

Revenues Are Ego, Margins Are Intellect — Market Signals and Omega's Edge

*The Importance of Backing Durable Market
Leaders Amidst the Current Frothy Valuation
Environment in AI Venture Capital*

Summer 2025



Omega Venture Partners — The Importance of Backing Durable Market Leaders

We are both grateful and purposeful in having built a platform imbued with pattern recognition, judgment, and discipline—one designed to distinguish signal from noise, and risk from return.

What follows is a look under the hood at what is driving the current AI frenzy, as well as Omega’s enduring edge—discernment, clarity, and depth born of 15+ years at the forefront of AI. We hope you find this an informative and clarifying read amid today’s turbulence.

We’ve seen this before—cycles, hype, and moments of exuberance unhinged from fundamentals. Don’t let the current froth fool you—it will pass.

Let’s examine the current frothy valuation environment in AI venture capital: capital is flooding into AI startups, and fear-of-missing-out manifests among investors despite companies without even a product or business plan, let alone any underlying economics.

Many of the investors bidding up private company AI valuations are genuinely in the dark, lacking technical fluency or sector expertise to ask the right diligence questions or look under the hood of underlying products. The result is a feedback loop of uninformed conviction chasing capital deployment—speed over substance. Many of these investors have yet to realize that the companies they are overvaluing are also structurally fragile (more on that below).

We have been in the game long enough to know that when superficial conviction, uninformed enthusiasm, and herd-driven hype reach a crescendo, the outcome is rarely durable. Frankly, it feels like the dotcom playbook, rewritten in ‘dot ai’. Generalist firms—under pressure to show relevance across the specialized domain of AI—are piling in, seeking to buy access as the top bidder, hoping something sticks, with signs of lemming behavior.

At Omega, our inside look at these private companies (close to 1,000 per year across early-growth & startups) as well as our ability to take advantage of ongoing dialogues with the proprietary Fortune 500 company relationships we have cultivated, gives us a continuous and meaningful edge in understanding real buyer behavior and ROI.

Case in point amidst the froth, Omega Fund II’s first two investments are both in highly proprietary opportunities where we backed durable market leaders—real businesses, capital-efficient, at compelling valuations. Our next investment is shaping up with similar character, and we continue to invest deeply to help these companies catalyze transformative value and unlock further upside.

The road ahead is rich with opportunity. Analysts view this as the fastest-growing enterprise software market in history—one that’s expanding and displacing entire categories of legacy applications. The long-term secular tailwinds are accelerating, and our portfolio is structured in alignment with these developments.

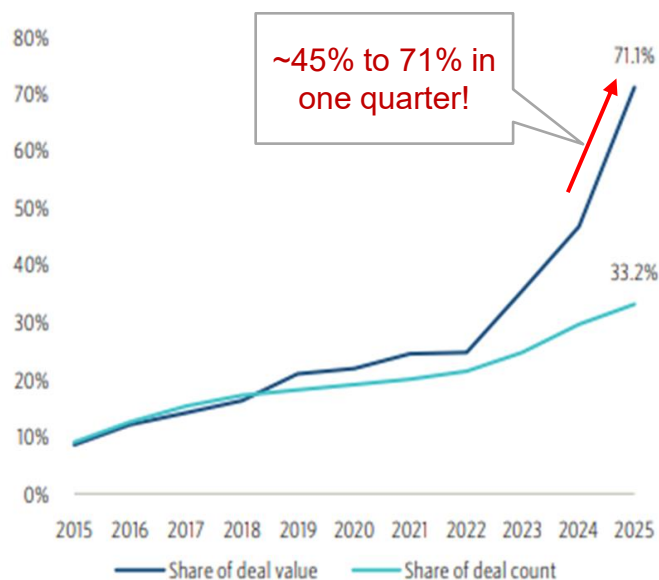
Market Signals & Omega’s Edge

1. Signs of a “Climax-Top”¹

Market Signal:	In 1Q '25, AI & ML soaked up >70 % of all U.S. venture dollars — up sharply from ~45% in 2024 — while representing <35 % of deal count
Why it Matters:	Capital is converging on a narrow set of headline names — Similar patterns preceded prior market resets (e.g., 2021).
Omega’s Edge:	<p>Price Discipline & Proprietary Access</p> <p>Omega’s purpose-built platform makes us a sought-after, differentiated partner — over 70% of our deals are proprietary.</p> <p>A right-sized fund enables us to remain highly selective in backing early-growth leaders with real fundamentals, participating when valuations meet our return thresholds.</p>

