Rothschild & Co
Global Advisory

Growth Equity Update

24 May 2022

- Growth Equity markets have entered a new phase.
- New investment slowing sharply and a concentration on existing portfolio companies.
- Due diligence on new investments has heightened; more structuring to improve downside protection; timescales lengthening. Some of the new investors of 2020/21 less active.
- Refinitiv Index estimates private capital value is down c46% ytd to end April - which would make it 2022's worst performing asset class (NASDAQ c- 28%).
- A slew of down rounds likely – valuation rather than company fundamentals led.
- Founders have new focus on cash preservation as well as the pursuit of revenue growth.
- Best-in-class companies, addressing critical rather than nice-to-have requirements, will continue to attract support.
- Specialist funds (crypto, fintech, cleantech) still need to deploy their capital.
- Looking for less bad to lead the sentiment turn - Market already discounting a lot of bad news…
- Lower valuations offer opportunity for consolidators and private equity.

Interesting times….

Sharp falls in public markets: The Tech heavy NASDAQ market is down 28% ytd, firmly in bear market territory with a number of high-profile stocks seeing very sharp reversals in fortune. The more broadly based S&P 500 is down 18% while the Euro STOXX 50 is down 15%.

Pace of IPOs has slowed: Q1 2022 IPO fund raising globally was US$131bn, half the level of Q1 2021. The pace and ease with which investors can monetise their late-stage private capital investments has deteriorated. There were no traditional IPOs at all in the period February 17 to March 14 in the US. With interest rates still rising and high inflation, most IPOs are in a *'wait and see'* mode; not definitively cancelled but deferred for potentially more auspicious circumstances later in 2022 or beyond.

How much does this impact private markets? Some are still debating whether and how much this impacts private markets. The initial response to the difficulties of the public markets was, in many quarters, to say that private markets are different and that momentum from the vibrant 2021 when private capital fund raising reached record issuance of $286bn, 2.2x the $126bn of 2020, would carry the market. This was fuelled by the concept that the major fundraisings of 2021 and the new entrants into the market (crossover funds, hedge funds, PE moving into early stage) meant that substantial dry powder would support the market.

The new environment: Private capital will clearly not be immune to the vicissitudes of public markets. The outlook might now be summarised as:

- There is a ***delayed effect*** between activity and valuations in the public markets and the private markets but the effect of lower public market valuations will inevitably come through.
- That there is still ***dry powder*** out there, albeit this may now be deployed more to ***supporting existing investments*** rather than new investments.
- That ***best-in-class companies***, addressing critical rather than nice-to-have requirements, will continue to attract support.
- That there is likely to be a ***growing number of down rounds***, although the substantial fund raising of 2021 and the ability of companies to eke out resources, get the support of existing investors and to use inventive structures, may limit the number of these.
- That the ***speed of the investment process*** will slow down considerably.
- ***Valuation criteria*** are likely to see a different emphasis with revenue multiples supplemented by a more traditional mosaic of valuation incorporating DCF and comparative public multiples.
- Rising interest rates have a direct impact on the inputs into valuation models through an increase in the estimated weighted average cost of capital in DCF models. This is most marked in early-stage businesses where the bulk of the worth is in the terminal value. ***A 1% rise in interest rates can be equivalent to as much as c20% off the DCF value of a very high growth early-stage company***.
- There are still ***hotspots for investment*** notably in fintech and software in Europe. Certain investors remain very active in the space with substantial funds to deploy.

Valuation - Multiples rebasing

1. What are we worth?

The Refinitiv Venture Capital Index was down 46% ytd to the end of April.

It is difficult to get an accurate snapshot of the performance of private capital companies. The full impact of the effect of lower public markets on the valuations of private funds and the perceived value of the companies in which they invest may take some time to become clear. Companies returning for funding may find that the valuation environment is very different from the time of their last raise.

