACCELERATE OF DECELERATE AS WE COME OUT OF THE PANDEMIC



IN THIS NOTE, WE TAKE A LOOK AT THE OPINIONS AND DATA PROVIDED BY A SAMPLE OF LEADING VC'S & ANGELS IN THE NOTWICS COMMUNITY

THERE HAS BEEN MUCH MADE OF THE NEW WAY OF WORKING... FROM HOME, VIRTUALLY, WHICH LETS FACE IT, IS HERE TO STAY, ESPECIALLY WITH BIG ORGANISATIONS LIKE TWITTER ANNOUNCING TODAY ...THAT EMPLOYEES CAN NOW WORK FROM HOME PERMANENTLY

MANY INVESTORS HAVE ACCEPTED THIS AS THE NORM, EVEN WITH THE START OF THE GREAT COMMUTE INTO LONDON YESTERDAY

BUT HOW MANY INVESTORS ARE ACTUALLY USING SCREENS TO FULLY COMPLETE DUE DILIGENCE & INVEST ?

THE DATA SAYS:

50% of respondents were of the opinion: We'll get ready to do deals online but try to meet up face to face before we complete

22% of respondents: We're uneasy & it's likely to take us much longer to complete deals because of virtual

15% of respondents: This won't change the speed we do deals, which we are still doing, but it does feel a bit odd

13% of respondents: More the geographically sparse VC's that were networked over different financial centres- felt its the norm

ANECDOTAL CONCLUSIONS

The majority of investors we surveyed, which included many of the leading VC's in London, have the general opinion that virtual communication is great, as a means of communicating, but the acceptance of this technology and use to conduct investment deals will remain slow

There are much fewer deals being completed overall and the opportunity still does exist for a VC to proclaim in the Tech paparazzi, that they have conducted the whole end to end investment process, via Virtual

THIS JUST HAS NOT MATERIALISED AT SCALE YET

WHY ?

The large part of the community still want to meet the founder, face to face, to be even more convinced about that individual, before they invest their fund's or their own money into that individual and/or business

Investors accept that they may have to social distance here, but certain investors are really holding out for this, when they look at new opportunities

Several funds commented they knew most of the founders relatively well before lockdown, so didn't consider face to face meetings as such a huge loss in the investment process

But others accepted, brand new introductions to founders, lower in volume currently, would need to evolve into face to face meetings over the next few months, if investment was to take place

Others also said it was essential to meet the other members of the team, especially other founders, face to face, before becoming comfortable about parting with their cash

SO ITS A NICE TO HAVE

It was also perceived to be great for "herding the cattle" or keeping in close contact with the Portfolio that most claim is a major part of their everyday life, currently
BUT THAT WAS ALL

SO THE PREDICTED IMPACT OF VIRTUAL SPEEDING UP THE INVESTMENT PROCESS ISN'T HAPPENING ...YET

This change in the mindset just hasn't happened yet

As time goes on - more funds accepted it could become more relevant

ONE FUND IN PARTICULAR...

Mentioned that if there was a second wave of the pandemic, in the UK, which could create a longer and more pronounced lockdown

This would be a massive catalyst for Funds to move from this is a nice tool. "gimmicky piece of Tech to communicate" ==> to the main and only way they invest

SO, NET/NET

IT'S FAIR TO SAY VIRTUAL (ZOOM / TEAMS / SKYPE/WHATEVER) IS A GOOD COMMUNICATION TOOL THAT HAS BEEN MASSIVELY ADOPTED BY THE WFH INDUSTRY

WFH IS STILL A BIT WEIRD FOR SOME INVESTORS - BUT THE INVESTMENT FROM HOME PROCESS WILL GRADUALLY BECOME MORE ACCEPTED IN THE MEDIUM TERM (2021) & LONG TERM (2022), HOWEVER IT HAS NOT HAPPENED AS QUICKLY, AS SOME FIRST PREDICTED, A COUPLE OF MONTHS AGO

HERE ARE SOME OF THE REALLY INTERESTING OPINIONS WE RECEIVED

"Again, this is still early days - we are still assessing what this new process will look like given that it is not clear what the new world looks like. However, practically, it would be more difficult to meet management, visit the business' premises, or even conduct DD without "on the ground" involvement"

"This won't change our deal doing but it feels strange BUT WE'RE ACTIVELY MAKING DEALS AND FORMING SYNDICATES VIRTUALLY. WE'VE ADAPTED WELL"

"This won't change our deal doing but it feels strange (Will increase due diligence around KYC and references)"

"Nothing against doing the full transaction phase remotely. But investing is a long term relationship, the harder part to do virtually is to ensure we can work well with the founders and vice versa. So i suspect we will wait to meet up in person before signing on the dotted line"

"We continue to have new dialogues but our "remote" process hasn't

have meaningful relationship-building, dialogue and DD with video calls and the like".

