Rothschild & Co
Global Advisory

Growth Equity Update

October 2022 – Edition 7

- We focus on the different approaches to the encouragement of venture capital and growth investing in the UK and France.
- The new UK Chancellor's mini budget on 23rd September saw a major shift in approach, representing a 'dash for growth'. This included action *'to unlock private investment across the whole of the UK'* with measures aimed at private growth businesses including changes to the tax regime, a boost to the Seed Enterprise Investment and the Long-term Investment for Technology & Science (LIFTS) schemes and pension fund reform to boost private markets investment.
- In France there is strong government emphasis on promoting the country as a *'start up nation'.* 2019's Tibi Report called for massive investment in disruptive technologies to drive future prosperity and the target for Tibi labelled funds is now €30bn. The French government's initial target of 25 French unicorns was met in January 2022 and is now for 100 by 2030.
- Meanwhile the market environment remains unsteady against a background of continued hawkish statements on interest rates in the US and mounting fears of recession. The S&P 500, NASDAQ and the Thomson Reuters Venture Capital Index have retreated 8%/8%/12% in the last month and by end September were down 25%/33%/58% for 2022 YTD.
- We revisit US VC dry powder which at end June 2022 was at a high of $290bn. A recent Decibel report suggests the industry invests c8-9% of dry powder each quarter suggesting the industry will slow only modestly in 2022 and continue to see high levels of investment in 2023/24.

The UK budget and private capital

UK budgets would not normally be the subject of our growth equity update but the UK Chancellor's mini budget on 23rd September marked a major shift in the nature of UK economic policy with its overtones of a 'dash for growth'. There were a number of measures directly relevant to growth and privately funded businesses. The government also flagged a number of changes to the regulation of the City of London financial sector designed to stimulate investment.

The key changes potentially relevant for private businesses are:

I. **Corporation tax held at 19%** instead of rising by 600bps to 25% from April 2023.

II. **Tax relief for early-stage investment vehicles.** The government is to extend tax relief on investment vehicles including venture capital trusts and enterprise investment schemes. These were previously subject to a sunset clause to prevent them from qualifying for tax relief after 2025.
III. **Increasing the scale and availability of the Seed Enterprise Investment Scheme**: This is designed to improve the ability of British companies to raise money. From April 2023, companies will be able to raise up to £250,000 of SEIS investment, a two-thirds increase.
IV. **Long-term Investment for Technology & Science (LIFTS) competition**, providing up to £500m to support new funds designed by institutional investors and fund managers, aiming '*to crowd billions of pounds of private investment into UK science and technology businesses'.* The government will call for proposals from *"promising fund structures and vehicles"* by the end of the year, with the aim of distributing funds in 2023.
V. **Pension fund reform to boost private markets investment**: The government will bring forward regulations to remove well-designed performance fees from the occupational defined contribution pension charge cap. This aims to increase investment by pension funds into UK assets, including private markets funds. The hope is that savers benefit from higher potential investment returns *'while providing clarity for institutional investors to help unlock investment into of the UK's most innovative businesses and productive assets.'*

The key elements of the government's new package announced on September 23 were (statement click here).

The Growth Plan 2022 - Dash for growth

I. A focus on being globally competitive with the city at the *'heart of the government's programme for driving growth across the whole economy'*.
II. An aim to deliver a medium-term trend growth rate of 2.5%.
III. *'Getting out of the way of business'* through supply side and tax reform.

The details on the supply side reforms and changes to City regulations will be published in the Autumn. The government says they will include *"scrapping EU rules from Solvency II to free up billions of pounds for investment".*

Substantial fiscal give away:

The government announced a give-away of c£45bn over the next four years.

This is in addition to the planned domestic energy package where initial estimates put the potential cost of the 'Energy Price Guarantee' at a headline £150bn. Subsequent commentary, based on declining wholesale gas prices suggest that the actual cost may be substantially lower while there should be some economic benefit from lower inflation and an implied greater ability to avoid recession.

Confirmation of the independence of the Bank of England*:* The new Chancellor, Kwasi Kwarteng, wrote to the Governor of the Bank of England on 22nd September saying *"you have my full support in your critical mission to get inflation under control. The government's commitment to the 2% CPI inflation target, and the independence of the Bank remains absolute."*

The Chancellor also encouraged the independent bank to take *"forceful action"* to control inflation.

"It is essential to businesses and households across the country that inflation is brought back to target, and I know and expect that the MPC will continue to take the forceful action necessary to achieve this and to ensure inflation expectations remain firmly anchored."

The new growth plan – changes affecting private businesses

The core of the government's message is that it wants to drive higher economic growth. The Growth Plan sets out action '*to unlock private investment across the whole of the UK.'*

Tax and incentive changes for businesses.

UK Corporation tax rate will remain at 19%. The previous planned rise to 25% has been cancelled.

New investment zones: The government plans to work with local partners to introduce Investment Zones across the UK. Investment Zones will benefit from tax incentives and planning liberalisation, and from a range of time-limited tax incentives over ten years.

The tax incentives under consideration are:

I. 100% relief from business rates on newly occupied business premises, and certain existing businesses where they expand.
II. Enhanced Capital Allowance – 100% first year allowance for companies' qualifying expenditure on plant and machinery assets for use in tax sites.
III. Enhanced Structures and Buildings Allowance – accelerated relief to allow businesses to reduce their taxable profits by 20% of the cost of qualifying non-residential investment per year, relieving 100% of their cost of investment over five years.
IV. Employer National Insurance contributions relief – zero-rate Employer NICs on salaries of any new employee working in the tax site for at least 60% of their time, on earnings up to £50,270 per year.
V. Stamp Duty Land Tax – a full SDLT relief for land and buildings bought for use or development for commercial purposes, and for purchases of land or buildings for new residential development.

See here for details.

Increasing private sector investment

Institutional investment into innovative UK Scale Ups – The government intends to launch the Long-term Investment for Technology & Science (LIFTS) competition, providing up to £500m to support new funds designed by institutional investors and fund managers, aiming '*to crowd billions of pounds of private investment into UK science and technology businesses.'* The government will launch a call for proposals by the end of the year to identify promising fund structures and vehicles, with the intention that funds go live as soon as possible next year.

