Alumni Ventures

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Playing Hard in the Early Innings

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Executive Summary

Alumni Ventures has been giving accredited investors access to venture capital in a smart, simple* way since 2014. We believe that venture has a place in the portfolios of many accredited investors. In this article, we'll explain one key reason for that conviction by reviewing how value creation and investor gains are increasingly found in venture markets vs. public markets.

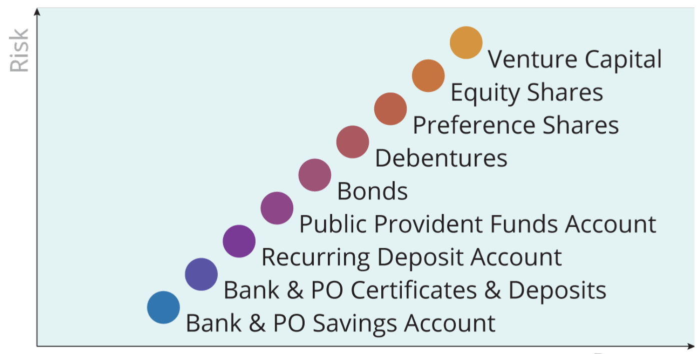
The High-Risk/High-Reward World of Venture Investing

Venture capital is the practice of investing in innovative, fast-growing private companies that are believed to have long-term equity appreciation potential. That opportunity for high returns is counterbalanced by two key risks, among others: long-term commitment of cash and potentially high failure rates of early-stage companies.[1] This is why venture is frequently called a high-risk, high-reward asset class.

Investing in venture capital typically means locking up cash in a fund for approximately 10 years. Over that decade, some companies in your portfolio may grow, while most will tend to muddle along or fail. Mark Suster of Upfront Ventures has described performance expectations for his venture fund investments as "1/3, 1/3, 1/3": one third will fail, one third will return the initial investment, and the remaining third will produce the majority of the fund's return.[2] We see a likely successful batting average as quite a bit lower, but the general idea holds true: Not every idea will be a loser (hopefully), it is a truism that not every idea will be a winner, and where a winner does take hold, it can offer the opportunity for greater investment returns than most mature companies will likely provide.

1 https://www.cfainstitute.org/research/cfa-digest/2015/11/the-venture-capitalpremium-a-new-approach-digest-summary
2 http://www.industryventures.com/the-venture-capital-risk-and-return-matrix/

Risk vs. Return of Investments



Source: *http://www.invest12j.co.za/article-vcc-investment-risks.php*

Typical Venture Performance Expectations

Strike-outs	Walks	Home Runs
33%	33%	33%

Source: *http://www.industryventures.com/the-venture-capital-risk-and-return-matrix/*

*AV offers smart, simple venture investing to accredited investors. Specifically, AV provides a path for individuals to own an actively managed diversified venture portfolio with a single investment co-investing alongside experienced VC firms. Traditionally, with limited investment capital and contacts, individual investors have had limited access to desirable deals alongside experienced VC firms, and even if they could access one or more such deals, it would take an inordinate amount of time, money and negotiation to build a diversified portfolio. With AV Funds, investors can choose from a number of funds to make a single investment to gain exposure to a diversified portfolio of investments selected by an experienced manager. AV Funds' simple fee mechanism permits investors to avoid constant capital calls throughout the life of the fund as found in other private investment vehicles.

It's important to note that in the ~10 years that venture companies grow, value is created over time before an exit is feasible — not solely in a liquidity event such as a merger/acquisition, exit, or initial public offering (IPO). Many of the most game-changing companies of the last 25 years are venture-backed: Amazon, Uber, Google, Facebook, Twitter, Spotify, etc. These businesses — disruptive category killers — took years to grow from small offices in their founders' garages to some of the world's most highly valued companies. Despite their growth, holders could not necessarily access the wealth.

For a case study, let's take a look at Uber's valuation over time. In 2010, the company priced its seed offering at $0.36 per share. In 2011, it offered Series A shares at $3.70 — a ~10x increase in value in just one year. In each subsequent round, the value of Uber increased, culminating in its 2019 IPO where shares were priced at $45.00 — an increase of ~125x from its seed round share price. That is an outstanding increase, but even then, holders often had to wait for years before they could see and hold cash.

And remember, we don't even need to name the many companies that some thought had similar products that have ended up written off or with reduced valuations. Some even rise in value significantly before falling hard.

