Rothschild & Co
Global Advisory

Growth Equity Update

September 2023 – Edition 18a

- We focused in our August edition on the impending *'Sandals to Semiconductors'* revival of the IPO market with the then potential IPOs of Arm and Birkenstock. Arm has subsequently priced at the top of the range and Instacart and Klaviyo have also kicked off their offerings
- In this edition we look at the dynamics of the three tech IPOs . The common features are a degree of caution on valuation and the use of cornerstone investors. Each of these companies is profitable, Klaviyo recently so. Appetite - Arm was five times or more subscribed - appears good
- Should private companies float at a discount to previous valuations? *"My advice to a company, if you can go public, you want to go public, you need to go public, don't wait too long." Jamie Dimon*
- The Rothschild & Co/Redburn Atlantic Growth Equity Conference was held on September 6th and was focused on IPO preparation. Click here for the Presentations and recordings
- The SEC has approved new regulations requiring private funds to give more information to their investors. The rules cover private equity, venture capital and hedge funds who will be required to report quarterly to their investors. We look at the ramifications
- Klarna returned to adjusted operating profit in Q2 2023 – a major landmark. In Q2 2022 it lost SEK 2.9bn ($260m). On demand grocery delivery is further back on the path to profitability. Getir is reportedly raising c$500m at a valuation of $2.5bn, versus its March 2022 peak of $11.8bn
- The three year anniversary of the UK Future Funds scheme, designed to help British startups in the Covid era, is causing problems for some
- Markets have stalled since mid-year as investors digest 'higher for longer' interest rates. NASDAQ is up 33% ytd, the S&P 500 17%, STOXX Europe 600 7%, the FTSE 100 1% and the Refinitiv Venture Capital Index is up 35% ytd.

A tale of three IPOs

We wrote in the August Growth Equity Update about the impending revival of the IPO market with what we characterised as the *'Sandals and Semiconductors'* phenomenon – a flush of IPOs to come led by Arm and including Birkenstock.

Our assertion was that shares have performed, volatility has reduced, interest rates are peaking, inflation is falling, a soft economic landing is on the way and that strategists are upgrading their year-end market targets setting a strong backdrop for the IPO market to resume.

Below we look at three of the key tech IPOs that have been announced so far- those of the SoftBank owned chip designer Arm, grocery delivery platform Instacart and the marketing automation platform, Klayivo.

If these IPOs are successfully concluded it would set the scene for a return to an active IPO market. There will still be challenges – in particular around valuation. Given the vicissitudes faced in public markets since 2021 investors will expect IPOs to come at more modest valuations with the market more circumspect about the level of premium it is willing to pay for growth.

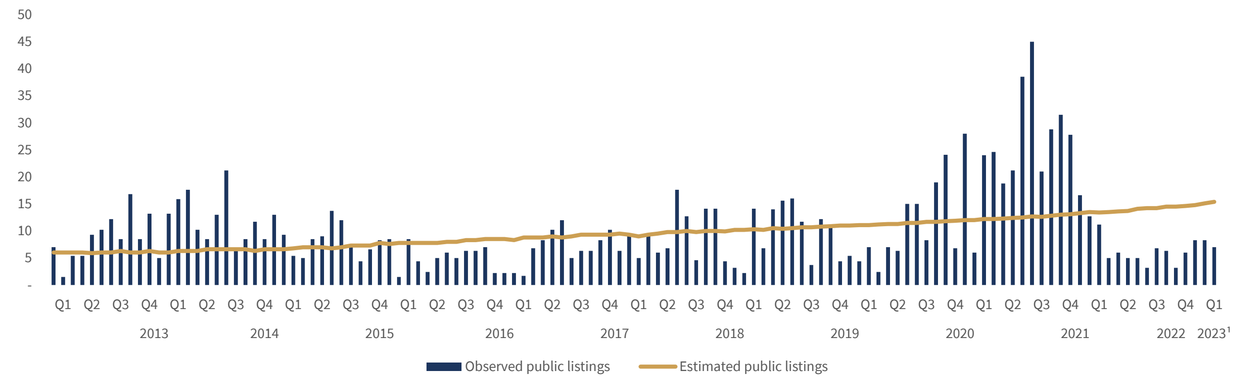
Owners of businesses looking to exit need to measure their desire to access liquidity and monetise assets after a long hiatus in the IPO market with the potential need, initially at least, to accept a lower valuation. If, however, these IPOs go ahead, achieve reasonable valuations and trade decently in the aftermath, then there appear to be few reasons for the IPO market not to broaden out. There has been a hiatus in the market for well over 18 months, there is a backlog of companies waiting to IPO and in many cases (Stripe etc) some substantial valuation revisions have already been made by their owners.

Indeed there are already signs of the IPO market broadening out. The pipeline of potential offerors continues to grow. As we anticipated in August Birkenstock has filed for its IPO. The company will list on the NYSE under the symbol BIRK. Private equity firm L Catterton bought a majority stake in the company in 2021 at a valuation of $4.3bn. LVMH also owns a stake. Bloomberg reports that the IPO may put a valuation of $8bn on Birkenstock which had annual sales of c$1.2bn and EBITDA of $435m in the year to September 2022.

Amer Sports, which makes the Wilson tennis racquet, has filed for an IPO with a target listing date of early 2024. According to a report on Bloomberg the valuation could be as much as $10bn and the amount sought in the IPO in the range of $1bn-$3bn.

Pitchbook estimates that the hiatus in IPOs in the last 18 months or so has left a backlog of roughly 220 US companies who might under normal conditions have listed in this time. This is illustrated in the chart.

Monthly VC-backed public listing count versus estimated IPO backlog



Source: PitchBook • Geography: US
Note: As of June 30, 2023

We are not the only ones to be anticipating the revival of the IPO markets. Here is the Goldman Sachs CEO David Solomon.

