diffusetap
Virtual Event Series

Bloomberg for Venture Investments

Guest Speaker:

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Founder & CEO
KingsCrowd

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DiffuseTap: Bloomberg for Venture Investments

Last time on DiffuseTap, Chris Lustrino, Founder and CEO of KingsCrowd, talked to us about the idea behind creating a rating and analytics platform for private investments, interesting market trends they've found with retail investors based on data, and debunking the myth that crowdfunding underperforms compared to raising capital directly.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speaker

Chris Lustrino is the Founder and CEO of KingsCrowd, a ratings and analytics platform for online private markets. They provide data and ratings on companies raising on platforms such as Wefunder, StartEngine, and Republic to help investors make better informed decisions. Chris has also helped private equity companies such as KKR and Riverside with their due diligence efforts.

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KENNY ESTES: Our expert speaker today is Chris Lustrino. Chris, could you introduce yourself and take it away?

CHRIS LUSTRINO: Absolutely, Kenny. Thank you so much for having me today. Very excited to be here with all of you. As Kenny mentioned, my name is Chris Lustrino, founder and CEO of KingsCrowd. My background is essentially in management consulting. I worked on behalf of every major private equity shop you could ever think of, including the KKRs and the Riversides of the world. I helped with their due diligence needs before they would conduct a purchase or a sale of one of their portfolio companies.

I did that for about three and a half years, and really came to see two key challenges with traditional private equity that I thought needed solutions to. The two challenges were transparency and access. These are things I've been preaching for about six years now. On the transparency front, we'd be working on behalf of these private equity shops, looking at target companies they wanted to purchase. And oftentimes, getting good financials out of those companies and understanding more about their market and getting good market data was nearly impossible. It seemed like making multi-billion dollar decisions with such poor data was a crazy thing. There had to be a better way.

On the access front, usually I would sit there and spend 400 to 600 hours doing diligence in a deal, and then not be able to invest in that company because I didn't work at a shop or wasn't an accredited investor. That drove me crazy and wondered why it was that way. That's when I stumbled upon this new world that had been working for several years now, which is the emergence of what we define as online private markets, where any retail investor can now actually invest into private companies, private real estate, collectibles, crypto – you name it.

I thought that was really cool, so I ran a fintech blog on it for about three and a half years. I was one of the first people to talk about emerging alternative lending and investing solutions to service retail investors, while solving the transparency component I also really cared about. That ended up being acquired in 2018 by one of the founders of Napster. After that, I got the idea to build KingsCrowd.

Put simply, the idea behind KingsCrowd is to build a Bloomberg-like data and analytics solution to help people make informed investment decisions into this new world of private market investing that's emerging. We expect there to be over $13 trillion in assets in the private markets. We all know they're not going to live offline for the rest of time. We want to become the de facto global data conglomerate that owns the world's private market data, and powers people in their decision making.

Since I founded the company about four years ago, we've raised about four and a half million dollars from nearly 4,000 individual investors. We're a team of 23 full time technologists, investor researchers, and marketing folks. We've rated billions of dollars in transactions. I have a whole bunch of really interesting stuff to get into about the business, but I'll leave it there.

AYLA KREMB: Beautiful. Thanks so much for the intro, we'll jump right in. I think that the biggest burning question is, where on earth does all this data that you use come from? We've done a lot of finger-licking estimations, but we want to know where it comes from exactly.

CHRIS: I spent many late nights at the consulting firm sitting there and thinking about how we could come up with a number for this market, or that market. It was funny. Sometimes you'd be looking at the most esoteric, weird little disease that no one had ever heard of. We talked to two doctors and that would become the extrapolation for creating a market. But there has to be a better way.

For folks who don't know, the area that we've been focused on over the first few years is the startup ecosystem. We were looking at seed, series A, and series B companies that are raising capital online. I'm talking about exchanges like Republic.com, Wefunder.com, SeedInvest.com, StartEngine.com, and so on. You can think of these marketplaces essentially as a NASDAQ, or New York Stock Exchange for startups where you can go and list your company, and then be able to access retail investors.

But in order to list your company, there are requirements. The government says “Hey, you want to raise from a broad pool of people? That's great. You could have access to them. But you're going to have to provide information.” That includes providing audited financials for the past two years of your business, including all of the statements, knowing exactly what the terms are and setting them clear, and revealing how much of the company is owned by certain individuals. If you own more than 25% of the business, you have to show what capital you've raised in the past and provide operating agreements.

It’s a level of information that we've simply never had. It's funny. Oftentimes people will say there's no way that you can glean any insights for early-stage companies from the financial data. But actually, when you have financial data on 3,000 to 5,000 companies, it starts to become really interesting. And you can imagine that there will be hundreds, thousands, or if not millions in the years to come. There are more insights that can be gleaned from it than people necessarily recognize.

