Rothschild & Co
Global Advisory

Growth Equity Update

March 2023 – Edition 12

- The collapse of Silicon Valley Bank has led public markets down and cast a pall over the venture capital market
- Venture capital market activity is already sluggish. S&P Global Market Intelligence reports global venture capital investment in January/February 2023 down 65% yoy
- The changing nature of venture capital deal terms. Orrick's Deal Flow 3.0 report indicates that, in contrast to 2021, 2022 saw a shift towards more investor-friendly terms
- Start-ups are pivoting towards cash and profitability. We look at Klarna's results to see the impact of its shift in focus post May 2022. Q4 revenue grew 19% yoy. The operating result, a loss of SEK2.2bn -2.8bn per quarter Q4 21 to Q2 22, fell to SEK1.2bn ($113m) in Q4 22
- The UK government is to commit £370m (c$445m) to support technology investment in a bid to make the UK a *"science and technology superpower"* by 2030 using a series of VC style initiatives. We review this and similar initiatives in the EU (€3.75bn), Germany (€1bn) and France (€500m).

Into the Valley

The demise of Silicon Valley Bank has added to the funding issues in venture capital markets.

Silvergate first…On March 8th crypto-focused US bank Silvergate announced it would move to voluntary liquidation. This followed $8bn of deposit withdrawals from its digital asset customers in the end December quarter, precipitated by the collapse of FTX. It also suffered $5.7bn of losses on its securities portfolio in 2022 and further losses in January and February.

Then SVB: On March 9th, the shares of SVB Financial Group, the parent company of Silicon Valley Bank, fell by 60%. The fall was precipitated by the announcement the day before by SVB of the sale of substantially all of its available for sale securities portfolio. SVB sold c$21bn of securities, resulting in an after-tax loss of approximately $1.8bn.

SVB commented that it was *'taking these actions because we expect continued higher interest rates, pressured public and private markets, and elevated cash burn levels from our clients as they invest in their businesses.'*

Concentrated deposit franchises: The problem for Silvergate and SVB was a combination of two factors. Both institutions had highly concentrated deposit franchises; Silvergate in crypto, and SVB in venture capital. Deteriorating industry dynamics in crypto and VC put pressure on these.

The second factor was the **sharp rise in Fed interest rates** in 2022. This exposed substantial unrealised losses in low yielding debt securities accounted for on a hold-to-maturity (HTM) basis. Selling the HTM debt securities to meet depositor withdrawals crystallised large losses for Silvergate and SIVB.

The collapse of Silvergate and the announced loss on the SVB securities transaction led to a run on deposits at SVB with $42bn being withdrawn in a day. SVB was then closed by US regulators on Friday 10th. Over the weekend crypto oriented Signature Bank, whose shares had fallen sharply in the uncertainty, was also closed.

Federal support: Over the following weekend a package of measures was announced by the FDIC (Federal Deposit Insurance Corporation). The key elements were an assurance that (i) all depositors of SVB and Signature would have immediate access to their deposits (ii) The Federal Reserve announced a $25bn funding measure to take pressure off other banks. The Bank Term Funding Program offers loans up to one year to banks pledging collateral, removing the need *'to quickly sell those securities in times of stress'*. This would enable the Fed to provide a backstop for uninsured US deposits.

Despite this, share prices in major regional banks continued to fall sharply.

President Joe Biden promised to do '*whatever is needed'* to protect bank deposits '*We will not stop at this. We'll do whatever is needed on top of all [this].*'

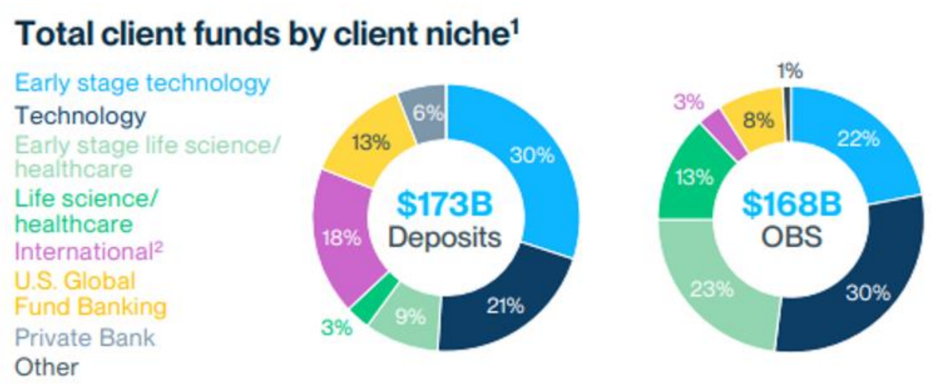
Rothschild & Co conducted an emergency sale process for SVB's UK arm resulting in HSBC buying the business for a nominal amount.