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Increasing the scale and availability of the Seed Enterprise Investment Scheme: This is designed to improve the ability of British companies to raise money. From April 2023, companies will be able to raise up to £250,000 of SEIS investment, a two-thirds increase. To widen the availability of SEIS the gross asset limit will be increased to £350,000 and the age limit from two to three years. The annual investor limit will be doubled to £200,000. The government calculates these changes will help over 2,000 companies a year.

Company Share Option Plan (CSOP) – To help attract talent from April 2023, qualifying companies will be able to issue up to £60,000 of CSOP options to employees, double the current £30,000 limit. The *'worth having'* restriction on share classes within CSOP will be eased widening access to CSOP for growth companies.

Annual Investment Allowance – The government will support UK businesses by making the temporary £1 million level of the Annual Investment Allowance permanent, instead of letting it fall to £200,000 after 31 March 2023. This is intended to support business investment and make tax simpler for any business investing between £200,000 and £1 million in plant and machinery.

Support for retail: To support retail, the government will introduce a new VAT-free shopping scheme for non-UK visitors allowing them to obtain a VAT refund on goods bought in the high street, airports and other departure points. All planned alcohol duty rate rises have been cancelled.

Supply side reforms

Various measures are outlined including (i) changes to the planning system for major projects. (ii) acceleration of digital infrastructure roll out (iii) reforms to simplify the regulation of businesses including simplification of the tax code (iv) regulation and innovation changes for farming (v) reforms to improve access to affordable, flexible childcare (vi) On the immigration system the government says it wants it to work for business and encourages highly skilled people and high growth businesses to choose to locate and invest in the UK.

Financial services sector:

The Government's statement set out a determination to restore London's status for financial services with an *'ambitious package of regulatory reforms.'* The statement says: "*The financial services sector will be at the heart of the government's programme for driving growth across the whole economy. Later this autumn the government will bring forward an ambitious deregulatory package to unleash the potential of the UK financial services sector. This will include the government plan for repealing EU law for financial services and replacing it with rules tailor made for the UK, and scrapping EU rules from Solvency II to free up billions of pounds for investment.*"

Measures announced include:

Cap on bankers' bonuses will be removed; The Prudential Regulation Authority will remove the current cap to bankers' bonuses which limits remuneration of certain bank staff to 100% of their fixed pay.

Bank surcharge will remain at 8%: From April 2023 banks and building societies will continue to pay an additional 8% rate of tax on their profits, rather than the reduced 3% rate that would have been the legislative default, leading to a combined rate of 27%. The increase in the Surcharge allowance to £100 million will go ahead to ensure that the tax system is supportive of growth within the UK banking market.

Pension cap on fees will no longer apply: The government will bring forward regulations to remove 'well-designed' performance fees from the occupational defined contribution pension charge cap, ensuring that savers benefit from higher potential investment returns '*while providing clarity for institutional investors to help unlock investment into of the UK's most innovative businesses and productive assets.*'

Other key changes

Personal taxation: There are a number of planned changes to the personal tax regime.

The planned 1.25% increase (from November 2022) in ***National Insurance contributions*** has been cancelled and the planned ***Health and Social Care Levy*** has been removed.

The ***basic rate of income tax*** reduces from 20% to 19%.

A proposal to abolish the ***top rate of income tax*** at 45% and reduce it to 40% from April 2023 was proposed but subsequently abandoned.

Stamp duty – The threshold at which first-time buyers begin to pay residential SDLT will increase from £300,000 to £425,000 and the maximum value of a property on which first-time buyers' relief can be claimed will increase from £500,000 to £625,000.

Energy:

The Energy Bill Relief Scheme (EBRS) is a six-month scheme to protect businesses from rising energy bills by providing a discount on wholesale gas and electricity prices at an estimated cost from October 2022 of £60bn.

£40bn Energy Markets Financing Scheme launching on 17th October (see here). This will address the liquidity requirements faced by energy firms from high energy prices. The EMFS will be available to firms who can show they are otherwise in sound financial health and make a material contribution to the liquidity of UK energy markets.

Sterling, interest rates and public finances:

The government is committed to fiscal sustainability and reducing debt as a proportion of Gross Domestic Product (GDP) over the medium-term. The government will take the responsible decisions that are needed to achieve this aim, including keeping spending under control.

Sterling

The pound's fall against the dollar gathered momentum after the government's fiscal package was announced on Friday 23rd September. By the following Monday sterling had hit an all-time low in Asia of $1.03, down from $1.13 the day before the announcement and $1.35 at the start of the year. By September 30 it had rallied back to $1.12.

The pound's fall in value is likely to help keep inflation higher than it would have been by pushing input and competing product prices higher. It may mean that the Monetary Policy Committee will raise interest rates further than it would otherwise have done.

Money and bond markets have also been impacted. Post the mini-Budget the 10-year gilt yield rose from c3.5% to 4.5% in three days. The Bank of England by suspending its programme to sell gilts and instead stepped in with a programme to buy up to £65bn of long dated gilts to steady the market. In turn this action is potentially inflationary.

Some perspectives on this are given by Kevin Gardiner, Rothschild & Co's Global Investment Strategist. He writes:

The UK government debt as a percentage of GDP is almost identical to that of the Euro Area and, at 95.9% is only the eight highest in the G20. Nor has the UK gone any more ex-growth than many other big European economies. The IMF real GDP growth 2022/23 forecasts published on 22nd September show the UK at 3.2%/0.5%; Germany at 1.2%/0.8%, Italy at 3%/1% and France at 2.3%/1%.

