Growth Equity Update

January 2024 – Edition 22

- ***2023 markets rallied***: 2023 ended with NASDAQ up 43%, MSCI US up 26% and MSCI ex US up 18%. The Refinitiv Venture Capital Index was up 56% leaving it 36% off its 2021 highs
- ***No clear direction yet in 2024:*** Inflation is well off the top, interest rates have peaked, recession has been avoided, GDP growth forecasts have been raised and earnings growth forecasts have been resilient. The sharp rally at the end of 2023 has though raised valuations and a setback on inflation indicators (inflation in December rose in each of the US, EU and UK) has dampened hopes of early interest rate cuts
- ***Modest upside?*** The median expectation of 20 investment banks for the end 2024 level of the S&P500 is 4,875, offering just 2% upside. The most optimistic of these forecasts has 11% upside
- ***2023 – Another tough year for VC***: Pitchbook numbers show global VC investment declined for the second successive year, down 35% on 2022. The US was down 29%, Europe was down 45%. Fundraising by VCs was down 49% yoy with Europe down 43% and the US down 61%. The value of exits globally was down 30% on 2022 and 85% down on the 2021 peak year
- ***Conditions set for a revival in secondaries:*** The valuation rally and the liquidity issues faced by employees and LPs may mean a revival of the secondaries market in 2024.

Markets – The outlook for 2024

Public markets finished 2023 on a high with the end of year Santa rally continuing the revival that had been seen from late October.

The ***NASDAQ Composite***, having been up 32% in H1, ended the year at its highs, up 43%. Ytd in 2024 (to January 18th) the index is up 1.5%.

The tech focused ***NASDAQ 100*** was up 54% in the year and closed the year 1% above its November 2021 peak. It is up 2% ytd in 2024.

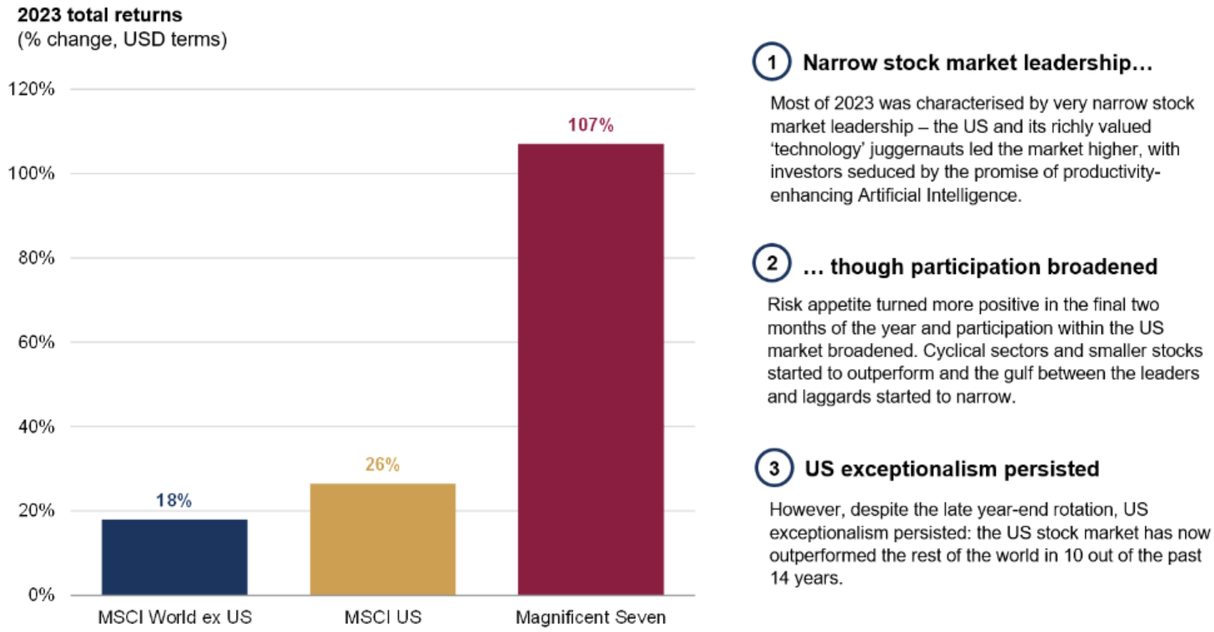
The ***S&P 500*** was up 16% in H1 2023 and closed the year up 24%, also in line with its late 2021 peak. It is flat ytd.

The ***STOXX 600 Europe*** was up 8% in H1 and, with a year-end rally, closed 2023 up 13%. It is down 2% ytd in 2024.

The ***FTSE 100*** was the laggard, flat in H1 2023 and up 4% for the year. It is down 3% ytd in 2024.

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 2023 and closed the year up 56%. YTD in 2024 it is up 4%.

Viewed more broadly the MSCI World ex US Index rose by 18% in 2023. MSCI US rose by 26%, the tenth year in the last 14 that it has outperformed the rest of the world. The year-end rally broadened a market outperformance that had been heavily concentrated in the Magnificent Seven tech stocks (Alphabet, Amazon, Apple, Tesla, NVIDIA, Meta and Microsoft). This group slightly more than doubled in value in 2023.



Source: Bloomberg, Rothschild & Co

At the start of 2024 the market appears uncertain on direction. There is the expectation of an underlying improvement in conditions in 2024 with inflation tamed, interest rates set to fall and recession avoided. Against that there remain specific risks. It is a very substantial year for elections with roughly half the world's population due to go to the polls in 2024. Notable elections will take place in the US, the UK, for the European Union, in India, Indonesia, Pakistan, South Korea, Mexico and many others. Geopolitical tensions remain high with the recent actions seen in the Red Sea again threatening global supply chains.

There is also the feeling that the markets ran hard in the final quarter of 2024 boosted by the expectation pivot point from the next interest rate moves being upwards to the next moves being downwards. By the end of the year, with the Fed's unexpectedly bullish December commentary about the risk of hanging on to high rates for too long, markets began to anticipate US rate cuts of up to 100bps and ECB cuts of up to 200bps by the end of 2024. Moreover the expectation raced ahead to these cuts coming early – perhaps by April in Europe and May in the US.

As we have moved through January some of this excess optimism has burned off in the face of reminders that progress on inflation may not be linear and that central banks might, after all, not be in a headlong dash to cut rates. Notably the December inflation numbers in each of the US, EU and the UK rose over November, breaking in each case a consistent downtrend in the preceding months. Combined with the rally in valuations at the end of 2023 this has led to a muted start to 2024.

Thus in the ***US*** in mid-December the Fed not only held rates, at 5.25%-5.5% but produced a dot plot indicating that its officials expect rates to close 2024 with interest rates 75bps lower at 4.5%-4.75% and with 2025 another 100bps lower at 3.5% to 3.75%.

Three developments since then have been interpreted more cautiously.

The ***tone of the Fed's December minutes***, when published, were more cautious in tone than the market originally anticipated:

"Participants generally stressed the importance of maintaining a careful and data-dependent approach to making monetary policy decisions and reaffirmed that it would be appropriate for policy to remain at a restrictive stance for some time until inflation was clearly moving down sustainably toward the Committee's objective."