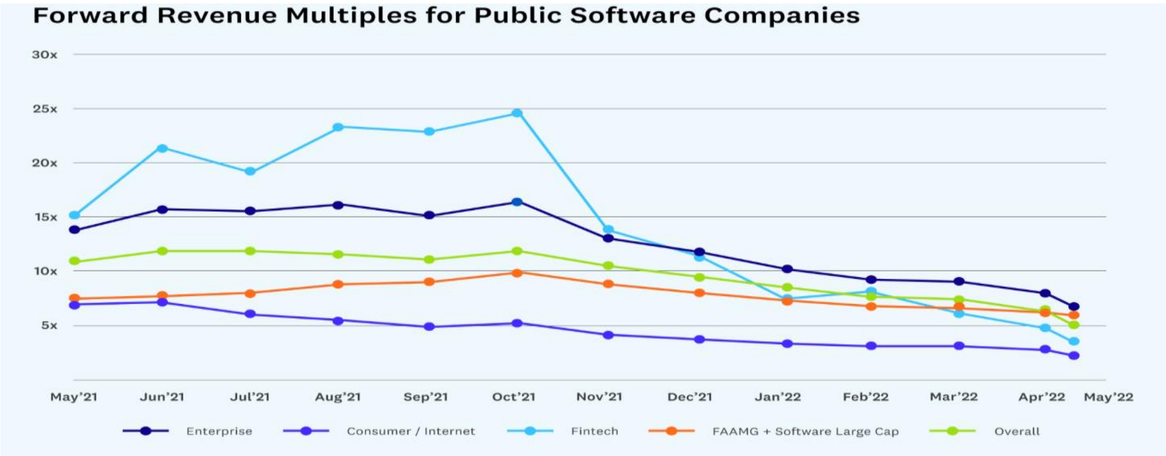
The Refinitiv Venture Capital Index attempts to monitor the real time performance of the venture capital industry. Its methodology, which uses private company data from 22,000 firms and estimates the value of each company over time, is outlined here. (Refinitiv Venture Capital Index). After a 24% fall in April the index was down 46% ytd to the end of April 2022.

REFINITIV VC INDEX MONTHLY PERFORMANCE

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC	YTD
2012										-7.82%	2.43%	-0.57%	-6.12%
2013	3.29%	-0.79%	3.56%	1.31%	4.23%	-4.25%	10.85%	2.69%	7.40%	3.38%	4.71%	4.81%	48.82%
2014	1.92%	7.10%	-8.60%	-4.98%	7.23%	6.38%	3.58%	6.75%	-0.83%	3.69%	6.15%	-4.14%	25.12%
2015	-2.62%	10.09%	-3.12%	4.09%	2.23%	-3.49%	8.12%	-7.99%	-2.36%	16.26%	2.51%	-0.23%	23.19%
2016	-7.54%	-5.70%	10.23%	-11.15%	9.09%	-6.39%	13.63%	1.87%	2.86%	-0.19%	-2.10%	-1.06%	0.37%
2017	8.19%	5.55%	2.43%	5.09%	6.79%	-2.37%	7.72%	4.00%	-1.31%	11.09%	-0.28%	-0.72%	55.83%
2018	17.82%	2.11%	-6.61%	1.79%	9.65%	2.14%	0.14%	10.24%	0.76%	-14.88%	0.43%	-10.89%	8.52%
2019	14.44%	6.63%	5.85%	8.27%	-11.03%	8.91%	3.62%	-4.19%	-3.11%	3.83%	8.95%	4.20%	53.67%
2020	7.91%	-8.74%	-10.87%	14.53%	13.37%	10.47%	9.20%	18.64%	-9.41%	-5.30%	13.61%	5.64%	67.92%
2021	-4.05%	6.75%	2.13%	7.57%	-0.57%	6.96%	4.17%	5.27%	-9.33%	9.99%	-5.69%	-0.22%	23.15%
2022	-20.25%	-13.58%	3.83%	-24.22%									-45.77%

Source: Refinitiv

CapIQ indicates that the median forward revenue multiple of public software companies peaked at c12x sales in October 2021 and is now nearer c5x. The scale of the decline in the public market comps is probably a reasonable indicator (albeit off different absolute valuation levels) of the scale of decline in the value of private companies in the same period.



Source: CapIQ courtesy of Future (a16z.com)

2. Late-stage valuations fall in Q1 22

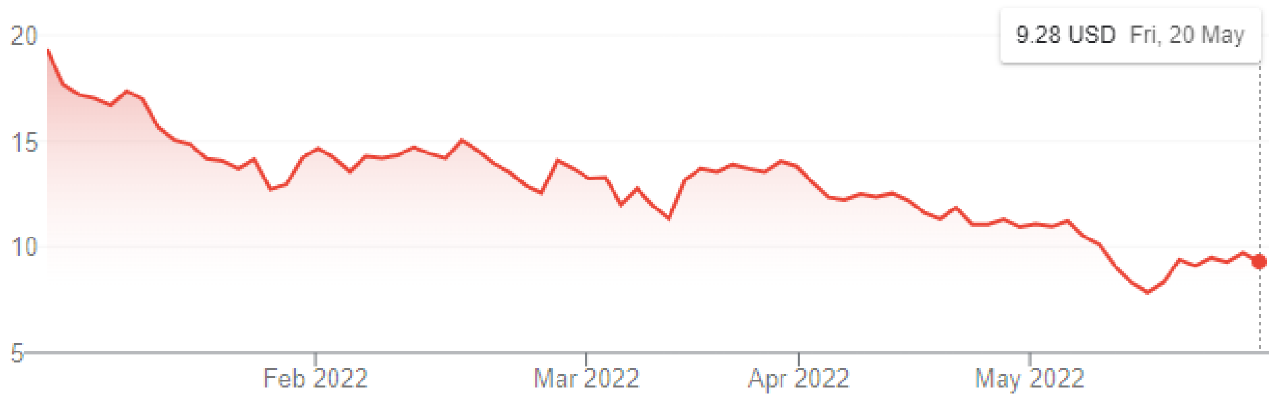
Down about 18% in Q1 2022 versus the 2021 average

