Rothschild & Co
Global Advisory

Growth Equity Update

November 2023 – Edition 20

- ***Markets rally***: Central banks have switched from warning of interest rate increases to warning against the expectation of early interest rate cuts. The Fed and the BoE have each held rates at their last two meetings, causing a rally in stock markets since late October
- ***IPO market falters:*** The faltering performance of recent US IPOs and the collapse in the share price of recent UK IPO, CAB Payments, on the back of a profits' warning has checked the momentum of new listings for now
- ***Venture Capital fundraising weak:*** Funds globally have raised $76.3bn after nine months of 2023 versus $171bn for the whole of 2022
- ***Exits weak:*** After 9m of 2023, US private equity exits had a value of $183bn putting the year on track for the lowest total of exits in a decade. Q3 saw exits valued at $44.1bn, down 41% from the prior quarter and – ex Q2 2020 - the lowest quarterly level since the global financial crisis.
- ***UK Mansion House Reforms***: The LSE has fleshed out plans for a new intermittent trading venue. Meanwhile , the Venture Capital Investment Compact sees twenty UK VC firms working with big UK pension funds to promote investment in venture and growth companies
- ***Profitable Klarna***: Klarna's €93m of positive Q3 net income marks its first quarter of positive net income for four years
- ***The NATO Innovation Fund:*** At €1bn it is 2023's biggest European venture capital fund launch.

Markets, interest rates and IPOs

Market rally in late October/ early November

A sharp rally at the end of October means that the S&P 500, having been down almost 10% from the start of September until the 27th October had lost only 3% by November 8th.

As has often been the case in recent times, the perceived direction of interest rates has been the clue to market performance. September's weakness came amidst a bond market decline caused by signs of continued robustness in the US economy. This caused the Fed to be more hawkish in its commentary on interest rates , emphasising repeatedly and strongly that interest rates would remain *'higher for longer'*.

The end October rally in turn was caused by some signs that the pressure on interest rates may not be sustained. The Fed held interest rates unchanged (albeit at a 22 year high) at its meeting on November 1st. This was the second meeting in a row at which it had held the rate at 5.25%-5.5%. This was despite continued signs of robustness in the US economy -GDP grew 4.9% yoy in Q3- and in jobs -nonfarm payrolls increased by 336, 000 in September. It was also despite US inflation in September coming in higher than forecast, up 3.7% yoy versus expectations of 3.6%. The 3.7% rate was flat on that for August. 'Core' inflation trended down from 4.3% to 4.1%.

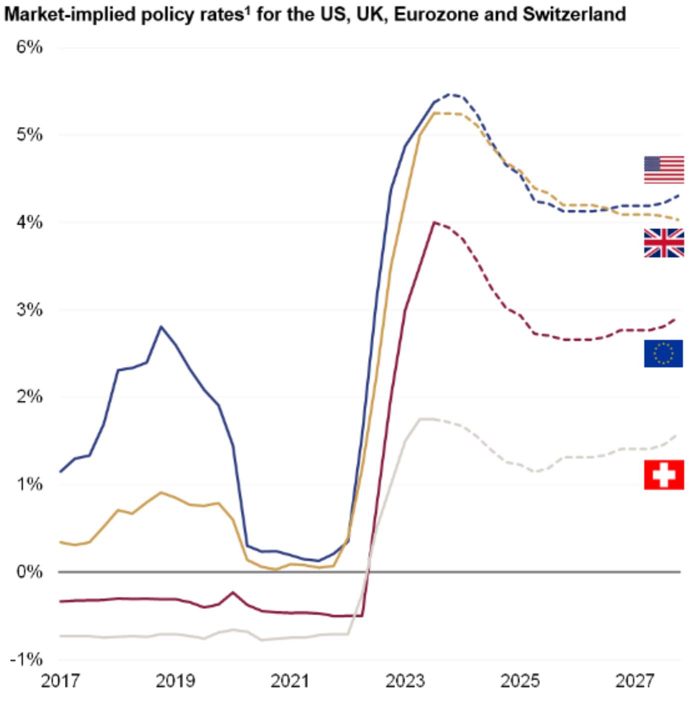
The Fed continued to hit a note of caution with its chair Jay Powell sticking to its *'higher for longer'* stance commenting,

"We are committed to achieving a stance of monetary policy that is sufficiently restrictive to bring down inflation to 2 per cent over time and we're not confident yet that we have achieved such a stance…. The committee is not thinking about rate cuts right now at all."

With rates having been held for two meetings in a row and the Fed also saying it would be '*proceeding carefully'* with future rate rises, the more hopeful commentators observed that the Fed could have been more aggressive in its remarks about keeping interest rates high. As a result the market's thoughts shifted to when interest rates might start to move down. In turn this was encouraged by unexpectedly weak job numbers posted on November 3. The October jobs number rose by just 150,000, well below market expectations of 180,000. In addition the August jobs number was retrospectively put at 165,000, a downwards revision of 65,000. Shortly afterwards the key indicator of business activity in the US service sector, the ISM Services PMI, was reported as declining to 51.8, down from 53.6 in September and below market expectations of 53.

As a result the market no longer expects a further rate increase at the last Fed meeting of the year on December 12 and is now anticipating the first rate cut in June 2024, a month earlier than previously thought.

Interest rates -Tightening cycle coming to a close?