Exhibit 1: FOMO in Motion

AI’s Share of Venture Dollars Spikes from 45% to 71% in Just One Quarter, with Increasing Deal Concentration



(Source: Omega Analysis; Data through Q1 2025)

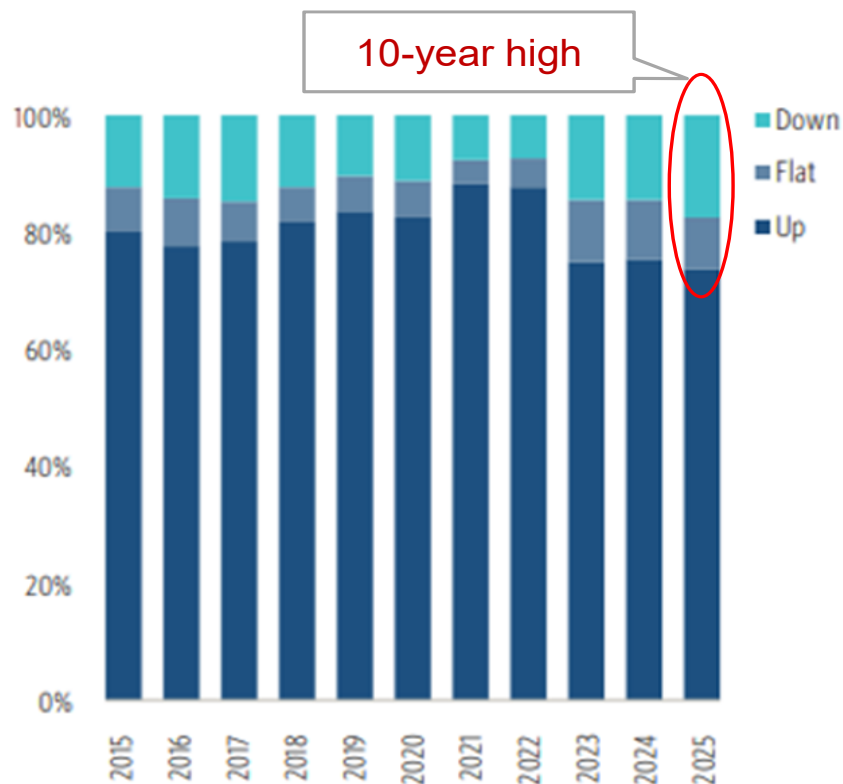
¹ Climax Top: A market top signal marked by a sudden surge in price and volume—often driven by panic buying — usually followed by a sharp reversal, indicating exhaustion of demand and potential trend reversal.

2. Valuation Cracks Emerging

Market Signal:	2025 is tracking toward a record share of flat and down rounds, indicating revenue fragility is already surfacing
Why it Matters:	Hyped valuations relying on shallow fundamentals and weak margins are losing support.
Omega's Edge:	<p>Early-Growth, Asymmetric Upside</p> <p>Omega's core portfolio consists of emerging category leaders with high growth, durable unit economics, attractive margins, and capital efficiency — attributes that compound value even as weaker peers re-rate.</p>

Exhibit 2: Valuation Fragility Surfacing

Percentage of Financings That Are Flat or Down Rounds Reaches Record Share



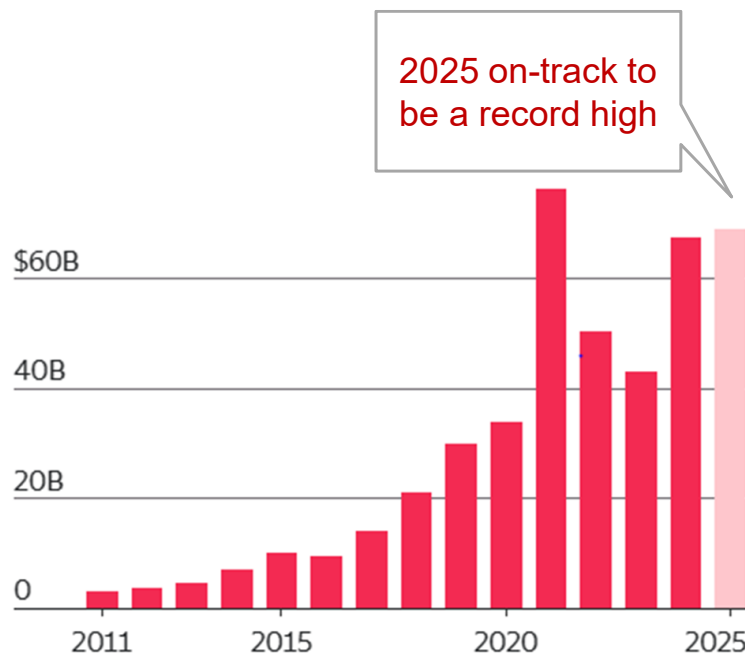
(Source: Omega Analysis; Data through Q1 2025)