G20 - Government debt to GDP

	%	Ref point
Japan	266	Dec-20
Italy	151	Dec-21
United States	137	Dec-21
Singapore	131	Dec-20
Canada	118	Dec-20
Spain	118	Dec-21
France	113	Dec-21
United Kingdom	95.9	Dec-21
Euro Area	95.6	Dec-21
Argentina	80.5	Dec-21
Brazil	80.3	Dec-21
India	74	Dec-20
South Africa	69.9	Dec-21
Germany	69.3	Dec-21
China	66.8	Dec-20
Mexico	52.1	Dec-20
Netherlands	52.1	Dec-21
South Korea	42.6	Dec-20
Turkey	42	Dec-21
Switzerland	41.4	Dec-21
Indonesia	38.5	Dec-20
Saudi Arabia	32.5	Dec-20
Australia	24.8	Dec-20
Russia	18.2	Dec-21

Source: Trading Economics; Rothschild & Co

The mini-Budget fiscal package may look at times inconsistent economically (stimulating growth, reducing taxes while discouraging inflation) but the UK government's balance sheet is in better shape than many (including the Office for Budgetary Responsibility and IMF) feared it would be two years back.

Nevertheless, the latest tax cuts landed in a context in which UK monetary policy has been looking less resolute than in the US or Eurozone of late. The MPC has been more equivocal on the need for higher rates despite an 800bps gap between CPI inflation and the policy rate at the latest meeting,

A significant part of the currency story is instead all-round dollar strength. Sterling has fallen by more than the other big currencies against the dollar this year, but in trade-weighted terms (that is, all-round terms) its decline is a more modest 8%. The yen has fallen by more on this basis.

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Interest rate outlook

The fall in sterling produced a response from the Government. The chancellor has brought forward his announcement of a new medium-term fiscal plan from November 23rd to later this month. The Office of Budget Responsibility will put out its new independent forecasts on the same day.

The Bank of England announced that there would not be an emergency Monetary Policy Committee to respond to the fall in sterling saying that while it would not *"hesitate to change interest rates as necessary to return inflation to the 2 per cent target sustainably in the medium term, in line with its remit"* this would come after *"a full assessment at its next scheduled meeting of the impact on demand and inflation from the government's announcements".*

The Bank of England raised rates by 50bps to 2.25% at its September 22nd meeting which met against a backdrop of twelve-month CPI inflation falling slightly from 10.1% in July to 9.9% in August. It met before the mini budget.

The Bank of England's chief economist said on September 27th that the UK government's loosening of fiscal policy *'will require a significant monetary response.'* The next MPC rates meeting is on November 3rd with another before the year end on December 15.

Post the mini budget market expectations are that interest rates could hit 5.5%- 6% by April 2023 up from previous forecasts of an increase to c4%.

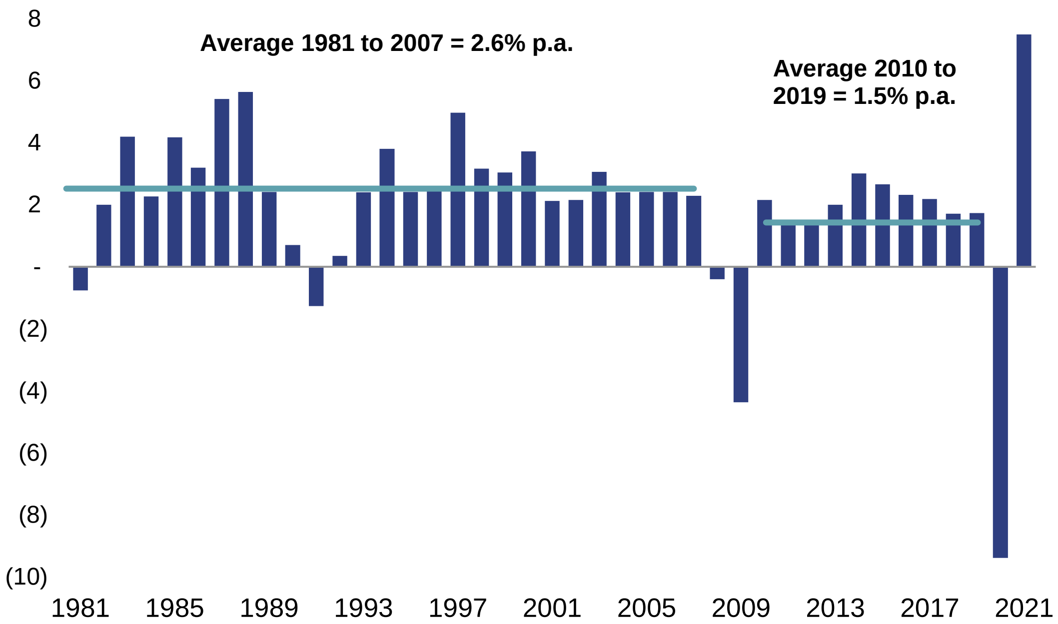
Economic growth

The view of Redburn's economist Mike Taylor is that *fiscal measures, notably the energy price guarantee, will make the imminent recession relatively short and shallow, lasting two or three quarters to early 2023 with a fall in GDP of around 1.5%. But tighter monetary policy will begin to exert an increasing contractionary effect through 2023, dampening recovery.*

He concludes:

The UK mini-Budget cut taxes in an attempt to lift the UK's poor trend rate of GDP growth. But the effect is likely to be minimal, not least because the overall tax burden remains high. Meanwhile, the significant easing of fiscal policy may result in higher interest rates than otherwise as the Bank of England seeks to bring inflation down to target.

Annual real UK GDP growth, %



Source: Datastream

Focus on France and its VC environment

"We were a start-up nation, we are going to become a nation of large technology companies. France has a vocation to be one of the nations writing the 21st century." French Economy Minister Bruno le Maire – June 2021.

In June 2017 French President Emmanuel Macron spent the afternoon wandering between the stalls and exhibits at the Viva Technology show in Paris. At the end of the afternoon, he gave a speech in which he stated that one of his major tasks as President was to tackle the digital revolution. He signalled that France should become a start-up nation with entrepreneurs as the new role models. He lauded the excellence of France's schools of engineering. His ambition was that the French state should act as a start-up, as a platform that makes it easier to become an entrepreneur.