US Federal Reserve

- The Fed Funds target rate range was held at 5.25-5.50% in November, for a second consecutive month
- Fed officials have tentatively signalled one further hike this year, with only modest cuts next year
- Announced the Bank Term Funding Program in March, providing short-term liquidity to depository institutions

The Bank of England

- The base rate was held at 5.25% again in November
- Markets are no longer discount any further interest rate hikes
- The Bank started to actively scale back its balance sheet in November 2022

European Central Bank

- After ten consecutive hikes, the ECB paused in October. The deposit rate is currently 4%
- No further rate hikes have been priced-in by money markets
- Unveiled the TPI² in July 2022, designed to prevent core-peripheral bond spreads from widening too much

Swiss National Bank

- Held its policy rate at 1.75% in September
- Markets are no longer suggesting further rate hikes this year

Source: Rothschild & Co, Bloomberg
1Derived from OIS curves (three-month tenor: USD-SOFR; GBP-SONIA; EUR-ESTR; CHF-CHF OIS).2TPI refers to the Transmission Protection Instrument. Past Performance is not a reliable indicator of future performance and the value of investments and the income from the can fall as well as rise. Correct to 2nd November 2023.

Meanwhile inflation in Europe is falling fast. The October Eurostat figure for ECB inflation was 2.9%, down from 4.3% in September and lower than estimates of 3.1%. Falling yoy energy prices contributed strongly to the decline.

Core inflation in Europe - the number excludes food and energy prices – is higher but fell from 4.5% in September to 4.2% in October, the lowest since July 2022.

Eurostat's flash estimate, released at the same time, showed European Q3 GDP growth contracted by 0.1%.

Interestingly some EU countries are now experiencing low inflation with the rate in Belgium at just 0.36% in October. The Netherlands is experiencing deflation. The inflation rate in the Netherlands was -0.4% in October, down from +0.2% in September.

The European Central Bank held its interest rate flat at 4% at its meeting on October 26th, the first time it has held rates after ten consecutive increases post July 2022. In an echo of the Fed's 'higher for longer' stance the ECB said that interest rates have reached levels that should contribute strongly in the fight against inflation -as long as they are *'maintained for a sufficiently long duration.'*

Like Jay Powell at the Fed, the ECB President Christine Lagarde is insistent that rate cuts are not on the cards,

"Even having a discussion on a cut is totally, totally premature. For the moment we are saying we are steady, we have to hold."

In the UK inflation remains stubbornly high, being reported at 6.7% in September, the same rate as August and slightly worse than expected. The core rate of inflation – it excludes energy and food costs – dropped from 6.2% in August to 6.1% in September. The October figure is expected to be markedly lower due to a high comp and falling energy prices. The Chancellor Jeremy Hunt commented:

"*Inflation rarely falls in a straight line, but if we stick to our plan then we still expect it to keep falling this year."*

At its meeting on November 2nd the Bank of England decided to hold rates steady at 5.25% for the second month in a row. Of the nine members of the Monetary Policy Committee, six voted to hold rates while three (all but one of the external -non BoE staff- members) voted for a quarter point rise. In line with his peers, the BoE governor Andrew Bailey said

"It's much too early to be thinking about rate cuts."

The theme is thus that central banks have switched from warning of interest rate hikes to warning against the expectation of early interest rate cuts.

The ***NASDAQ Composite*** is down 2.7% from the start of September to November 8th. Having been up 32% in H1, and having peaked in mid-July at up 38%, the index is now up 31% ytd.

The tech focused ***NASDAQ 100*** is down 1.2% start September to start November and is up 41% ytd as opposed to 46% at its mid-July peak.

The ***S&P 500*** was up 16% in H1. It has lost c2.7% since the start of September and is now up 15% ytd.

The ***STOXX 600 Europe*** was up 8% in H1, has lost 3% since the start of September and is now up 4% ytd.

The ***FTSE 100*** was flat in H1, is flat since the start of September and is down 2% ytd.

The ***Refinitiv Venture Capital Index,*** which seeks to monitor the real time performance of the venture capital industry and whose performance is partly driven by the moves in public markets, and particularly tech heavy indices like NASDAQ, was up 29% at the end of H1. It is flat since the start of September and is now up 35% ytd (to November 8).

The fall back in equity markets in September came as four high profile number of IPOs were launched in the US market. These bellwethers of IPO market revival have fared relatively poorly. Each of them listed and is now a public company. Three of the four had a *'pop'* on the first day with Birkenstock the exception. As of November 10 only Arm is trading above its IPO price.

Performance of September/October's 'Big four' IPOs.

	Symbol	Offer date	Shares (m)	Offer price $	Amount sold ($m)	First day Close $	Change %	Current price $	Change %
Arm Holdings	ARM	14-Sep-23	95.5	51	4,871	63.6	25	52.3	2.5
Instacart	CART	19-Sep-23	22.0	30	660	33.7	12	25.2	(16)
Klaviyo	KVYO	20-Sep-23	19.2	30	576	32.7	9	25.3	(16)
Birkenstock	BIRK	11-Oct-23	32.3	46	1,486	40.2	(13)	40.6	(12)

Source: Rothschild & Co (prices as at 10th November 2023)

In the UK, CAB Payments, which floated in early July at 335p at a market cap of £851, had a substantial profits warning in late October. The shares fell 70% in a day and have barely recovered with the company's market capitalisation now standing at just £176m.

In Europe several planned IPOs are reported (see FT October 18th) to have been postponed after the disappointing response to the Birkenstock IPO. These include the French software company, Planisware, the German drivetrain technology business Renk, and German B2B fuel charge card business DKV Mobility. Press reports in mid-October suggested that private equity group CVC Partners would imminently announce its intention to float in Amsterdam. Reports a week later suggested that the IPO plan has been postponed until early 2024.

