# Startup Investment

| APRIL | 2020

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pwc

ANGEL ASSOCIATION NEW ZEALAND

# Succeeding with courage and insight ↓

## Welcome to the April 2020 edition of Startup Investment magazine.

It is my deep hope that this edition of Startup finds you, your family and colleagues well during these uncertain times.

Our work demands that we live half our lives in the future, using current data to make predictions about what lies ahead. Yet, no one – from the financial sector or any other – could have predicted the arrival, impact and still-unknown consequences of COVID-19. Many aspects of our lives will be changed by this global crisis.

As our attention is drawn towards pressing daily matters and difficult decisions to stay afloat, productive and sustainable, the realm of Startup investment – the very nature of which is long term – offers up a good deal of hope and possibility. In this edition, our commentators expand on the opportunities for investors and startups during uncertain times.

Rob Vickery from Hillfarrance Venture Capital stresses the importance of vision from the investor community, indicating that thoughtfully backing promising founders now, could yield solid results down the track. This view is supported by Debra Hall of Kiwinet, who reminds us that early investors tend to be optimists, familiar with uncertainty.

It seems we are facing an era where brave and innovative companies supported by bold insightful investors will be those who succeed and – in the meantime – we must stay connected and hold our course.

We hope you enjoy this autumn edition of Startup Investment, in which we welcome Suse Reynolds as the new Chair of the Angel Association and give thanks to John O'Hara for his time in the role.

ANAND REDDY
PARTNER, PWC

# The sun always comes up ↓

Stepping into the chair of the Angel Association at a time like this is not without its challenges.

But, if you could choose a group of people to be in the trenches with, I'd pick startup founders and early stage investors every time. They run on creativity, optimism and generosity which are powerful qualities for getting out of difficult situations in good shape.

We are delighted to reveal that enthusiasm for investment in New Zealand startups is reflected in another record year of investment and activity in 2019. You can dig into the details in this edition. The figures show a lift of $12m invested into startups last year to take us to over $128m invested in almost 130 deals. This means we have had year on year growth of over 15% per annum since 2012.

Of course, these numbers are going to look very different in a year's time, but they illustrate a level of engagement and momentum that will absolutely deliver exponential returns in the long term. Venture capital is not called "patient capital" for nothing!

> "The rationale for early stage investment in high growth tech ventures is compelling in good times and bad. A well-managed, suitably-sized portfolio may deliver an IRR of 20-30%.

The rationale for early stage investment in high growth tech ventures is compelling in good times and bad. A well-managed, suitably-sized portfolio may deliver an IRR of 20-30%. In an era of low to negative interest rates, this is appealing.

But the rationale for backing this asset class goes beyond financial returns. Successful early-stage investors are also motivated by the knowledge they are supporting the creation of businesses that make the world a better place – ameliorating climate change, developing cures for disease, bringing people together, creating new jobs and developing disruptive ways of delivering more sustainable value to people and the planet.

New businesses are responsible for almost all net new job growth. AirBnB, Xero, Slack, Vend and Uber were all born out of the GFC. Stay tuned for the next round of these ventures.

None of us are immune to the emotions of scarcity being whipped up by #COVID-19. It's frightening, anxiety-generating stuff. But we must work hard not to let emotion override reason and reality. The sun always comes up.

There is no doubt that early stage investors have plenty of challenges ahead but I am utterly convinced the New Zealand startup ecosystem and its backers and investors will be rewarded for sticking with it. Optimism, creativity and generosity – grounded in a gritty appreciation of reality – always win.

SUSE REYNOLDS
CHAIR,
ANGEL ASSOCIATION

# In it for the long run ↓

## Why does startup investment make sense in challenging economic times and what do you think is the role of people and ideas in relation to this?

COVID-19 is a system shock that will have a significant impact on the global financial markets and will place pressure on startups for the next 12-18 months at least. This pressure will manifest itself in the form of longer fundraising cycles, fewer sources of startup capital, reduced valuations and the need to extend their runway and reduce burn.