"Over the course of the next few months, especially if Arm and some of these other IPOs go well, I think you're going to see a meaningful increase in activity.''

And here is some robust advice from the CEO of JP Morgan, Jamie Dimon. He observes that private companies should not delay their IPOs just because their potential valuation might be lower than it was during a 2020/21 funding round. His advice to companies thinking like that is that they,

"need to grow up. My advice to a company, if you can go public, you want to go public, you need to go public, don't wait too long."

Looking at the three tech IPOs leading the charge:

<u>**ARM Ltd – Shoulder arms**</u>

A lot of column inches have been devoted to the Arm IPO. The key is that the Arm IPO is going ahead – though there has been debate over growth prospects and valuation. Looking at the recent developments.

SoftBank acquired Arm in 2016 for $32bn. At the time SoftBank paid £17 per share for Arm, which was quoted on the LSE. It was a 43% premium to its closing price on the day before the offer and 41% higher than Arm's all-time high.

SoftBank recorded the fair value of Arm at $45bn in its Q1 results to the end of June 2023. These results came out on August 8th. SoftBank asserted that '*AI on Arm is Everywhere*'. It also highlighted NVIDIA's Isambard 3 Supercomputer announced in May 2023 that will feature Arm based NVIDIA Grace CPU 'superchips'.

SoftBank purchase of minorities values Arm at $64bn: Subsequently SoftBank moved to take full control of Arm by buying the 25% that it did not already own. The purchase of 25% of Arm from the Vision Fund for $16bn on August 18th implied a valuation for the entity of $64bn.

Early reports suggested an IPO valuation of $60-80bn: In early August the Financial Times was reporting that, during discussions with potential cornerstone investors, Arm was targeting a valuation of up to $80bn. Bloomberg also carried the $60bn-$80bn potential price tag.

Which slimmed to $50bn-$55bn immediately pre IPO: As August progressed and the IPO filing neared, the market expectation was that the valuation would come in a range of $50bn-$55bn.

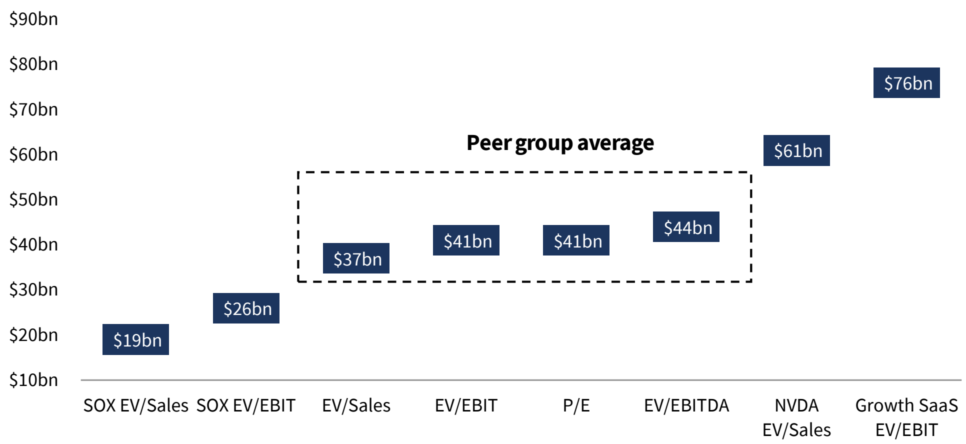
Initial price range $48bn-$52bn: On September 5th the initial pricing range for the IPO was announced. The price range was $47-$51 per share, valuing ARM at between $48.2bn and $52.3bn. Arm attracted up to $735m in investment from cornerstone investors including AMD, Apple, Cadence, Google, Intel, MediaTek, NVIDIA, Samsung, Synopsys and TSMC.

Only 9.4% of Arm's shares are being sold meaning that at the mid-point ($50.25bn) around $4.7bn of stock was being made available.

Strong demand -priced at top end: On September 11th it was reported that strong demand would mean that the books for the Arm flotation would be closed a day early with books at that point said to be five times oversubscribed. On September 13th it was announced that the stock would be priced at the top end of the range at $51 per share, a valuation of $52.3bn.

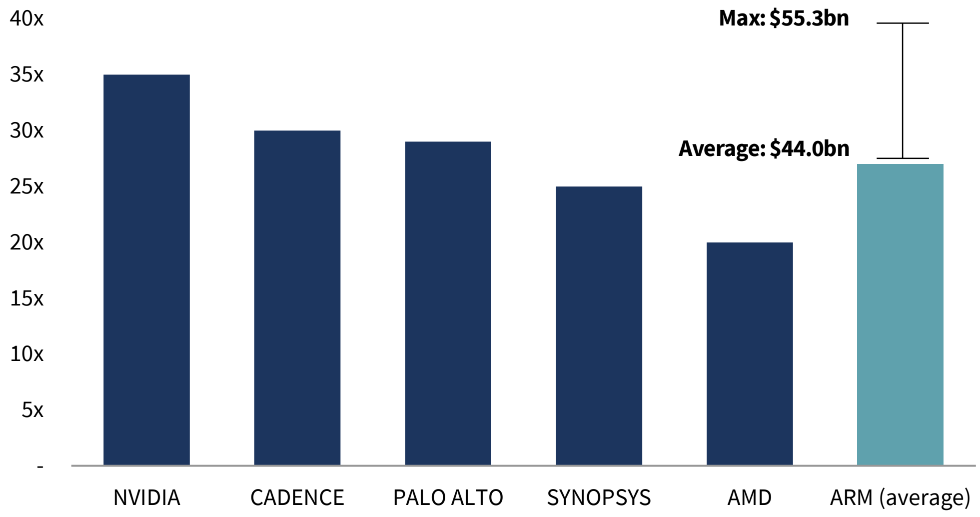
Our colleagues at Redburn Atlantic have written extensively about the valuation of Arm. The charts neatly summarise the proposed Arm price range in comparison with peers. Unhelpfully in the run up to the IPO the multiples for Nvidia, a key peer, compressed significantly. Arm's $52 top end of the range pricing means it is positioned at the upper end of peer multiples.