Rothschild & Co strategist Kevin Gardiner summarises the current key drivers of the market in this graphic:

GROWTH *Neutral*	***Economic resilience continues*** The two biggest economies in the world grew at an annualised rate of around 5% in Q3, and output has been resilient even in Europe. We are still not out of the cyclical woods: business surveys remain soft, monetary policy may not have had its full impact yet, and oil prices might spike anew. However, with real wages currently growing again on both sides of the Atlantic, we continue to think that a major downturn is neither necessary nor likely.
INFLATION *Neutral*	***Disinflation becomes more visible*** It looks increasingly as if the corner has been turned on headline and even core inflation, in both the US and Europe. Nominal wage growth remains more restrained than could have been the case – perhaps because pay is rebounding in real terms, as noted – and European energy prices remain far below last year's highs. We continue to think a seventies-style wage-price spiral will be avoided
POLICY *Negative*	***Interest rates: higher for longer*** Central banks realised in 2022 that their credibility was at stake, and eventually acted decisively to raise nominal interest rates. As inflation trends lower, the big central banks are increasingly 'data dependent', and instead of signalling further hikes (which still cannot be ruled out) are suggesting instead that rates will not be falling any time soon. Money markets are increasingly pricing-in rates which are "higher for longer", the sort of plateau-shaped profile we have had in mind
GEOPOLITICS *Negative*	***Geopolitical risk surges anew*** The grim events in the Middle East have suddenly rekindled global tensions, even as the trauma in Ukraine seemed to be contained. Amidst the emotion it is easy to imagine the worst, but as yet, safe haven assets and currencies, and – importantly – oil prices, have not moved outside recent ranges. China-US tensions still matter most, and the temperature around Taiwan remains a little cooler: both sides seem to recognise the importance of stepping back from the brink of mutually assured economic destruction (or worse). However, domestic US politics looks even more dysfunctional than usual
VALUATIONS *Neutral*	***Valuations remain balanced*** Stock market valuations were not stretched even before the last three months' reversal, and earnings expectations continue to stabilise around the prospect of resumed growth in 2024. But in the meantime, even European bonds are starting to offer plausible real yields again, and presenting stiffer competition to stocks – and more credible diversification – than for many years
CANARIES / RISKS *Neutral*	***Low volatility may not last*** Banking risk faded quickly after March's drama, but the risk of financial accidents surely remains elevated after such a sharp normalisation of interest rates. Economies are not out of the cyclical woods just yet. But traded options are not especially expensive, even though the free 'Fed put' has been withdrawn, and bonds increasingly offer more cost-effective diversification, as noted. We remain unconvinced that cryptocurrencies offer anything here

Source: Rothschild & Co

VC Fundraising trends

Tough going - funds globally have raised $76.3bn after 9m of 2023 versus $171bn for the whole of 2022

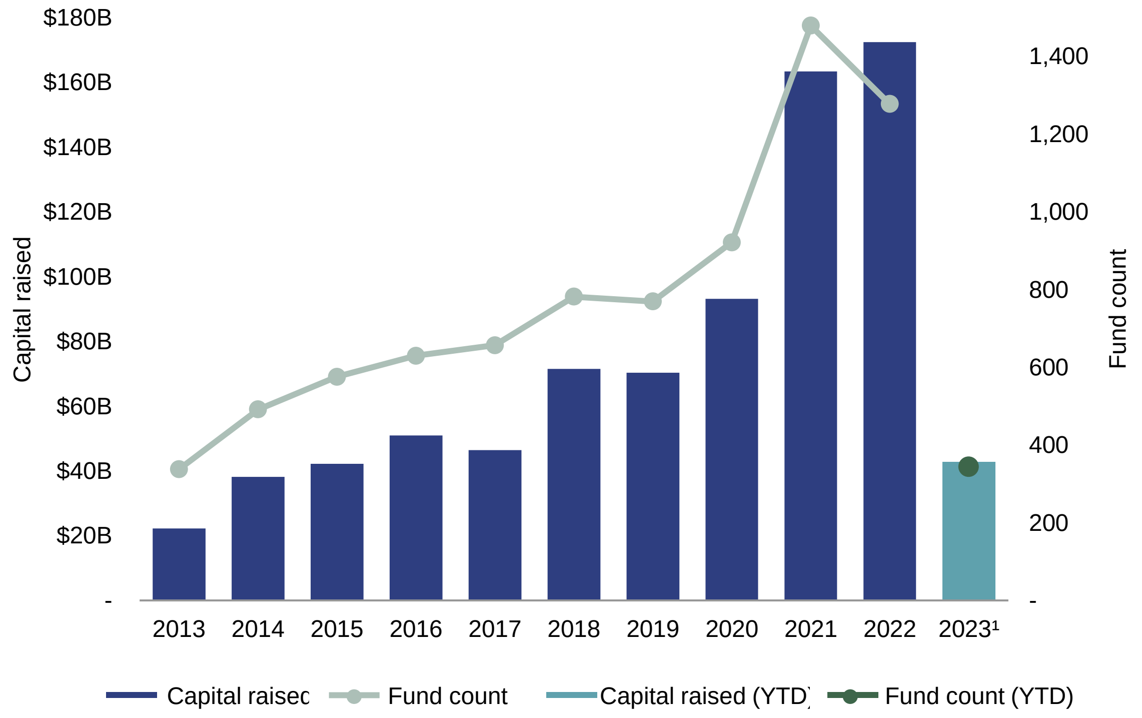
Pitchbook reports that US VC fundraising is at a low ebb. Pitchbook estimates that after nine months of 2023 US VC funds have raised $42.7bn putting US VC fundraising on a run rate to reach c$57bn in the full year. This would compare with $163bn/$173bn for the full years 2021/22. It would represent a fall of 67% yoy.