The ***December jobs figures*** published on January 5th showed that the US added 216,000 jobs in December, higher both than expectations and the November number of 175,000 (albeit the recent trend has been for subsequent downwards revisions of payroll numbers).

The ***December inflation numbers*** produced on January 11th saw inflation at 3.4% versus the 3.1% figure of November. Market expectations had been at 3.2%. The core inflation rate (ex-food and energy) was down at 3.9% versus November's 4% but was higher than market expectations of 3.8%.

Nevertheless in mid-January Christopher Waller, a governor on the Fed's board, hit a more upbeat tone saying

"Based on economic activity and the cooling of the labour market, I am becoming more confident that we are within striking distance of achieving a sustainable level of 2% PCE inflation."

The next PCE inflation number (personal consumer expenditure) is due on January 26.

The ECB held rates unchanged at 4% for the second successive time at its December meeting while commenting that interest rates would be kept at '*sufficiently restrictive levels for as long as necessary'* in pursuit of the 2% inflation target.

The ***EU December inflation figure was higher than November's***. Issued on January 5th it saw inflation back up to 2.9% from 2.4% in November. The October figure was also at 2.9%. This ended a six month run of declining numbers. The market had anticipated the rise with consensus at 3%, slightly higher than the eventual December outturn. The rise was chiefly caused chiefly by falling government subsidies on food, gas and electricity. Inflation in France rose from 3.9% in November to 4.1% in December. Inflation in Germany rose from 2.3% to 3.8%.

Core EU inflation, excluding energy and food, was at 3.4% down from November's 3.6%, but in line with market expectations.

Economists appear optimistic that core inflation will start to fall again in January. The ECB indicated in December that it expected headline inflation to average 5.4% in 2023, 2.7% in 2024, 2.1% in 2025 and 1.9% in 2026.

The market had been anticipating the first ECB rate cuts to occur as early as March- April 2024. The December inflation numbers had commentators pushing the timescale out by a further month. Remarks by ECB president Christine Lagarde in mid-January at Davos were antipathetic even to this expectation. She commented that market expectations for an ECB rate cut in the spring were '*not helping'* the fight against inflation suggesting instead that the data required to justify a rate cut would not be ready until *'late spring'.*

In **the UK** the December inflation figure, as with the US and the EU, saw a reversal in direction with the rate rising for the first time in 10 months. The December inflation rate was 4% compared with 3.9% in November and expectations of 3.8%. Core inflation, ex food and energy prices, was flat versus November at 5.1% but higher than consensus forecasts of 4.9%. Services inflation, regarded as *'sticky'* and a good measure of underlying price pressures, rose to 6.4% in December versus 6.3% a month earlier. Economists also expect the January inflation figure to rise.

Prior to these numbers the market had anticipated a 25bps UK rate cut as early as May and c125bps of rate cuts in 2024 as a whole. Post these numbers the expectation that the Bank of England would signal an early cut faded and the expectation of 2024's rate cuts dropped to just 100bps.

These more cautious signals perhaps indicate why **equity strategists remain relatively cautious** about the potential upside in markets in 2024.

The next table looks at the expectations of the major investment banks for the level of the S&P500 index by the end of 2024. The S&P 500 index started the year at 4,770. In this survey by Bloomberg and the FT the median expectation of 20 major investment banks for the 2024 closing level of the S&P 500 is 4,875, implying upside of just 2%. The highest forecast, Yardeni Research's 5,400, represents upside of just 11%. Eight of the 20 forecast the S&P 500 at the same level or lower by the end of 2024. It is perhaps some comfort that the equivalent targets at the start of 2023 were typically too low and were upgraded sharply through the year.

S&P 500 - Strategists 2024 targets		
S&P 500 Start year	4,770	
	Target	**Implied upside %**
Yardeni Research	5,400	13
Fundstrat	5,200	9
Oppenheimer	5,200	9
BMO	5,100	7
Citigroup	5,100	7
Deutsche Bank	5,100	7
Goldman Sachs	5,100	7
Bank of America	5,000	5
RBC Capital Markets	5,000	5
Ned Davis Reearch	4,900	3
UBS	4,850	2
Barclays	4,800	1
Evercore ISI	4,750	(0.4)
Societe Generale	4,750	(0.4)
Stifel Nicolaus	4,650	(3)
Wells Fargo	4,625	(3)
Scotiabank	4,600	(4)
Morgan Stanley	4,500	(6)
Cantor Fitzgerald	4,400	(8)
JP Morgan	4,200	(12)
Average	4,861	2
Median	4,875	2

Source: FT, Bloomberg ANR data, news stories; Targets are generally for year end 2024.

Putting all this into a broader context the major takeaways are that the market thinks that interest rates have peaked, the central banks are warning that the job on inflation is not yet done, but the markets have moved on to assume that if the next rate move is not to be up, it must be down. Mean economic growth has been robust and better than expected. Corporate earnings are holding up and fears of economic recession have receded. Valuations, as this graphic from Rothschild & Co strategist Kevin Gardiner indicates , are in a long term context , not over stretched.

Source: Rothschild & Co, Bloomberg, Datastream, S&P Global
US earnings yield in second chart is based on real cyclically-adjusted earnings
Past performance is not e reliable indicator of future performance and the value of investments and the income from them can fall as well as rise.
This documents does not constitute a personal recommendation or an offer or invitation to buy or sell securities or any other banking or investment product. Correct to 3rd January 2024.

IPOs in 2024: Positive performance by public market indices in 2023 is a better backdrop for the revival of IPO markets in 2024 and indeed the start of the year has seen a number of companies making initial filings for IPOs. Progress though is likely to be cautious with sentiment fragile and valuation expectations likely to be an issue.

The record of recent large IPOs remains mixed. Looking back at the big four US IPOs of the autumn of 2023 we see that to January 17 only one of the four has outperformed the market since IPO, one is flat and the other two have underperformed by more than 20%:

- Arm is up 34% since IPO, strongly outperforming the NASDAQ, up 7% in that period.
- Birkenstock is up 7% since float marginally underperforming the S&P500, up 8%.
- Klaviyo is down 14% since its IPO, underperforming NASDAQ by 24%.
- Instacart is the laggard, down 17% since IPO and underperforming NASDAQ by 27%.