Arm - Valuation summary



Source: Redburn Atlantic, Bloomberg, Visible Alpha as at 31 July 2023

Arm – peer group EV/EBITDA multiple 2024e



Source: Redburn Atlantic, Visible Alpha, Factset, Bloomberg

Instacart – a profitable grocery delivery business

Instacart is that rare beast, a profitable grocery delivery business. The delivery platform targets the $1.1tn US grocery industry via its own marketplace offering (allowing users to order and have delivered groceries from over 1,400 retail partners) and through grocers' own websites, powered by Instacart's Enterprise Platform.

As Redburn Atlantic's analyst James Cordwell writes,

"Instacart's solution has been to partner with existing grocery retailers. Via Instacart's platform consumers can collate an order from one of the company's 1,400 retail banner partnerships (collectively representing over 85% of the US grocery market). Instacart will then dispatch one of its 600,000 'shoppers' (employed as independent contractors) to gather the order from the store and deliver it to the consumer, with delivery speed options ranging from 30 minutes to next-day delivery. (Inventory remains with the retailers meaning it has an asset light business model).

Through this model, Instacart has been able to build a base of 7.7 million 'monthly active orderers' (MAOs) and has increased GTV at a 78% 2019-22 CAGR. It facilitated 263 million orders in 2022 with the average order value standing at $110.

From just $28.8bn gross transaction value (GTV), the company generated $62m GAAP operating profit in 2022 (0.2% of GTV), and profits expanded to $269m in 1H23, 1.8% of GTV."

Maplebear Inc, the owner of Instacart, launched its IPO on September 11 and Instacart may start trading by September 19.

Offer size is $616m: The stock will trade on NASDAQ with the ticker CART. The size of the offering is put at $616m or 8% of the equity. Interestingly the proceeds are mainly to meet its obligations under restricted stock units . This was the issue that obliged Stripe to raise a $6.5bn funding round in March this year. (See April's Growth Equity Update).

Initial valuation range is $8.6bn-$9.3bn: The pricing of the Instacart IPO is at $26-28. With 331m shares to be in issue that is equivalent to a valuation of $8.6bn-$9.3bn.

Instacart's peak private round valuation was at c$39bn in 2021. Since then its internal valuation has been twice marked down, first to $24bn in March 2022 and then to $15bn in July 2022.

Internal valuation fell to $13bn in October 2022: In October 2022 Bloomberg reported that Instacart had lowered its internal valuation to $13bn representing ~0.4x CY23 GTV, and 20-22x CY23 adjusted EBITDA. The adjusted EBITDA multiple is lower than the 30x commanded by Doordash, but broadly in line with the ~23x implied by Uber.

IPO valuation deemed conservative: The valuation being sought by the sponsors of the deal is generally deemed to be realistic and perhaps even conservative. Redburn Atlantic, looking at the comparator group (Uber, DoorDash, Lyft, Deliveroo etc) values the business at $32-40 per share.

Cornerstones: Like Arm, Instacart has sought to reassure the market by establishing a cadre of cornerstone investors. In its case Norges, TCV, Sequoia, D1 Capital Partners and Valiant have in combination committed to buy

~$400m of stock. In addition, PepsiCo has agreed to purchase $175m of convertible preferred stock in a parallel private placement.

Klaviyo – First party data

Klaviyo also filed its S1 on August 25th and also announced its pricing on Monday 11th September. It will trade on the NYSE under the stock symbol KVYO.

Klayivo is a marketing automation platform, used primarily for email and SMS marketing. It offers a SaaS solution that integrates with popular eCommerce sites, notably with Shopify. Indeed at the end of December 2022 some 78% of Klaviyo's ARR derived from customers using the Shopify platform.

Loss making in 2022 - $473m revenue/$55m operating loss: The company year-end is December. In 2022 revenue was $473m, up 63% yoy. Klaviyo produced an operating loss of $55m (negative 11.6% margin) and a non GAAP operating loss of $26.2m (excludes amortisation of marketing expenses and stock based compensation), a negative operating margin of 5.5%. Free cash flow was a negative $41.8m (-8.8% margin).

In the last two quarters the operating income has turned positive ($0.9m and $7m) with the non GAAP operating income at $23.3m and $20.8m with a margin of 14.9% and 12.6% respectively. Both the March and June quarters saw positive FCF at $13.9m and $39.5m respectively (margin 8.9% and 24%).

In the twelve month period ended June 2023 Klaviyo had revenue of $585m, up 57% yoy and closed the period with over 130,000 customers.

On trend - Data, machine learning, AI: Klaviyo stresses its credentials as a data, machine learning and AI driven business.

"*Our modern and intuitive SaaS platform combines our proprietary data and application layers into one vertically-integrated solution with advanced machine learning and artificial intelligence capabilities*."

At the end of June 2023 the company had over 6.9 billion consumer profiles across its customers, and in year to June 2023 processed over 695 billion events, such as data on how consumers engage across channels, like opening an email, browsing a website, or placing an order.

Shopify has an 11% stake: Shopify paid $100m for an 11% stake in Klaviyo in August 2022, described as an injection of strategic capital. Private equity firm Summit Partners, which has c23% pre IPO, is the other big external owner. CEO and founder Andrew Bialecki has c38% of the stock and his co-founder Ed Hallen 13.9%.

Most recent valuation was $9.5bn: In total Klaviyo has raised c$770m in private markets. In May 2021 it raised $320m at a $9.5bn post money valuation. It retains cash balances of c$440m.

Initial pricing range is $8bn at the mid-point: Klaviyo is looking to sell 19.2m shares at a price range of $25-27. There are 252m basic shares in issue giving a valuation of $6.8bn. Fully diluted the potential valuation could rise to $8bn. The offer size is c$500m with 60% primary and 40% secondary.