The volume of new funds is also reduced yoy. The nine month 2023 total is 344 putting it on a run rate of 459 new funds in the year, down from 1480/1278 in 2021/22 , representing a fall of 64% yoy.

One characteristic of the market is that top tier VC firms are still coming for new capital but are raising smaller funds than in the past. This may be a function of the negative returns bring reported by US VC funds. In the October Growth Equity Update we reported that US based venture capital funds' IRR fell to -16.8% in Q1 2022 – the last period for which figures are available.

Some commentators observe that, as well as theoretical gains, Limited Partners are keen to see cash returns from the funds in which they are invested. This may be easier for large firms with a longer track record of activity than it is for newer firms. With exit activity limited by the very slow IPO market and the fall away in M&A activity, this is tougher even for longer duration funds. This may in turn lead to a slowdown of fundraising activity with firms lengthening the gaps between their fundraising rounds.

US VC fundraising activity



Source: PitchBook data; Note: As of Sept. 30, 2023

Data from the Venture Capital Journal shows this US experience is replicated globally. VCJ numbers suggest that funds globally have raised $76.3bn in the first nine months of 2023 versus $171bn for the whole of 2022. In its classification VCJ sees $35bn of funds raised ytd in the US, $21.5bn are multi-regional and $9.3bn each devoted to Europe and Asia Pacific, with the balance of $1.2bn split between Latin America, the Middle East and Africa.

The ten largest funds closed in Q1-Q3 2023 are shown in the table.

10 largest funds closed in Q1-Q3 2023				
Fund Name	**Fund Manager**	**Target Size ($m)**	**Current Size ($m)**	**Region Focus**
NEA 18 Venture Growth Equity	New Enterprise Associates	3700.00	3,200	Multi-regional
New Enterprises Associates 18	New Enterprise Associates	2900.00	3,000	Multi-regional
Bain Capital Venture Fund 2022	Bain Capital	1000.00	1,400	North America
Lux Ventures VIII	Lux Capital Management	Undisclosed	1,150	North America
Nato Innovation Fund	Nato Innovation Fund	Undisclosed	1,079	Europe
Galvanize Innovation & Expansion Fund I	Galvanize Climate Solutions	Undisclosed	1,014	North America
RTP IV	RTP Global	Undisclosed	1,000	Multi-regional
Qiming Venture Partners RMB Fund VII	Qiming Venture Partners	Undisclosed	900	Asia-Pacific
8VC Fund V	8VC	880.00	880	North America
Canaan XIII	Canaan	650.00	850	Multi-regional

Source : Venture Capital Journal

Looking for the exit

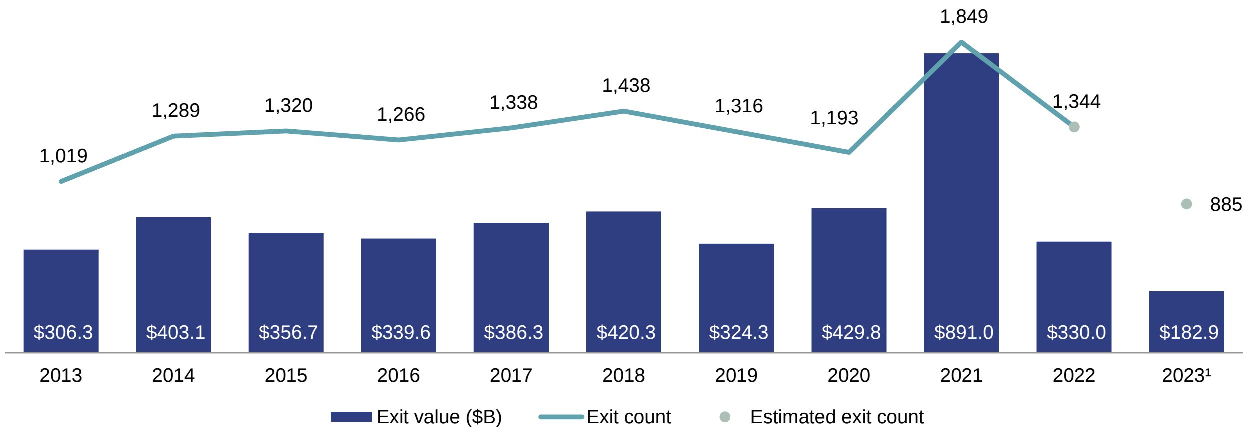
Environment for exits is tough

With the IPO market continuing to struggle and M&A also at a low ebb, private equity is faced with difficulties in finding an exit mechanism for its investments.

Pitchbook estimates that US private equity exits totalled 885 in the first nine months of 2023. These had a value of $183bn, putting the year on track for what would be the lowest total of exits in a decade. Q3 was particularly weak with its $44.1bn value of exits down 41% from the prior quarter and reaching – ex the Q2 2020 lockdown quarter- the lowest quarterly level since the global financial crisis. The Q3 total was 84% lower than the Q2 2021 peak.

It is a similar picture in Europe where Pitchbook estimates the number of exits after 9 months of 2023 down by almost half versus the same period in 2022.