So, we use all their offering statements that are filed with the EDGAR SEC website. We use the offering pages where they provide a lot of information about their business. That's where they're trying to sell you on their business. We go through that, and then we do our own third-party proprietary work, where we go off and we use third party sources for market sizing.

We do all sorts of LinkedIn polls as well. We have social polls, we're doing news feeds, we have all sorts of information that we collect on each company. We're collecting over 500 individual data points on those companies. And then, we have APIs with most platforms, where we're actually getting daily themes (almost by the hour) of how much money is being raised by those companies, and how many investors are partaking.

That could really give you a sense of how successful that raise is going to be. There’s actually a very broad set of data that's available to us that we can ingest, and we can look at that at scale across thousands and thousands of companies.

KENNY: That's really great. I will say that as far as the core business and the problem that you're looking to solve, I suspect you'll have kindred spirits in our favorite cigar chomping Joe Milan. If you haven't run across him, you guys look at these things the same way. But also, you're in a great position to see what's going on at a macro level, because you're in the data. What are some surprising trends that the data is bearing at the moment that you'd like to share with the group here?

CHRIS: There's one thing that I think is really interesting. We all know about the traditional venture world and just how incredible the valuations can be at times. What we're finding is that in an open marketplace where people can ask questions, investors can literally question you. If you go to Republic or Wefunder, SeedInvest or any of them, you can go to an offering page where you can execute an investment and own a piece of equity in that company. And also, you can ask questions to the founder.

These companies are out there competing against every other company that's raising capital. Just to give you a sense, today, there are over 700 companies just in the seed stage that you can invest in. You're competing against a very broad pool of companies. And what that does is it brings valuations down into a more rationalized space. Why? Because you're going to get called out if you have a really crazy valuation. If you can compare and contrast and look across all of these investment opportunities, it starts to pull down the valuations into a more rational area. And that's been really interesting to watch.

Now, they're still super high. There's no doubt. The fact that most companies raising are between $5 and $15 million valuation is still very, very high. But the reality is, if you look at the YCombinators of the world, they're raising between $25 and $30 million. And oftentimes, these companies have traction. These companies are raising via these marketplaces with some real financials. It has been interesting to see how an open and transparent marketplace can actually help rationalize valuations. That's been a really interesting insight.

Then, the other cool thing has been to watch the growth of retail investors wanting to invest in private companies and gaining comfort. When COVID happened, the market fell off for about a month and a half. And then suddenly, it just explodes. Almost overnight, we went from seeing only 100,000 to 200,000 retail investors partaking in this market to over a million.

This year, we'll probably see a lot of activity across regulation crowdfunding and regulation A plus, which are the two key regulations that enable non-accredited investors to invest in private businesses. We'll probably see $4 to $5 billion being invested this year in businesses from across probably 2 to 3 million individual retail investors.

AYLA: That's a really good point. An interesting question is, when you look at retail investors versus institutional investors, what kinds of companies are they more interested in? Is it just the GameStops of the world that they're chasing after? How does that divide the market?

CHRIS: It's interesting because I think folks have been educated. If you read things like the Inside VC newsletter or the Axios pro rata, you become educated relatively quickly. I thought that's what would happen. We'd see more food and beverage do really well, and things that people can really relate to, like those consumer products.

But what we found is that people love investing in technology and things like B2B SaaS because they know that they're really scalable, and they've heard the stories about how successful those companies can be. So, while there are definitely moments where you see that more consumer-centric company that is easy for people to relate to, like a food and beverage company with 20 million in revenue raising a growth round, people are really gravitating towards the things that they've seen other people get wealthy doing. So, it is a mix. I would say there's a surprising amount of people thinking about this in a more sophisticated manner and thinking about it the way a more traditional VC might think about it.

KENNY: That actually segues well into Chris Sorensen's question here. The main idea is that the earlier you invest, the higher the returns, especially when it comes to tech SaaS. Is that true? How much analysis have you done? Is it true on a risk reward basis overall?

CHRIS: It is your best shot to make the most amount of money, there is no doubt. But it is the most risky. I haven't done the math, but I'm sure a lot of people don't end up becoming billionaires, like some people do. But what I will say that what's really interesting about this space is that, especially in those early days, the minimum to get into a startup used to be 50 to 100k, just to be at the table as an angel investor. But now, you can put in just $50 or $100. The minimum has come down dramatically.

