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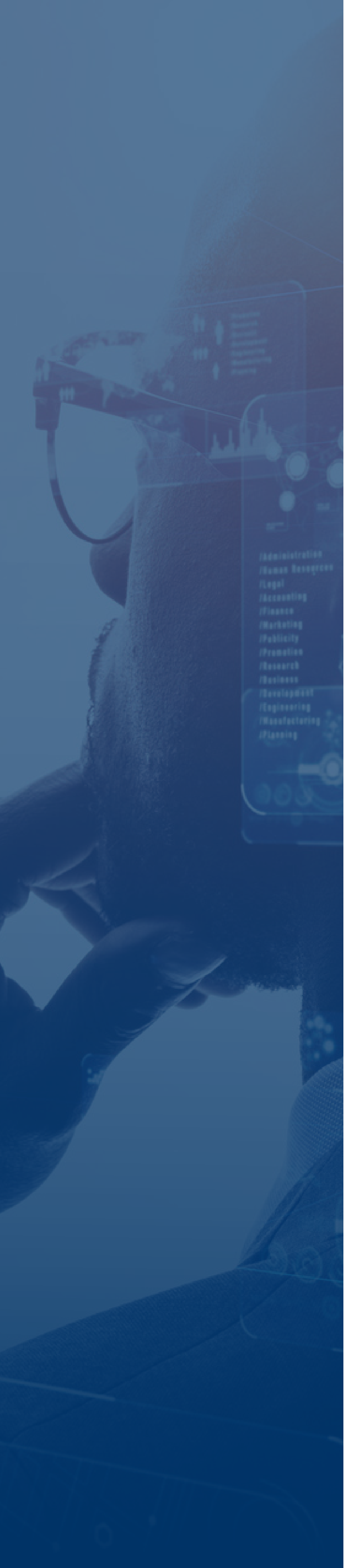
MMMSIGHTS

Emerging Tech Investment Report & Trends for H2 2024

By Nick Foreste



What's ahead for tech investing? The deals made in 2023 reveal trends that will influence deal making in 2024. The 2023 tech investment scene was marked by preservation capital and lifeline deals. While overall deal volume remained low, continuing a trend from a lackluster second half of 2022, the deals made in 2023 temporarily bought companies additional time and likely set the stage for a more active second half of 2024.

Morris, Manning & Martin, LLP's Emerging Companies and Venture Capital practice works closely with tech companies in the Southeast and beyond, as well as the funds that invest in these businesses. For insight into how the events of 2023 may affect 2024, we tapped into the expertise of our network for this first edition of the MMMsights Emerging Tech Investment Report. Our findings surfaced several themes that will affect the industry this year.

2023 Highlights & H2 2024 Trends

1

Valuation Disconnects:

Deal volume was primarily impacted by a disconnect on valuation between companies and prospective investors. **2024 Trend:** Founder expectations and company cash situations are trending towards a valuation realignment with investors.

2

Investor Leverage:

Where deals were made, investors wielded considerable leverage, using various tools to de-risk their investments. 2023 featured many structured minority investments, with participating preferred equity investments reemerging. **2024 Trend:** We expect to see less structure where companies have focused on profitability and enter the market with greater negotiating strength. For others, structure may be here to stay.

3

Avoiding Down Rounds:

Companies largely avoided down rounds, choosing instead to raise capital via stopgap extensions and debt financings when possible. **2024 Trend:** Those transactions (even when combined with widespread layoffs) were not likely long-term answers for companies; they merely held off pressure imposed by slow sales cycles and labor expenses.

4

H2 Brighter Forecast:

We expect a surge of deal-making activity beginning by the second half of 2024, as valuation expectations normalize, cash flow obstacles persist, and credit markets likely become more attractive. Further, 90% of funds report expectations of taking portfolio companies to market in 2024.