US PE Exit activity at a low ebb



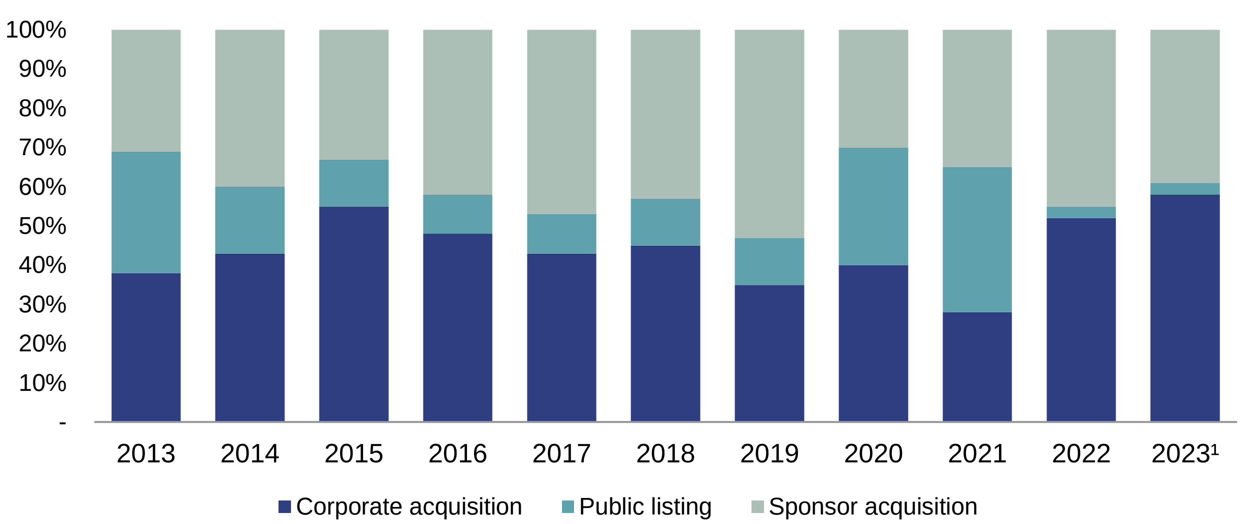
Source : Pitchbook; Geography US; Note : As of September 30, 2023

Most private equity exits are being achieved through corporate M&A, which accounted for 55% of exits in the first nine months of 2023. Q3 though was weak with the number/value of exits via M&A falling from 101/$39bn in 2022 to 94/$25bn in Q3 2023. This means Q3 2023 had the lowest volume quarterly exit count to corporates on record and the lowest quarterly exit value since the Q2 2020 lockdown quarter.

After flashes of activity in September, the poor performance of recent IPOs means that exit via the IPO route remains difficult. Many market participants view the IPO market as not likely to pick up from its current low levels until interest rates actually begin to fall – generally seen as not before the end of Q1 2024. Three of the four big recent US IPOs (Instacart, Birkenstock and Klaviyo) are trading below their IPO price. Arm Holdings is modestly above its issue price.

The chart shows just how far IPOs have fallen away as an exit route for PE backed assets in 2022 and 2023. With corporate M&A at 55% of the total, and sponsor to sponsor exits at 42%, IPOs accounted for just 3% of P/E exits in the first nine months of 2023.

Share of PE exit value by type



Source : Pitchbook; Geography : US Note : As of September 30, 2023

London’s new trading venue

An intermittent trading venue for private companies

In the UK in early July the Chancellor Jeremy Hunt launched his Mansion House Reforms. The core of the initiative is an agreement signed by nine of the UK’s largest pension providers to commit 5% of their ‘default’ funds from defined contribution pensions to private companies and start-ups by 2030.

The government hopes this may unlock an additional £75bn of financing for growth by 2030. This will, according to Mr Hunt *“finally address the shortage of scale up capital holding back so many of our most promising companies.”*

Accompanying this, as part of his reforms for the UK listings market, Mr Hunt has proposed an *‘intermittent trading venue’* for private companies. The proposal is a new hybrid trading platform to allow private companies to trade periodically rather than continuously. The trading venue will seek ‘*to bridge the gap between private and public markets.*’ The intention is that this should be in place by the end of 2024.

His report outlined the plan. “*And, in a highly innovative step which represents a global first, we will establish a pioneering new ‘intermittent trading venue’ that will improve private companies access to capital markets before they publicly list. This will be up and running before the end of 2024, and put the UK at the forefront of capital market innovation.*

Some details of how the new intermittent exchange would work have now been revealed by the London Stock Exchange.

Darko Hajdukovic, Head of New Primary Markets at the LSE comments of the private markets,

“What we see currently is fragmented liquidity, we see lack of transparency, we see uncertainty in terms of execution, and uncertainty [on] timing of execution” observing that private companies face the problem of a *‘lack of access to capital or a high cost of capital, or both. One of the reasons is existing investors do not have clear exit strategies. There are limited options available to them to enable liquidity in their shares."*

Having identified the problem, the LSE’s proposal is that private companies who have registered with the LSE will be able to opt in to trade shares at a set number of auctions every year. Initially these auctions are likely to be held monthly. The registered companies can choose whether or not to participate each month. The companies would remain private but benefit from the public market’s infrastructure.

The market would, by its nature, be only a secondary market. No new equity can be sold via this mechanism. It would though allow founders, employees, investors and other holders of the private company’s equity to monetise all or part of their shareholdings. It would also allow new investors to buy equity in these companies from existing shareholders.

A company joining a public market is required to issue a prospectus. The LSE has indicated that companies participating in the intermittent market would need to provide some information, that this will fall well short of the scale required for an IPO but that the exact criteria have not yet been established.

The LSE claims that it has already received interest from companies from around the world in participating in the new trading venue.

“Investors will get a lot of benefits... certainty of execution ... additional information and ... easier price discovery. We really want to solve a genuine problem in the market around companies being able to access the capital they need to grow."