Price performance of the 'Big Four' US Autumn 2023 IPOs

	Symbol	Offer date	Shares (m)	Offer price $	Amount sold ($m)	First day Close $	Change %	Price $ Nov 10 $	Change %	Price Jan 17 $	Change %
Arm Holdings	ARM	14-Sep-23	95.5	51	4871	63.6	*25*	52.3	*3*	68.5	*34*
Instacart	CART	19-Sep-23	22	30	660	33.7	*12*	25.2	*(16)*	23.9	*(20)*
Klaviyo	KVYO	20-Sep-23	19.2	30	576	32.7	*9*	25.3	*(16)*	25.9	*(14)*
Birkenstock	BIRK	11-Oct-23	32.3	46	1486	40.2	*(13)*	40.6	*(12)*	49.4	*7*

Source: Rothschild & Co

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 grew briskly in the third quarter, and this momentum continued into the year-end. The soft business surveys appear to be stabilising – even in Europe. But we are still not out of the cyclical woods: monetary policy may not have had its full impact yet, and energy prices might spike anew (see below). 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 *Positive*	***Disinflation becomes more visible*** It looks increasingly as if the corner has been turned on headline and even core inflation across the major economies – central bank targets are moving into focus. Importantly, nominal wage growth remains restrained – perhaps because pay is rebounding in real terms, as noted – and energy prices remain far below 2022's highs. Wage settlements struck today may reflect inflation from a year ago: wages may be a consequence – and not yet a cause – of inflation
POLICY *Neutral*	***Interest rates: easing in 2024?*** Central banks belatedly realised that their credibility was at stake, and eventually acted decisively to raise nominal interest rates in 2022 and 2023. Inflation has since fallen meaningfully on both sides of the Atlantic, and the tightening cycle seems to have concluded. However, central banks remain vigilant – the recent shifts lower in interest rate expectations look a little overdone – but modest rate cuts this year seem plausible to us
GEOPOLITICS *Negative*	***Geopolitical risk intensifies*** 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). Election cycles loom in the US and UK – the political noise in 2024 will become louder
VALUATIONS *Neutral*	***Valuations remain balanced*** Global stocks are close to all-time highs following the year-end rally. Valuations are still inexpensive and earnings expectations continue to stabilise around the prospect of resumed growth in 2024. Despite the big year-end rally in bond markets – and the loss of valuation headroom – real yields are still mostly positive. Bonds offer 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 – despite their revival in 2023 – offer anything here

Source: Rothschild & Co

Venture Capital markets in 2023

It was another tough year

The first look numbers for 2023 annual activity levels in the venture capital market have been published by Pitchbook.

They show a picture of an industry going through a painful transition from the boom period leading up to the peak in November 2021 to an industry contemplating a much more subdued *'new normal'*. The key factor has been the level of interest rates. The existence of essentially 'free' money post 2008 as interest rates were sustainedly low drove a boom in the venture and growth equity markets. The flush of money going into the sector and the ostensibly high returns attracted incremental capital from LPs and new types of participants in these markets, like crossover investors. The sharp rise in rates from the start of 2022 changed the return dynamics of the industry and although inflation and interest rates now appear to have peaked there will be no early return to the conditions of free money – interest rates will remain higher for longer.

The fall-out from boom conditions to those of the new normal is still being played out. The effect was muted in 2022 as the momentum of deals already underway and the time to adjust meant that activity levels were still relatively high.

The impact has come into sharper relief in the 2023 numbers. The excesses have gone out of the industry – marked by a number of high profile failures like WeWork, FTX and Silicon Valley Bank. The exit market has sharply declined with the much more muted IPO market and the virtual the disappearance of SPACs. The parallel difficulties faced by the private equity industry means that the M&A market is much weaker. As March Nachmann, global head of Asset and Wealth Management at Goldman Sachs said recently in an FT interview:

"Private equity will look different over the next 10 years than it looked over the past 10 years. It will be a little bit back to the future in a sense. Over the past 10 years you could rely on lots of leverage, cheap cost of capital and multiple expansion, and you made your returns that way. That will be harder to do going forward."

The effects of the 2021 boom are still being played out in a generation of venture backed companies and indeed in the VC funds that own them. Companies have been unable to rely on the potential of a further fundraising round to persist with a growth oriented, cash consuming business model. Instead they have been forced to rein in their ambitious growth plans and to focus instead on unit economics, cash and profitability to the detriment of their growth aspirations. The exalted multiples at which many companies raised in 2020-21 are now very much in the rear view mirror. Private multiples have declined to reflect the fall in public multiples and the relative scarcity of cash. Growth rates have declined meaning that companies face some years of slog to get to a scale where previous valuations might be approached. Fund raising in the interim looks very dilutive to founders – introducing a disincentivising element to new funding rounds.

"Over the past 10 years you could rely on lots of leverage, cheap cost of capital and multiple expansion, and you made your returns that way. That will be harder to do going forward."

March Nachmann, global head of Asset and Wealth Management at Goldman Sachs

Some VC investors face similar issues. The concentration of fundraising with larger funds with a strong track record means that those with a weaker record, or new funds, are being starved of capital. We have seen cross over investors withdrawing from venture capital, reducing teams or focusing back on domestic markets. We have seen some VC firms merge and some shuttered.

This all sounds very gloomy. The redressment from the 2021 excesses is likely to continue in 2024. There are though some more positive indicators.

Public markets performed much better in 2023 and this offers the prospect in 2024 of a gradual return in activity in M&A and IPOs.

Inflation has fallen sharply and interest rates should fall in 2024. Although interest rates will stay higher for longer this is a better backdrop for both public and private markets.

As market conditions ease the exit market should improve, easing the flow of capital around the venture and growth equity ecosystem.

There are industries where investor appetite remains substantial, most obviously in artificial intelligence but also in Climate Tech and software.

Venture capital led companies have had some time to adapt to the realities of the new market conditions. Companies are now more commonly run in a more rational style – looking at a relatively near term horizon for the achievement of profitability and cash – arguably infusing the ecosystem with better practices and sounder companies.

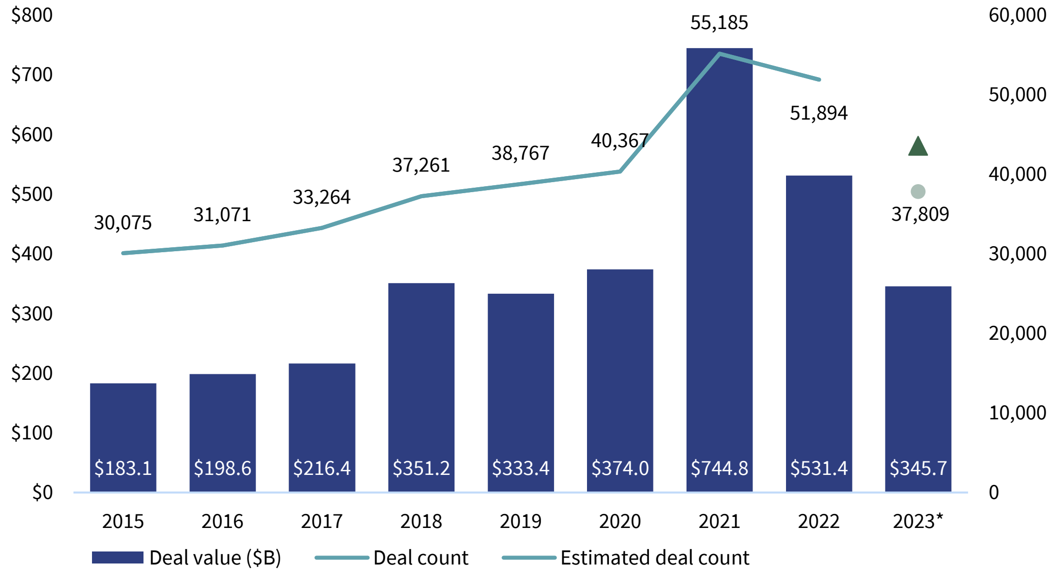
A look at the 2023 statistics

Global VC investment down 35% yoy: The Pitchbook numbers show that global VC investment declined for the second successive year. The estimated total global spend on VC investment was c$346bn, down 35% on 2022.