"We'll get ready to do deals online but try to meet up face to face before we complete. NB: many of the founders we are speaking with have already met at least one member of our team in person at some point over the years; we are unlikely to rush deals with founders we have never met"

THEME 2 - THE VALUATION DROP.. AN INVESTOR OR BUYERS MARKET



SO, THE WORLD & HIS WIFE ARE WELL AWARE OF THE DROP OFF IN VALUATIONS

HOWEVER, NOTWICS WERE INTERESTED TO UNDERSTAND THE REALITIES OF THIS - RATHER THAN THE MANY "CHATTY MAN" OPINIONS FLOATING AROUND THE SOCIAL MEDIA, PREDICTIONS OF WHERE VALUATIONS ARE. OR ARE HEADING TOO

SO WE POSED THE QUESTIONWHAT WERE FUNDS AND ANGELS ACTUALLY SEEING IN THEIR CONVERSATIONS WITH FOUNDERS IN RECENT FUND RAISES ?

THE DATA SAYS:

- # 81% of respondents highlighted that -30% was the right valuation reduction currently. It was strangely a near unanimous number, as a norm for most Early to Series A investors
- # 17% of respondents felt -40% valuation drop to pre-COVID times was acceptable
- # 2% of respondents believed 50% was the right number

ANECDOTAL CONCLUSIONS

OVERALL

There was a measured commentary here amongst respondents, but clearly all were of the opinion of how low will we go over the summer

It was accepted widely that Valuations could drop further if the pain in the wider economy drags more on the confidence and value of the digital economy in the UK

HOWEVER..

There will always be a top 5% of founders - even in these tough times for founders. that have the right business, for the new world that will not see these valuation pressures and will raise at the price they want

THE EXCEPTIONAL EXCEPTIONS TO THE RULE !!

THE DEFENSIBLE VALUATIONS

It was also clear that the businesses that could immediately scale into highly demanded /

fully functioning, generally SAAS, B2B & verticals which were relevant to the new world of WORKING/CONSUMING/EATING/MOVING/LIVING/STAYING ALIVE/BEING SECURE/MOBILE/IN TOUCH/HEALTHY/WELL/FINANCED/SMART) were seeing valuations stand up

THE VALUATION ZORRO - OR SLASHER !!

There was an emerging theme of caution towards the somewhat unproven AI / ML / Deep Tech / Data Science / on the edge solutions - with excellent Tech credentials but limited or early customer traction

These names had been receiving stellar valuations pre-COVID - so had a long way to fall, in the opinion of some cynics

Some have seen their somewhat loftier valuations sliced down to size more dramatically

Additionally businesses that had pivoted into COVID to attempt to get traction were seeing extreme valuation hits - as they had triple whammy of unproven tech, in unproven times, with low or very early monetisation

ON TIMING

Some investors - still think far too early to draw a line under the right valuation correction and we'll see a true pattern emerge as deals that were started in COVID times get completed by June end

Consensus suggested it could take anywhere from 3-5 years for valuations to potentially recover to near the multiples we saw at pre-COVID times

IN CONVERSATION WITH SOME INVESTORS ON THE LATER STAGES

IT WAS PREDICTED THAT...