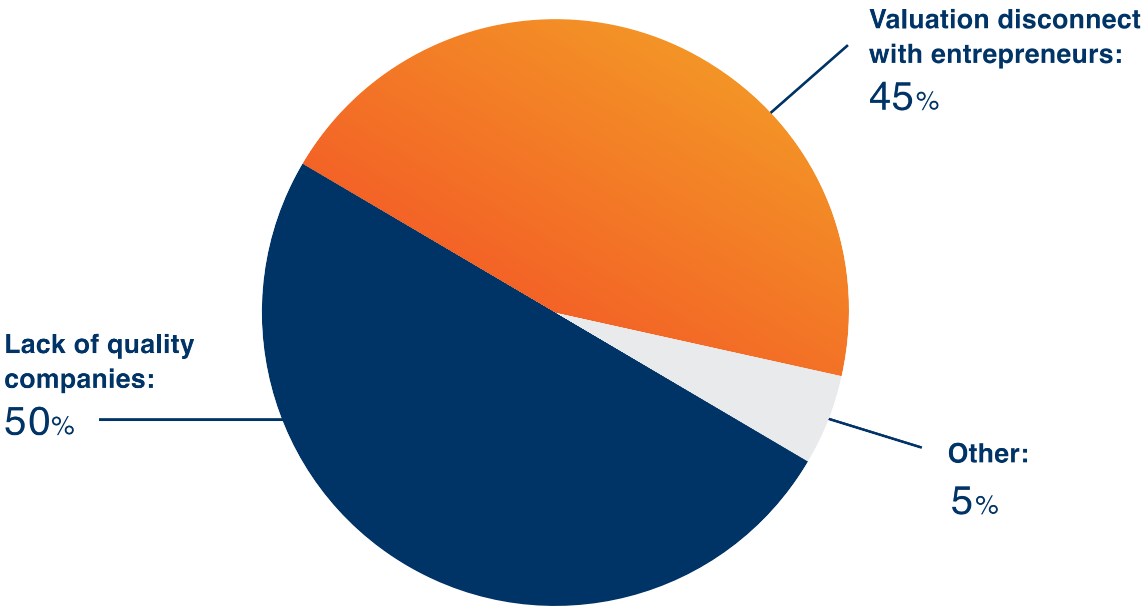
Now let's analyze 2023 deal trends and "lessons learned" from a rocky year.

2023 Deal Volume and Valuations

In 2023, 61% of funds surveyed missed their target deal volume, primarily due to valuation disagreements. When selecting an outside investor, responding companies cited valuation as their most important factor by a wide margin. However, companies also cited the lack of available capital as the primary reason they did not raise outside funding in 2023 (or perhaps a lack of available capital at acceptable valuations?). On the other hand, responding funds cited the valuation disconnect as one of their biggest challenges to deploying capital. We expect to see more deals in 2024, as time closes the gap in the valuation divide and expectations regarding multiples recalibrate.

What Was Your Biggest Challenge in 2023?

