Polynomial Ventures

Direct-Listed VC-Backed Companies Delivered Greater Asset Values Than VC-Backed Traditional IPOs in 2021

Profitability is no longer essential criteria for a successful public liquidity event

By Steve Valentor

With decades of experience in tech, I have had a great view of venture-backed IPOs. Famous success stories include Intel, Apple, Microsoft, eBay, Google, Meta (formerly FaceBook), Alibaba, etc. In fact, these venerable securities continue to earn their places in many diversified portfolios. And rightly so, they are all incredibly profitable. More recent public offerings have performed a bit differently.

The world seems to have changed after Amazon showed that profits need not be related to valuation. With a market cap of $1.6 trillion, Amazon only generates a scant $33 billion (2%) for its shareholders. By contrast, Meta, with a $609 billion market cap, returns $39 billion (6.4%) and Intel returns $19.9 billion, or 10.3%, against its $209 billion market cap. [Making sure this is a picture that's free to use.]

In 2021, 36 VC-backed companies sponsored traditional IPOs. Of those, only five generated positive income. In fact, as a group they lost $77 billion on $239 billion in revenue.

There are two ways that shareholders can earn returns on their shares: through operating profits or increases in stock prices. The lucky shareholders of those five profitable IPO companies earned nearly $700 million (almost 10%) on $7.5 billion in revenue. Unfortunately, those same shareholders saw their market cap drop by $5.4 billion since the IPOs of the "profitable five."

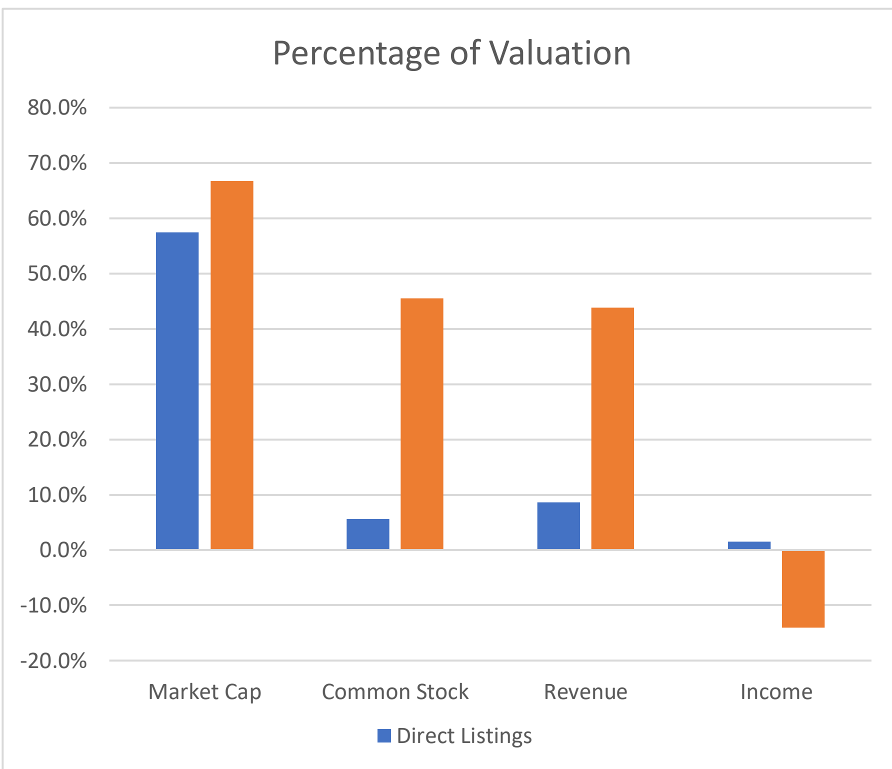
As is usually the case with IPOs, the best customers of the underwriting investment banks who were given access to the new shares did well on the day. For them to get that benefit, someone had to buy the shares from them. Collectively, shareholders who invested in the 2021 IPO vintage lost 1/3 of their investment as market caps dropped from a collective $545 billion to $364 billion. In terms of earnings, those 36 companies posted total losses of more than $76 billion. This paints a bit of a dismal picture. Losing money on operations and seeing the value of your assets drop by $181 billion in less than a year can be disconcerting.

One might argue that under the cloud of a raging global pandemic, underperforming assets must be tolerated. However, during this same period, Dow Jones added 11.8% and the S&P 500 increased by 17.4%. Many of the issues in these averages also paid dividends during the period.

All that investors who purchased those IPO shares can do at this point is hope for a brighter future, and one might question the value that VC fund managers have delivered to their investors. Actually, it is exceptional!

If you recall, the aggregate market cap of those 36 companies is $364 billion. According to their balance sheets, the shareholder equity only cost investors $248 billion - and that figure includes all of the new funds brought in with the IPOs. The pre-IPO venture capital investments have enjoyed phenomenal returns: FactSet reports that the number of VC-backed unicorns (>$1 billion enterprise value, post money) increased from 175 in 2020 to 515 in 2021.

It is safe to say that the traditional model of VCs backing early stage companies then creating liquidity events through IPOs is alive, well and thriving.



Perhaps an even more attractive model is emerging. In 2021, six VC-backed companies “went public” through direct listings rather than IPOs. Not only did these companies save the expense and distractions of the underwriting investment banks and obligatory road shows, they also were able to capture the initial surge of their public offering for the VC investors. These investors carried the bulk of the risk and arguably deserve the benefits. (In direct listings, no new shares are issued; existing shareholders sell their shares directly to the new public investors.)

Those six companies’ collective earnings were a positive $2.1 billion on $12 billion in revenue, or 17.5%. Shareholders saw their $12.7 billion investment peak at $138 billion on listing day then recede to $79.3 billion in market cap today.

It is clear that in 2021, investors in VC-backed companies that were direct listed saw their asset values increase significantly more (6.24 times) than VC-backed traditional IPOs (2.19 times), and profitability is no longer essential criteria for a successful public liquidity event.

Steve Valentor is a 30-year technology industry veteran who has worked in computer engineering, semiconductor R&D and software development for companies ranging from startups to the Fortune 200. He has held positions from entry level engineer to senior technical management, CEO and board chair. Currently the managing partner of Polynomial Ventures and an adjunct professor at DePaul University, Valentor holds an M.B.A. in finance and a bachelor’s degree in math, both from the University of Illinois at Chicago.

Polynomial Ventures invests in early stage technology companies outside of Silicon Valley and Boston. The Chicago-based firm is an emerging, registered investment adviser (RIA) operating an evergreen fund.