Darko Hajdukovic, Head of New Primary Markets at the LSE

There are already, of course, junior markets In London. AIM, which is the LSE’s junior market, is an exchange which allows companies to float with a much lighter regulatory and disclosure burden. Indeed the companies listing on AIM can side-step even this light regime if they explain why they are not complying with AIM’s regulatory requirements. AIM uses a system of nominated advisors (Nomads) to advise companies, to ensure that they comply with the listing requirements and to act as some reassurance to investors that the companies in which they are invested are receiving oversight in a largely self-regulatory regime.

The UK's other regulated market is the Aquis Stock Exchange. It is specifically targeted at small growth companies and it has two tiers.

The ***Access*** tier is designed to be the first stage of being a publicly quoted company. Access is aimed at early-stage companies with little or no trading history.

The ***Apex*** tier is an upper tier market segment for larger, more established growth companies. Apex companies are expected to have a proven growth strategy and higher standards in governance.

Both tiers act as primary and secondary markets and a source of continuous trading and liquidity. As with AIM the key appeal to companies is the light regulatory and disclosure burden required to get a listing.

Arguably the key difference between the new LSE intermittent trading venue and the existing junior markets is the idea that the new market will have intermittent rather than continuous trading. Of course even continuous markets in small, illiquid companies have a de facto intermittent trading element as bargains of any size will require matching and this can take some time. The new market simply appears to formalise this with its 'once-a -month' approach. Beyond that the differences in regulatory and disclosure requirements, as well as tax treatments for employees, founders and share buyers, may emerge as the other potential differentiators.

The Venture Capital Investment Compact

UK Venture Capital firms to work with the big UK pension funds to promote investment in venture capital and growth companies as part of the UK Chancellor's Mansion House reforms.

In the UK in early July the Chancellor Jeremy Hunt launched his Mansion House Reforms. Amongst other things these are designed to promote the channelling of defined contribution pensions into private companies. The core of the initiative is an agreement signed by nine of the UK's largest pension providers to commit 5% of their 'default' funds from defined contribution pensions to private companies and start-ups by 2030.

The nine DC pension schemes who have signed up to the Chancellor's 'Mansion House Compact' are Aviva, Scottish Widows, L&G, Aegon, Phoenix, Nest, Smart Pension, M&G and Mercer. These funds represent around two-thirds of the UK's DC workplace market

At present these funds invest just 0.5% of their c$500bn of assets to unlisted UK companies. The intention is that, if the scheme is adopted more broadly by other pension providers, the proposed changes could induce c£50bn of additional investment in start-ups by 2030.

Mr Hunt has also targeted a shift in the investment intentions of local government pension scheme allocations. The aim is to encourage such schemes to double investments in private equity to 10% from c5% presently. The government hopes that this may amount to c£25bn additional investment into private companies bringing the total from these initiatives to £75bn.

As part of this process the British Private Equity & Venture Capital Association (BVCA) is promoting a ' Venture Capital Investment Compact'. The BVCA looking to recruit around twenty funds who will work with the nine pension funds signed up to the Mansion House Compact. The aim is to get the VC funds involved to work with the pension funds to iron out operating difficulties faced by the pension funds in channelling their investments into venture capital . Such things might include initiatives to help with liquidity and more regular fund valuation schedules to enable pension funds more accurately to track the progress of their investments.

In late October twenty venture capital firms with £25bn of assets under management and with investments in more than 1800 companies signed up to the BVCA's compact. The signatories include Octopus, Balderton and Lakestar. These twenty VC firms have committed to attracting UK pension funds as limited partners into the funds they manage. They will also look to work with pension funds to produce suitable investment structures for the pension players.

There was no commitment on the level of fees to be charged by the venture capital bodies to pension funds. Historically the industry has worked with a 'two and twenty' model charging 2% of assets under management and 20% of profits over a pre-agreed benchmark.

“Many overseas investors have jumped at the chance to invest in – and benefit from – the performance of innovative UK firms. UK savers must have access to the same opportunity. We want to seize this opportunity for British pension savers to benefit from returns garnered from VC innovation in the UK…”

BVCA Chief Executive Michael Moore

The full list of signatories to the Venture Capital investment Compact and an outline of its scope and purpose can be found here: BCVA Investment Compact.pdf

The BVCA claimed at the announcement of the signatories that the UK VC industry has outperformed listed UK equities. It cited research stating that UK managed Venture funds have returned 16.7% pa over the ten years to end December 2022 and UK Growth Equity Funds 12.8% pa. The FTSE All Share Index has returned 6.5% pa.

The Chancellor, Jeremy Hunt commented, *“This compact is a huge win – demonstrating that our world-renowned venture capital firms stand ready to help our pension providers allocate funding to our high growth companies.”*

Klarna- Profitable Q3

Quarterly positive net income for the first time in four years.

We have been charting the financial turnaround of Klarna in recent Growth Equity Updates. Klarna’s improving financial results continue with the company having reported its first quarter of positive net income for four years.

In Q3 2023 (end September) Klarna had a net profit of SKr90m (€8m), compared with a loss of SKr2.1bn (€179m) in the equivalent 2022 period.

Gross Merchandise Volume (GMV) was up 22% yoy and Klarna’s revenue rose 30% yoy to SEK 6.0bn (2022 SEK 4.6bn). The take rate (Revenue/GMV) continued its upwards progression at 2.47%.