Later stage was likely to see dramatic valuation haircuts as down rounds become plentiful and we could witness the end of the Unicorn era

Several Private Equity buyers were rumoured to be waiting in the wings for potentially distressed, especially US unicorns

SO, NET / NET

IT IS CERTAINLY A BUYERS MARKET IN REGARDS OF VALUATION AND INVESTORS HOLD ALL THE CARDS

SOME WILL REMAIN ON THE SIDELINES, BUT THEN RETURN WHEN THEY KNOW THEY CAN GET EVEN BETTER DEALS

OTHERS WILL RETURN WHEN THEIR FUNDS NECESSITATE THEY HAVE TO BE BACK IN THE MARKET, AS VC'S DIE IF THEY DON'T DO DEALS

THESE VALUATION OPPORTUNITIES MAY TEMPT MANY & LEST BEHOLD - MEMORY HAS TAUGHT US THAT SOME OF THE VERY BEST TECH BUSINESSES HAVE BEEN BUILT IN ECONOMIC DOWNTURNS.. TO THE CASCENT POINT THAT THOSE WHO GAMBLE WITH THE DEVIL - SOMETIMES PROFIT THE MOST !!!

HERE ARE SOME OF THE REALLY INTERESTING OPINIONS WE RECEIVED, HIGHLIGHTING THAT ITS NOT ALWAYS SO BLACK AND WHITE IN CONVERSATIONS OVER VALUATION

"I'm not sure asking for a single figure of the valuation decline is of any value here Chris!. We have only seen one renegotiation on pre-money valuation on a deal which was between term sheet and completion and this settled out at -10%.

The "fair" discount is likely to vary quite widely depending on the perceived quality and robustness of businesses (i.e. their ability to withstand the significant uncertainty about operational environments and constraints over the next 12-24 months).

Some very specific deals will move to a premium rather than a discount;

such a very substantial discount as 50%, even 40%, perhaps even 30%, it's more likely imo that the deal is actually no longer doable at all, or at least no longer doable by the same investors.

The nature of the investment, the valuation, the risk, the amount that can sensibly be raised in a way that works for all parties, etc, etc, will change the profile of the appropriate investor community for the investment".

"Valuations will likely take a hit but I feel very strongly that market conditions is only part of what makes a valuation at an early stage"

"30%-50% depending on stage - but with a protracted downturn in the macro - we could be looking at 40%-60% in the second half of 2020. Scarily bad situation for founders - so stretch that cash"

THEME 3: HOW WILL COVID IMPACT THE HORNET'S NEST - THE PRIVATE INVESTMENT COMMUNITY ITSELF ?



INVESTORS OPINIONS OF THE FUTURE IS SOMETHING THAT HAS ALWAYS REALLY INTERESTED NOTWICS

WE WERE PARTICULARLY INTERESTED IN FINDING OUT WHAT THEY FELT ABOUT THE IMPACT OF COVID ON THEIR OWN INDUSTRY (ANGEL & VC)

& NOTE: THERE WERE SOME PRETTY DRAMATIC AND DRASTIC OPINIONS OFFERED HERE ...SO BRACE YOURSELVES !!!

ANECDOTAL CONCLUSIONS THE INDUSTRY WILL SHRINK, BUT EMERGE STRONGER

It was predicted, like any market crisis - this will claim its victims, not only amongst the founders but also amongst the funds

So an overall downsizing of the investment industry as whole was predicted to emerge from our conversations

Naturally, there was some commentary around LP's, with a clear feeling that "You are only as good as your last fund"

One highlighted, that poor fund performance, accelerated by COVID, combined with a lower, overall LP confidence in the riskier private market assets, could be the perfect storm curtailing finance for some established VC names !!!

On a more optimistic note,

The vast majority of investors we quizzed believed that the investment industry will emerge stronger, with greater experience across the board, with one stressing it would be good to get rid of a few of the wannabees !!!

SPENDING INVESTING MAY INCREASE

As mentioned before in this piece, one potential outcome from the adoption of online / virtual investing (screens & remote working) could speed up investment process around private Technology companies instead of the cumbersome current process
 # As one leading, punchy female VC friend commented that fewer tourists in the industry would speed things up too !!!