Two year fall of 54%: 2022 was itself down 29% from the 2021 peak year total of $745bn. The two year fall in global VC funding is 54%.

Similar levels to 2018-20: VC markets had an exceptionally strong 2021. Even though the public and private markets peaked in November 2021, the momentum in private market deals carried the higher level of investment well into 2022. 2023 thus had a tough comp, contributing to the scale of the 35% yoy decline. Looking further back the $346bn investment level in 2023 is similar to the $333bn-$374bn annual range seen in 2018-2020.

Global VC Deal Activity

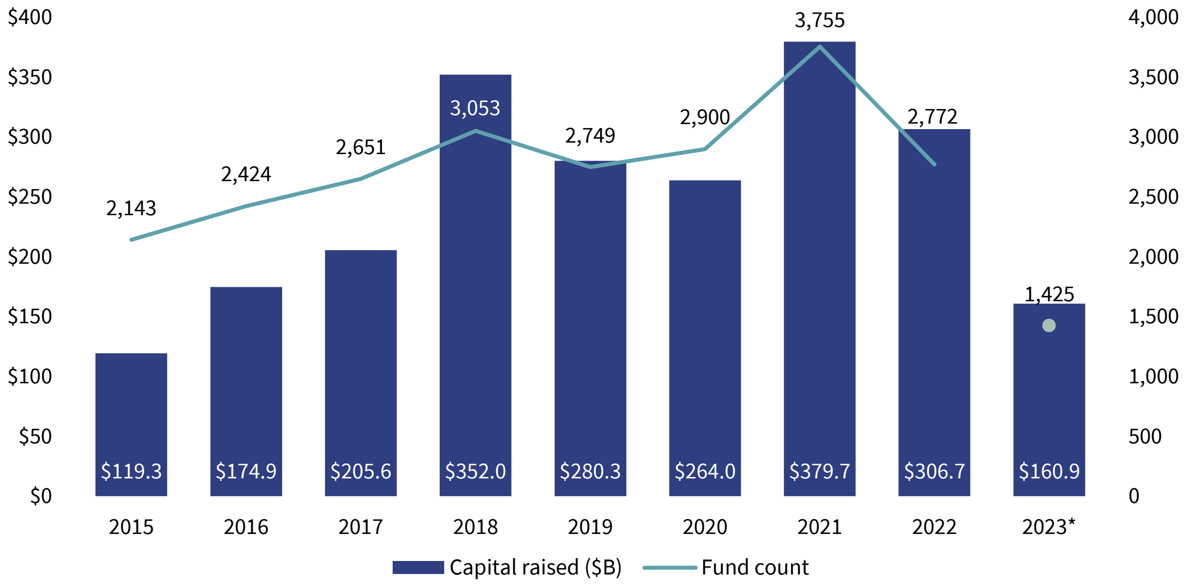


Source : Pitchbook

Global VC firm fundraising down 49% yoy: The figures for global fundraising by VC firms show that the industry struggled to raise new funds in 2023. In total the year saw $161bn of funds raised versus $307bn in 2022 and $380bn in 2021. Fundraising has not been at such a low level since the $119bn of 2015.

Concentration in fewer funds: The money raised has been concentrated in fewer funds. The new fund count of 1,425 in 2023 was just over half the 2,772 level of 2022 and much the lowest number in the last decade.

Global VC Fundraising activity

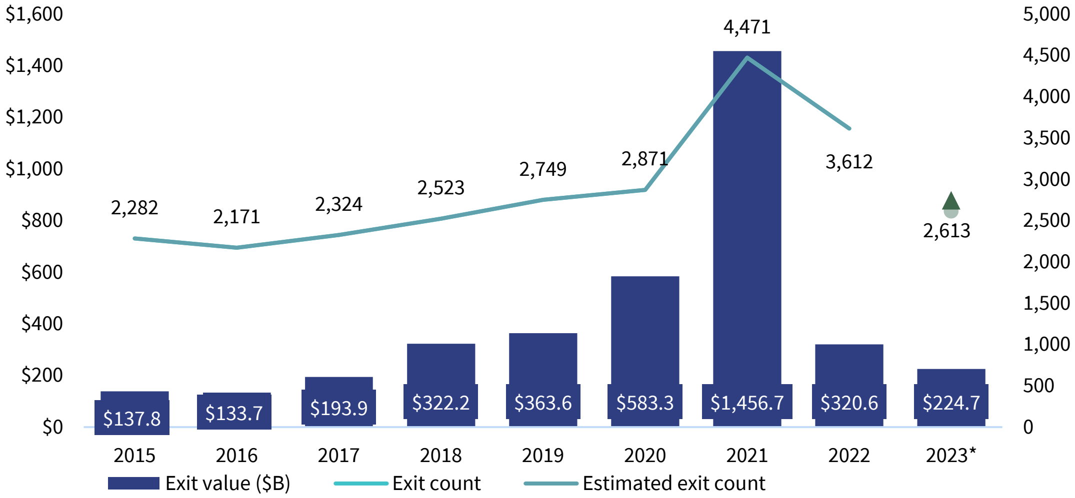


Source : Pitchbook

Value of exits depressed: Emphasising the issues faced by VC funds, the level of exit proceeds was at a low ebb in 2023. Both the M&A and the IPO markets were depressed as market participants adapted to a higher interest rate regime.

Exit value down 30% yoy and down 85% versus 2021: The value of exits globally in 2023 is estimated by Pitchbook at $225bn, a fraction of the $1,456bn of 2021 and still 30% down on the $321bn total of 2022. Exit proceeds were at their lowest level since 2018.

Global VC Exit activity



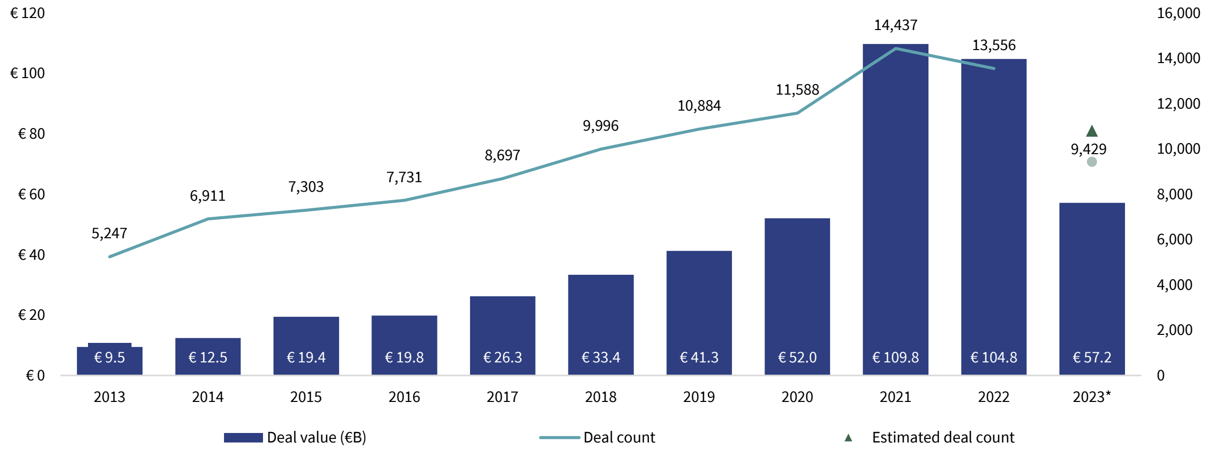
Source Pitchbook

Focus on Europe

European VC deal value down 45% yoy: The total value of European VC deals in 2023 is estimated by Pitchbook at €57.2bn, down 45% yoy versus the €105bn of 2022. It is worth noting that 2022 was a tough comp with total deal spend in that year almost matching the €110bn of the peak year in 2021.