So it's true that not all "paper gains" — gains that have yet to be realized through a liquidity event — end up as cash in hand. However, what we tend to see before any type of exit is that as a startup's operational growth accelerates, the company's value increases.

A key fact to note is that more companies are staying private longer — or not going public at all. Between 1993 and 2000, the average number of yearly IPOs was 451. From 2000 to 2016, it dropped significantly to only 108.[3] As more companies are remaining private longer, the best time to get into high-growth deals is not typically occurring at the IPO stage. In our view, high-growth opportunities are happening at Angel, Seed, and Series A rounds.

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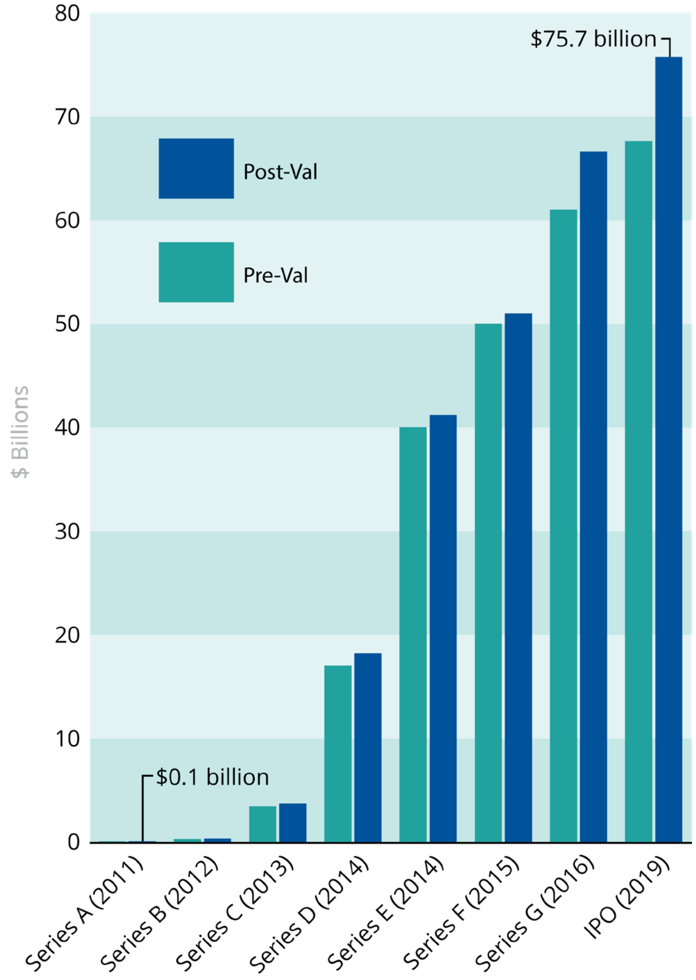
Uber's Valuation Progression: Pre- and Post-Round Valuations



3 https://openviewpartners.com/blog/why-are-we-seeing-fewer-venture-capital-backed-ipos/#.XXLDIZNKi-t

Hitting Home Runs by swinging early in the count

Taking theory into practice, let's take a look at a hypothetical investment in Amazon. If you had invested $50,000 in the seed round of Amazon back in 1996-97, that stake would be worth $3.5 billion today — or a return of 70,000x.[4] While the size of that win is atypical, it supports the argument that, over time, venture can produce outsized returns.[5, 6, 7] That is certainly a home run. Keep in mind, of course, that if you had invested in any number of other early stage opportunities, you might have little or nothing to show for it; some investments would be strikeouts. But our view is that, like an aggressive baseball player, you might make solid contact more often if you swing earlier in the count.

The bottom line is that if you wait for an IPO to invest in a great new venture, your greatest chances to clean up are probably past.

Below is a table of returns that Angel, Seed, and Series A round investors made from recent, notable IPOs:

RETURNS PERFORMANCE OF SELECTED STARTUPS FROM EARLY VC ROUNDS TO IPO

Company	Original Investment Amount	Round	IPO Date	Company Valuation at IPO	Exit Value[8]	Return at IPO
Uber	$300,000	Angel	May 2019	$75.1B	$36.6B	122,000x
Slack	$200,000	Series A	April 2019	$23.3B	$2.7M	13.5x
Lyft	$300,000	Seed	March 2019	$24.0B	$31.8M	105.9x
Pinterest	$100,000	Seed 1	April 2019	$10.0B	$1.6M	16.0x
Zoom	$150,000	Series A	April 2019	$9.2B	$9.0M	60.0x

Compare this to performance post-IPO — after the company is available on public markets. As you can see below, returns can be a mixed bag. The bottom line is that if you wait for an IPO to invest in a great new venture, your greatest chances to clean up are likely past.