SVB in the venture capital ecosystem: As at end December 2022 almost half of US venture backed technology and life sciences companies banked with SVB. 44% of 2022 US venture backed technology and healthcare IPOs banked with SVB. The UK business had c3,000 clients. The company claimed $212bn of assets, $342bn of client funds and $74bn of loans.

For seed and Series A stage businesses SVB offered cash deposit solutions, payment options for suppliers, plastic and virtual cards for expense management and deposits. For venture funded businesses it offered Treasury services, venture debt and, for international companies, an infrastructure for US operations. For late stage and public companies SVB offered corporate finance capabilities supporting corporations with working capital needs, growth capital, acquisition financing solutions and syndicated facilities. It handled global payments and forex and offered leveraged tailored strategies to manage currency exposure and volatility.

This SVB graphic shows its spread of funds by client type.

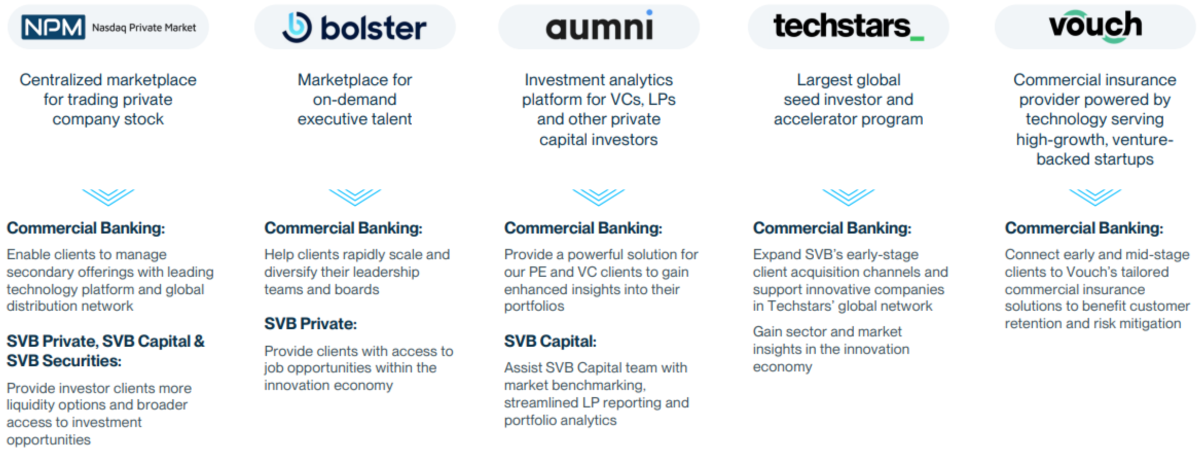
SVB – an overview



Source: SVB website

As well as its Silicon Valley Bank, SVB Private, SVB Capital and SVB Securities divisions the company was involved in a range of partnerships stretching across the venture capital scene including the NASDAQ private marketplace and Techstars, the largest global seed investor and accelerator programme.

Silicon Valley Bank – Strategic Partnerships



Source: SVB website

With the benefit of hindsight, it may appear odd that en masse tech and early-stage companies would concentrate their risk in one financial institution.

Part of the answer appears to be that SVB offered a service tailored to such businesses which was difficult to find elsewhere. Here's Tommy Ricketts, co-founder and CEO of BeZero Carbon quoted in CityAM.

'Traditional banks should also take note. Most start-ups chose SVB because they offered tailored solutions, were quick to deal with, and were an effective partner. Revolut is the main alternative. Many, like us, have both.