There were some specific announcements including a €10bn public fund managed by Bpifrance to invest in start-ups. There were changes to the French tax system in capital gains and the wealth tax to encourage entrepreneurs and investors. Notably he confirmed the introduction of the French Tech Visa, a four-year visa to attract key workers from abroad to work in France.

In September 2019 President Macron announced ahead of France Digitale Day a new target - *"I'll leave you with a goal: there should be 25 French unicorns by 2025."*

There were then were 11 unicorns in France, behind the UK with 29 and Germany with 17 but ahead of all other countries in Europe. At the time Pierre Entremont Co-Founder & Partner of First, a seed stage VC firm, commented:

"In France, the pipeline of potential $1bn+ companies have never been so promising, and has even started to deliver with Doctolib. The first exits will follow soon, and with them the 'mafias' of operators with first-hand rocket ship experience that we lack. We perceive this as the last significant step before ecosystem maturity."

French start-ups that raised more than €50m (2015 to June 2019)

	Nom	Secteur	Date derntère levée	Montant dernière levée (M€)	Montant total levé (M€)
1	OVH	Cloud	août-16	250	250
2	Meero	Plateforme	juin-19	203	260
3	BlaBlaCar	Plateforme	sept-15	176	291
4	Voodoo	Gaming	mai-18	172	172
5	Deezer	Plateforme	août-18	160	455
6	Sigfox	IoT	nov-16	150	277
7	Doctolib	Plateforme	mar-19	150	234
8	Devialet	Hardware	nov-16	100	140
9	HR Path	Software	avr-19	100	135
10	ManoMano	Plateforme	avr-19	110	183
11	Ynsect	Hardware	fév-19	110	132
12	Dataiku	Big Data	déc-18	89	128
13	Wynd	Software	janv-19	72	110
14	Actility	IoT	avr-17	70	101
15	Evaneos	Plateforme	sept-18	70	92
16	PayFit	FinTech	juin-19	70	89
17	VadeSecure	Cybersécurité	juin-19	70	80
18	BioSerenity	Santé	juin-19	65	83
19	Mirakl	Software	févr-19	62	88
20	Ledger	Cybersécurité	janv-18	61	68
21	Vestiaire Collective	Plateforme	janv-17	58	116
22	Believe Digital	Plateforme	juin-15	55	55
23	Ivalua	Software	mai-19	54	121
24	Shift Technology	FinTech	mar-19	53	88
25	ContentSquare	Software	janv-19	53	107
26	Blade	Cloud	Juin-17	51	65
27	OpenClassrooms	EdTech	mai-18	51	59
28	LinkbyNet	Cloud	août-16	50	50
29	Recommerce	Hardware	févr-18	50	57

Source: Communiqués de presse; Crunchbase; Dealroom. Chiffres à mi-juillet 2019 ; Tibi Report 2019

In July 2019 **the Tibi Report** was produced under the auspices of the Ministry of the Economy and Finances. Stating that in the fourth industrial revolution Europe is far behind the US and China it called for massive investment in disruptive technologies as a key driver of French sovereignty and future prosperity. By September 2019 the French government was able to say that it had secured €5bn of committed investment into tech businesses with Mr Macron saying, "*We'll have €2 billion that will go in so-called late-stage funds and €3 billion for funds managed by asset managers specialized in [publicly listed] tech companies.*"

In January 2020 the target was extended to €6bn of commitments to support VC funding by 2022 and then to €20bn.

A review of the Tibi initiative carried out in June 2021 (and published in August) by the Ministry of Finance announced that it had exceeded expectations. Simultaneously Bruno Le Maire, the Minister of the Economy, Finance and Recovery speaking at the *'Financing the Fourth industrial Revolution"* conference in early June announced that the total subscriptions raised in Tibi labelled funds had reached €18bn. He increased the Tibi target for financing of investment funds in French technological start-ups from €20bn to €30bn.

"I propose to you a new target of €30bn invested in French technological funds by 2022. This means that we must all mobilize, but also mobilize new investors. I am thinking in particular of foreign investors, through the participation of eleven new investment bank partners, fund-raising intermediaries, who are going to go and mobilize these investors all over the world. This new target will enable us to increase the number of partner investors and increase the capital committed to funds invested in France, and also allow long-term investment of the best foreign funds in our country.''

Speaking at the same conference Philippe Tibi highlighted two key routes to reach the new target of €30bn target *"the very important domestic channel, employee savings and retirement savings"* on the one hand, and the *"international channel, all long-term investors, sovereign funds, pension funds, foreign insurance funds and family offices."*

An Ernst & Young Report ' *2021 Barometer on the attractiveness of France'* (here) also published in June 2021 ranked France as the leading European country for international investments in 2020.The 985 investment projects identified in France came ahead of 975 in the UK and 930 in Germany.

> *"What target am I fixing for us? To try to develop 10 tech giants in Europe, in the coming five years, and to increase the number of our unicorns to at least 100 by 2030, which is feasible."*
>
> Emmanuel Macron – June 2022

It was June 15th, 2021, a week after the Financing the Fourth industrial Revolution, that French President Emmanuel Macron updated the targets and internationalized them to Europe. He endorsed the target of 10 European companies worth €100bn by 2030 proposed by the Scale Up Europe collective (see report here).

To compete with the US and China Macron stated, *"We need to build a stronger European ecosystem and champions, and entrepreneurs need to push governments to be more efficient."*

Recommendations in the Scale Up report include the creation of an *ecosystem favourable to the listing of tech companies on European stock markets;* a *tech worker status for European talent, with a standardised contract and the portability of social rights across the continent;* a *standardised framework for patent transfer to accelerate technology transfer out of universities, and between start-ups and large companies* and the implementation of *a tax credit for European companies investing in European start-ups.*

Using successful elements of the French experience President Macron called for the creation of a '*European tech visa'* to attract oversees talent and for extra investment from institutional funds.

Key current trends in the French VC and tech markets

Boosted by government initiatives France saw $11.6bn invested in venture capital businesses in 2021 with a preponderance in tech. The biggest round was the $680m Series B of fantasy soccer startup Sorare. Led by Softbank it valued the blockchain based fantasy football game at $4.3bn. The eCommerce platform Mirakl raised $555m in Series E funding, EcoVadis a global provider of business sustainability ratings, raised $500m and the DIY marketplace ManoMano attracted $355m.