AREAS OF INVESTMENT

Some funds may increase their exposure to the earlier stage and do what's known as bottom fishing
 # They may prefer to spread their risk going forward with investments across more smaller, earlier stage investments, as Early Stage start-ups are more nimble and can work their cash better
 # Perhaps some of this re-focusing down the pipe "to go earlier" maybe prompted by some of the predicted later stage horror stories - yet to play out of the larger and medium sized businesses that run on large working capital needs, who many predict will not survive the crisis

STRONG WILL GET STRONGER

For those Funds and Founders that manage to trade through the crisis, its deemed they will potentially be in a stronger position when it comes to fund raising
 # They will have proven resilience and adaptability in the face of extreme challenges

ON TIMING

The money is still there with most of the funds (dry powder) and will start flowing again more freely in 6 months time again
 # The star will also potentially rise of the debt funds, in this crisis, with more potentially joining rounds with equity investors over the next 3-6 months

WHO WILL BE THE CASUALTIES OF WAR

It was widely viewed that the Corporate Venture Funds could struggle as their parents retract back towards their core businesses more
 # The Angel industry, especially in the UK was feared to see a big decline in activity, which could lead to a massive drop off in potential founders for Seed / Later stage funds to back in the future (6/12/18 months time)!!

SOME OF THE MOST INSIGHTFUL COMMENTS ARE HERE:

"The strong will likely emerge stronger and the weak will likely be critically impaired. True for early stage companies, true for early stage investors. But the angel sector and the VC industry themselves are not going to go away looking on a medium term horizon. The way they operate practically may change fundamentally. The hot sectors for the next period will shift. The VC centres of excellence may dissipate (e.g. the Bay Area physically may become "the Bay Area" metaphorically but in a much less physically concentrated sense). But, absent the collapse of capitalism more widely, and looking on a five year timeframe rather than an 20 year timeframe, it doesn't seem likely to me that there will be some sort of a complete paradigm shift in the fundamentals that underpin investment approaches to the high risk tech sector"

"If pre 2008 is anything to go by, it may be some time for the angel

"Likely positive if world doesn't implode > a bigger version of the flight to risk (read return) that happened post GFC. Unless we get hyper inflation in which case inverse. Deflation would be positive driver probably"

"Angels will retract in short/medium term. Good investors will deploy more capital understanding that higher returns available. Decent companies will thrive and emerge stronger. Exits will be pushed out"

"Long term, I don't think it's likely to shrink. I think within 18 months COVID 19 will be seen as a short term shock with longer term impacts but a shock that affected pretty much all asset classes. If anything, I think all COVID will encourage is portfolio diversity, so those who historically have relied on property and public markets might decide to diversify their portfolios more, and early stage SEIS/EIS investing may benefit from that".

"My feel is a more cautious approach, with a flight to opportunities that support global health service supply chains, personal health safety solutions and tech solutions that make working remotely more effective. I feel less funds will be available in medium term - their existing invested businesses will still be short on cash, and in an upturn are likely to absorb more equity as look to fund cash flow for new orders"

"As with post-08/09 I think there will be some very good opportunities that emerge now which result in some strong returns for the VC industry. There was already a bit of a reckoning beginning in 2019 with WeWork, etc. around 'startups' that burn inordinate amounts of money with no clear path towards profitability. Investors are continuing to view deals more critically, and I think there will be some 'survival of the fittest' within the investment landscape. There may be a decrease in volume but the quality should improve, ultimately making the industry stronger"

"Still early to say. Think some who are less committed may pull back, could be angels, FOs & corporates in particular. The ones who see this as proven asset class will continue to keep investing. For the VC industry, lots of dry powder as people have assumed we are at close to the end of the cycle for a while. There is a chance the industry in theory is well placed with good amounts of capital to deploy over the recession. Hopefully UK/ Europe continues to perform and good companies keep emerging over the next 2 years, which will leave the industry in a better place. It will prove the final key test for Europe tech industry, which has yet to survive and thrive over a recession. Fingers crossed, this is the moment the industry will "graduate"

"I think it will be healthy cleaning as lot of mediocre funds that raised funds and mediocre start-ups that should have been funded in first place. We will see healthier start-ups / better models that will survive and do well. So overall - industry will emerge stronger as best players will get even better"

"Some funds will not be able to raise new funds, some angels will be less weary to invest. From the VC point-of-view, less dry powder will be worse for entrepreneurs but hopefully it means the bar will be higher and the good companies will still be properly funded. From the angel point-of-view this will be very bad as they are VERY important to the tech community and we already need to improve on this front in the UK/Europe. My biggest worry going forward is if the angel industry shrinks dramatically"