POST-IPO RETURNS PERFORMANCE OF SELECTED STARTUPS

Company	IPO Price/Share	Time Elapsed Since IPO	Today's Price[9]	% Change from IPO	S&P 500 Return Comparison[10]
Uber	$45.00	14 months	$31.08	-30.93%	8.84%
Slack	$38.50	15 months	$31.09	-19.25%	6.78%
Lyft	$72.00	16 months	$33.01	-54.15%	9.99%
Pinterest	$16.00	15 months	$22.17	38.56%	6.78%
Zoom	$36.00	15 months	$253.54	604.28%	6.78%

4 https://www.businessinsider.com/jeff-bezos-on-early-amazon-investors-2016-10
5 PitchBook: Data accessed on 27 August 2019.
6 https://observer.com/2019/05/uber-ipo-nyse-7-investor-winners/
7 https://www.theinformation.com/articles/pinterests-ipo-winners
8 Based on IPO price
9 Yahoo Finance, as of June 30, 2020.
10 Total return from month of IPO through Q2'2020; Buyupside.com: S&P 500 Returns. Accessed 06 September 2019. https://www.buyupside.com/shillerdatainfo/stockreturncalcinputsp.php

Case Studies From Certain of AV Funds' Portfolios

In AV's own funds' portfolios, Logz.io and Particle, provide two interesting examples of value creation.*

LOGZ.IO

Logz.io, an investment AV made in its first fund in 2014, is a an open-source log analytics platform designed to help companies of all sizes derive more value from machine data.

- AV bought in at $0.02 per share in Logz's seed round.
- In 2017, AV exited part of the investment at $0.14 per share as a way to hedge and lock in some gains, but also kept part of its investment in the company.
- Logz recently had an up-round, increasing the share price to $0.48, or 24x on the fund's initial purchase price in paper gains.

That example shows that AV was able to capture value in two ways, taking some gains while leaving some "money on the table." Though Logz has yet to have an official exit, AV is excited about the prospects for this company.

PARTICLE

Particle is an Internet of Things (IoT) platform created to help businesses connect and manage their devices. AV's Green D Funds 2 and 3 invested in the company.

- Green D Fund 2 initially invested in the company at $1.50 per share.
- Based on the company's accelerating growth, Green D Fund 3 invested at $2.51 per share at the next round opportunity.
- The company has now had a third raise, with shares valued at $4.67.

While this is still a paper win (i.e., unrealized) for Green D Funds 2 and 3, the early investment is showing a gain of 3.1x, and the later investment is valued currently at 1.9x.

* For illustration purpose only. These deals are not intended to suggest any level of investment returns; not necessarily indicative of deals invested by any one fund or investor. Many returns in investments result in the loss of capital invested. These deals are not available to future fund investors except potentially in certain follow-on investment options.

Why You Should Consider Venture

Adding VC to your investment portfolio gives you the opportunity to get into high-growth companies at an early stage, possibly build world-changing businesses, and potentially realize a significant payout a decade later.

Furthermore, there are more investment opportunities in the private market as companies stay private longer. In addition, post-IPO returns can sometimes be much more anemic or even a loss for someone who buys the public stock. Simply put, significant value is being created in private markets that you lose out on if you wait to play the public market.

As a final thought, compare the two pieces of data in the figure to the right and decide which way the wind seems to be blowing.

If you'd like to learn more about how AV creates smart, simple venture portfolios for accredited investors, please reach out to Community.Relations@av.vc.

IPOs

70%

approximate all-time share of U.S. IPOs with negative earnings

Venture Capital

330%

increase in global VC exit proceeds since 2010

SOURCE: https://www.toptal.com/finance/venture-capital-consultants/state-of-venture-capital-industry-2019, data from PitchBook.

About the Author

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Sasha is a member of the Office of Investing, focusing on sourcing, analysis, and research. Previously, she was a Management Consultant at Stax, Inc., a boutique consulting firm specializing in private investment diligence and growth strategy engagements. Before Stax, Sasha worked at a private-equity-backed startup in the seafood industry, and prior to that, within the Strategic Planning and Marketing group at Brown Brothers Harriman. She volunteers her time as Judge and Mentor for MassChallenge and also as an Alumni Ambassador for Cornell's Johnson School. Sasha has an MA (Honours) from the University of St. Andrews and an MBA from Cornell University's Johnson College of Business.