Cornerstones pledge $100m: Cornerstone shareholders including (according to Bloomberg) BlackRock has pledged to buy $100m of shares in the issue, equivalent to 20% of the deal size.

Four common themes:

A degree of caution on valuation: In each case the issuers are taking a valuation beneath an earlier benchmark. Initial valuations for Arm were at $60-80bn, and the recent deal between SoftBank and the Vision Funds put the benchmark at $64bn, whereas the initial pricing range was at $52bn at the high end. The Instacart pricing at $9.3bn is well beneath the peak of $39bn and even the revised $13bn of October 2022. At potentially $8bn, Klaviyo is the one nearest its last private valuation which was at $9.5bn.

Rush to profitability: Arm is very profitable and has been for years. Between 2019 and 2022, Instacart's adjusted EBITDA has increased from negative $454m to positive $187m, improving from -8.8% GTV to +0.6% GTV. Klaviyo was FCF negative and loss making in 2022 but has turned both metrics around in the first half of 2023. For now at least the IPO candidates feel the need to have both revenue growth and profitability.

Safety First – cornerstones: After the hiatus in the IPO market a chunky cornerstone has been deemed in each case a necessary precaution. Arm has an array of technology names buying 15% ($735m) of its $4.9bn issue, Instacart's institutional cornerstones are in for $400m. Klaviyo has cornerstones at 20% of the deal size.

The appetite appears to be there: Most obviously in Arm where the book build was accelerated and where the strike price was at the top of the initial pricing range. Early signs on the others are good too, a mix of decent pricing and underlying appetite given improved market conditions. As one commentator puts it:

> *"On the heels of what has arguably been the slowest IPO market in 20 years, investors are hungry for new ideas and VCs are getting impatient."*
>
> Rob Wotczak, CEO of Freedom Capital Markets

The Rothschild & Co/Redburn Atlantic Growth Equity Conference

The conference was held on September 6th and focused on IPO preparation

September has got underway with a flurry of major flotations spearheaded by Arm, Instacart , Klaviyo and Birkenstock. This makes the content of the conference, whose theme was planning for a flotation ahead of an anticipated reopening of the IPO window, particularly apposite.

The sessions included Redburn and Rothschild strategists on the state of economies and markets; Redburn analysts in the growth sectors of fintech, artificial intelligence, software, climate tech and biotech revealing what is top of mind with the investors they speak to every day; a session on medium range IPO preparation by Rothschild & Co; a representative of NASDAQ discussing the dynamics of listing in the US; a session on the practicalities of what a company has to go through to become public; and a panel with fund managers on what they look for - and don't look for - in a company's IPO.

The slides and video recordings of the sessions are available here:

Presentations and recordings

Rothschild & Co provides high quality, impartial and long-term advice. If you would like to follow up with the Private Capital team at Rothschild & Co please contact Chris Hawley or Patrick Wellington

Klarna – Profitable!

Improvement continues – breakeven at the adjusted operating profit level in Q2 2023.

The major headlines of H1 2023 are that the business recorded its first month of net profit and its third consecutive quarter of gross profit in the US.

Klarna has produced half year results to the end of June 2023. Unusually for a private company the fintech business produces a full financial report twice a year plus an accompanying presentation.

The interim 2023 report charts the improvement in its financial performance. In early 2022 Klarna shifted its business model to focus on profitability. It reduced its staff numbers by 10% in May 2022.

We reviewed the 2022 performance in our Growth Equity Update in March. Already the reorientation was having positive effects. Klarna's FY22 revenue continued to grow, up 18% to SEK 19.3bn while the adjusted FY22 operating result was a loss of SEK 7.8bn.

Klarna's performance improved in the last two quarters of the year. Revenue stepped up to SEK 5.6bn in Q4, yoy growth of 19%.The adjusted operating loss, which was between SEK 2.2bn and SEK 2.8bn each quarter between Q4 21 and Q2 22 (and which fell to SEK1.6bn in Q3 22) reduced to SEK1.2bn ($113m) in Q4 22.

That positive progress has continued in the first half of FY23. The key features are:

Total net operating income – Klarna's preferred definition of revenue – has continued to grow strongly despite rising interest rates and pressure on consumers. Revenue growth was 21% yoy both for H1 and Q2.

Operating expenses fell by 16% or SEK 1.8bn ($162m) yoy.

Net credit losses were SEK 1.8bn in H1, down 38% from SEK 2.9bn in the same period in 2022. The credit loss rate in Q2 was 0.41% , halved from 0.8% in Q2 2022.

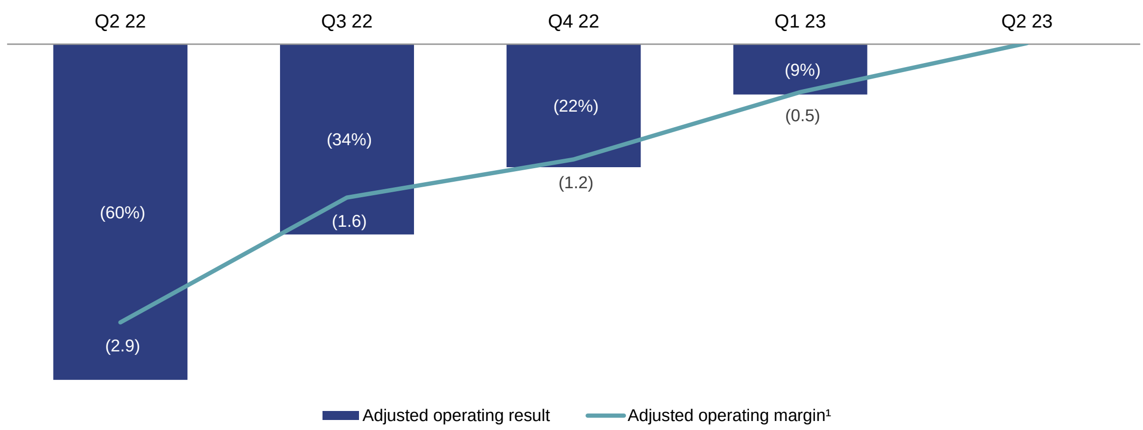
The adjusted operating loss – Klarna's preferred definition of profitability – reduced to SEK0.5bn (c$45m) from SEK 5.1bn ($458m) in H1 22.