This being said, it is an important time to be a startup investor and it isn't for the most obvious and expected response – to get bargain basement deals with exciting startups that are hurting for funding. Instead, this is a time for impactful and thoughtful investment into promising founders that have a bold, long-term vision; a product road-map that has the potential to drive significant value to its customers and a business strategy that is focused on sustainable and profitable growth from the onset. I expect that COVID-19 will be the catalyst for the creation of a number of multi-billion dollar companies who are looking for their first brave investor.

It should be noted that it is likely that a significant number of startups will cease to exist, both prematurely and as a result of a business model that isn't adaptable to the new, post-COVID-19 world. I have the belief that second or third time founders are far more investible than those on their first venture and this is a time to listen to the other ideas of the entrepreneurs in your portfolio.

Investors should also be paying attention to the needs of their existing portfolio and participating in and syndicating bridge rounds, helping them with process reengineering and driving new customers to their companies. I believe that investors only become truly 'great' through their actions in the bad times and not the good.

## Who or what is your favourite example of an investee venture?

I never want to have a favourite portfolio company, but I have particularly enjoyed working with those that push me to look at challenges and opportunities in a different way.

In 2017, through the venture fund that I founded in Los Angeles, I led a seed stage investment round into a company called Spidr Tech, which had successfully launched a customer service platform for law enforcement agencies and the communities that they serve. The company ticked all of my boxes: credible founders (they are two actively serving police officers), early signs of growth (they had a dozen different police departments paying for the product), and the ability to attract great talent through passion for the company and not a bigger wage packet. We ended up leading their first institutional seed round, which attracted Google as a co-investor, and I joined the board.

In the three years since investing, I have helped them manage M&A offers, hire and fire talent, raise new rounds, audit existing and design new sales processes, resolve disputes and, most importantly, added a bunch of new great friends to my family. The experience has furthered my development as an entrepreneur and an investor and I have passed on more value to my other portfolio companies as a result.

The latest development is perhaps the most rewarding – the police are now successfully using Spidr Tech to enhance the communication of how to mitigate the community spread of COVID-19 with the public that they serve, saving lives as a result.

## What do we need more of to expedite NZ Startup outcomes, growth and returns?

Firstly, and the most obvious one, is local capital. The NZ angel community is unique on a global scale, both in its size but also its passion, however, the market needs more locally domiciled, larger institutional sources of capital to drive growth and to provide a reason to resist the temptation for a startup to up sticks and base in overseas markets where capital is more abundant. This is important because I saw firsthand the benefit of having value and wealth creation recycle within the market that generated it. Los Angeles punched above its weight when existing founders invested their wealth as an LP or an angel; created second, third or fourth companies; and when senior employees at their companies, flush with some additional disposable capital, left and built their own businesses.

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# I believe that investors only become truly ‘great’ through their actions in the bad times and not the good.

I believe that growth in a startup should be measured by how much they achieved on as little capital as possible. I am not especially excited about giant valuation increases from rounds led by household name venture firms. I get excited when I meet founders who have bootstrapped their way to significant revenue without raising external capital.

As for returns, this is a ten year asset class and I am not investing my LP’s capital to generate public market-esque returns. I am looking to increase the total value of our paid-in capital by magnitude of 10-15x. To achieve this, I am looking for companies that create customer-centric, sticky products that command a high ACV (average contract value), to have minimal to no competition at the point of launch, and to be able to attract world-class talent – all without needing to move their headquarters outside of Aotearoa.

ROB VICKERY
PARTNER & CO-FOUNDER
HILLFARRANCE VENTURE CAPITAL

"Startup confidence in New Zealand has been strong up until now, but we are yet to see the full impact COVID-19 will have. Most early stage investors in New Zealand seem to have a long term view for high growth which is promising. New Zealand has been doing a good job of supporting new startups, which has seen many more great companies achieve success overseas leading to greater learning opportunities for the ecosystem as they share their experiences and knowledge. Coupled with this has been the strong investment support to the ecosystem through the announcement of New Zealand growth capital partners and other growth funds coming into the market.

