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Settled and striving players in the expansion-stage ecosystem are already looking past the pandemic.

Many market observers who were initially perplexed by how resilient public equities have been thus far in 2020 have concluded that any potential upside to the remainder of the year and into 2021 has been fully priced in. However, as with any trend that is confusing on the surface, there are important underlying nuances that further explain what is happening.

As of the time of this writing, there are multiple private companies—primarily larger and more mature—that have either done better than expected during the COVID-19 pandemic or have performed as expected after adroit maneuvering. Many others are still striving to get back on track. Most companies in the expansion-stage population, which the Road to Next series covers, have survived, if not thrived, so far. The success of these companies is in part due to the continued support of private investors and the broad fiscal and monetary stimuli embraced by governments worldwide.

The pressing questions are twofold, then, for these businesses: If economic activity doesn’t start tracking back toward growth while more flexible, digitized systems of working solidify, is this a new normal to which companies must adapt? Or, if a company has adapted, how can it further capitalize upon the opportunities and thwart the incipient dangers presented by a radically different competitive landscape?

This edition of Road to Next explores in detail how expansion-stage companies have prepared and are preparing for the post-pandemic world during the last weeks of this summer and beyond. It considers dynamics ranging from logistic matters, such as the workflows between a mix of fully remote and headquartered employees, to proofing cash flows against potentially deteriorating economic trends.

It is still entirely possible that the pandemic’s economic ramifications are not even half realized. Although we expect even the hardest-hit sectors of travel, tourism, and in-person consumer experiences to return in some fashion in the near future, the timeline of that recovery remains uncertain. More definite is that consumer spending will plummet unless companies receive additional income support, from whatever source available, and it will likely take some time before those that have lost jobs can find work once again, while others still may stand the risk of losing employment or furlough.

Leaders and investors cannot know what may transpire, but they can prepare for a variety of scenarios, from the optimistic to the worst case. That is what these expansion-stage companies and their backers are doing now; what will set the leaders apart from the rest is the breadth and depth of preparation, as well as the courage for opportunism.

Heather Gates
Audit & Assurance Private Growth Leader
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With more than 25 years of financial services experience, Heather serves as the national Private Growth leader with oversight of the Deloitte Private, Emerging Growth Company, and Private Equity businesses within Audit & Assurance.

Jason Menghi
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With more than 20 years of audit and accounting experience, Jason specializes in serving private equity firms and their portfolio companies.

Deloitte and PitchBook have collaborated to produce a unique methodology for the Road to Next series, in order to better analyze a new segment of companies that emerged in the 2010s. Dubbing this segment the expansion stage, the methodology utilizes investment data restricted to late-stage VC, PE growth, and private corporate financing. In addition, companies must still be privately held by aforementioned investment firms.
Executive summary

Amid the expansion-stage ecosystem, multiple companies are positioning for the post-pandemic era. So far, funding for these businesses has yet to decline appreciably despite the initial impact of the COVID-19 pandemic.

Themes of this issue:

Antifragility: What margins are necessary to withstand a second dip in economic activity? How can client retention remain fortified? What are the key defining traits for a business culture that can navigate a high-stress environment?

Consolidation: What acquisitions, at what time, would make sense in this environment? Not every expansion-stage company has fared well thus far. Accordingly, partnerships and outright absorptions are more likely to occur.

Diversification: Which companies can offer attractive valuations to private investors in this stressed landscape? Private investors, particularly those that are nontraditional, can find new opportunities across sector foci they may not have previously considered that were massively accelerated by the pandemic.

Opportunism: How can companies implement changes now that have been long needed but were postponed until stakes shifted? What new product lines or services can be launched now that can capitalize on the trends that have been massively accelerated?

“Many companies have made a quick shift in reducing costs, tightening operations, and exhibiting overall resilience thus far.”

Heather Gates
Audit & Assurance Private Growth Leader
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- After a decade of nearly uninterrupted growth, the expansion in private markets has culminated in an environment still awash with private capital. Even though deal volume has slowed down, investors are still plying expansion-stage companies with plenty of capital to maintain growth rates or weather any downturn.

- By late July 2020, investment dollars have hardly slumped even though deal volume has diminished somewhat; the $78.0 billion funneled into expansion-stage companies already nearly matches annual tallies seen between 2014 and 2017.

- Dealmakers have shied away from opportunistic consolidation thus far, but it is highly probable that as we realize the true extent of the economic dislocations resulting from the COVID-19 pandemic, and as more businesses suffer, acquirers will likely engage in more opportunistic M&A among the expansion-stage ecosystem.

- Investors are still being cautious, overall, even amid strong capital invested and revenue figures; through July 2020, expansion-stage companies recorded a median revenue of $41.3 million at the time of the transaction.