In Q2 Klarna made a marginal profit – SEK10m - at the adjusted operating profit level – a major landmark for the business. In the equivalent quarter it lost SEK 2.9bn ($260m). Its last quarterly profit was recorded in Q2 2019 before Klarna made its major expansion move into the US.

Klarna made a small net profit in May, the first time it had done this since August 2020 and founder and CEO Sebastian Siemiatkowski is reported as saying that the business has further profitable months ahead.

Adjusted operating profit at Klarna excludes restructuring costs, share based payments, related tax and depreciation and amortisation. These charges were flat yoy at SEK 1.4bn.

Klarna- Adjusted operating results (SEKbn)[1]



Source: Klarna;
Note 1 Adjusted operating result excluding (a) Restructuring costs; (b) Share-based payments and related payroll taxes (c) Depreciation & amortization

Klarna recent quarterly financials

	FY21	FY22	Q122	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q2 YoY
Gross Merchandise volume	689.1	837.3	187.0	209.2	199.0	242.0	210.7	238.6	14%
Income statement									
Total net operating income	**13.9**	**16.7**	**3.6**	**4.0**	**4.1**	**5.0**	**4.4**	**4.8**	**21%**
Revenue	15.9	19.3	4.4	4.7	4.6	5.6	4.9	5.5	17%
Credit losses	(4.6)	(5.7)	(1.2)	(1.7)	(1.5)	(1.4)	(0.8)	(1.0)	(41%)
Total operating expenses before credit losses	(15.9)	(21.5)	(5.0)	(6.1)	(4.8)	(5.6)	(4.7)	(4.6)	(24%)
Adjusted Operating Results (Non IFRS)	**(5.2)**	**(7.8)**	**(2.2)**	**(2.9)**	**(1.6)**	**(1.2)**	**(0.5)**	**-**	**-**
Net result for the year	(10.4)	(7.1)	(2.6)	(3.8)	(2.2)	(1.9)	(1.3)	(0.9)	(77%)

Source: Klarna, Rothschild & Co

At the Q3 stage at the end of November 2022, Sebastian Siemiatkowski, Klarna's CEO and co-founder said *"Klarna has made huge progress on our path to profitability, which we expect to hit on a monthly basis in the second half of 2023."*

Having achieved its first breakeven quarter and profitable month ahead of schedule in Q2 2023, Sebastian Siemiatkowski's thoughts are turning towards a potential IPO. Klarna has historically talked of three criteria for an IPO (i) that it be well established in the US (ii) that it should have a sustainable business model and (iii) that there should be substantial growth potential.

In the US, where it has 37 million users, Klarna has now achieved three consecutive quarters of gross profit. The group has returned to profitability and revenue growth is still 20% plus yoy. As a result Sebastian Siemiatkowski is reported in the press as saying,

"From an IPO perspective, the requirements have been met. So now, it's more market conditions. It's more a question of us getting ready and prepare the organisation. We don't have any official date; we haven't announced anything."

Getir – Stand and Deliver

By contrast the on-demand grocery delivery sector is further back on the path to profitability. Getir is reported to be raising c$500m in a deal that will value the business post money at $2.5bn.

In June 2021 Getir raised $550m, tripling its valuation to $7.5bn post money in a deal led by Tiger Global and Sequoia in which Mubadala and Disrupt AD, both parts of Abu Dhabi's sovereign wealth funds, participated.

In March 2022 Getir raised $800m in new funds at a valuation of $11.78bn in a deal led by Mubadala with 16 other investors joining the round.

In December 2022 Getir acquired its counterpart German business Gorillas in a deal valuing the combined group at $10bn. That deal valued Gorillas at c$1.2bn against a previous valuation of $3bn in September 2021. The combined group was valued at $10bn, implying $8.8bn for the Getir business.

In April 2023 Mubadala, GSquared and Michael Moritz are reported to have contributed $475m in a round to Getir valuing the business at c$6bn pre money. In total the company has raised just over $2bn to date.

Getir is now again reported to be raising $500m of fresh funds at a $2.5bn post money valuation. This round appears to have the same group of investors, Mubadala, GSquared and Michael Moritz and the two rounds may have connected terms. Although the valuation is greatly reduced, down almost 80% from the March 2022 deal eighteen months ago, this is still a substantial raise.

The rationale of the Getir investors appears to be that, as funding conditions have deteriorated in this sector and the ranks of the competition have thinned out, the prospects of Getir surviving as market leader on the back of fresh backing must be enhanced.

Getir has simultaneously been taking steps to advance the point of break-even.

The 2021 Getir accounts published on the website of the Dutch Chamber of Commerce showed 2021 revenue of $466m (vs $182m in 2021, +156%). The operating loss was $589m, equivalent to 1.26x revenue. The loss was up from $38m a year previously.

Cost of goods sold was at $357m, giving a gross margin of 23%.

Key operating cost items in 2021 included logistics and delivery expenses of $261m, personnel expenses of $158m and marketing expenses of $169m.

Since then Getir has shut operations in a number of countries including Spain, Italy and Portugal. It is now focused on five core territories Turkey, the US, Germany, the UK and the Netherlands which produce over 95% of its revenues. It has cut staff in these territories too. In the latest of a series of job cuts it took out 2,500 jobs or 10% of the total across its five remaining territories in August 2023.

New SEC rules on private fund disclosure

The Securities and Exchange Commission has approved new regulations that will require private funds to give more information to their investors.