According to PitchBook's VC Valuations report released in early May, the average late-stage pre-money venture capital valuation has decreased around 18% from 2021's highs. It finds that the average size of a median late-stage VC deal fell from $134m in 2021 to $110m by the end of Q1 2022.

3. What's happening with SPACS?

Down 52% ytd

The De-SPAC ETF, a passively-managed portfolio of 25 US-listed stocks that went public as the result of a merger with a SPAC, is down 52% ytd. Data compiled by Bloomberg shows that 21 listings that planned to raise a combined $6.9bn were pulled in April. The same data source shows 165 SPACs waiting to go public. Another 600 already in existence are looking for targets ahead of deadlines to return money to investors.



Source: NASDAQ DSPC

Market feedback – a shift in the environment

4. Feedback from one of the largest venture capital investors of 2020/21

2022 capital to be invested will be a fraction of that of 2021 and concentration on existing portfolio.

In 2022 this fund now plans to invest only a fraction of the capital that it invested in 2021. It indicates that its due diligence process has become significantly more in depth and intensive. The concentration is on its existing portfolio, working out which companies need funding and if so where to deploy and on what terms. In many cases it feels the best-case outcome for these companies is that they continue to develop and therefore over time *"grow into"* their 2021 valuations.

5. Commentary from VC firms

Changing investor focus.

Given our range of contacts we see a variety of comments on market conditions from all sorts of investors in venture capital. Current common themes are (i) There is a disconnect between public and private markets and uncertainty on when this will align. (ii) Investor focus will be more on cash burn. Multiples might come down, but companies with good growth and strong management teams will still be raising. (iii) There is a little less competition on deals. (iv) Processes are taking longer. (v) Some portfolio companies are affected by labour market squeeze and wage inflation, and customer exposure in Ukraine. (vi)There are still opportunities out there and some funds are under pressure to deploy.

Demonstrating the deployment, TechCrunch reports that Tiger Global's fund XV, which closed in March 2022 at a value of $12.7bn, is *'almost fully invested.'*

Many down rounds likely – good consolidation opportunities for companies with funds from 2021.

Another investor comments that smaller growth funds, at around $3bn of assets under management, seem to be out of the market completely. Their view is that it feels there will have to be down rounds in many places. It is certain *'there will be some big explosions.'*

In turn, they feel that companies that raised large rounds in 2021 and have good runway for their core business should have the ability to execute buyside M&A on attractive terms

> "We are more conservative when it comes to the pace of new investments. Other private investors are also doing so, I believe. We should be taking a defensive position at the current moment."
>
> *Masayoshi Son – Founder and CEO of Softbank*

Company trading conditions

6. From a European market research start up

Inflation helpful in some sectors.

This company has large consumer packaged goods companies as its major customers and observes that a higher inflation environment can be positive for such businesses given their ability to push up prices on items that consumers will continue to buy. This is reflected in the comments of the founder of the market research business who observes *'We will cruise through it with 40-50% growth and turn a profit next year'.*

7. From a European video games developer start up

Salary inflation pressure of 20-30%

This company is performing well and anticipating a new fund raise in 2022. Amongst other things the proceeds of the raise will be targeted at a 20-30% increase in salaries for its c250 staff. As the founder observes *''it's a tough market for talent and compensation is going up.''*

8. Layoffs in venture capital backed firms

Fast revenue growth, fast cash burn companies may be vulnerable

By contrast, since the start of 2022 over 70 start-ups have made significant layoffs, according to data collected by Layoffs.fyi. This includes a number of businesses that have abruptly closed (including Halcyon Health, Fast in the US, SEND in Australia). Other well-known names have made substantial reductions. Source: Layoffs.fyi

> "Right now, the start-ups that are in the trickiest situation are growth-stage start-ups with unicorn-type valuations, a high burn rate, good but not great metrics, and 12 months of cash. You're going to see a lot of layoffs there, because companies need to urgently cut their burn if they don't want to run out of cash."
>
> *Matt Turck, partner at Firstmark quoted In WIRED*

9. Immediate news flow focused on risks to growth

Immediate news flow will likely stay negative, market is already discounting a lot of bad news, lower valuations imply opportunity.