The adjusted operating result – which excludes restructuring costs, share based payments, related payroll taxes and depreciation and amortisation - rose from a loss of SEK 1.6bn in Q3 2022 to a positive SEK 0.5bn result in Q3 2022. Within this credit losses fell by 46% from SEK1.5bn to SEK 0.8bn. Credit losses as a percentage of GMV reduced 56% yoy.

The US achieved its fourth consecutive quarter of profit with GMV increasing 46% yoy and credit loss rates reducing by 28%.

Sebastian Siemiatkowski, the CEO and Co-Founder of Klarna commented;

“With a profitable quarter and continuous double digit growth, we have achieved exactly what we set out to do. This fantastic success sets us up for the busiest shopping period where our AI powered products will help consumers make their money go further, find the best deals, and get inspired. Our growth has accelerated in Q3 and we will build on this momentum in Q4 with further investments to drive value to our consumers and merchants alike.”

Alongside the results the FT reports that Klarna is establishing a UK holding company. It presently has a Swedish banking licence. The UK holding company was described as an *‘early step on a journey towards eventual IPO’.*

In an interview with City AM Sebastian Siemiatkowski said in relation to Klarna’s future:

“*I’ve always had three tick boxes that I want to have before thinking about a public listing. One was, I think we should be a global company. And the way the world works, global means US. You have to be established in the US.*

Secondly, you have to have a sustainable business model. A year ago, we were growing heavily in the US, we saw fantastic growth but we were running at a negative gross margin so we were losing money on every transaction. [Klarna has now] matured [and is making money on every transaction].

And then the third thing is, which I think Google had amazingly in ’05 when they listed they still had tremendous amount of growth ahead of them.

I sincerely believe that within a few years, we'll see the emergence of four or five very significant retail banking slash FinTech players that will disrupt this market. For Klarna, I think we have a chance of being one of those four or five global companies."

The NATO Innovation fund

At €1bn it is 2023's biggest European venture capital fund launch

The biggest venture capital fund to be launched in Europe in 2023 is the NATO Innovation Fund (NIF) . Launched by the North Atlantic Treaty Organisation it is described as '*the world's first multi-sovereign venture capital fund*.'

Its stated purpose is to invest in start-ups *developing cutting-edge technological solutions, leveraging the potential for commercial innovation to address critical defence and security challenges*. The Fund will invest €1bn in early-stage start-ups and venture capital funds that are working on dual use developing emerging and disruptive technologies of priority to NATO.

The ***nine priority verticals*** identified by the NIF are artificial intelligence (AI); autonomy; quantum; biotechnologies and human enhancement; hypersonic systems; space; novel materials and manufacturing; energy and propulsion and next-generation communications networks.

The Fund's Limited Partners include 23 NATO allies at the highest levels of government, venture capital, innovation and defence. The countries involved are Belgium; Bulgaria; Czechia; Denmark; Estonia; Finland; Germany; Greece; Hungary; Iceland; Italy; Latvia; Lithuania; Luxembourg; Netherlands; Norway; Poland; Portugal; Romania; Slovakia; Spain; Türkiye and the United Kingdom. Sweden will join once it completes its full accession to NATO and will add another €40m to the NIF's funding.

The NIF does not, as yet, include the United States although the US has not ruled out joining at some stage in the future. The US already has a similar body, In-Q-Tel based in Arlington, Virginia. IQT supports the CIA and other US intelligence agencies. Its investments typically range between $0.5m and $3m and it focuses on '*mission critical areas'* such as digital intelligence; trusted infrastructure; Autonomous systems; Industry 4.0; Intelligent connectivity; data analytics; AI and machine learning and IT platforms.

The intention is that the NIF will make direct investments into start-ups located in any of the 23 participating Allied nations. It can also make indirect investments into deep tech funds with a trans-Atlantic impact.

The style of the fund is that "*It will provide patient capital to meet the needs and timelines of deep tech innovators and to secure an enduring future for the Alliance's 1 billion citizens."*

NATO's assistant secretary-general David van Weel commented in an FT interview that *"There's a lack of venture capital for deep tech, especially in Europe. We wanted to provide more capital on our side to invest in these companies to avoid them having to turn to Chinese investors."*

The chair of the NATO innovation Fund is Klaus Hommels, the founder and chair of Lakestar. He commented:

"As the importance of technology in all parts of our lives increases so does the need for digital and technology sovereignty. The NIF is the first multi-sovereign venture capital fund that will support emerging technologies and drive much needed innovation in areas touching the Alliance's objectives."

Two more members of the NIF's board are Fiona Murray, associate dean of innovation and inclusion at the MIT School of Management and Roberto Cingolani, the former minister for ecological transition and founder of the Italian Institute of Technology.

The investment management arm of the fund is based in the Netherlands. It will be led by Andrea Traversone, former managing partner at UK-based Amadeus Capital. The NIF will lead early stage investments with initial cheque sizes of up to €15m. The intention is that the NATO network of c90 NATO-affiliated test centres and more than 6,000 Allied scientists will be available *'to pressure-test solutions.'*

There is an existing initiative within NATO , the existing Defence Initiative Accelerator for the North Atlantic (DIANA). The intention is that the NIF and DIANA will cooperate closely. DIANA has a network of 10 affiliated accelerator sites to support its accelerator programme.