The €57.2bn value of deals done in 2023 exceeded the total in any of the years 2013-20.

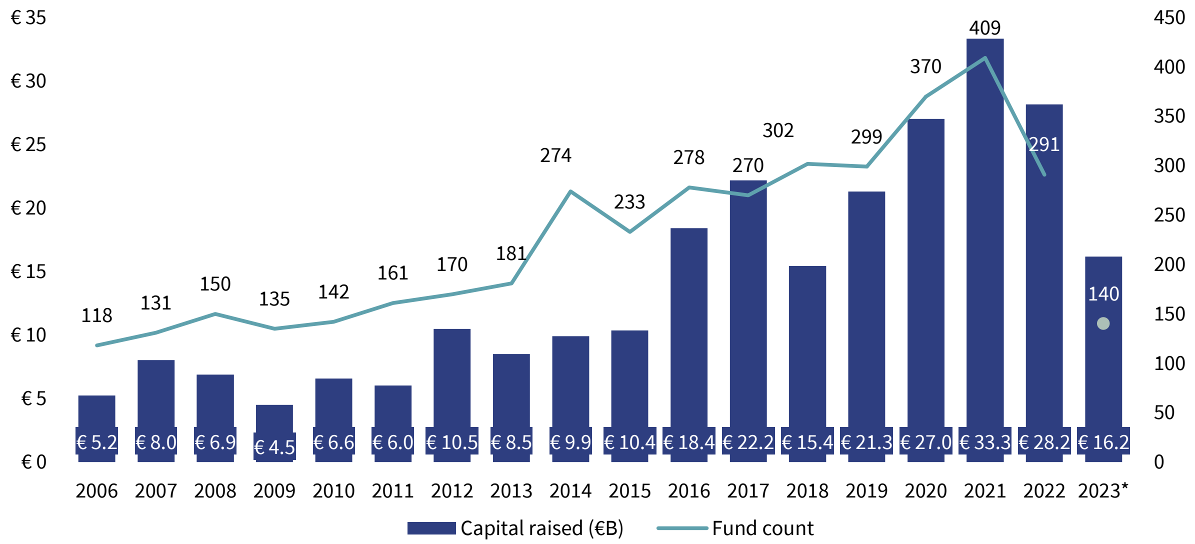
European VC Deal Activity



Source : Pitchbook

European VC funds raised €16.2bn in 2023: This was the lowest figure since 2018. It was down by over half from the peak year of fundraising in 2021 (€33.3bn) and down 43% versus 2022's €28.2bn. Again, the fundraising was concentrated in fewer funds with the number of new funds dropping by 52% yoy to 140.

European VC fundraising

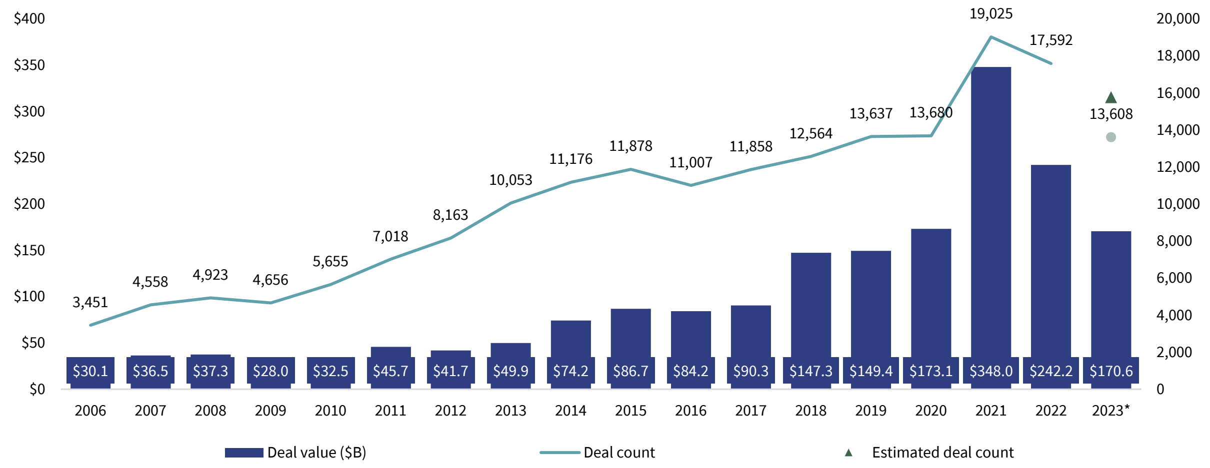


Source : Pitchbook

Focus on the US

The yoy fall in deal value was less marked in the US: US venture deal value totalled $171bn in 2023. This was down by 29% from 2022 (global -35%, Europe -45%).The decline is 51% from the 2021 peak year total of $348m. The 2023 outturn is similar to the $173bn seen in 2020 and ahead of every other year 2006-2019.

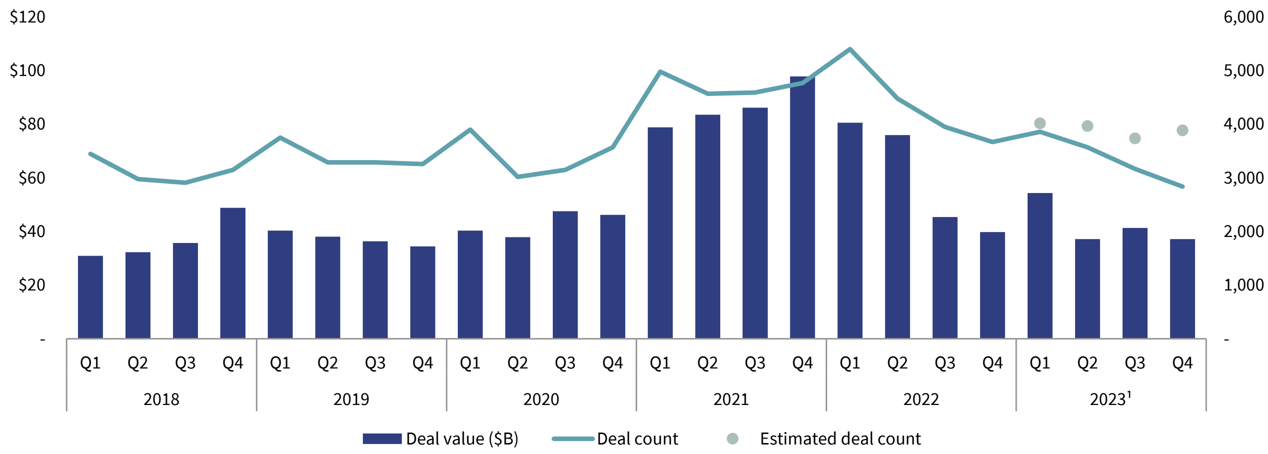
US VC Deal activity



Source: Pitchbook

On a volume basis Q4 2023 saw an estimated 3,934 deals completed. This was 28% lower than the peak volume quarter of 2022. On a value basis tbhe last three quarters of the year all saw a similar value of deals. Q1 2023 was higher, boosted by the $10bn investment by Microsoft in Open AI and the $6.5bn round for Stripe, the two largest deals of the year.