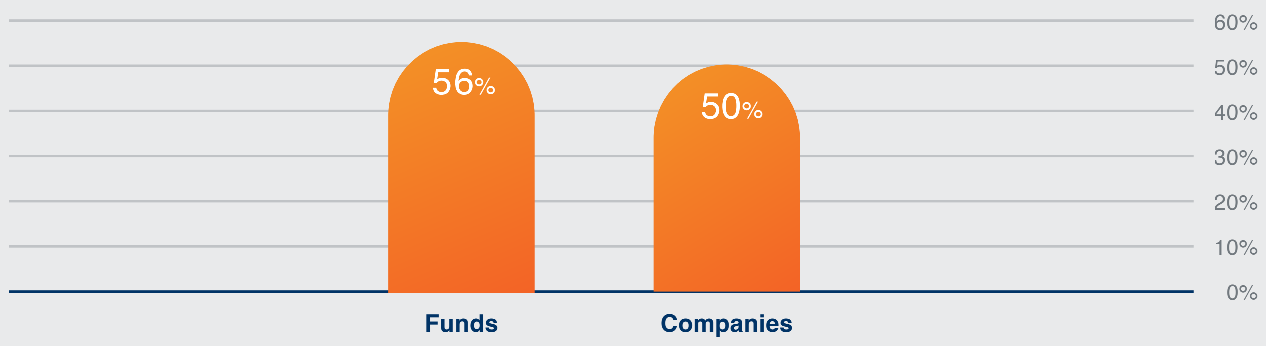
Investor Responses



For venture rounds, extensions – deals led by insiders with share prices flat with prior rounds – were extremely common as shown below. Generally, these were most common with companies that raised capital around 2021 and have continued growth – i.e., they've grown into what may be considered a high previous valuation in today's environment.

2023 Deal Volume and Valuations Cont.

Respondents participating in rounds structured as extensions



So what valuations are funds expecting? Setting aside of host of important factors (total addressable market (TAM), customer metrics, etc.), funds reported expected valuations as follows:

TYPE OF COMPANY	RANGE	AVERAGE	MEDIAN
Early growth, ***not yet profitable***	5-10x ARR	7x ARR	7x ARR
Lower growth, ***EBITDA positive***	5-20x EBITDA	9x EBITDA	6x EBITDA

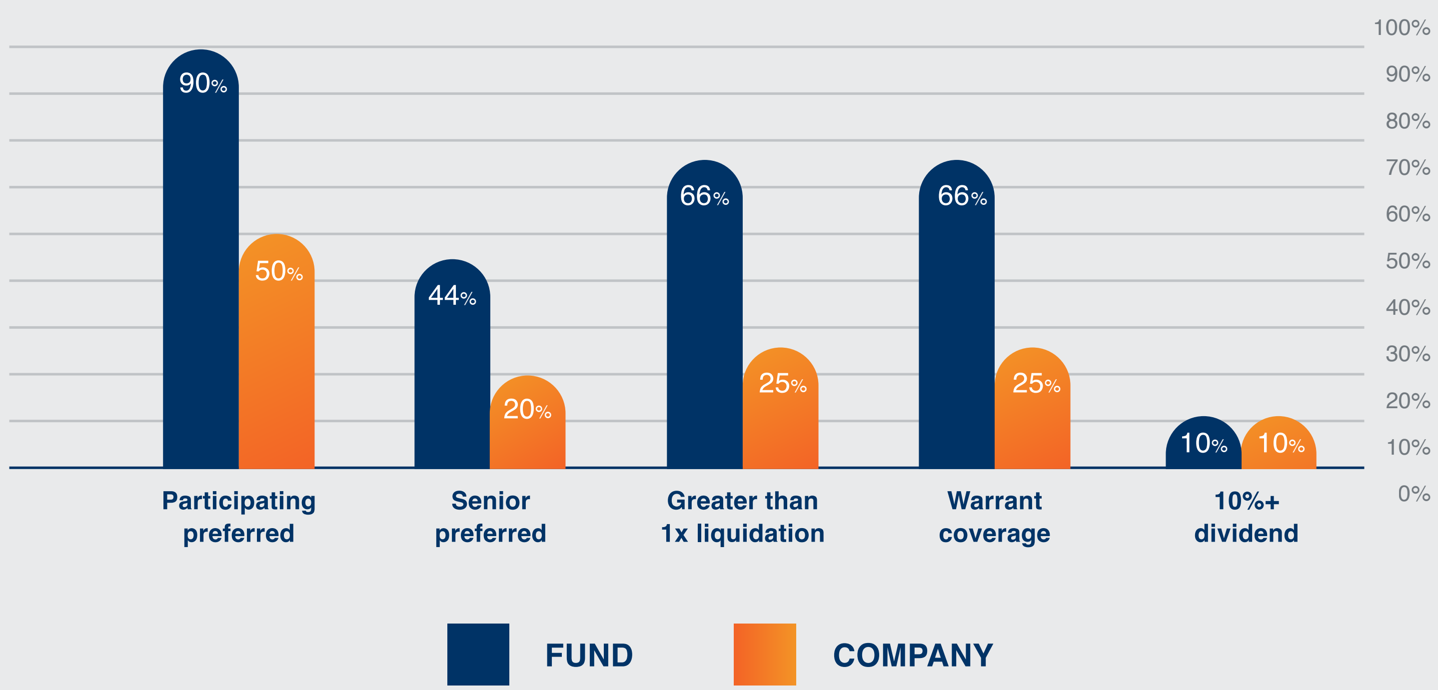
For majority buyouts, 70% of MMM practitioners reported deal volume was down at least 25%, primarily in the platform deal sector, with 50% of practitioners reporting platform deal volume down 50% or more.