AMELIA GAIN
CEO AND CO-FOUNDER
PRENO

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Currently it is hard to anticipate the full extent and duration of the COVID-19 pandemic in New Zealand or its impact on the globe in the longer term. However, as our economy emerges from it, technology exports will likely lead the way. New Zealand has a growing number of large technology businesses that are embedded in major markets providing what are often essential services internationally. These companies are resilient, agile, ambitious and know how to execute.

As capital streams have become more global, foreign investment has transformed the domestic investment scene as local investment continues to rise. This is due to the growing number of exciting opportunities available. The rapidly expanding number of early stage companies are tapping into global opportunities sooner and the larger companies are achieving significant economies of scale.

The net result will be a new New Zealand that preserves all the things that make this country so great, with a growing of confidence in our true potential.

GREG SHANAHAN
MANAGING DIRECTOR
TECHNOLOGY INVESTMENT NETWORK

# Where to from here?

## What do you think will give people confidence to invest in a new COVID-19 environment and what role will people and ideas play in this?

By default, startup activity is grounded in finding solutions to problems through the dedication and expertise of brave and creative people, unafraid of the 'blank canvas' ahead of them. This remains true when the markets are up or down. My observation is that 'overall NZ' business confidence is not correlated with the availability of financial assets for the 'believing investors/backers of people and ideas'. The argument for the early stage landscape being one of hope and enthusiasm, of renewal and breakthrough, is even stronger in times when 'traditional' investing preferences may be downbeat.

The private investors who believe in NZ startups are essentially placing ROI behind 'giving back', supporting this way of thinking and leveraging their expertise and networks in service of a deserving idea and founding team. Additionally, while I cannot speculate on the increase in cheque size of the existing investors, there's undoubtedly a marked increase in numbers of people who give to this sector, via formal (mentorship and governance roles) or informal (network connections, interest, word of mouth). This involvement, coupled with their (even if smaller) cheque, will ultimately contribute to a growing movement and to an upbeat space.

## Who or what is your favourite example of an investee venture?

My favourite venture is the science backed one. There's been a growing pipeline of such ventures lately prompted by Government support (Callaghan, KiwiNet, NZTE), the rise of entrepreneurial universities programs (UniServices at University of Auckland, while most other universities have their own Technology Transfer Offices in place) and the brilliant global success of predecessors enriching the entrepreneurial narrative from within the research community (PowerbyProxy, Lanzatech, Soul Machines, Engender, etc). Early stage investors have greater access to this pipeline due to the increased collaboration between said entities and the angel networks.

## What must we do to support our companies both during COVID-19 and in the aftermath to expedite NZ Startup outcomes, growth and returns?

The levels of returns in the NZ Startups space is dependent on time and the number of properly funded deals, assuming the specialisation, continuity and sophistication of the mentors and investors surrounding them is increasing. While the availability of Series A funding is being solved with the presence of a number of local and foreign VC arms/entities, as well as NZ Government initiatives, I believe our industry's preoccupation should be one of 'continuity and recruitment' of angels who 'roll their sleeves up' towards performance. These folk are sometimes personified by lead investors, other times they are more discreet, but equally instrumental as a sounding board and support network for founders who are working hard at conquering a new market, proving market fit or who have entered their scale up phase.

As for the outcomes, my view is with each return, recycling capital, knowledge and networks will pave the 'highways' to global expansion nodes for companies still in the startup or scale up phase. The markets and investors abroad will become familiar with Kiwi startups successes and their disruptive way of thinking, strengths and expertise – thus being less resistant or hesitant to listen when first approached. They'd be 'primed for expecting great growth and returns from the next Kiwi venture they come across.'

DANA MCKENZIE
INVESTOR AND DIRECTOR

"The argument for the early stage landscape being one of hope and enthusiasm, of renewal and breakthrough, is even stronger in times when 'traditional' investing preferences may be downbeat.