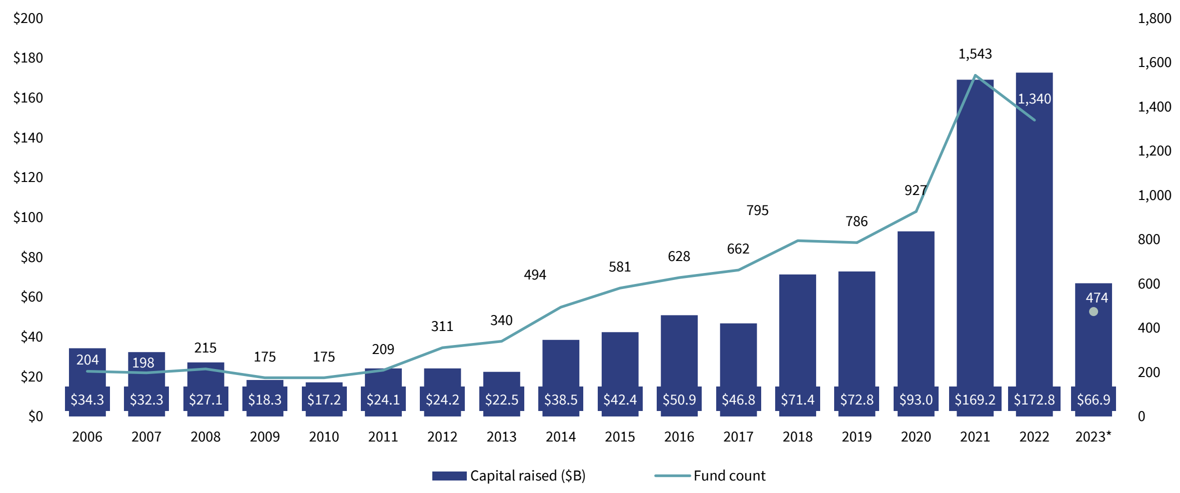
US VC deal activity by quarter



Source: Pitchbook NVCA Venture Monitor. As of December 31 2023.

US VC fundraising down 61% yoy: $67bn was raised by US VC firms in 2023, a fall of 61% yoy from the $173bn raised in 2022. That year had marked the peak of US VC fundraising, slightly exceeding the $169bn raised in 2021. 2023’s $67bn marks the lowest level of funds raised since the $47bn of 2017. Capital raised by first time funds fell to a seven year low with established managers capturing 75% of the total new capital in 2023.

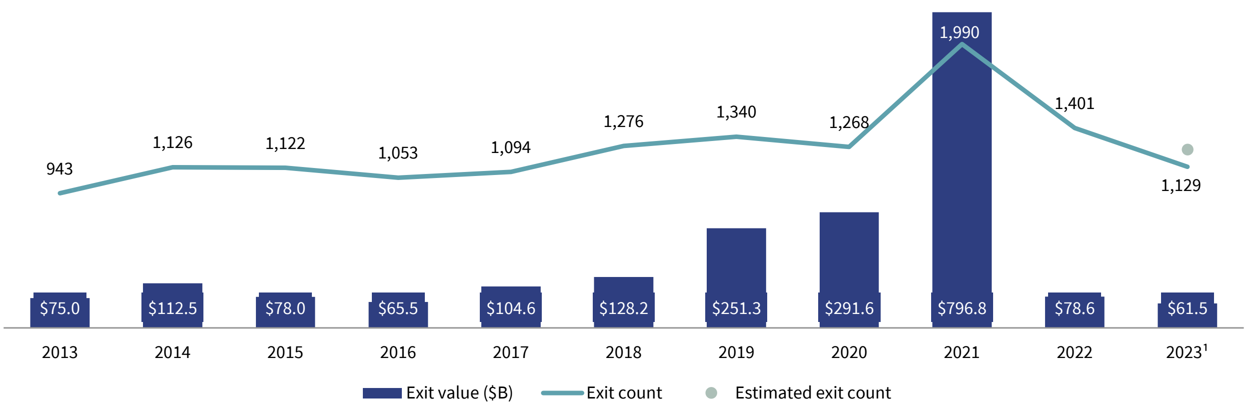
US VC fundraising



Source: Pitchbook

US VC exit activity the lowest for a decade: Combined with this, US VC exit activity was at its lowest level for a decade at $61.5bn, reflecting the weakness apparent in both IPO and M&A activity. Q4 was particularly depressed with, according to Pitchbook, just $1bn from IPO exits and $4.9bn from M&A.

US VC exit activity



Source: Pitchbook NVCA Venture Monitor. As of December 31 2023

The secondaries market

May revive in 2024 as a consequence of constipated IPO and M&A markets and some closing up of valuation expectations between buyers and sellers.

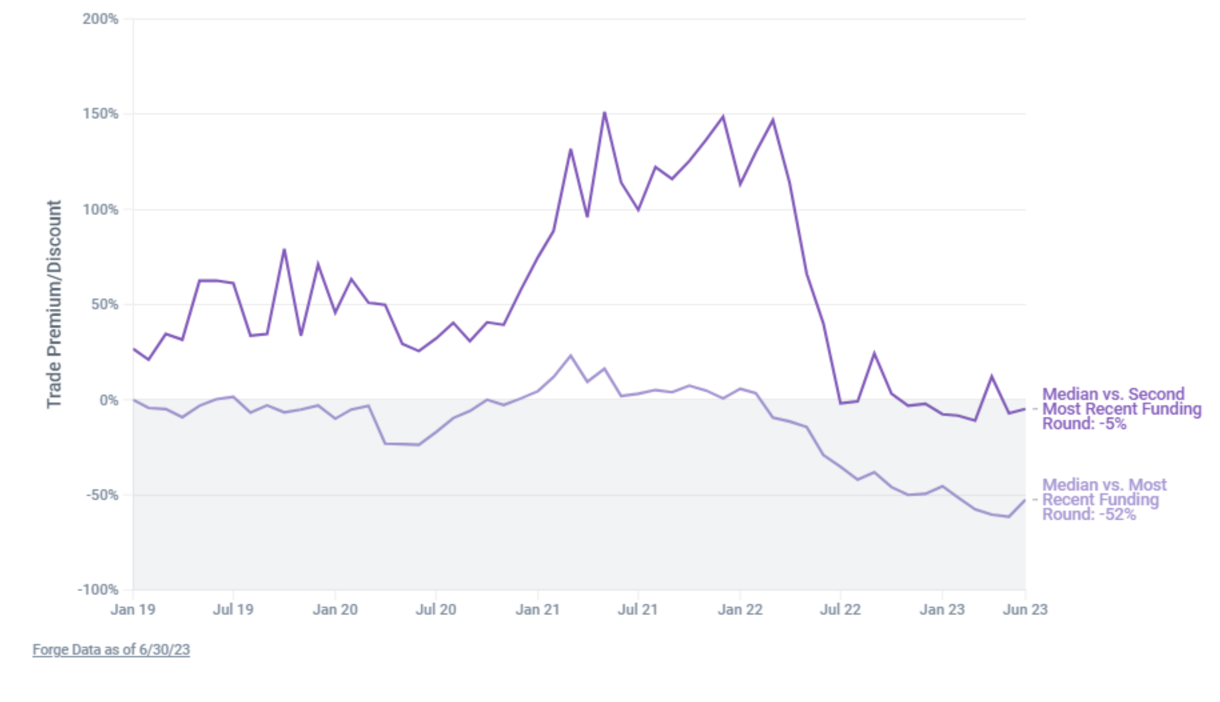
Secondary market revival? One of the consequences of a weaker exit market for both IPOs and M&A is the expected rise in the secondary market in 2024. Conditions appear ripe for this market. The delay in IPOs means that owners of private companies, LPs, founders and employees, have seen their money tied up in companies for longer than expected with a liquidity event potentially still some distance away. The secondary market in venture companies allows employees and investors a liquidity alternative.