Smaller bolt-on (rather than platform) deals were commonplace, however, as well-funded or mature businesses looked to capitalize on cash-strapped targets. These deals were oftentimes made out of desperation for sellers, with 70% of practitioners reporting handling deals where investors did not receive at least a 1x return of capital.

Buyer De-risking

More fund representatives are prioritizing profitability over growth in the current investment environment. That squares with the observation of MMM's practitioners, who pointed to several indicators that buyers took a careful approach in 2023, actively de-risking their deals. MMM practitioners universally reported longer due diligence periods and a higher percentage of deals featuring structured or contingent levers.

Structure Used in 2023 Deals

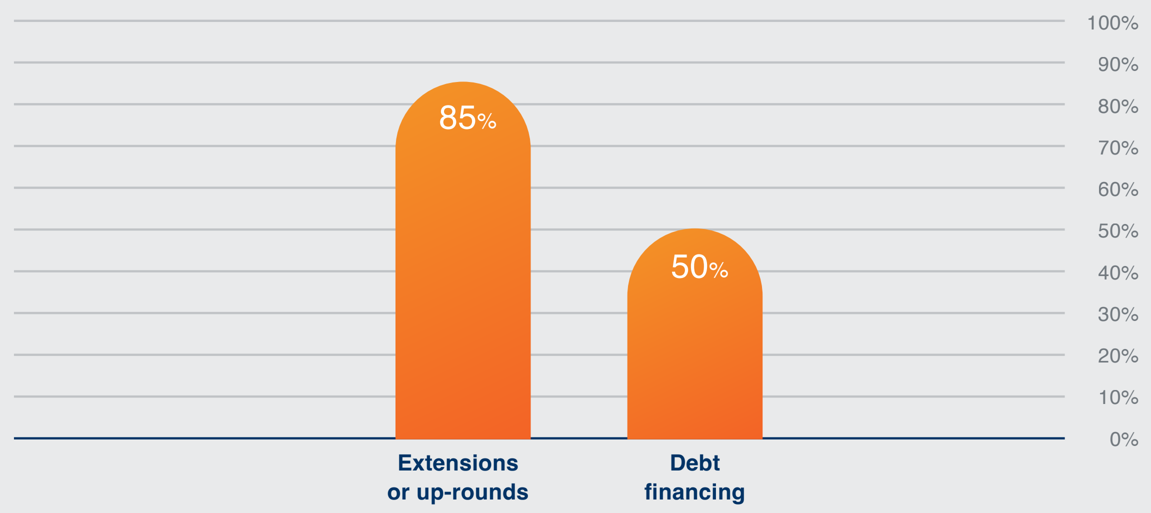


On the majority front, funds and practitioners alike cited a higher percentage of deals featuring more contingent consideration structured as earnouts to stretch multiples, and a higher percentage of deal consideration serving as holdbacks and escrows to backstop for indemnification.