- Across the expansion-stage ecosystem, some businesses have already borne the initial brunt of change well and adapted swiftly; others are still working with their investors and other stakeholders to do so. Speed is double-edged in this environment, as companies also grapple with the potentially lasting effects of the current environment and accordingly do not wish to move too hastily and sacrifice prematurely. A balance is consequently beginning to emerge. Businesses are focusing on internal reorganizations and external investments plus resource allocations that were initially scoped prior to the pandemic, simply bringing them forward sooner than planned. Hence, they can ensure they are not veering too far from alignment.
Background

Private markets are still awash with capital. Even though deal volume has slowed, investors are still plying expansion-stage companies with capital.

Expansion-stage PE and VC deal activity by quarter

Expansion-stage PE and VC deal activity

Expansion-stage M&A activity

Source: PitchBook | Geography: US
*As of July 23, 2020
The post-pandemic era

Four key themes are defining companies’ preparation for a post-COVID-19 world.

Antifragility

Throughout the pandemic, resilience has been the byword in corporate playbooks. For expansion-stage companies, the benefits of size and relative maturity have combined with a degree of agility not necessarily matched by publicly traded counterparts. Hence, they have been able to draw on investors’ support and stave off the worst impacts to their businesses yet. Looking ahead, resilience will not be enough; antifragility, or the attributes that enable a business to withstand further shocks, is the new imperative.

First and foremost, antifragility for these expansion-stage companies is shoring up balance sheets to prolong runways and overall amplify margins for any range of financial impacts. The businesses that have been able to secure funding in 2020 to date boast a lofty median revenue: $41.3 million. Moreover, the ample supply of private capital and the demand for additional resources have resulted in a healthy median deal size through H1 2020. Although expansion-stage businesses have had to do more work to stay afloat, and investors have consequently had to perform more due diligence to justify and close capital infusions, many have succeeded on both accounts. For those looking to do the same, record sums of dry powder remain available across private financial markets. As growing consensus assumes market volatility going forward, companies are utilizing scenarios wherein revenues decline by a quarter to a third or hold steady, and adapting accordingly to prove that they are braced for further turbulence.
This edition of Road to Next explores in detail how expansion-stage companies have prepared and are preparing for the post-pandemic world during the last weeks of this summer and beyond. It considers dynamics ranging from logistic matters, such as the workflows between a mix of fully remote and headquartered employees, to proofing cash flows against potentially deteriorating economic trends. This infographic is a data-driven snapshot of the key metrics defining these businesses as they traverse the current environment and position themselves for the post-pandemic future.

### Median expansion-stage deal size ($M) by type

- **$41.3M**
  - A remarkable high in median revenue for the companies still securing investment in 2020 to date

- **$15.9M**
  - A healthy return to 2018 levels for the median growth equity deal size

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### Median expansion-stage revenue ($M) at time of deal

- Investors have dedicated **$78.0 billion** to expansion-stage companies through late July, suggesting the pandemic has hardly affected enthusiasm.
“Many companies are reaching out to discuss their businesses, taking interest in first-time audits, and considering other measures to better position themselves for stability looking forward.”

Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

“With the help of PE investors, there was a significant focus on capital management and strengthening the balance sheet. This process may prove to be beneficial in the long run and pay dividends once things start to turn around.”

Jason Menghi
Audit & Assurance Private Equity Leader
Deloitte & Touche LLP
A commonly expressed concern for players in public markets is that the universe of publicly listed companies is shrinking. An equally common refrain, particularly from players in private markets, is that the companies that would have gone public have instead stayed private, contributing to the creation of the expansion-stage segment. However, an undiscussed trend is that companies are also consolidating across the expansion stage, albeit at a lesser rate given their relative age. In 2020 to date, expansion-stage companies have secured a median pre-money valuation of $124.0 million. At such a scale, they’re able to acquire small startups early in their lifecycles to either achieve a more commanding market position or expand products and services.

More specifically, PE portfolio companies are looking for potential rollups to complement or expand their strengths, particularly in the realm of digitization. Venture-backed firms that still have a major liquidity event on their roadmap in the midterm are considering what additional capabilities are better acquired than created organically. Consolidation and concentration in key segments, even among expansion-stage companies, will characterize the post-pandemic era as the latest wave of emerging technology companies at the growth stage mature into category leaders.

“Companies are capitalizing on potential savings as well as longer-term investment in automating processes, systems, and tasks that call for lower thresholds of autonomous judgment and high degrees of repetition. This could prompt either in-house development or investment outside the organization to acquire the capabilities.”

Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP
Diversification

Special acquisition corporations and direct listings have been in the news over the past few years, the former even more so in 2020. The pros and cons of these public market pathways were hotly debated. Companies that pursued these routes were motivated by either access to a broader pool of potential capital or some type of liquidity that would remove temporary constraints related to early-stage backers and founding talent seeking realized gains. In the future, companies seeking an exit may opt for these atypical avenues or perhaps even more novel mechanisms, such as a buyout, from a sector-focused PE fund.

In the post-pandemic era, a global base of investors will likely also target expansion-stage companies for investment. Many of those investors are nontraditional participants that are looking for sources of returns beyond the scope of traditional asset allocations. PE firms have been broadening their exposure to relatively mature, growth-stage companies for some years now, but as venture firms mature, and as hedge and sovereign wealth funds look to diversify their exposures, expansion-stage, privately held companies have become attractive opportunities for portfolio diversification. These nontraditional sources may continue to supply both capital and broader support to expansion-stage companies—and those that are near that stage—for some time.

“Large, privately held companies with sufficient headcount and a talented senior management group have long been a desired target of PE firms—particularly those that can operate with less PE involvement—and will likely continue to be, especially in this environment. Companies with strong balance sheets are likely to be top choices.”

Jason Menghi
Audit & Assurance Private Equity Leader
Deloitte & Touche LLP

Expansion-stage IPO activity

Expansion-stage deal activity with nontraditional investor participation

Source: PitchBook | Geography: US
*As of July 23, 2020
In terms of business opportunities, the COVID-19 pandemic has exposed the need for more robust communications tools, cybersecurity infrastructure, and access-variable logistics. But there are many more advances that will be built upon those initial foundations, such as remote working operations intermixed with augmented reality displays and telecommunications utilizing patchwork mesh grids to ensure local reliability, as yet to be anticipated. For example, large-scale events with many people in close proximity are not going to disappear, but coordinators will require the ability to more accurately monitor the movements of each attendee at a major conference.

Beyond opportunities for new technical capabilities, there are clear tactical choices for companies and investors alike. Many PE firms are taking the time to reprioritize and cut less profitable products and services. Others are utilizing a difficult period to double down on necessary investments into replacing aging technical infrastructure. Venture backers and their portfolio companies are looking to pivot, not just in response to the current pressures exerted by the pandemic, but by longer-term trends that were recognized earlier but not rendered as acute as they are now. Unicorns, the largest venture-born private companies that are now slowly pursuing exits, are actually able to and need to accomplish both pivots and liquidity given their scale and continued infusions of capital at a significant rate, especially in the past seven quarters. As several such companies stretch the liquidity limits of private financial markets, they fortunately remain at a size where they can be relatively nimble, which is imperative to succeeding in the post-pandemic phase.

“Companies that can seize the moment to launch new products and services that were much further off in roadmaps are laying the groundwork to benefit significantly post-pandemic. For example, there is a fine balance between the greater robustness of supply chains that is needed and the potential for applying predictive analytics that can retain some of the benefits of just-in-time inventories. Not every playbook needs to be abandoned wholesale.”

Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

Source: PitchBook | Geography: US
*As of July 23, 2020
Methodology

Geographical region: United States

**Capital overhang:** Calculated as the sum of capital yet to be deployed that is available for investment. This report includes US-based VC and PE growth funds.

**Cash flows:** Aggregate capital called (known as contributions) by funds and aggregate capital returned (known as distributions) to LPs from funds by year. Only cash flows from US-based VC and PE growth funds are included in this report.

**Assets under management (AUM):** Aggregate dry powder (uncalled capital), as well as aggregate NAV (net asset value, i.e. the value of underlying fund investments) by year. AUM is restricted to US-headquartered VC and PE growth funds.

**Active investors:** The number of active investors is calculated by including either investors who have raised a venture or growth fund in the trailing five years, or those who have made four or more VC or PE growth investments in the past three years. There is no exclusion on investor type apart from angel investors.

All investment data is restricted to late-stage VC, PE growth, or corporate financing types as defined by PitchBook.

Tourist investors are defined as hedge, mutual, or sovereign wealth funds. All exits are defined by PitchBook’s primary exit types: buyouts, acquisitions, or IPOs. The underlying companies are those that have at minimum achieved any of the investment data under restrictions.

Company inventory is calculated by tallying the number of companies that achieve either late-stage VC, PE growth, or corporate financing by year and have not recorded an exit event as of the year in question.

All exits unless otherwise noted were made by companies that fall under aforementioned criteria for expansion-stage companies. The number of sellers was based on the count of investors classified as PE by PitchBook within the IPO event.

This report was written at the end of July 2020.

Data provided by [PitchBook](https://www.pitchbook.com)
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