A WORD FROM J.P. MORGAN

Our views on venture

There is increasing optimism around the state of markets, though the higher-for-longer rate environment, geopolitical tensions, and US election cycle remain risks to the outlook.

Most macroeconomic indicators point to a soft landing, as consumers, businesses, and markets have handled inflation, elevated labor costs, and higher-for-longer interest rates much better than expected. As labor markets remain solid and inflation progress has slowed, the Federal Open Market Committee (FOMC) now expects only one 25-basis-point rate cut in 2024 and GDP growth of 2.1%.[1]

History tells us there is little correlation between election years and the timing or direction of Federal Reserve (Fed) action. As the economy and inflation continue to normalize post-pandemic, the FOMC remains focused on the data to inform how it manages monetary policy in the context of its dual mandate of stable prices and full employment.

Risks associated with prolonged higher interest rates, geopolitical tensions, and election outcomes are difficult to predict, but it is unlikely that these are fully reflected in projections and market levels. It would not be surprising if markets get skittish in the lead-up to the November election. In the meantime, optimism has been in the air on the prospect of lower interest rates.

With rising equity markets and low volatility, the capital markets engine is restarting.

Keith Canton, Head of Americas Equity Capital Markets at J.P. Morgan, remains cautiously upbeat about where the IPO market is headed. IPO proceeds raised year to date are running comfortably ahead of last year's pace. Based on public filings and pipeline visibility, 2024 appears to be tracking to a $30 billion-plus year, including an expectation that activity will taper off into the election and year end. To put into context, this is notably higher than 2023's $19 billion of IPO volumes, but still below the $40 billion to $45 billion baseline trend pre-COVID-19.

Larger-than-normal valuation discounts for the 2024 IPO cohort have helped set the stage for mostly positive aftermarket performance. Historically, an IPO discount of approximately 15% to an issuer's public comparable set was typical. Year to date, these discounts have been in the 20% to 30% range.

Canton notes that even though scalability, durability, and profitability all remain important attributes, at the end of the day, the IPO market is a growth market, and growth rates continue to be a key valuation driver. Across cohorts, companies with stronger growth profiles consistently garner higher valuations than their lower-growth peers.

Regarding scale, run-rate revenues of $100 million might have been deemed "public company ready" for software companies in 2021. In the current market environment, to be considered sufficient and attract public company investors, that metric likely needs to be closer to $300 million to $400 million.

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With only six tech IPOs through H1, there has been increased participation from consumer, industrial, healthcare, and financial services issuers. Importantly, investors have returned to viewing IPOs as a viable asset class. There have been encouraging signs that the market is broadening out beyond sector-specific portfolio managers. For example, we are seeing deep mutual fund and generalist portfolio manager participation.

Contemplating and preparing for an IPO can be an exhilarating time, but Canton advises companies to keep the long game in perspective. It is important to consider ahead of time how you want the market to view your company once

1: "Federal Reserve Issues FOMC Statement," Board of Governors of the Federal Reserve System, June 12, 2024.

public. Land on the key performance indicators (KPIs) you want to report on quarter in, quarter out, and start developing that narrative and tracking those metrics well ahead of IPO. Also, ensure you can predict and deliver on expectations in your financial model. Balance being aggressive with realistic in your projections, as public markets reward predictability and consistency.

Venture investment activity appears to be finding its footing in line with 2018 to 2019 levels.

Carly Roddy, Head of West Coast Private Capital Markets at J.P. Morgan, is seeing activity levels for later-stage private raises accelerate as the first wave of IPOs successfully comes to market. Private capital volumes are ahead of last year's pace, and we have seen renewed interest from crossover and mutual fund investors in leading rounds for late-stage private companies. Growth equity and private equity investors remain engaged with record dry powder to put to work and pent-up demand following limited deal activity the last two years.

Despite the uptick in investment activity in recent months, it is too early to say if this marks an inflection point. In addition, valuations have likely not fully reset lower, and trends are noticeably bifurcated by stage and sector. Data from Aumni, a J.P. Morgan company, indicates sequential improvement in early-stage post-money valuations and prevalence of down rounds over the past six months; however, the uptrend in down rounds for late-stage companies has yet to abate. A significant number of companies have not raised a follow-on round since 2021. Those historic valuations are unlikely to be fully supported in the current environment—an overhang we expect to be worked through over the coming quarters.

According to Roddy, even with down rounds representing an elevated 35% to 40% of Series C and later raises, companies are nevertheless taking advantage of the market reopening to raise primary capital and/or to help facilitate secondary liquidity for employees or earlier shareholders.

AI continues to be a prevalent theme in private capital markets, with several multibillion-dollar raises, representing 45% of year-to-date volumes.

Notwithstanding the improved capital markets environment, the lack of exits over the past two years has notably slowed the pace of VC fundraising in 2024.

The annualized run rate of VC fundraising in 2024 has dropped to the $35 billion to $40 billion range, roughly half of 2023's pace and the lowest since 2015, as the dearth of exits has hindered the recycling of capital into new funds. Combined with the valuation overhang for late-stage companies, we are generally seeing VCs being very patient around deploying capital. Dry powder reserves are high in absolute terms but toward the lower end of the last several years' range as a percentage of AUM.

Another trend coming out of the slower environment for venture is that fund lifecycles are stretching back out to three to four years from a low of two to 2.5 years in 2021. In many cases, we are seeing smaller fund sizes with longer durations. This is driving an elevated turnover dynamic of younger partners at larger firms, as the path to general partnership is evermore opaque.

Amid the challenging environment, Jeff Kaveney, Head of J.P. Morgan Private Bank's Fund Banking Group, has observed normal to slightly lower VC borrowing activity, with overall levels around pre-market disruption averages. There is little appetite among VCs for additional risk in the current backdrop given higher interest rates and the likely very gradual road ahead to harvesting the existing ecosystem of portfolio companies.

The fundraising environment has become increasingly competitive. We're continuing to see capital move into the market, but also a higher level of scrutiny from investors. LPs are becoming more selective, focusing on funds with a strong track record, clear differentiation, and robust value-add strategies.

Despite the competition, there are still ample opportunities for funds that can demonstrate unique value propositions and strong performance metrics. It's crucial to focus on sectors and companies that are resilient to interest rate fluctuations. This might include industries with strong cash flows or those less reliant on external financing.