# Getting technical about the future ↓

## Why should New Zealand startup investors continue to invest, even in a COVID-19 environment?

New Zealand startup investors are smart, and many have weathered storms before (though not necessarily of this magnitude). No doubt investment behaviours will change – and some will stop investing in new startups to support their own business, or indeed a small handful of companies in their portfolio that they believe will perform strongly in the 'after-world'.

As difficult as it is right now, I believe that many early stage investors will be looking to the future – a future where what we do now can create exponential value and impact. Venture investors are always on the lookout for opportunities – and crisis creates opportunity. Those who 'play' in the early stage space are consummate optimists – they have to be.

Rational analysts would no doubt say that in low interest rate environments, people are willing to take more risk to find higher returns, and nowhere are those potentially higher than investing in a startup that goes on to become a unicorn.

But that's not how human behaviour works – we are not rational beings – and startup investment is about as far as you can get from rational behaviour!

## What do we need more of to ensure we keep 'making a difference', stay upbeat and not let uncertainty or fear take over?

People, people, people... we need more talent, more international perspectives and connections on both the tech side and the investor side. Closed borders and xenophobia is the absolute enemy of the growth mindset that we need to foster to attract the right people, and the right money into these fledgling businesses, and eventually again physically into NZ if we want to grow at least some of them here.

This is going to be challenging for the next year or so, there is no denying it, but until physical connection is possible again, we must double down on connecting virtually. Our new businesses need global connection, and closed-border attitudes are perhaps even more damaging than physically closed borders (a temporary necessity).

While it's relatively less hard to connect to technical talent from abroad, though still far too time consuming for our tiny teams, the difficulty we have in bringing in management talent and investor talent, is very real. Communities can become stale if we're only talking to each other. These are the people who keep us looking upwards and outwards.

DEBRA HALL
START-UP DIRECTOR
KIWINET

“People, people, people... we need more talent, more international perspectives and connections on both the tech side and the investor side.

“We are working with a large number of companies at the moment who are trying to manage their businesses through an incredibly uncertain time. The number one thing a founder needs to do in this time is to stay solvent/funded. We are pretty confident that with the sheer amount of dry powder looking for a return, when this pandemic is over, funding will be fast to flow back into the sector.

Our current advice to companies is relatively simple: look after your people however best you can, assess your supply and demand chains for any disruption and build in strategies for dealing with the disruption, including understanding what your cash flow forecasts may look like for at least the next 6 to 12 months. Make the tough decisions now, which may require stopping some or all discretionary spend. Existing investors want to support their portfolio of companies, so start talking to your investors and give them confidence that there is a plan to get through this.”

DYLAN LAWRENCE
GM INVESTMENT
NEW ZEALAND TRADE & ENTERPRISE (NZTE)

# Rethinking the status quo ↓

Startup world is often counter-cyclical when it comes to the financial markets – let's not forget many of the current cohort of successful startups were born out of the 2009 GFC. So what makes them more attractive in challenging environments? Bruno Bordignon of Avid Legal gives us his thoughts.

Pain has a price – most startups evolve out of some pain-point that they have found an innovative way to solve, however, trying to get market traction and people valuing 'pain' in good market conditions is difficult. We see many great startups with killer solutions but, when faced with selling that solution, are hit by organisations who would rather status quo (even if it costs more) than solving their pain. Times like these force people to rethink the status quo.

Agility is priceless and, even better, creates time. The fact that startups have never been comfortable and always cash-poor means that they keep iterating on themselves and are agile in their approach to knowing their business and understanding their market. This gives them the opportunity to be smart with cash, and run small iterations (or tests) on the market in an efficient manner. Being able to rapidly iterate extends their runway and time, where larger businesses and competitors sometimes don't have the luxury with their locked in cost structures.

Investors will often revert back to startups in times of unstable financial markets as they feel they have more control over their destiny. We aren't talking about veto rights at a board level, but knowing they're involved in a startup where they can directly impact and influence through their thinking, whilst being part of a team executing on a vision. There are plenty of investors out there right now looking to have a direct impact on startups' lives – in more halcyon times, it is often difficult to get the full attention of investors, so now is the time for startups to truly tap into smart money.