We have a portfolio management tool on our site at KingsCrowd. We aggregate the market. We help you with your search, we do our own ratings and analytics, and we help you with your diligence. The last problem that we solve for is management. For instance, after you've made that investment, and you also have one on Republic, five on WeFunder, and three on StartEngine, etc., it gets really unwieldy to manage all of your investments.

We've actually created a portfolio management tool so that you can list all of your companies in one spot. Think of it a little bit as a Mint.com, where you can track all your investments. And we're building a lot of really interesting tools that allow you to track the performance of your portfolio over time.

Now, all that data has allowed us to see what investor behavior looks like. On average, our investors have over 14 investments in their portfolio. Simply said, a lot of these folks are really diversifying. The most that we've seen so far (and we've talked to this individual, so you know it's not crazy) is 700 investments. It's very easy to put $100 to $1,000 in 700 individual startups. You have the ability to create a very diversified portfolio, if you prefer to try and manage that risk reward profile.

AYLA: That's fascinating. Do you know anything about the returns that they might have gotten from those investments? That would have been a nice little temp check. There are over 800,000 additional retail investors that came in as COVID hit. Have they been better off, or worse off for participating?

CHRIS: Like with any startup investing, it's going to take many, many years to really glean what ends up happening. One thing I can tell you is that we look at an aggregate number of companies that have been well rated by KingsCrowd. This involves your upper echelon companies. Just in about two years, we're seeing a two and a half to 3x on a portfolio. If you had invested in all our companies that were 3.7 to five on a rating scale by being the best, you'd have about a two and a half to 3x.

And by the way, most of those companies still haven't gone for a new round of funding, and nearly all of them are still alive. There's been four exits to IPOs. There was one company buyback. To give you an example of a few companies that have done very well right within that portfolio, there's a company called NowRX.

They started raising money from seed investors with basically an idea on paper to create an automated pharmacy delivery service that will deliver your medicine within a couple of hours. They went from an idea on paper and a $20 million valuation when we first said they were great. Now, they have 30 or 40 million in revenue this year, and they're doing a $300 million round. People have done very, very well in that one.

Another company Alto IRA did a round on Republic at a $30 million valuation just about a year ago. They're now up to a $250 million valuation. They just did a Series B, and that's all been institutional investing. There have been a lot of success stories in this space. I went to an investor event recently. There were a few folks who had this investment in a couple of robotics companies that got bought out. They put in 100 and they got $700, and they just couldn't believe it. There have been some real wins. But I will say that it's still very, very early, and it's going to take more time for it to play out. Maybe in five to seven years we'll have a good handle on what that looks like.

KENNY: Makes sense. One intuition check I'd like to get out of you. Many people including me believe that crowdfunding is probably not the best signal as compared to being able to raise capital directly and privately. That might vary just based on the relationships you have. But also, if the business is doing well, the money will find you that way, as opposed to having to go out and take the $5,200 checks.

I know one gal who did a big raise 10 years ago, and she says it was the worst decision she ever made. She still has a guy who demands a call every quarter, who gave her $15,000, 10 years ago. But that's the company. So, is that bias that generally crowdfunded opportunities underperform actually borne out in the data?

CHRIS: That's an old notion. If you look at where that all started, it's probably with the VCs. The reality is the data does not suggest that. And more importantly, I think what we're seeing is that capital is a commodity. Founders are not stupid. They're going to look to where they can find the best capital, or the cheapest capital.

I have over 4,000 investors in our deal. I went from an idea on a piece of paper to over 400,000 subscribers, acquiring five companies. We've grown massively with a team of 20 plus full-time employees, and the people who got in on our first round of $2 million valuation are doing very, very nicely, just to be clear. So no, there has been an incredible amount of success stories. That bias is certainly not true.

And by the way, in the first few years, VCs would laugh at me and kick me out the door. Now, we've had five VCs partake in our series already. Andreessen Horowitz is now suggesting to some of their portfolio companies to go and list on these exchanges. Mercury bank raised at a $1.6 billion valuation. And then, they put up 5 million from their customers, and sold out 5 million in 40 minutes. It was crazy.

Of all the companies I've seen this year, this is the one that most concerned me because they raised at a $1.6 billion valuation on 2 million in revenue. I thought, "boy, that feels like a 660 times revenue multiple. I'm not so sure that's the best valuation." But you know that it's a great company if they've raised that much money, and I think they are doing very innovative things.

The reality is that big shops are starting to buy into this market. And that's what we will take. YCombinator has a partnership with WeFunder and has listed over 100 of its companies on WeFunder. We're seeing more and more adoption. It's funny. The calls I get are from founders who are going through the VC process looking at term sheets and saying, "I'm not so sure I love that term sheet. I have another capital source. Why don't I go there?"

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Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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