Our views on the state of the venture capital markets

2022 saw sharp falls in the public markets on the back of a combination of global inflation, rising interest rates, and increased geopolitical risk. By Q4 2023 inflation is coming down and interest rates appear to be at their peak, albeit the peak may be sustained for longer than the market originally hoped. There has been a substantial rally on NASDAQ, led by the major tech stocks, a rally more palely reflected in other markets. The Refinitiv Venture Capital Index, which seeks to monitor the real time performance of the venture capital industry, fell 55% in 2022. YTD to early November it is up 35%, meaning the total fall since the start of 2022 is now 39%. Our summary of the outlook is:

- The deterioration in the interest rate, inflation and macro-economic environment has had a sharp impact on valuations in private markets. The scale of the fall in the Refinitiv VC index in 2022 was much more substantial than the 33% fall on NASDAQ. This has been reflected in some big valuation reductions in some high-profile VC rounds
- There is substantial dry powder in the VC industry. This though appears to be prioritised to support existing rather than new investments
- Best-in-class companies, addressing critical rather than nice-to-have requirements, continue to attract support. There are still hotspots for investment most notably in Artificial Intelligence. Certain investors remain very active in the space with substantial funds to deploy
- The speed of the investment process has slowed considerably. The volume of new deals has reduced. The level of diligence on new deals has stepped up
- For much of the year big late-stage deals were few and far between with the strongest part of the market in terms of appetite being in Seed and Series A where there is less immediate pressure on valuation. The last though have seen a notable pick-up in large later stage deals, most notably in ClimateTech and Software
- 2023 has seen more downrounds, albeit the substantial fund raising of 2021 and the ability of companies to eke out existing resources has limited the number of these
- It seems likely that the more difficult conditions for fundraising, and the lack of a clear path in some cases to early cash positive status, will mean a flurry of venture capital backed businesses looking to sell or merge their businesses
- Valuation priorities have shifted with investors having moved away from an emphasis on revenue growth and revenue multiple emphasis. There is a sharp focus instead on profitability (or a rapid path to it), on positive free cash flow and an emphasis on DCF and comparative based multiples.

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

A selection of recent deals on which we have advised.

Skyroot: $51m Series B

- Sole adviser on its Series B raise of INR 4,030m (US$51m) from GIC Private Limited and LK Advisers
- Looking to 'uberize' space for small satellite operators, Skyroot will use its differentiated solid propulsion technology to offer on-demand, affordable launch vehicles. It plans its first orbital launch by early 2023

YuLife: c $800m Series C

- Adviser to YuLife on its investment by T Rowe Price
- TRP's first ever private investment in European FinTech
- The Series C extension values YuLife at c.$800m, a 3x uplift from its valuation at its Series B announced in July 2021

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
- Follows US$170m Series D2 round in Sept 2021, on which we also advised

Marwyn Acquisition Company II: £500m equity raise

- 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, largest independent content producer globally, and Betclic Everest Group, Europe's fastest-growing sports betting platform. Pegasus is an Amsterdam-listed SPAC
- Largest ever European SPAC business combination an PIPE raising

Insight Partners: strategic investment in Precisely

- Led 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

Kpler: Minority stake Acquisition

- Adviser to Five Arrows Growth Capital and Insight Partners on joint acquisition of a minority stake in Kpler Holding S.A. from its founders
- Consisted of acquisition of c.30% of secondary share capital of Kpler plus primary investment of €20m
- Kpler is a leading SaaS provider of data and analytics to energy markets

Harmay: US$90m Series D

- Advised Harmay on its US$90m Series D equity financing from a group of leading Chinese and global growth equity /venture capital funds
- Harmay is a premium beauty retailer
- Raise was led by QY Capital (an entity related to Alibaba New Retail Fund) plus existing investors

SEBA Bank: CHF110m raise

- Advised on fundraising co-led by a consortium of new investors specialised in blockchain and fintech including Altive, Ordway Selections and Summer Capital
- DeFi Technologies, leader in decentralized finance, and Alameda Research, a global cryptocurrency quantitative trading firm, also participated

First Digital Bank: US$120m capital raise

- Advised on capital raise through a syndicate of investors including Tencent, SBI Investment Co, Julius Baer, and West Coast Equity Partners
- First bank to receive a banking license in Israel for over 42 years and first neobank in Israel

Fibrus: £270m seven-year debt package

- Advised on package comprising a £200m capex facility, £20m revolving facility and up to £50m uncommitted accordion facility
- Fibrus is an alternative provider of full fibre network infrastructure and broadband in rural UK
- Highly active in European fibre infrastructure: our 7th debt financing mandate in UK fibre in last 3 years

Neuberger: US$4.8bn valuation Getty Images combination

- Advised on business combination valuing Getty at an enterprise value of US $4.8bn, equivalent to 15.2x enterprise value to 2022E Adj. EBITDA of US $315m
- CC Neuberger Principal Holdings II is a special purpose acquisition company that completed its IPO in July 2020, raising US $828m in proceeds

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

- Advised on combination with European FinTeach IPO Company 1 B.V - a SPAC that raised c.€382m through IPO on Euronext Amsterdam in 2021
- Azerion provides solutions to automate purchase and sale of digital advertising inventory
- Landmark transaction - one of the largest de-SPAC transactions across Europe to date

Gousto: £240m primary and secondary rounds

- £70m primary financing for food delivery company Gousto with Softbank Vision Fund 2 in Jan '22
- In Feb '22 secondary component of £170m from institutional investors including SoftBank, Grosvenor Food & AgTech, Railpen and Fidelity
- Valued Gousto at £1.2bn on a pre-money basis

GreenWay: €85m Series C

- 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

Diabeloop: €37m Series C

- Advised on its €37m Series C capital raise
- Following extensive investor outreach, LBO France was chosen to lead the raise jointly with existing investors including Supernova Invest, AGIR à dom., CEMAG INVEST and Odyssée VenturesA
- Diabeloop provides automated insulin delivery system and handset facilitating diabetes management

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

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