In January 2022 France hit its target of 25 unicorns when the Lille-based warehouse robotics company Exotec announced a $335m raise at a value of $2bn.

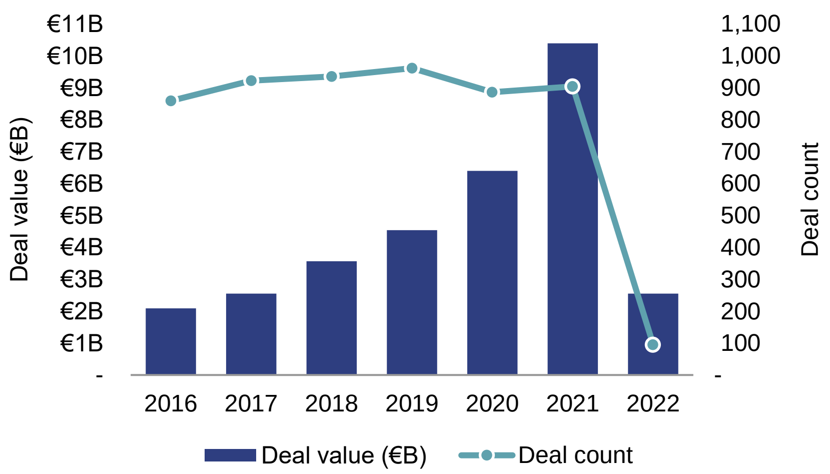
France's 25 Unicorns – January 2022

Biggest French VC deals in 2021 and 2022[1]				
Company	**DealSize(€M)**	**Close Date**	**Post Valuation (€8)**	**Select Investors**
Sorare	€576.4M	09/20/21	€3.7B	SoftBank, Atomico, D1 Capital, Eurazeo
Qonto	€486M	01/10/22	€4.4B	Tiger Global, TCV, Alkeon, KKR, Insight Partners
Mirakl	€470.4M	09/21/21	€3B	Silver Lake, Permira, Elaia Partners, Felix Capital
Back Market	€450M	01/11/22	€5.1B	Sprints Capital, General Atlantic, Aglaé Ventures
ContentSquare	€411.8M	05/25/21	€2.3B	SoftBank, KKR, Highland Europe, Bpifrance
ManoMano	€316.6M	07/05/21	€1.9B	Dragoneer Investment Group, General Atlantic
Ledger	€312.1M	06/10/21	€1.2B	10T, Nucleus Adventure Capital, Yes VC
Exotec	€295.4M	01/17/22	€1.8B	Goldman Sachs Asset Management, 83North, Breega
Back Market	€276M	05/18/21	€2.6B	General Atlantic, Daphni, Goldman Sachs Growth
Vestiaire Collective	€254.4M	03/01/21	€1B	Kering, Tiger Global, Idinvest Partners, Eurazeo

Note: 1 - As of Feb. *Source: PitchBook*

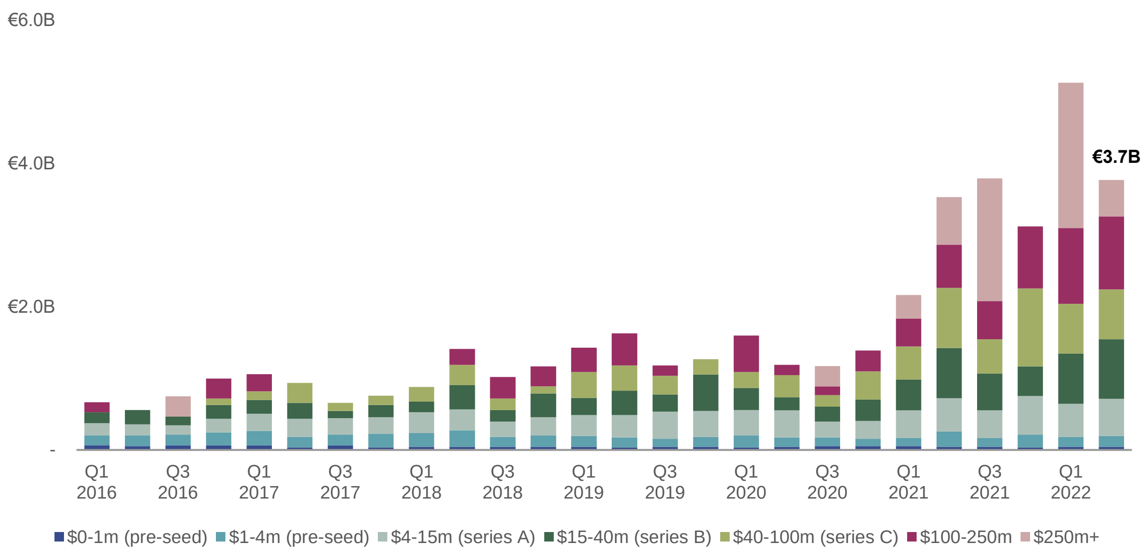
According to PitchBook data the amount raised by startups in France more than trebled from 2017 to 2021.