Transparency and price discovery issues: The traditional issues with the secondary market relate to its lack of transparency. The market is lightly regulated and there is no central venue for trading. It is a facet of this market that the potential secondary investor is typically looking for a steep valuation discount to a previous public round. The logic of this is that the party looking to sell in a secondary transaction is showing some urgency, not content to wait, for whatever reason, for a conventional liquidity event. Price discovery, given the lack of a single central trading venue on the one hand, and often limited information disclosure about the company whose stock is being traded on the other, is difficult.

The market in secondaries was relatively weak in 2022 and 2023. The rise in interest rates and the fall in public market valuations that ensued, combined with the often heady valuations at which private companies raised money in 2020 and 2021 meant that price discovery became even more difficult. The valuation of private companies on which limited financial information was available became even harder to discern and as a result the valuation gap – the bid-ask gap - became in most cases too wide. Put simply the gap between the seller's expectation of how much their company was worth and the buyer's lower valuation based on a cautious assessment of risk, has simply been too great.

This is illustrated in the next exhibit which is from the secondary market venue, Forge. The data is from June 2023. It shows that at that point private companies in the secondary market were trading on average at a c52% discount to the value in their most recent funding round. Whether owners of private companies would find the other data issued by Forge, that they were on average trading at just a 5% discount to the valuation in the raise before last, reassuring is debatable…

Trade Premiums/Discounts to Last Two Primary Funding Rounds



Source: Forge July 2023

Conditions for secondary market revival: On this basis there are a couple of factors driving the optimism that the secondaries market may revive in 2024.

First, public markets and public valuations have seen a revival in 2023, reducing some of the valuation uncertainty and potentially the bid-ask spread.

Second the continued hiatus in the exit market should mean that there is a ready supply of stock from LPs and employees.

Third there are signs of increasing institutional attention to the secondaries market. Just as we have seen examples of venture capital businesses buying back in to public companies that they have previously owned and IPOed and whose share prices have slumped, so we are seeing investors take an increasing interest in looking for value opportunities via the secondaries market.

In this context a number of new fund raises have recently been carried out by funds targeting the secondary market. These include:

Lexington Partners – which runs $75bn in secondary private equity and co-investment funds and is part of Franklin Templeton, announced in January this year a $22.7bn raise for a Global Secondary Fund '*providing liquidity* *solutions to owners of private investments'*. The fund was upsized from an initial target of $15bn. Circa $5bn is reported to have been earmarked for investment into venture capital.

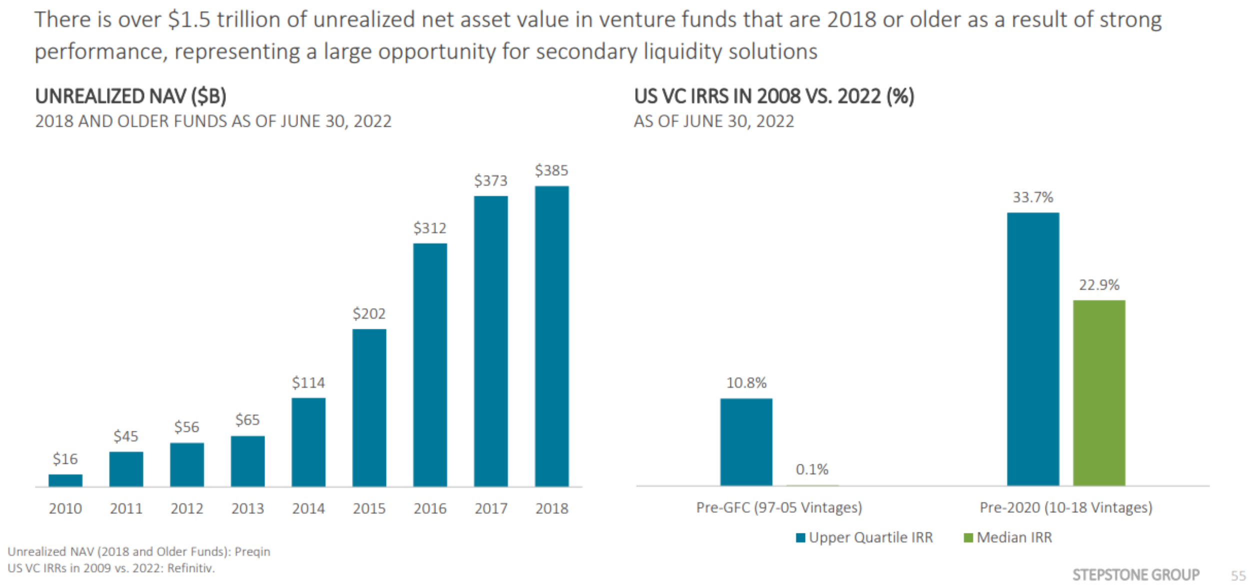
Pinegrove Capital, an offshoot of Brookfield and Sequoia Heritage, is reported to be raising up to $2bn, including $500m in total from its founder partners, to invest in venture capital secondaries.

In mid-2023 Stepstone Group raised $1.6bn for its latest secondary fund, the Stepstone Secondaries Opportunity Fund V.

Pitchbook reports that in the first nine months of 2023, fundraising for vehicles dedicated to secondaries reached $681bn across 39 funds, beating totals for every year except 2020.

This chart from the Stepstone Group investor day in June 2023 gives some idea of the scale of the secondaries opportunity.

Stepstone Group - VC investments in the ground represent a large secondaries opportunity.