3. Insiders Propping Up Marks

Market Signal:	Insider-led financings are set to shatter the 2021 peak — more investors are marking up their own books rather than attracting fresh price-setting capital
Why it Matters:	“Mark-to-what-I-want” valuations obscure true market appetite.
Omega’s Edge:	<p>Conviction Built on Expertise & Enterprise Insight Advantage</p> <p>15+ years of deep immersion across AI and venture cycles give us the pattern recognition and underwriting judgment to price risk accurately while acting with confidence and clarity.</p> <p>Ongoing dialogue with proprietary Fortune 500 decision-makers keeps us ahead of the curve — giving us early insights into market demand, product fit, and buyer priorities before they surface in data.</p>

Exhibit 3: Price Discovery Eroding

Insider-Led Financings Near Peak Levels



(Source: Omega Analysis; Data through Q2 2025)

Four Structural Fault Lines

Below are four structural fault lines we see recurring with striking frequency—systemic weaknesses defining the current AI valuation froth—followed by a few recent examples.

First: Beneath the headline revenue figures of many of today’s AI startups lie business models **heavily dependent on third-party foundation models** owned by the likes of OpenAI, Microsoft, and Google. This dependency is not just operational; it is existential. This puts many of these AI startups in a fundamental dependency position if the underlying foundation model decides to compete with them.

We predicted last year that AI coding assistants would collide head-on with the very platforms they rely on, because code generation is among the lowest-hanging fruit applications for a foundation model. Sure enough, Anthropic launched Claude Code and OpenAI launched its coding model called Codex within days of each other over the last quarter.

Second: Many AI startups are winning investor enthusiasm with demos and **prototypes that look impressive but mask shallow product depth**. The rapid advancement of foundation models and hyperscaler tooling has lowered the barrier to producing slick demos—especially when built on third-party models.

Thanks to the rapid advancement of foundation models and hyperscaler tools, it’s now much easier to generate slick demos—especially when a startup’s AI is built on top of a third-party model—with minimal time and resources. But a dazzling prototype is not a scalable product. It’s akin to using AI to generate a painting in Picasso’s style—that doesn’t make the user the next Picasso.

In the past, building a compelling prototype required hard-won technical tradeoffs; now, AI automates many of those choices, often without founders realizing the architectural constraints they are baking in. These shortcuts become evident only when the company tries to scale, by which time the company is locked into invisible bottlenecks it never consciously chose.

Third: Reported revenue **metrics are increasingly divorced from the durable benchmarks** of classic SaaS businesses. Historically, low churn and high, stable margins anchored software valuations. Today, many AI startups operate with negative or weak gross margins, churn exceeding 20%, and usage-based pricing that makes revenue volatile and easy to overstate.

Customers are still experimenting, and without genuine stickiness or defensible moats, top-line growth is often a vanity metric rather than a sign of durability. As we put it in Forbes: **“Revenues are ego. Margins are intellect.”** Alarmingly, we see companies conflating forecasted or hypothetical revenue with realized ARR—blurring the line between aspiration and reality.

Fourth: The velocity of AI innovation means that **yesterday’s leaders can be leapfrogged overnight**. Today’s hyped startups are not guaranteed staying power; sharper, faster-moving entrants can—and often do—displace them. We have witnessed this pattern repeatedly over the last five years, with once-celebrated “category leaders” losing 80%+ of their value as the ground shifts beneath them.

At Omega, we avoid these pitfalls through a precise lens on what lasting leadership truly requires. As history shows, Google wasn’t the first search engine—but it became the enduring market leader. Too many investors today are paying Facebook-level valuations for the equivalent of MySpace—or worse.

Examples: A former CTO of OpenAI recently raised capital at a \$10B valuation—pre-product. Another OpenAI co-founder raised \$32B for a concept-stage company not expected to launch a product anytime soon. Just days ago, a sub-2-year-old startup saw its valuation jump from \$2B to nearly \$5B in weeks, fueled not by fundamentals but by undisciplined capital chasing momentum.

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