The immediate macroeconomic news on inflation, rising interest rates, increasing commodity and foodstuff prices and geopolitics remains negative in tone.

The headwinds and their effects: In the private markets it is likely that new investment money will be more difficult to raise, that investors will need to make swift and sometimes harsh decisions on which of their portfolio companies they will wish to support, there may be some withdrawal of the newer types of investor from the venture capital market, there will be a growing number of down rounds, investment due diligence on new investments will heighten and timescales will lengthen. Founders will have to accept lower valuations and more dilution than they have been used to recently and in managing their businesses may require a greater focus on the path to profitability rather than the supremacy of revenue growth.

10. Any reasons for greater optimism?

There are though some notes of succour.

The proposition offered by most private capital companies remains intact. Corporate earnings have thus far remained relatively robust. Disruptive private companies attacking a big market with critical functionality should remain in vogue – look at the $160m raise for the banking software platform Thought Machine at a $2.7bn valuation in recent days. Well capitalised companies with a route to profitability will remain robust and despite a slowing economy will continue to grow.

Taking advantage of lower valuations: In the short-term valuation declines have left some investors in a difficult position. The opportunity though for those with cash and/or the ability to raise money is the chance to invest again at a more favourable stage of the valuation cycle. There is an opportunity here for private equity firms as well.

Less opprobrium in down rounds: There is likely to be a growing number of down rounds, although the substantial fund raising of 2021 and the ability of companies to eke out resources, get the support of existing investors and to use inventive structures, may limit the number of these. Given that many of these down rounds will be caused by the general downturn in valuations rather than the specific issues of individual companies, the opprobrium related to them should be less. It's a function of valuation rather than the underlying merits of the business.

Market already discounting a lot of bad news: The Stock Market is efficient at discounting the known or suspected future. Once the change in mood arrived for growth stocks the fall has been swift and severe. The market is now discounting high inflation, rising interest rates, war and dislocation arising from the Ukraine situation, and the various effects of Covid – on the one hand supply side difficulties arising from the disruption to activity in China and on the other the reversion to a post Covid normality in the 'Covid winners' like Peloton and Netflix. The market has already ignored a largely robust Q1 trading period for corporate earnings on the expectation that things will deteriorate in Q2 and beyond.

And private capital already the worst performing asset class of 2022: Although private capital markets are less liquid and transparent than public markets it is hard to argue that private market valuation falls have lagged those of public markets. NASDAQ is down c28% ytd, the private markets are down, according to Refinitiv, c46%.

Looking for 'less bad' to lead the turn: At present the market continues to absorb the negative change narrative and this will likely continue to dominate the news agenda for a while. In due course this narrative will become 'less bad'. The core factor is probably inflation whose leap has driven the new era of rising interest rates. Once inflation and interest rates appear to have peaked the pressure on markets should ease, the IPO log jam will start to be released with the benefit in turn cascading back through the private capital markets. There are one-off factors that could help – any sign of cessation in hostilities between Russia and Ukraine; the relief from heightened Covid restrictions in China; and, more prosaically that, recession fears having been raised, the global economy simply manages to avoid falling into recession.

When? The joy of private capital is that the timing need not be exact. The J curve of investment in venture capital expects a period of low or negative return after initial investment and several years of investment duration to produce positive returns. Investing in 2022 potentially offers the same style of disruptive company as in 2020/21 but with lower valuations, company managements focused on an arguably more desirable path of growth balanced with a path to profitability and less excess capital funding would-be competitors.

> 'Investing in 2022 potentially offers the same style of disruptive growth company as in 2020/21 but with lower valuations, company managements focused on a potentially more desirable mix of growth balanced with a path to profitability and with less excess capital funding would-be competitors.'

Rothschild & Co: Selected 2022 deals in Growth Equity and Private Capital

A selection of the deals on which we have advised thus far in 2022.