The new rules cover private equity, venture capital and hedge funds. These bodies will be required to produce in-depth quarterly reporting to their investors. In practice this should mean that limited partners (LPs) get substantially improved transparency. VCs will have to provide their LPs with quarterly financial statements – not presently standard practice - and will be required to run annual audits on each fund under management. The quarterly reports will use standardised metrics to allow easier comparability across fund reporting groups. There are also stipulations requiring private funds to give more disclosure on expenses.

These new rules and amendments under the Investment Advisers Act of 1940 (Advisers Act) now require private fund advisers registered with the Commission to:

Quarterly Statement Rule. Fund advisers must provide investors with quarterly statements detailing information regarding private fund performance, fees, and expenses.

The statement must disclose fund-level information regarding performance, the cost of investing in the private fund, fees and expenses paid by the private fund, as well as certain compensation and other amounts paid to the adviser. They must:

● Obtain an annual audit for each private fund; and:

● Obtain a fairness opinion or valuation opinion in connection with an adviser-led secondary transaction.

The new rules require that all private fund advisers:

● Prohibit engaging in certain activities and practices that are contrary to the public interest and the protection of investors unless they provide certain disclosures to investors, and in some cases, receive investor consent; and:

Preferential treatment rule: The rules prohibit providing certain types of preferential treatment that have a material negative effect on other investors. They also prohibit other types of preferential treatment unless disclosed to current and prospective investors.

To address the material, negative effects of specific types of preferential treatment on other investors, the reforms prohibit all private fund advisers from providing preferential terms to investors regarding: a) certain redemptions from the fund, unless the ability to redeem is required by applicable law or the adviser offers the preferential redemption rights to all other investors without qualification; and b) certain preferential information about portfolio holdings or exposures, unless such preferential information is offered to all investors. In addition, this rule prohibits all private fund advisers from providing preferential treatment to investors, unless certain terms are disclosed in advance of an investor's investment in the private fund and all terms are disclosed after the investor's investment.

SEC Chair Gary Gensler has said the changes will increase competition and transparency into an industry that he estimates collect *'hundreds of billions of dollars in fees per year'.*

The proposals were originally put forward in early 2022 and have met with a largely unenthusiastic response from the private funds industry. Some early proposals to ban certain types of preferential treatment and some fee types were watered down to allow these practices to continue but with improved disclosure required. Typically favourable redemption rights offered only to some investors will be ruled out and information on fund holdings must now be shared with all investors rather than having a two tier system of disclosure.

It also allowed for existing contracts to be run down gradually over one to two years rather than be immediately superseded.

The SEC estimates that fulfilling the requirements under the new regulations may cost the industry annually some $961m.

Bobby Franklin, chief executive of the National Venture Capital Association *commented "We will be focusing on its potential to stifle innovation and harm the economic environment for venture and start-ups."*

Six bodies - the National Association of Private Fund Managers, the Managed Funds Association, the Alternative Investment Management Association, the American Investment Council, the Loan Syndications and Trading Association and the National Venture Capital Association have filed a lawsuit in the US Court of Appeals for the Fifth Circuit in Texas in an attempt to reverse the rule changes.

UK Venture capital - Future Fund runs into problems

The three year anniversary of the Future Funds convertible loans designed to help British start-ups in the Covid era, is causing problems for some.

The UK government created the £1.14bn Future Fund during the COVID pandemic as a route to offer funding for British start-ups in a time of economic uncertainty. The Future Fund started operations in April 2020 with the undertaking to match investments from other funders with the amounts being extended ranging from £125k to £5m. The scheme was operated by the government owned British Business Bank.

The initiative offered cash in the form of convertible loans to UK startups. The intention was that the convertibles would convert into equity, typically after three years. The terms allowed the British Business Bank to purchase equity at a 20% discount when its note converted. The primary criteria for extending the loan, and companies being eligible, was that the companies should be able to match the amount received with funding from private investors.

At the time the project was rolling out the post 2021 downturn in the VC market was not anticipated. The difficulty since then in raising VC backed funds is significant. The Future Funding programme terms included a proviso that if a company had not raised a 'priced round' before the three year anniversary of the of the Future Fund funding then the company must repay the full amount, plus a 100% *'redemption premium'*. In effect this means that many businesses face being obliged to pay double the amount of the initial loans.

The three year limit is now being progressively reached for these businesses. Most of these are small start-ups, often at the seed or pre-seed level. For some of these businesses the prospect of repaying twice the original amount is a substantial challenge.

The British Business Bank has said that it may allow strongly performing companies to extend the timescale over which repayment is demanded stating:

"The Bank will always aim to secure value for money and protect the taxpayers' interests but has introduced the possibility of extending the convertible loan term for solvent companies that might need additional time to complete a fresh fundraising.''

The most recent statistics on the British Business Bank website show that the scheme was extended to a total of 1,191 companies before it was closed in 2021. The end June 2023 figures show that 642 of these companies have exited the deal; the British Business Bank has taken equity interests in 591 of the companies and there have been 51 cash realisations, usually as a result of a company being acquired. Some 129 companies, 11% of the total , have gone into insolvency. The number of loans still outstanding is 420.

Breakdown of the Future Fund portfolio as at 30June 2023

	As at 30 June 2023	Previous Quarter	Change since previous quarter
Loans	420	502	(82)
Equity interests	591	529	62
Cash realisations	51	49	2
Insolvencies	129	111	18
Total	1,191	1,191	

Source: British Business Bank

Sifted reports, however, a number of examples where companies have reported inflexibility by the British Business Bank. It cites one example where the Bank is alleged to have refused to extend its convertible when other backers were willing to extend their loan. It reports another where a company claims that a would-be acquirer willing to pay the Fund's loan and premium could not do so as the British Business Bank preferred to convert the loan into equity. The founder then struggled to raise the loan amount and the premium at the end of the three year term, flirting with bankruptcy instead. Sifted quotes an anonymous founder saying:

"We were told that the government was here to support the startup community, but now it's all turning out kind of predatory.''