France - Record year for VC investment in 2021



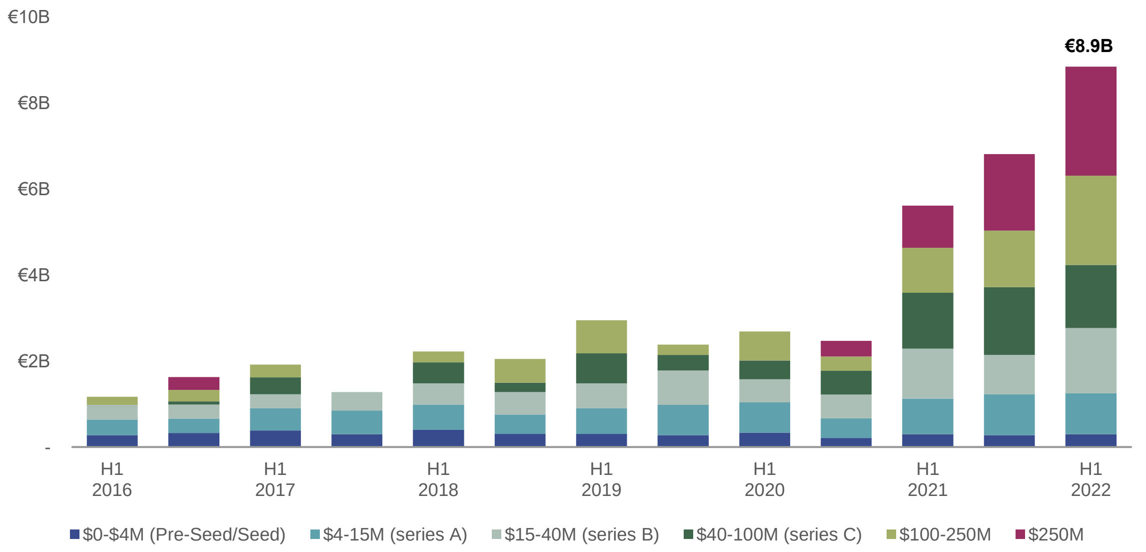
Source : Pitchbook

Continuing the trend and despite the general slowdown in VC venture funding France has posted its highest Q2 for venture funding on record in 2022 with €3.7bn invested.



Source: Dealroom

Overall, this has taken H1 2022 fundraising for French start-ups to €8.9bn, a 1.6x increase on the heady 2021.



Source: Dealroom

Momentum has stayed strong in the French market and remains dynamic with some significant fundraisings over the summer. Contentsquare's $400m Series F (plus $200m of debt) valuing the AI digital experience analytics business at $5.6bn, was one of the largest raises in Europe in July.

Other significant deals include a $250m raise for Innovafeed, the vertical insect farm operator for animal nutrition which was one of the biggest raises raise in Europe in September. Close behind in September was Zeplus, the EV charging business, which attracted a $240m investment from Intermediate Capital. The crowdfunding platform ClubFunding Group raised $125m and the Paris-based online brand food delivery industry solution Not So Dark raised $80 million in a Series B round aimed at expanding franchise operations across Europe.

Trends in the French VC and tech financing market are similar to those we have seen elsewhere. Investors remain keen to invest but are more selective and the pace of investment is more measured than in 2021. The emphasis has switched away from a focus on out-and out revenue growth towards favouring companies with proven unit economics able to pass-through inflation and cost pressures and with a more balanced growth / profitability profile. Clear barriers to entry and a differentiated offer remain key.

The extensive Rothschild & Co Tech team in France reports that Deeptech, software, Defi, Cleantech and Healthtech are currently the most targeted sectors for investors. Those more exposed to consumers (such as Adtech, marketplaces, gaming) are less favoured.

Unicorns remain mostly well-funded with several private rounds done internally. We have seen public raises recently from the likes of Contentsquare, Mano Mano and Alan.

As elsewhere alternative financing like venture debt is being increasingly envisaged by the startup ecosystem and supply of venture debt has expanded with the creation of venture debt funds like ISAI Growth Lending.

As the financing environment has changed, we have seen the acceleration of the consolidation in some sub-sectors. We expect more and more M&A transactions which need support and intermediation from investment banks.

We are also beginning to see the first restructuring deals in Tech occurring for companies not able to raise. Strategics are very active with an increasing appetite for private but also public tech companies.

These trends were confirmed by the **1,200 startups, investors and speakers who participated to the Tech Night hosted by Rothschild on the 28th of September.**

France Digitale has analysed the recent sources of finance in French VC funding. It has analysed the 441 investors who have backed companies in the most recent French Tech Next 40/120 list. It reviewed the venture capital funds, angel funds, family offices, private equity funds, and institutional investors who form the cap tables for these companies. It found of the 441 investors identified, 182 (41%) are French and 218 (49%) are non-European, of whom the largest group (142 or 32% of the total) were American. 40 of the investors (9%) were from the rest of Europe. This indicates that the French investor group is now being supplemented by major overseas support - a demonstration of the attractiveness of the French VC scene and French tech in particular, to foreign investors.

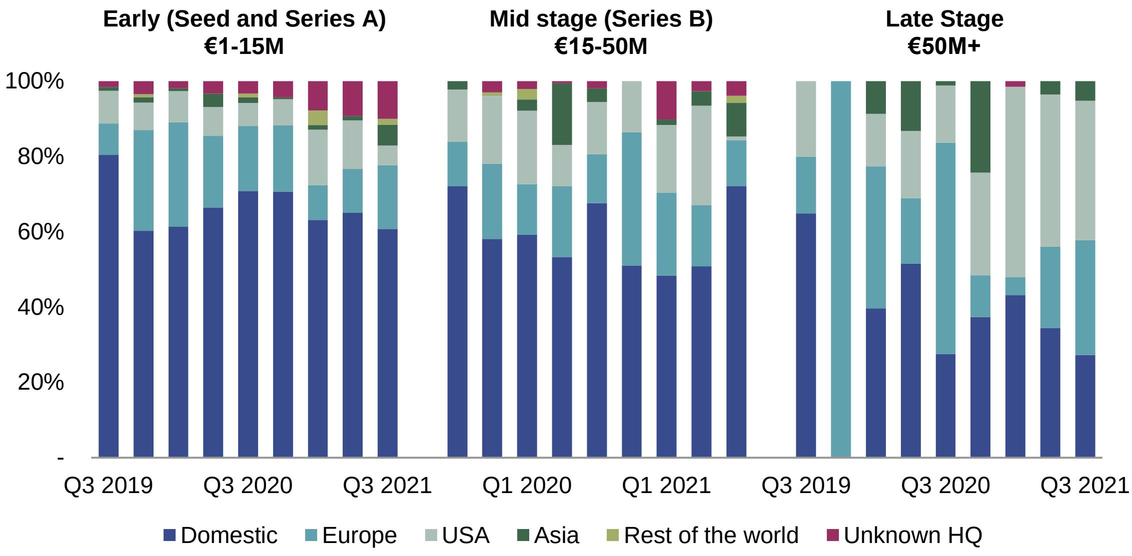
By type of investor 51% were venture capital (VC) funds, 23% private equity funds, 16% venture capital funds of large groups (CVC), 4% public investors, 2% Family Offices, 3% a groups of individual private investors (groups of business angel) and 1% in the “Other” category (Hedge funds, etc.).