Source: Stepstone Group

At a more modest level Forge Global is one of the biggest marketplaces for the trading of secondary shares. A public company, its most recent quarterly filing was for Q3 2023. It noted that Q3 2023 trading volume was up 53% relative to Q2. Kelly Rodriques, CEO of Forge commented:

"*Though the IPO window remains mostly closed, we're seeing continued traction in markets activity and a narrower bid/ask spread than we have since the start of the downturn. These are encouraging signs that investment in the private market is returning."*

He also observed that:

"Q3 marked a reversal in several of the trends that have weighed on the private market since the beginning of 2022. The bid-ask spread narrowed meaningfully in the quarter to a low of 12% in August and ending the quarter at 15%, its lowest level in 6 quarters. The spread has been trending downward since it peaked at 30% in April as valuations have shown some signs of levelling off compared to the steep declines since early 2022."

"As valuations have steadied, we had observed improvement in the breadth of the market. The number of unique issuers with closed transactions on the Forge platform has trended up the last 2 quarters, growing 37% from Q1 to Q3. And the number of unique issuers with sell-side interest reached an all-time high of 228 in August and remained high compared to prior periods through the quarter, which we believe reflects a pent-up demand for liquidity and a growing number of companies that are staying private longer."

Forge produces more data to illustrate this potential upturn in interest in secondary trading.

The median trade prices compared to the last primary funding rounds for private market companies on Forge Markets showed a -54% discount in November. This figure bottomed at -61% in May 2023.

The median bid- ask spread on new indication of intentions (IOI) was 15% in November, close to its 14% average 2020-23 but well below the spike of 28% in May 2022 and that of 30% in April 2023.

Our predictions for the venture capital market in 2024

Our thoughts on likely trends in the venture capital market in 2024.

Artificial intelligence gathers pace: The early big investments have been into the LLM providers and the scale of funding for these means the big players have moved out of reach for some funds. There is though likely to be a focus on new businesses using applications of AI. Virtually every tech related start up website references the use of AI to power its applications. 2024 may be the year when the wheat is sorted from the chaff and a wave of investment reaches the next tier of AI companies.

Strategic investors and ClimateTech projects: There is momentum still behind the wave of investment in ClimateTech projects . Indeed the top four VC deals in Europe were all for ClimateTech businesses, headed by the fundraising at H2 Green Steel. What is surprising is that these deals typically mean breaking the 'new rules' of VC investing. These are sometimes pre revenue and certainly pre profit businesses and there is heavy capital investment required to scale projects like battery gigafactories or EV charging station networks. The capital is there though for this type of project, whether strategic green funds, pension funds or sovereign wealth.

Focus on corporate governance: As the venture capital market has normalised some of the excesses seen in the system have dropped out. 2023 saw crypto under scrutiny post the fallout from FTX. That raised issues over control and corporate governance structures in start-ups, a factor of which the market was reminded in the events at Open AI towards the end of the year. Some large investors have turned the scrutiny on themselves, slowing down their investment processes and raising safeguards. The demise of Silicon Valley Bank marked a watershed in attitudes from the heady times of 2020-22 to a more circumspect investment environment.

Funding rounds are slower: The corollary of the fall away of the 'hot' market conditions of 2020-22 is that the environment to invest is less pressured. There are still areas, notably AI, of rapid and substantial decision-making (Mistral raised a €100m round within four weeks of its creation and another €400m round six months later). More typically VC investors are taking their time to do substantial due diligence, working with their investee companies. It means that funding rounds are more onerous and take much longer than they did in the recent past.

Company casualties mount: The venture capital model assumes a relatively high failure rate of companies along the way, with the effect hopefully more than offset by some good, and some spectacular, successes. The shift in the interest rate environment and the ensuing change in the ease of accessing capital is though a pivot moment and it is likely that the number of venture capital backed projects that shut down will climb in 2024 as some companies run out of financing road or the motivation to continue in straitened circumstances. A recent Pitchbook report cited that in 2023 3,200 US venture capital backed companies, that had raised a total of $27.2bn, went out of business.

More down rounds: In 2023 the number of down rounds increased but it wasn't a flood. The same trends though should persist into 2024. Companies have tightened their belts, focusing on cash and profits, often at the expense of top line growth. As the cash raised in 2020-22 runs out and as there is often still a gap before self-support can be reached ,companies must go back to the market – or more probably their existing investors – to raise. The less attractive growth dynamics combined with the lower public valuations since the last raise (the market peaked in November 2021) and the lower availability of capital combined with a higher investment hurdle, means that there should certainly be more down rounds.

Venture capital firms under pressure as well: Fund raising is tougher, in part because with weak M&A and IPO markets the flow of capital around the system and in particular back to LPs, has been disrupted. In this environment we may see consolidation of funding around the bigger VC firms with the strongest track records. Even for such funds the scale of new fundraising may diminish. Some smaller funds may find it more difficult to raise and some casualties may become apparent here as well – whether via M&A and consolidation into bigger units or by closing funds and returning money to investors.

The IPO environment to improve: The oddity of 2023 is that it was a very tough year for the venture capital market (*"the most difficult year for start-ups in at least a decade"* Peter Walker, Carta's head of insight quoted in the New York Times) while the public markets did well - NASDAQ was up over 40% and the S&P 500 over 20%.

Clearly part of that was rebound from the fall away from the peak in November 2021, while VC investment must look at the long term interest rate curve rather than focusing on short term rates, the driver of the market's year-end rally. Yet buoyant public markets must offer hope for an improved exit environment in 2024 and 2025. With the first

US interest rates still slated for mid-year, and cuts in the EU even earlier, the prospect of a growing IPO revival should be on the cards.

And M&A as well: Again it has been tough in the M&A market. There is a higher hurdle rate yet the dislocation of public and private valuations would appear to offer opportunities for exit via M&A, and there is a lot of dry powder out there. A recent Coller Capital survey of 110 PE investors from around the world with total assets under management of $2.2 trillion found that 60% of investors said they expect an increase in mergers and acquisitions in global private markets over the next three to five years. Only 11% of respondents anticipated a decrease in M&A activity.

How will the end of 2024 look? US interest rates could be 75bps lower according to Fed officials with another 100bps of reduction in prospect for 2025. Venture Capital companies will be two years into the focus on profits and growth, more and more will be turning that corner to demonstrate that profitability is there and looking for funding for renewed growth. Public investors may have made some good money on reasonably priced IPOs. Global economic growth may have slowed modestly in 2024 (2.7% in 2023 to 2.6% in 2024) but the incoming US President (Trump, Biden, Haley, Obama?) will be looking at forecasts of a reacceleration in 2025.

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. In 2023 there was 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. In 2023 it was up 56% meaning the total fall since the start of 2022 is 36%. 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 was reflected in some big valuation reductions in some high-profile VC rounds in 2023.

▪ 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 2023 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 few months though have seen a notable pick-up in large later stage deals, most notably in ClimateTech and Software

▪ 2023 saw 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 recent deals in Growth Equity and Private Capital

A selection of recent deals on which we have advised.

Castore: £145m equity funding

- Sole adviser to Castore, the premium sportswear brand and end-to-end retailing platform for global sports teams on its first institutional funding round
- The £145m equity investment was led by The Raine Group and valued Castore at £800m pre-money (£945m post)
- Rothschild & Co Debt Advisory also upsized Castore's RCF by £25m to a total of £100m

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 $120m+ Series C

- Adviser to YuLife on its investment by T Rowe Price
- T Rowe Price's first ever private investment in European FinTech
- The Series C extension valued 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

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

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

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

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