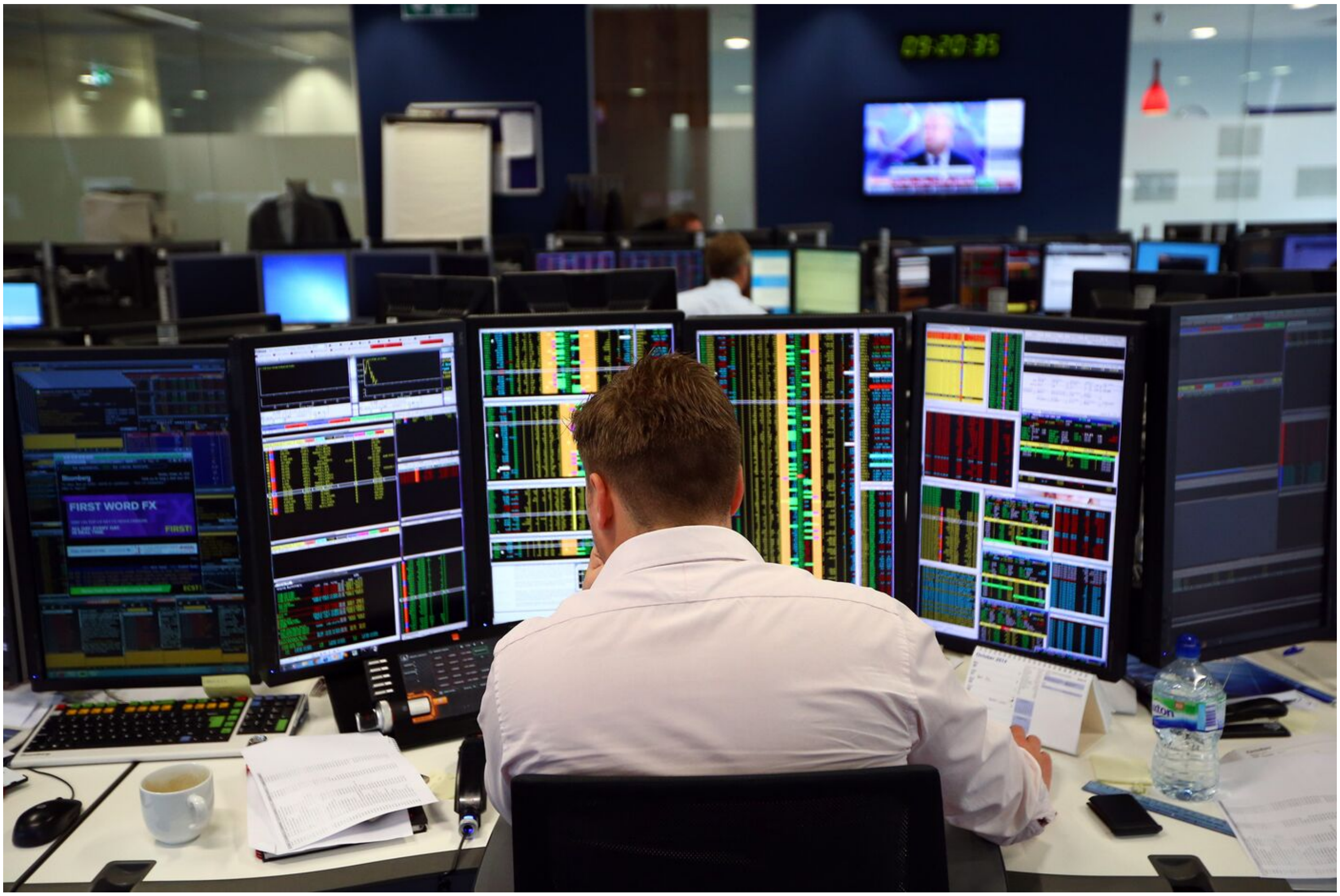
Wealth
Investing

Shares of Startups Are Turning Dirt Cheap, Attracting Venture Funds

- Investment firms bolstering stakes in closely held companies
- 'It's a sea change' from a year ago, says EquityZen's Haslett



Photographer: Carl Court/Getty Images

By Hema Parmar, Linly Lin and Sarah McBride
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It's a bargain-hunter's dream, and for sellers it's sometimes the only good option left.

Secondary markets – where backers of closely held startups can sell their stakes to other investors – are drawing increasing interest from venture capital funds and other money managers seeking to snap up chunks of private companies on the cheap.

Cash-strapped founders, employees and investors are under pressure to sell their stakes amid a wave of tech job cuts, a tepid IPO market and rising interest rates. That has helped to drive down prices. As of May 31, shares of startups were trading at a median discount of 61% compared to valuations at their latest funding rounds, according to a report by Forge Global Holdings Inc.