A critical part of the French investment infrastructure is BPI, the public investment bank formed in 2012 from the merger of the OSEO, CDC Entreprises and FSI investment bodies. In 2015 it launched three accelerators for start ups and in 2018 it became the French sovereign fund with the integration of CDC International Capital. Now the sovereign wealth fund is the most active French VC and targets the entire VC lifecycle. According to PitchBook data it has made a total of 794 VC investments, has conducted 111 exits and has almost $44bn of assets under management.

Top French and Overseas VC investors in Next40/FT120 by number of deals			
French VC Investors		**Overseas VC nvestors in France**	
Name	**Number of deals**	**Name**	**Number of deals**
Bpifrance	48	Accel	7
Eurazeo	40	Cathay Innovation	6
Kima Ventures	22	General Atlantic	6
Alven	16	Goldman Sachs	6
Partech	15	Index Ventures	5
BNP Paribas	10	KKR	5
Agoranov	9	SoftBank	5
ISAI Gestion	7	Tiger Global Management	5
Wilco	7		

Source: France Digitale

Foreign investors are typically more active in later-stage French funding rounds, while domestic investors continue to dominate at the earlier stages.



Source: Dealroom

France - Where to next – further ambition.

In June 2022, with the number of French unicorns now estimated at 27, Mr Macron updated the targets. Speaking at the Paris VivaTech conference he stated:

"What target am I fixing for us? To try to develop 10 tech giants in Europe, in the coming five years, and to increase the number of our unicorns to at least 100 by 2030, which is feasible.'

Dry powder revisited

https://www.linkedin.com/pulse/opening-floodgates-290-billion-venture-capital-reserve-jon-sakoda/

A recent report by Jon Sakoda of Decibel Capital revisited the issue of dry powder in the venture capital world, a subject which we touched upon in the Rothschild & Co Growth Equity Update 4, published in August. The key points of the Decibel report are:

The VC industry has raised $573bn since 2016 (of which $261bn in the last six quarters alone).

Dry powder is the total amount of capital that VCs have to invest in existing or new companies, and is reported quarterly by the NVCA and Pitchbook. As of the end of June 2022, this number was recorded at an all-time high of $290bn.

Decibel observes that when a VC firm raises money, it typically commits its capital to investments over a three-year investment period. Albeit with variance across funds, in aggregate the industry invests c8-9% of dry powder every quarter.

On this basis the Decibel dry powder model suggests that the VC industry will have only a modest slowdown in 2022 versus 2021 and should continue to see high levels of investment in 2023 and 2024.

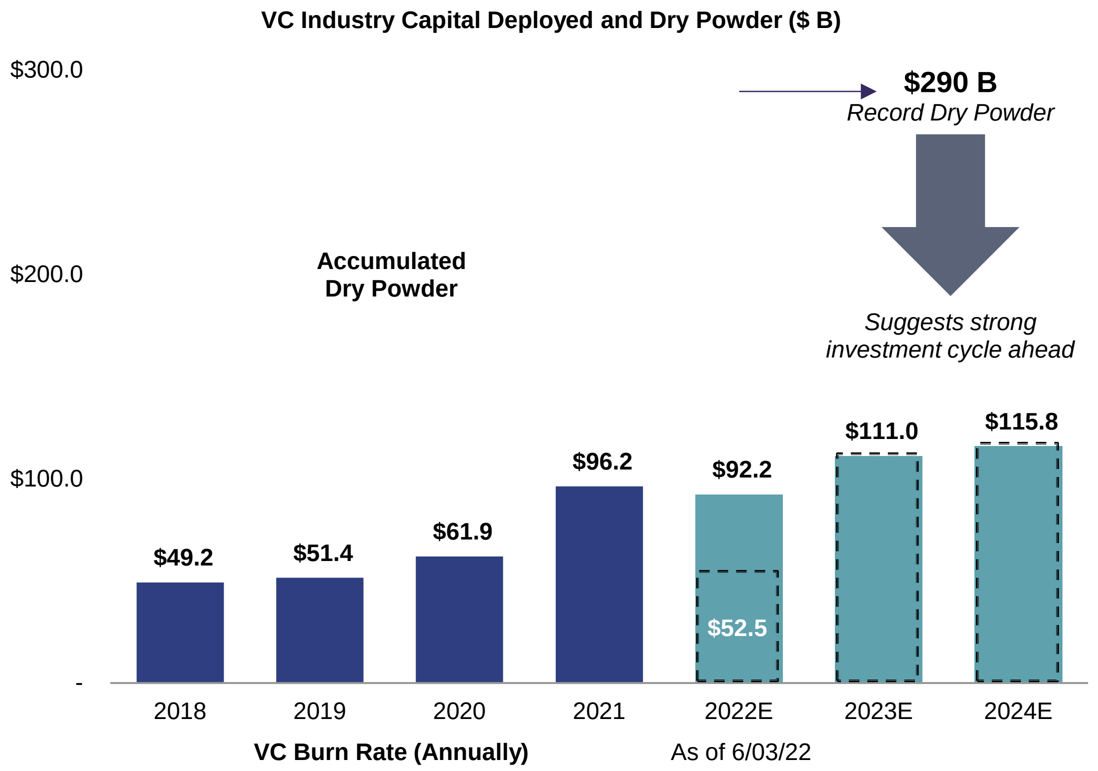
The Decibel analysis suggests that high levels of venture capital funding will continue. The company suggests that deployment of that capital will change somewhat:

i) The public market correction has made it more difficult for later stage investors to justify record high valuation multiples. Decibel expects *'more flat and insider supported rounds for later stage companies that raised last year as the market tries to find a "new normal" level for private valuations.'*