The British Business Bank's new CEO, Louis Taylor, has stated that he wants to model the institution as a '*sovereign growth fund'*, able to reinvest proceeds from its venture capital investments. The venture capital arm of the British Business Bank, British Patient Capital, was established with £2.5bn of funding and a 10-year mandate to 2028 to provide long term finance to start-up companies. British Patient Capital now manages assets with a value of £3.1bn. Total commitments, including capital from other institutional investors, are now more than £10.7bn.

Investor Feedback

We monitor feedback from venture capital investors on the state of the market. The key themes we are seeing are:

(i) Investors are seeing activity and value in seed and early-stage rounds

(ii) Attractive opportunities in later stage rounds are fewer and investors report a lot of internal rounds. There is a sense that well placed companies continue to defer raises in 2023 "*General environment is slow…Deal flow getting a bit better but generally slow."*

(iii) The appetite of some investors appears to be increasing – perhaps helped by the valuation reset in private markets and the revival in public markets, particularly NASDAQ

"We took a year off investments in May 2022 to May 2023… now trying to 'make things happen'"

(iv) Many investors we speak to observe they are looking at opportunities and [are] *"open for business right now"*

(v) Investors observe that valuation expectations are often still too high, and that founders' expectations have not fully adjusted.

It will come as little surprise meanwhile that August was a quiet month in the VC market, even by seasonal standards.

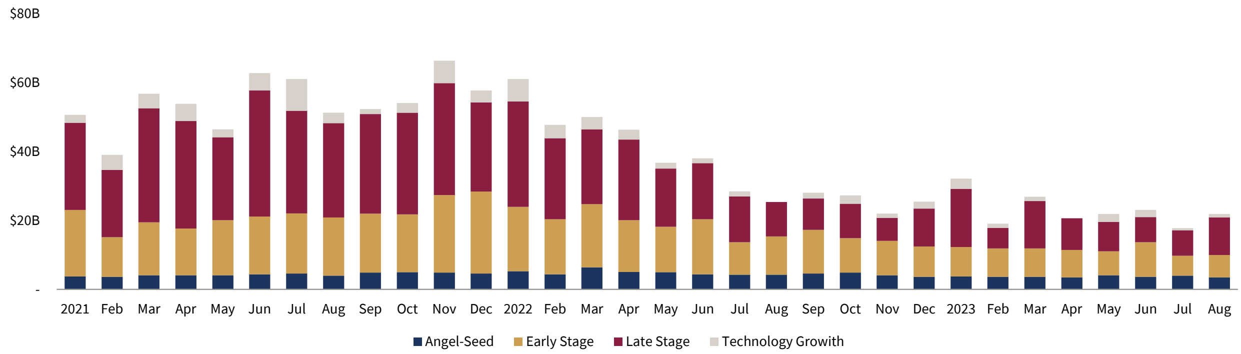
The slowdown was more in terms of the volume of deals rather than their value. According to CrunchBase, global venture capital funding was at $22bn in August 2023, down 16% from the c$26bn invested in July 2022. The August figure was close to the c$23bn monthly average seen ytd in 2023.

Deal counts fell 44% from 2843 in August 2022 to 1599 in August 2023

A notable feature, driving the value versus volume dynamic was that late-stage funding in August was at c$13.3bn up 25% yoy.

Early-stage funding almost halved and seed funding was down by around one-third from a year ago.

Global funding by stage through August 2023



Source: Crunchbase

By contrast, September has started strongly. In Europe the c$3.5bn raised in the first half of the month exceeds the total for Europe in September 2022.

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 Q3 2023 inflation is coming down and interest rates appear to be close to their peak. 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 mid-September 2023 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 notably in artificial intelligence, fintech, climate tech and software. 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 have been 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. Recent weeks have seen a pick up in large late stage deals, notably in ClimateTech

▪ There will likely be a growing number of down rounds in 2023, albeit the substantial fund raising of 2021 and the ability of companies to eke out existing resources may limit the immediate 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 moving away from a growth and revenue multiple emphasis. There is a sharper focus on the path to profitability and positive free cash flow and an emphasis on DCF and comparative based multiples.

Markets – A check

Markets are holding the higher levels although the progress in the growth indices has stalled.

The ***NASDAQ Composite*** was up 32% in H1 , peaked in mid-July at up 38% and has edged back to +33% ytd.

The tech focused ***NASDAQ 100*** was up 46% ytd at its mid-July peak and is now up 41%.

The ***S&P 500*** was up 16% in H1 and is now up 17% ytd. The ***STOXX 600 Europe*** and ***FTSE 100*** are largely unchanged since mid-year leaving them up 7% and 1% respectively ytd.

The ***Refinitiv Venture Capital Index***, which seeks to monitor the real time performance of the VC industry and whose performance is partly driven by the moves in public markets and particularly tech heavy indices like NASDAQ, is up 35% ytd having been up 29% at the end of H1. Its performance since the end of June has outpaced its counterpart public indices.

The market is wait and see mode. Generally the indicators are positive, and this drove the revival of global equities (up 14% in H1) to mid-year. Now there is some sifting through the evidence to see how strong things actually are. The upshot is that investors are viewing the economic and market situation as decent and robust although still with headwinds and lacking extra forward momentum.