THEME 4: SO THE HERE AND NOW - WHAT'S THE CURRENT STANDING



WRAPPING UP ALL THESE VIEWS & PERSPECTIVES IT'S VERY CLEAR THAT INVESTORS CURRENTLY ARE STILL SUPPORTIVE, BUT THINGS HAVE DRAMATICALLY SLOWED DOWN IN THE LAST MONTH IN THE UK VC AND ANGEL SCENE

THERE APPEARS TO BE TWO CAMPS EMERGING:
====> A SMALL HARDCORE THAT ARE ACTIVE AND LOOKING AT CONTINUING THERE INVESTMENT

===> THEN THERE IS THE OTHER CAMP - WHO ARE MAINLY PORTFOLIO MANAGING AT THE MOMENT. THEY ARE KEEN TO ENTERTAIN CONVERSATIONS / ENGAGE / BUILD VIRTUAL RELATIONSHIPS AND THEN LOOK TO ACCELERATE THEIR POTENTIAL INVESTMENT OPPORTUNITIES FROM SEPTEMBER INTO Q4.... SO HAVE A WATCHING BRIEF AT THE MOMENT

WHEN VISIBILITY AND ASSURANCE ON THE WIDER WORLD BECOME EVIDENT, AN OPTIMISM THAT WE ARE OVER THE WORSE SOCIAL AND ECONOMIC COVID CHALLENGES, THIS COULD BRING BACK THE MAJORITY OF FUNDS AND ANGELS ON THE SIDELINES

THE GREAT HOPE IS THAT THIS WILL BE AT THE END OF THE SUMMER, FOR A TRUE SANTA CLAUS RALLY !!

BUT WHAT'S ALL THIS MEAN PRACTICALLY NOW ?

- # There are a number key funds still out there looking and few still completing deals.
- # The hardcore of active angels is starting to shrink as COVID has killed some of their income and capital gains, so there is no upside to doing any EIS investing
- # Investors will be offering lots of conversations, but realistically, these will be elongated and at the speed dictated by the investor
- # In general Founders don't expect any rounds to close in a hurry - have a number and add 2-3 months onto this

NET / NET

THE MAJORITY OF FUNDS ARE GOING TO CHINESE BUDDA THE REST OF THE YEAR & THEY ARE IN NO HURRY

THEY ARE AS HANK SAYS - "THE KINGS OF THE HILL" NOW - RATHER THAN THE FOUNDERS IN THE PAST, WHO HAVE RULED THE ROOST FOR THE LAST 7 YEARS... SINCE AILEEN LEE, AT COWBOY VC DECREED THE BREED OF SUPER FOUNDERS CALLED UNICORNS

ONE VC RADICALLY COMMENTED "2020 HAS BEEN A DISASTER AND WRITE OFF - SO LETS KITCHEN SINK IT / TURN OFF THE TAP - & THIS WILL MAKE US LOOK GREAT IN THE YEARS AHEAD" - WHICH I THOUGHT WAS A BIT BRUTAL

TO CONCLUDE...

ITS GOING TO BE A LONG HARD SUMMER, NOT NUCLEAR WE HOPE - BUT HOPEFULLY SEPTEMBER WILL OFFER GLIMMERS OF HOPE _ WITH POTENTIALLY THE FLOODGATES OPENING AGAIN IN Q4

WE'LL BE CONDUCTING A FURTHER SURVEY ON SENTIMENT IN JUNE TO WORK OUT WHETHER THIS IS OPTIMISM OR REALISM, AS THE SITUATION REMAINS FLUID !

NEWCASTLE START-UP WEEK ONLINE

WHEN:

NEXT WEEK: 18-22 MAY 2022

WHERE:

ONLINE - LINK IS BELOW

WHAT:

We've been a big fan and supporter of this event over the years - which has now moved online.

===> Captain Paul Lancaster - is the local hero in the NORTH EAST that has done a stellar job in pulling together this excellent line up for next week.

===> The investor day is Wednesday - "Funding and Finance"

===> For more on 'Newcastle Start-up Week ONLINE' which will be delivered through our private Facebook Group between 18-22 May

FIND OUT MORE AND RSVP

CHRIS' THOUGHT OF THE MONTH

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INSTAGRAMUSEMENTS

COVID CONFUSION - [WHAT WHERE WHEN WHO?](#)

!! STAY WELL AND STAY ALERT !!

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