Carsome: US$290m Series E

- US$290m Series E fundraise led by SeaTown Holdings International and 65 Equity Partners Holdings
- The funding round brought Carsome's valuation to US$1.69bn, cementing its position as Malaysia's first and largest tech unicorn
- This was the second fundraise by Carsome this year following the US$170m Series D2 round in September 2021, on which we also advised

Marwyn Acquisition Company II: £500m equity raise

- In March 2022 advised Marwyn Acquisition Company II on the launch of its equity raise, by way of a 12-month placing programme
- The company will seek to raise up to £500m during the next twelve months from equity investors in a structure which is distinct from the typical 'SPAC' structure

FL Entertainment: €7.2bn combination with Pegasus Entrepreneurs and simultaneous c€550m equity raising

- FL Entertainment is composed of Banijay, the largest independent content producer globally, and Betclic Everest Group, Europe's fastest-growing sports betting platform. Pegasus Entrepreneurs is an Amsterdam-listed SPAC backed by Financière Agache and Tikehau.
- Largest ever European SPAC business combination and PIPE raising.
- FL Entertainment becomes Amsterdam-listed, with pro forma market capitalisation of €4.1bn

Insight Partners: strategic investment in Precisely

- Lead investment in a recap of Precisely Software Incorporated, in an investor group that will also include Partners Group, Clearlake Capital, TA Associates, and Centerbridge Partners
- Precisely is a leading data integrity and infrastructure software company targeting enterprise customers. Its software solutions are used to help its customers organize, validate, collate and analyze data in an accurate and efficient manner across diverse environments.

GreenWay: €85m Series C

- In February advised Greenway Infrastructure on its €85m Series C fundraise
- Led by a consortium of infrastructure funds including Generation Capital and Helios Energy Investments. The transaction is the first known investment by an infrastructure fund in an EV charging network in Central and Eastern Europe

Harmay: US$90m Series D

- Harmay is a premium beauty retailer offering 9,000+ SKUs from 400+ international brands in China, and via its WeChat mini-program store
- Advised Harmay on its US$90m Series D equity financing from a group of leading Chinese and global growth equity /venture capital funds
- Raise was led by QY Capital (an entity related to Alibaba New Retail Fund) and included existing investors General Atlantic, Eastern Bell Capital, N5 Capital and Ocean Link

SEBA Bank: CHF110m raise

- In January 2022 acted on SEBA's CHF110m fundraising co-led by a consortium of new investors specialized in blockchain and fintech including Altive, Ordway Selections and Summer Capital
- DeFi Technologies, a NEO listed leader in decentralized finance, and Alameda Research, a global cryptocurrency quantitative trading firm, also participated

First Digital Bank: US$120m capital raise

- First Digital Bank (FDB) is the first bank to receive a banking license in Israel for over 42 years and the first neobank to operate in Israel
- Advised on FDB's US$120m capital raise through a syndicate of investors which included Tencent, SBI Investment Co, Julius Baer, and West Coast Equity Partners
- Transaction valued FDB at US$320m on a post-money basis and built on the success of Rothschild & Co's £325m Series D fundraise for Starling Bank in 2021

Fibrus: £270m seven-year debt package

- Fibrus is an alternative provider of full fibre network infrastructure and broadband in rural UK
- Advised Fibrus in relation to a £270m seven-year debt package, comprising a £200m capex facility, £20m revolving facility and up to £50m uncommitted accordion facility
- We are highly active in European fibre infrastructure with this transaction marking our 7th debt financing mandate in UK fibre in the last 3 years following mandates with G.Network, CityFibre, Covage, Altice, Gigaclear, INEA and inexio

Neuberger: US$4.8bn valuation Getty Images combination

- CC Neuberger Principal Holdings II is a special purpose acquisition company that completed its initial public offering in July 2020, raising US $828m in proceeds
- Advised the company on its proposed business combination with Getty Images valuing the target company at an enterprise value of US $4.8bn, equivalent to 15.2x enterprise value to 2022E Adj. EBITDA of US $315m
- Transaction is expected to close in the first half of 2022, subject to customary closing conditions

Azerion: €1,300m enterprise value combination with EFIC1

- Azerion provides technology solutions to automate the purchase and sale of digital advertising inventory for advertisers, publishers and game creators. It also operates online games and digital content
- Advised Azerion on its €1,300m enterprise value combination with European FinTech IPO Company 1 B.V ("EFIC1") - a SPAC that raised c.€382m through IPO on Euronext Amsterdam in March 2021 with the objective to combine with a fast growing, profitable and tech-enabled European champion
- Landmark transaction - one of the largest de-SPAC transactions across Europe to date

Gousto: £240m primary and secondary rounds

- In January 2022 completed a £70m primary financing for food delivery company Gousto with Softbank Vision Fund 2
- In February we completed the secondary component of £170m from institutional investors including SoftBank, Grosvenor Food & AgTech, Railpen and Fidelity International
- Transaction valued Gousto at £1.2bn on a pre-money basis, ~£400m higher than the December 20 round, with EV/EBITDA in the mid 20s

For more information, or advice, contact our Growth Equity team via the author:

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