While all of the above represents a significant opportunity to startups, challenges still remain. The key ones from my perspective are:

**Team attrition** – behind every great startup there is a great team, and retaining that team will be critical. In recent discussions with Phil McCaw he was already cognisant of the "flight to safety" reaction experienced by startup teams where people are tempted to go back to a perceived safer corporate job. Startups will need to work keeping their team tight and revisit how much they have allocated in ESOP as part of looking at ways to retain that talent.

> "Behind every great startup there is a great team, and retaining that team will be critical.

**Being heard** – with all of the noise in the market around COVID-19, most corporates tend to be focussed on the immediate problem and not some of the solutions waiting to emerge. Getting to the right people within organisations to make sales has always been difficult. Now, if you manage that, getting their attention will be more challenging. Perhaps the sometimes unconventional sales approach of startups might just win out here!

**Telling the story** – with so much disruption in markets, it can sometimes be difficult for startups to articulate their proposition – too many opportunities can be as much as a curse as too few. Startups, now more than ever, will need laser focus on their story, purpose and proposition – this is not just limited to customers, but also to investors. Startups will need to be using every piece of data on their business (and their market) and demonstrate the learnings from their iterations to show how they will emerge as a lead player in their market.

While cash is always king, we have seen from previous experience in the 2009 GFC that investment runs counter-cyclical and there will be investors looking for a home for their cash. Expect to see a return to syndication, and people sharing a lot more for the collective good – this can't be a bad thing, right? So let us all practice more random acts of kindness and work together to seize the opportunities ahead.

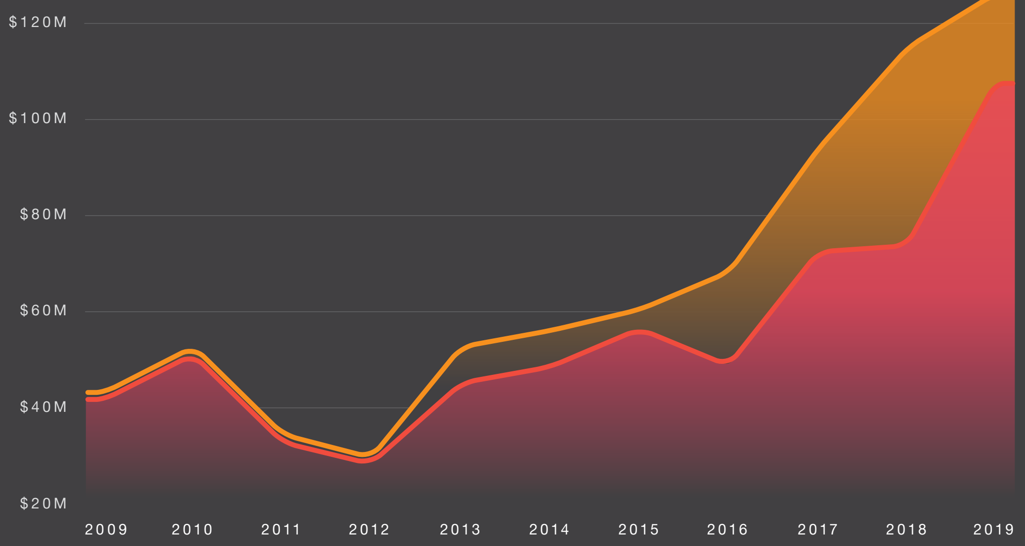
BRUNO BORDIGNON
DIRECTOR
AVID LEGAL

# Startup investment trends ↓

The latest Young Company Index data indicates that investment in New Zealand startups continued to grow during 2019. Investors doubled down on their existing investments by providing follow on capital while using syndication to achieve greater diversification. How will investors respond to the current challenges?