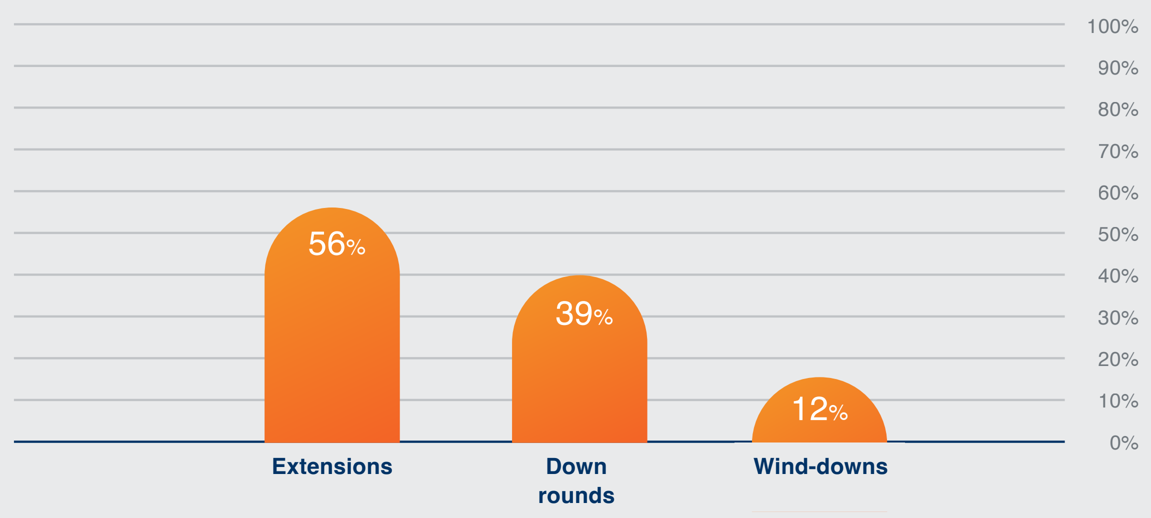
Deal Takeaways and H2 2024 Forecasts

Interestingly, 2023 did not include as many down rounds as the difficult funding environment might have suggested, with only 15% of responding companies participating in such rounds.