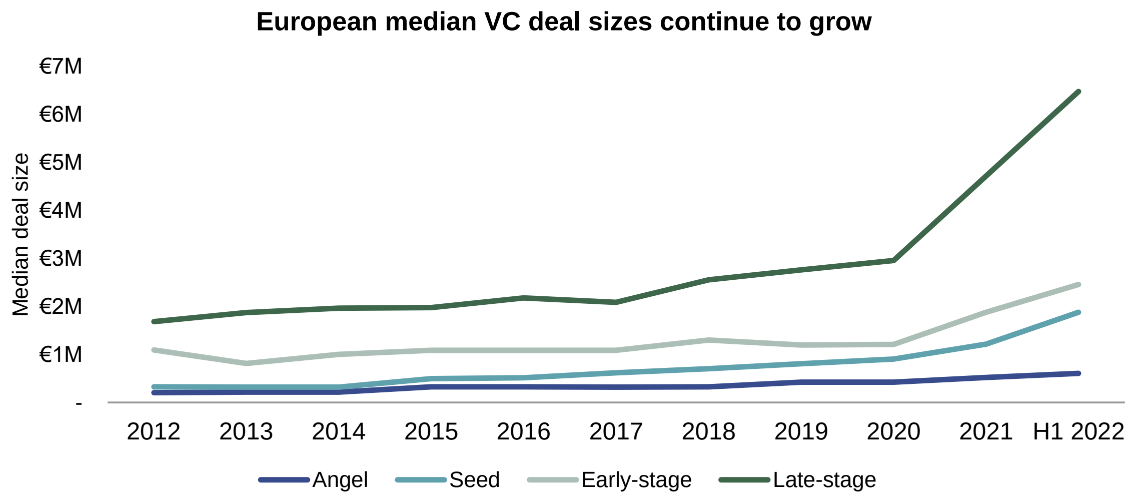
ii) The return of *"growth plus efficiency"* valuation metrics vs *"growth at all costs"* operating plans will lead to a right sizing in funding needs for most startups. This revived focus on growth and profitability, rather than growth at all costs, will lead to fewer very large rounds at early stages of company development. Instead rounds will be *'rightsized'.*

iii) The implication is a combination of '*normalised valuations and round sizes*'. In theory this should in turn lead to more capital available being able across the market for individual companies.

iv) As funds trickle down and shift from later to earlier stages this should provide a boost to the early stage market.



Source: Decibel



Source: Pitchbook

[European VC deal sizes defy downturn | PitchBook]

According to PitchBook's Q2 2022 European VC Valuations Report in the first six months of 2022 round sizes across all stages rose compared with 2021. The median early-stage deal size increased by 32% to €2.5 million, while the median late-stage deal size grew 38%, despite the stage being the most affected by public market volatility and concerns about the asset class's overvaluation.

Pitchbook also attributes this in part to the level of dry powder in the market observing that **globally** venture investors have $562.4 billion in dry powder destined for startups.

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.
III. Many observe that well placed companies are deferring raises in 2022.
IV. Many investors we speak to observe they are *looking at opportunities and [are] open for business right now.*
V. The sense remains that valuation expectations are too high, and that founders' expectations have not fully adjusted.

Investor comments:

Investor appetite

Slow market, but active

Very open for business and looking for ideas

Looking actively to ramp up deal flow.

Beginning to see more deal flow in recent weeks and open to looking at new opportunities

Keen to invest but not many deals around at the moment

Business models

Will struggle to do unprofitable at gross profit level and businesses with very significant cash burn

More focused on path to profitability

Portfolio is 50/50 cash burning vs profitable businesses. Top line growth is very much the driving metric

Looking for positive gross margin and good unit economics

Will look at loss making businesses as long as the unit economics are good

Consumer exposure proving challenging in the current market

Valuation

Valuation – don't have enough datapoints yet. Still see external deals at crazy pricing

Still high multiples

In current market, require structuring in their investments:

More structure (more in the US than EU)

Our views on the state of the venture capital markets

Since the start of 2022 we have seen sharp falls in the public markets on the back of a combination of rising global inflation, rising interest rates, and increased geopolitical risk. The Refinitiv Venture Capital Index, which seeks to monitor the real time performance of the venture capital industry is down 58% year to date close to its lows in down in mid-June. High inflation is inducing substantial negative real interest rates yet there is substantial cash on the sidelines.

Our summary of the outlook is:

- The deteriorating 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 is much more substantial year to date even than the fall on NASDAQ. This has been reflected in some big valuation falls on some high-profile VC rounds.

- There is substantial dry powder in the VC industry at c$500bn.This may now be prioritised to supporting existing rather than new investments but should support the overall market.
- Best-in-class companies, addressing critical rather than nice-to-have requirements, continue to attract support. There are still hotspots for investment notably in fintech, cleantech and software. Certain investors remain very active in the space with substantial funds to deploy.
- There will be a growing number of down rounds, albeit the substantial fund raising of 2021 and the ability of companies to eke out existing resources may limit the immediate number of these.
- The speed of the investment process appears to have slowed considerably. The volume of new deals has reduced. The level of diligence on new deals has stepped back up.
- Funding for the VCs themselves remains strong which is a positive indicator for H2 2022 and into 2023.
- 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.
- An interesting paradigm is that earnings forecasts for public companies have not fallen much as yet. The fall in the market indices indicates the buy side anticipating earnings deterioration. This in turn means that multiples for public companies are low by recent standards. As earnings forecasts start to fall (the crunch time is imminent as Q3 is when companies begin to run out of road to make up shortfalls) multiples should naturally inflate. At that point, as multiples for public companies recover, the prospect of fundraising for growth oriented private companies becomes more attractive.

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

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

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

Castore £50mn RCFn

- Sole debt adviser to Castore on its new multibank £50m Revolving Credit Facility
- Castore is a global premium performance sportswear retailer. Castore also partners with global sports teams, supplying products and managing their retail operations

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 and 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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