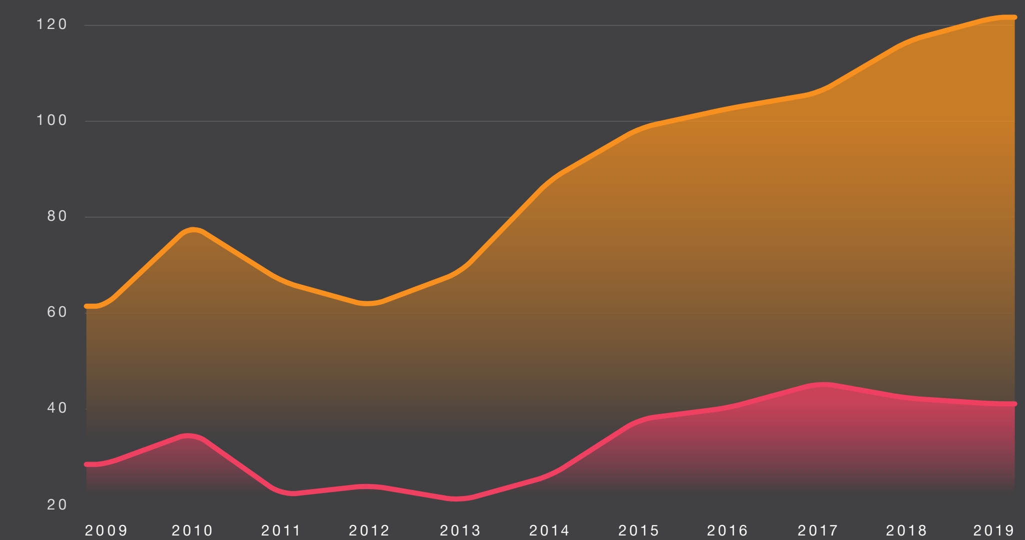
## GROWTH IN TOTAL FUNDING RECEIVED BY NEW ZEALAND STARTUPS FROM 2009 – 2019

OFFSHORE FUNDING? ● YES ● NO




## NUMBER OF NEW VERSUS FOLLOW ON CAPITAL DEALS COMPLETED EACH YEAR FROM 2009 – 2019

● FOLLOW ON CAPITAL ● NEW CAPITAL




During

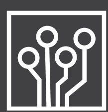
2019

investors provided **$86.8m** of follow on capital for New Zealand startups.

The top three sectors where investors are choosing to double down on their investments include:

SOFTWARE & SERVICES

$1.3m
average follow on capital per startup



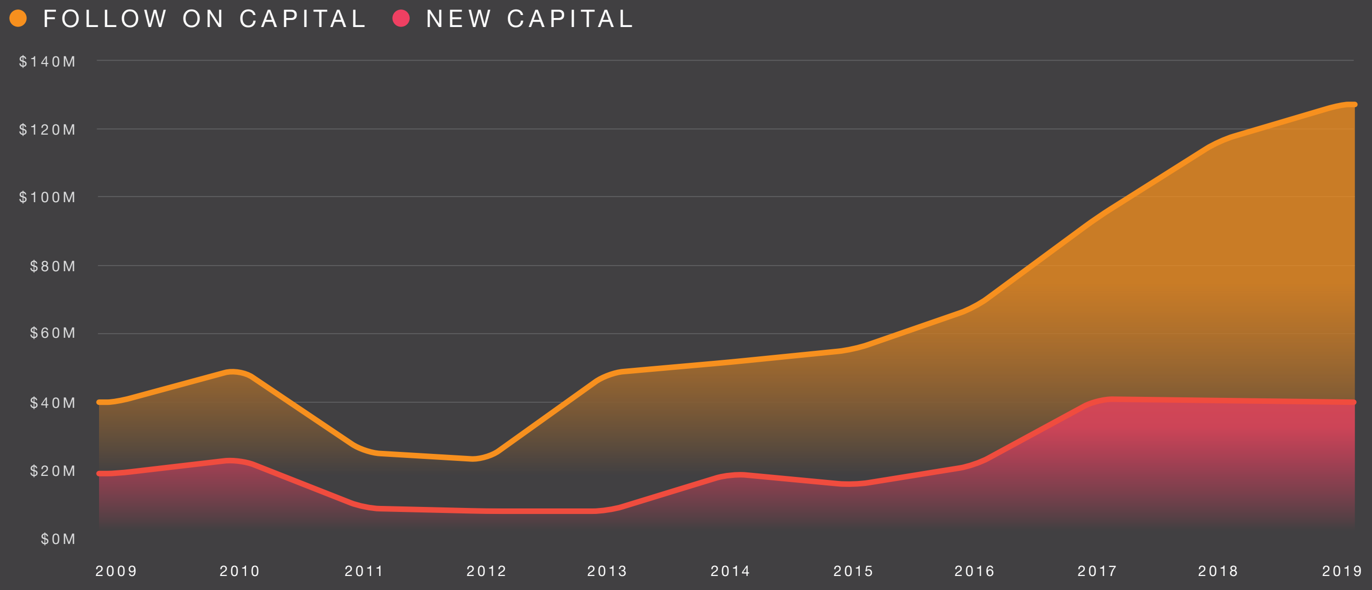
TECHNOLOGY HARDWARE & EQUIPMENT

$815k
average follow on capital per startup

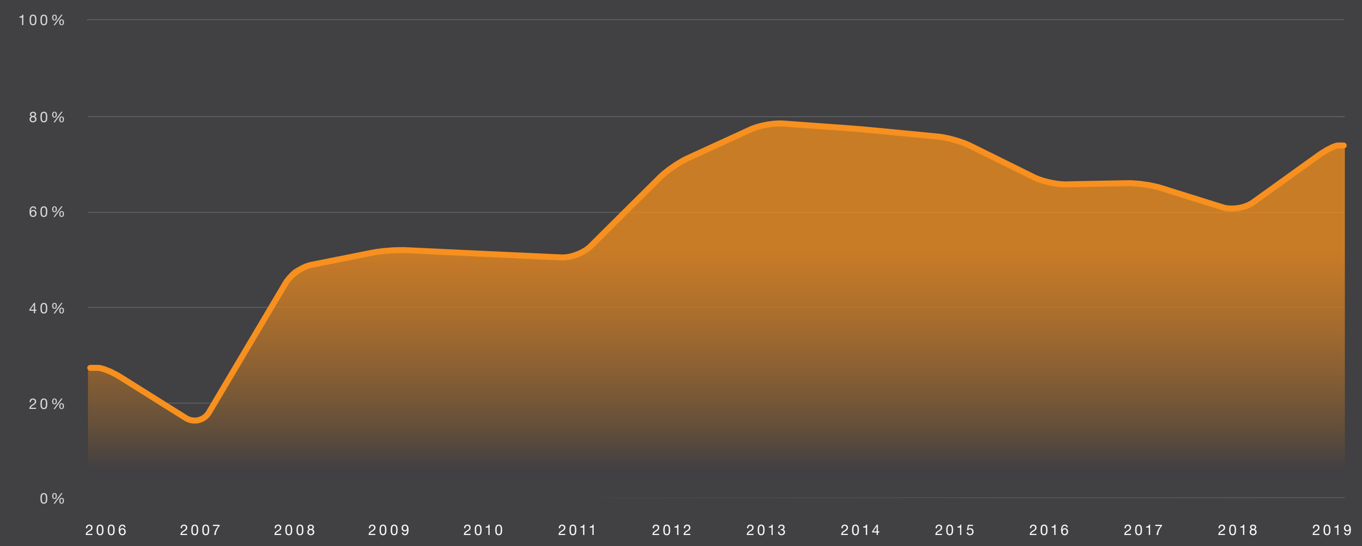
PHARMACEUTICALS, BIOTECHNOLOGY & LIFE SCIENCES

$537k
average follow on capital per startup

## TOTAL NEW CAPITAL AND FOLLOW ON CAPITAL PROVIDED EACH YEAR FROM 2009 – 2019




## TREND IN INVESTMENT SYNDICATION FROM 2006 – 2019



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