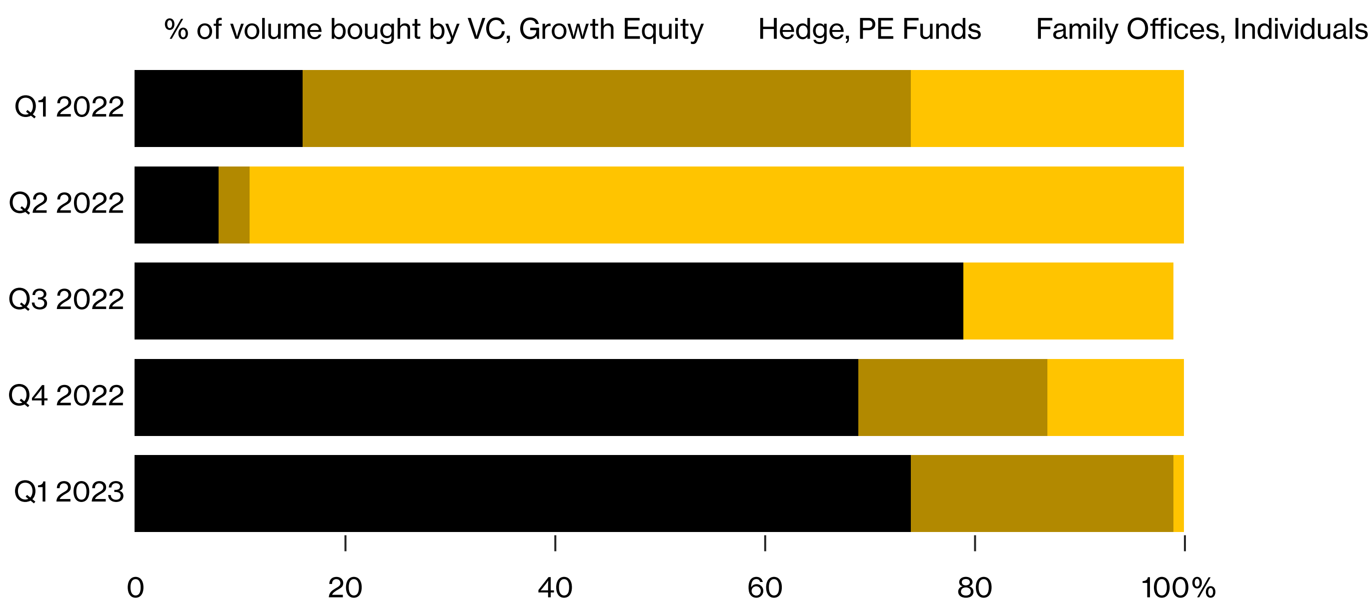
That's the hottest opportunity in the secondary markets since the 2008 financial crisis.

"It's a sea change," said Phil Haslett, founder of EquityZen, a marketplace for private shares. Until a year ago, hedge funds and VCs "would shun the secondary market," he said. "Now they have capital to blow on it."

Andreessen Horowitz is increasingly buying shares on the secondary market, and Bain Capital Ventures, Bessemer Venture Partners and Kleiner Perkins are tapping it to boost stakes in existing portfolio companies. Hedge fund giants such as Coatue Management and Tiger Global Management are actively hunting for deals, according to people familiar with the matter. It's even drawing newer participants such as private equity firms.

VC Accel, a long-time backer of online ticket vendor SeatGeek, is another example. Last summer, the firm was able to grab more shares at "a great price," partner Rich Wong said in an interview. Since then, Accel has been pouring tens of millions of dollars into other businesses it already owns, including Vercel, a provider of cloud-computing software, and developer software maker Sentry, Wong said.

VCs, Hedge Funds Have Become Biggest Secondary Market Buyers



Source: Zanbato

In addition to Tiger Global and Coatue, Dragoneer Investment Group and Altimeter Capital Management are among the multibillion-dollar firms exploring the market for deals. Some crossover hedge funds – so called because they invest in both private and public companies – are also sellers.

Coatue is doing fewer, but bigger, transactions. Earlier this year, it bought $700 million of shares from founders of security software maker OneTrust – and, with a presence on the company's board, helped with its restructuring, other people said.

That deal is a blueprint for future ones, with Coatue snapping up sizable shares at steep discounts in companies it's already invested in or knows well, the people said.

Liberty Street Advisors, a New York-based investment firm, is buying on the secondary market after seeing "high-caliber, late-stage growth" companies trading at a discount of 30% to 50% to their last funding rounds – and it expects prices to fall more as sellers come under pressure to raise cash, Chief Investment Officer Christian Munafo said in an interview.

Some big money managers are so eager for deals that they're willing to buy stakes piecemeal - something that previously wouldn't be worth their time. Institutions overseeing $5 billion are open to picking up stakes in $2 million increments, and some firms with $500 million of assets are doing deals for as little as $500,000, EquityZen's Haslett said.