Companies Participating In



Investors Participating In

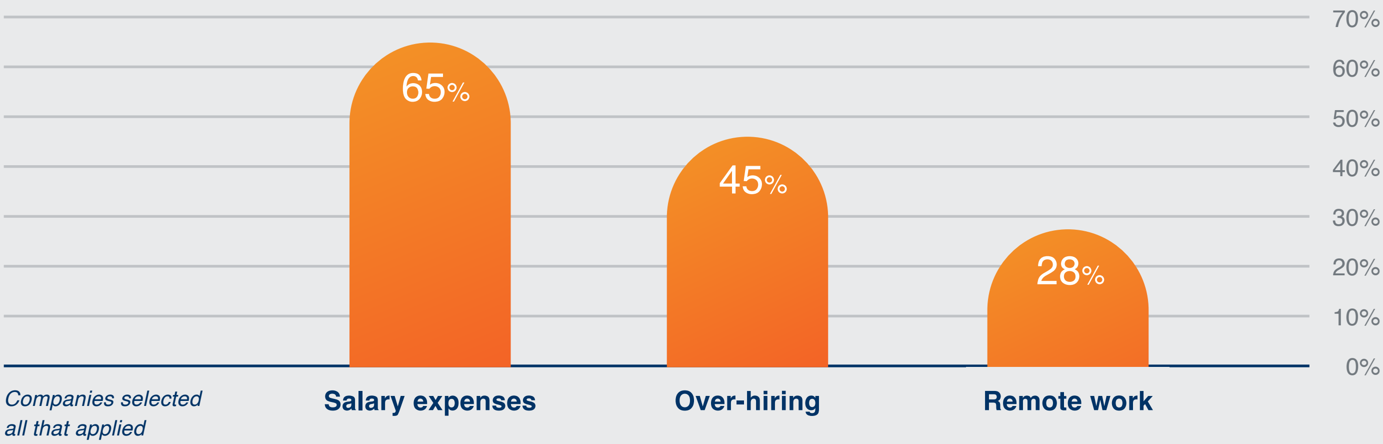


The number of extensions and debt financings suggests that companies may have been buying time for themselves in 2023. Companies funding operations with these continuation vehicles generally raised less capital than desired and will likely need to transact again in 2024. Further, reported business challenges revealed signs of cash pressure: 40% of responding companies executed layoffs in 2023 and many cited the largest challenges to their business related to cash-burning metrics.

Deal Takeaways and Forecasts Cont.