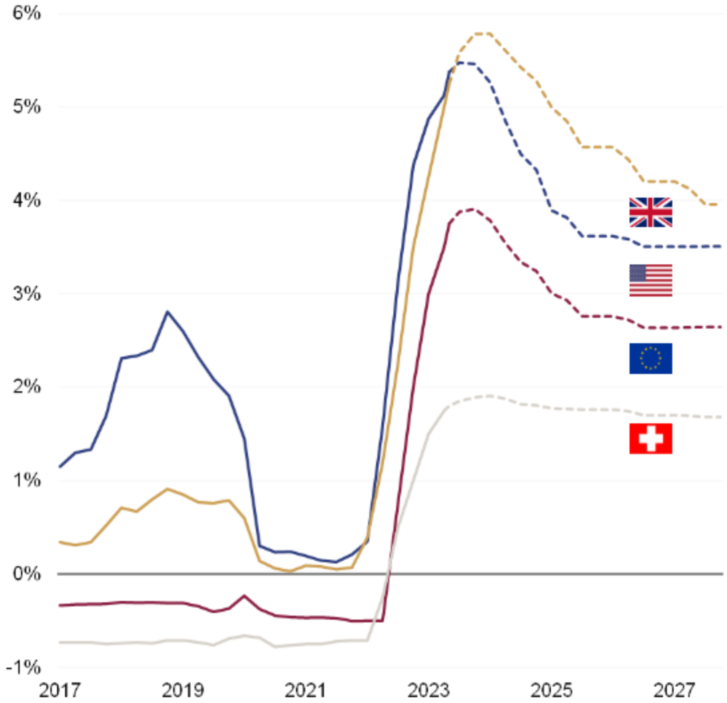
The US has led in terms of getting inflation down even though it remains well above the target 2% level. The August US CPI figure impacted by rising petrol prices disappointed at 3.7% versus expectations of 3.6%. The July figure had been 3.2%. Core inflation, on which the Fed is more focused, rose at a lower rate, up 0.3% points month on month after 0.2% points in July and remains down yoy at 4.3% (versus 4.7%).

Despite the increase in the headline rate the market is pricing in no move in the interest rate at the next Fed meeting on September 19-20. It expects just one more rise in this cycle from the current 5.25%-5.5% to a high of 5.75%. Some market participants think rates have already peaked. Thereafter, as the chart shows, US interest rates are expected to decline to c3.5-3.75% by 2025 and then to hold those levels, the *'higher for longer'* scenario.

Elsewhere the UK continues to grapple with inflation. Like in the US the rate of inflation is expected to rise in August. The June figure of 7.9% dropped to 6.8% in July but rising petrol prices are expected to push it back above 7% in August. Services inflation remained high at 7.4% in July This data will be published on September 20th just before the Bank Of England Monetary Policy committee meets on September 21. Despite rising unemployment UK wage growth was 7.8% in the three months to July, ahead of inflation at 6.8% and potentially adding to inflationary pressures. UK interest rates are expected to reach 5.75% in two more hikes from the current 5.25% and still to be at c4% by 2027.

In Europe the ECB raised interest rates by 25bps to 4% on September 14. It was the tenth consecutive raise. Most market participants though see 4% as the high for ECB rates. The accompanying commentary by the ECB appears to back the view that its 2% inflation target is achievable without further rises. It commented "*Interest rates have reached levels that, maintained for a sufficiently long duration will make a substantial contribution to the timely return of inflation at the target.*"

Implied policy rates[1] for the US, UK, Eurozone and Switzerland



Source: Rothschild & Co, Bloomberg [1] Derived from OIS curves (three-month tenor: USD – SOFR; GBP – SONIA; EUR – ESTR; CHF – CHF OIS).

Meanwhile strong wage growth outstripping inflation is not confined to the UK with the US and EU seeing the same phenomenon. This is supporting the consumer even as interest rates rise. July headline US retail sales, for instance, rose by 0.7%. All of this is contributing to the idea that recession should be avoided . A soft economic landing in the US now appears to be the consensus view. Growth though is expected to be modest. Consensus expectations for US GDP growth are at c1.5% for 2023/24e. In Europe GDP growth is seen about flat in 2023 and growing 1.3% in 2024e. The UK is seen growing at c0.6% in both 2023 and 2024e.

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

GROWTH *Neutral*	***Economic resilience continues*** Business surveys continue to weaken as monetary tightening makes itself felt – with more to come (see below). However, hard data on output and spending remains upbeat, particularly in the US, and in Europe, support is on the way in the shape of lower energy prices. Technical recession remains possible, but a more significant downturn still seems unlikely
INFLATION *Neutral*	***Disinflation – slow but sure*** Headline US inflation is back in unremarkable territory, and Europe's is about to fall significantly too. Core rates are proving more stubborn, as expected – particularly in the euro area and the UK – but wages have accelerated by less than they could have, and falling European energy prices will ease cost-of-living pressures. 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 acted decisively to raise nominal interest rates. Policy rates in the US and UK are now above "normal", but the tightening cycle is still not quite done (the Bank of England and ECB likely have furthest still to go). Moreover, with core inflation sticky, money and bond markets are beginning to realise that rates may not fall quickly: we expect a more plateau-shaped profile extending well into 2024
GEOPOLITICS *Negative*	***Geopolitical risk cools a little*** As we feared, it was premature to see unrest within Russia's armed forces as making peace any more likely, and the inconclusive conflict in Ukraine continues. In the global context, however, China-US tensions matter most, and there has been a modest cooling of temperature around Taiwan: ongoing high-level missions suggest that both sides recognise the importance of stepping back from the brink of mutually assured economic destruction (or worse). President Xi is aware of China's best interests, and we think he will remain patient. Meanwhile, a possible change in US leadership is still more than a year away
VALUATIONS *Neutral*	***Valuations remain balanced*** Stock market valuations were not stretched even before August's setback, and earnings expectations are stabilising around the prospect of resumed growth. Meanwhile, more bonds are offering plausible real yields again, particularly in the US and UK, and offering 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 as higher interest rates make themselves felt it could easily revive: the risk of financial accidents surely remains elevated. And as noted, though resilient to date, economies are not out of the cyclical woods just yet. But traded options are a little cheaper of late, even though the free 'Fed put' has been withdrawn, as are bonds (as noted). We remain unconvinced that cryptocurrencies offer anything here

Source: Rothschild & Co

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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