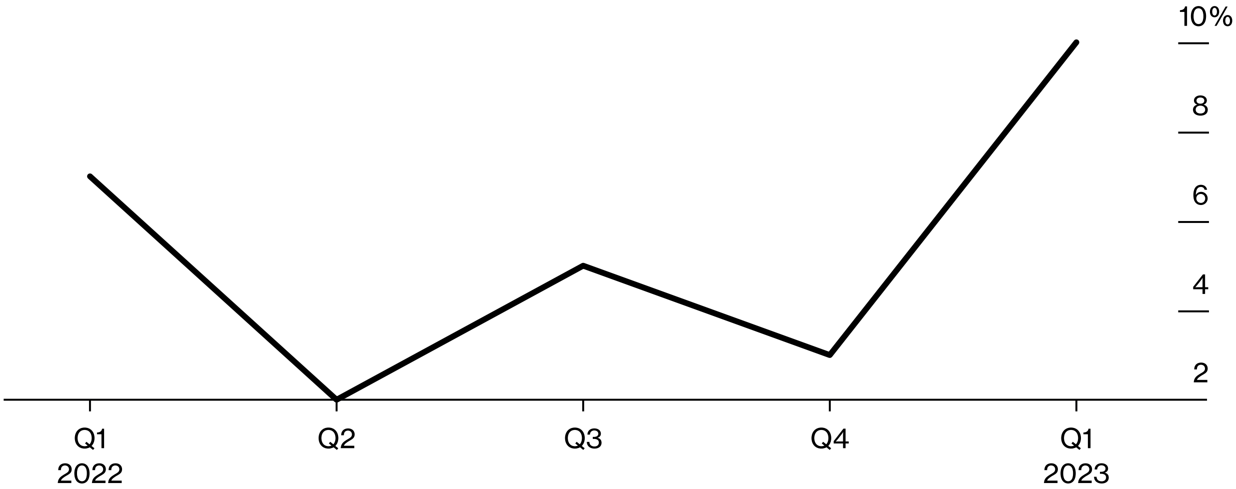
The opportunities have also attracted new entrants, such as Thoma Bravo and KKR & Co. – traditional private equity firms that don't typically dabble in the secondary market. They're buying equity from existing shareholders or even whole portfolios of stakes from other institutional investors, people familiar with the matter said.

Oaktree Capital Management is exploring ways to do the same, while Silver Lake's Waterman fund has begun playing matchmaker, helping shareholders in its portfolio companies find interested buyers.

VC firms and hedge funds are now the biggest buyers in the secondary market - both in terms of dollars spent and number of buyers, according to Zanbato, a platform that helps banks and broker-dealers trade private shares on behalf of their clients. Most are adding to stakes in companies they already own, said Zanbato's chief growth officer, Akrati Johari.

Existing Shareholders Are Adding to Their Stakes

In the first quarter, current stockholders ramped up their use of 'first dibs' rights to buy shares on the secondary market



Source: Forge Global
Note: Data show percentage of transaction value that current shareholders used their right of first refusal on in order to increase their stakes.

The reason for buying has shifted, too. In 2021 and early 2022, many buyers were funds that couldn't participate in a startup's primary round because of outsize demand. As a result, they would often pay a premium for shares. Now the tables have turned: Fewer primary rounds and IPOs, amid more so-called down rounds and industrywide markdowns, have made secondary prices attractive.

The pool of sellers is getting bigger. Institutional investors such as Tiger Global and Dan Loeb's Third Point are both looking to sell stakes in companies on the secondary market.

The Canada Pension Plan Investment Board is also weighing a sale of $3 billion of private assets. Caisse de Depot et Placement du Quebec, the country's second-biggest pension manager, sold $2 billion of private investments on the secondary market in 2022 and is open to another transaction of a similar size this year, one person said.

Representatives for all of the firms declined to comment or didn't respond to multiple requests for comment.

Read More: Canada Pension Mulls Sale of $3 Billion in Private Holdings

In 2022, buyers and sellers were at a standoff, but now they're closer to agreeing on prices than they have been all year, based on bid-ask spreads cited in the Forge Global report.

Most Popular Private Companies in the Secondary Market

These firms saw surging demand in May

Private company	Buy interest	Price change from most recent funding round	Date of last round
Gusto	98%	-63%	2022
Rippling	96	-53	2023
Outreach	95	-64	2021
Celonis	91	-49	2022
Deel	90	-47	2022

Source: Caplight Technologies
Estimated current prices are based on active trades tracked by Caplight across various broker-dealers

"Now that sellers are starting to accept lower valuations and get more creative with deal structure, the secondary market is starting to pick up, but we still have a long way to go," said Ryan Logue, head of private market solutions at LTSE. "The private market is really slow to react to public market turmoil."

The number of actual deals done this year is still fairly low relative to the opportunity, said David Wachter, co-founder of W Capital Partners. That's because buyers aren't interested in struggling firms, and it's still not clear how much later-stage businesses are worth – especially as companies delay funding rounds to avoid lower valuations, he said.

"When there is clarity on those valuations, which should be soon this year, then the buying opportunity will be great for the next five years," Wachter said.

– With assistance by Layan Odeh