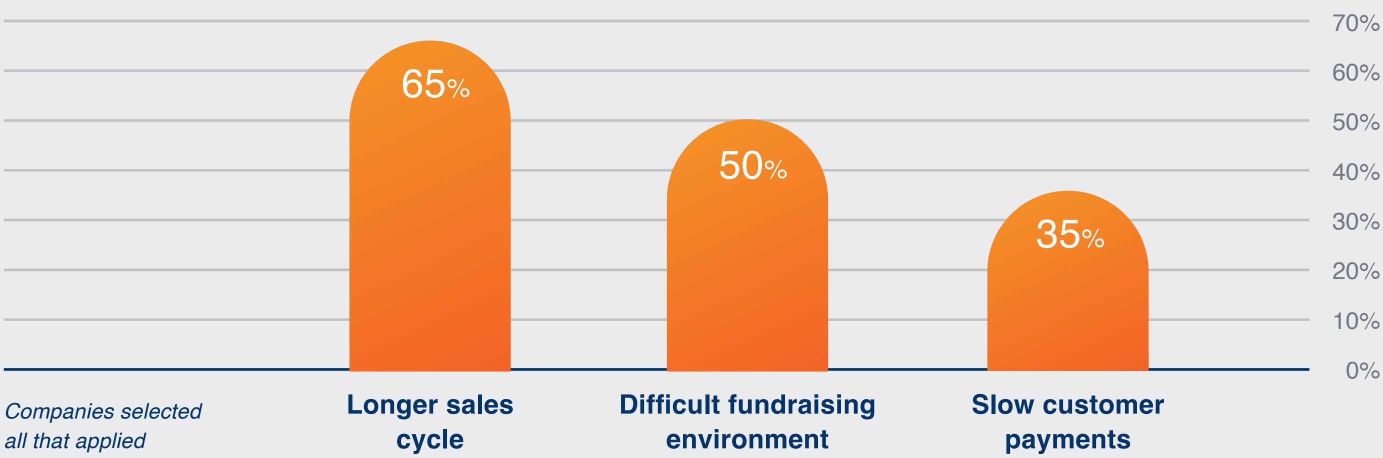
Most Challenging Workforce Dynamics

Company Responses



Biggest Challenges in 2023

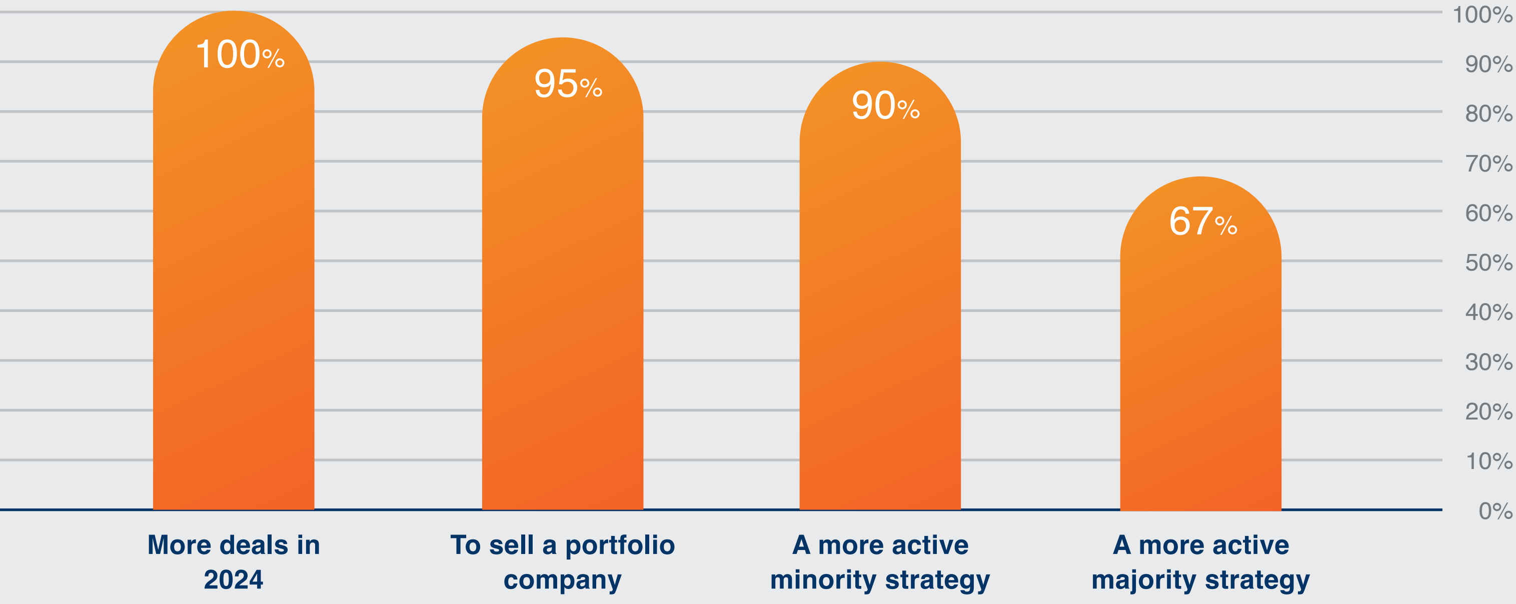
Company Responses



Almost all companies expect these challenges to persist in 2024, which could pressure them to enter deals – even, perhaps, the down rounds they avoided in 2023. Notwithstanding the headwinds, 90% of companies are optimistic that their financial performance will improve in 2024.

Funds, meanwhile, see a very active year ahead.

Funds Expecting



As we navigate into the second quarter of 2024, our anticipation for a rise in overall transaction volume remains strong. We expect funds and companies to enter the marketplace with realigned expectations and a renewed eagerness (and need) to engage in transactions in the near term.

About the Author

As co-chair of the Emerging Companies & Venture Capital (ECVC) practice, Nick Foreste has over a decade of experience and is nationally ranked in advising high-growth technology companies and tech-focused private equity, growth capital, and venture capital firms on various corporate matters, mergers and acquisitions, and financing rounds.

Methodology

The MMMsights Emerging Tech Investment Report is based on a survey of a robust cross-section of emerging technology companies, funds and investors that regularly transact with them, and practitioners from Morris, Manning & Martin that collectively closed more than 300 technology deals in 2023. Of the company and fund/investor respondents, 56% are based in the Southeast, with other respondents covering the entire United States.

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MMM offers comprehensive legal services to the venture capital and emerging market communities. We specialize in advising high-growth technology companies and tech-focused private equity, growth capital, and venture capital firms on corporate matters, financing rounds, and mergers and acquisitions. Our team supports technology companies throughout their corporate life cycles, from early stage and angel funding to growth equity financings, bolt-on acquisitions, and exits. We represent companies in a wide range of sectors, including SaaS, Fintech, technology, cryptocurrency, healthcare, and media. Pitchbook recognizes MMM as one of the top 25 most active law firms in the US representing companies in venture capital deals and among the top three most active in the Southeast.