Start-ups need large payroll facilities, cash management functions, and multi-currency accounts and payments. They don't need working capital facilities typical of more mature businesses. That makes them an unattractive client so available services are often slow and basic, if offered at all…..It's reasonable to say the lack of competitive alternatives served to crowd deposit holders into SVB and create a single point of failure.'

As the SVB drama (rapidly) unfolded Bill Ackman, CEO of Pershing Square commented,

'The failure of SVB Financial could destroy an important long-term driver of the economy as VC-backed companies rely on SVB for loans and holding their operating cash.'

Indeed, it appears that venture capital firms are almost immediately missing SVB and its capabilities. In an initiative organised by General Catalyst, 325 VC firms signed a statement issued on March 10 stating that they would be happy to work once again with a properly capitalised SVB. Signatories included Accel, Bessemer Venture Partners, Highland Capital, Lux Capital and Sequoia.

'Silicon Valley Bank has been a trusted and long-time partner to the venture capital industry and our founders. For forty years, it has been an important platform that played a pivotal role in serving the startup community and supporting the innovation economy in the US.

The events that unfolded over the past 48 hours have been deeply disappointing and concerning. In the event that SVB were to be purchased and appropriately capitalized, we would be strongly supportive and encourage our portfolio companies to resume their banking relationship with them.'

'The failure of SVB Financial could destroy an important long-term driver of the economy as VC-backed companies rely on SVB for loans and holding their operating cash.'

CEO of Pershing Square, Bill Ackman

Clearly SVB or parts of it may re-emerge in some form. Its failure though makes life more difficult for venture capital companies and founders as they seek to chart a route through the difficult early stage, often pre profitability and positive cash flow, phase of their existence.

A further check to market progress: The immediate short-term effect of the SVB collapse was a further check to the progress of, and confidence in, public markets. To be fair the market had already peaked in early February. NASDAQ by March 8th was up 11.5% ytd, having already fallen by 5.5% since early February. The S&P 500 peaked on 2nd February and was down 4.5% leaving it up just 4% on the year.

In both cases the weakness had been caused by the robustness of the US and global economies which had persuaded the market that the Fed might reaccelerate the scale of interest rate rises.

Worldwide business surveys suggest that global growth momentum is reviving helped by a resurgent Chinese economy. According to the Global PMI survey, worldwide manufacturing activity began to expand in February, the sectoral output measure rising to 50.8 from 48.7 in January. Worldwide service activity expanded even more robustly, its activity measure increasing from 50.0 in January to 52.6 in February.

Redburn's economist, Ian Harwood wrote, *'Crucially the US economy continues to display a degree of vigour which the Fed is unlikely to judge consistent with a rapid and sustained abatement of underlying inflation pressures.'*

This view was warranted when Federal Reserve chair Jay Powell told the Senate banking committee at the start of March that *'the ultimate level of interest rates is likely to be higher than previously anticipated'* and that *'If the totality of the data were to indicate that faster tightening is warranted, we would be prepared to increase the pace of rate hikes.'*

The market's started to price in a renewed expectation of a 50bps rate rise at the Fed's upcoming meeting on March 21-22 with futures markets indicating US rates peaking at about 5.63% in September, up from the previous expectation of 5.47%. Indeed, Rick Rieder, chief investment officer of global fixed income at BlackRock commented in early March that '*We think there's a reasonable chance that the Fed will have to bring the Fed Funds rate to 6%, and then keep it there for an extended period to slow the economy and get inflation down to near 2%.'*

The downswing of the market has been exacerbated by the sudden loss of confidence in venture capital focused banks. Fears over the value of bank bond portfolios meant that the KBW Bank Index (which tracks the performance of the leading US banks) fell by 24% between the 8th-10th March. NASDAQ lost 5% in that period (leaving it up 7% ytd) and the S&P 4% to leave it virtually flat YTD.

A change to the interest rate environment? The demise of SVB may though contribute to a shift in the decision-making dynamic of the Fed in respect to interest rates. Up to the collapse of SVB the fear was that the US economy was showing an alarming ruggedness in the light of rising rates. The three-day collapse of SVB, and the attendant dislocation to a high growth part of the economy can be viewed as the Fed's attempt to slow the economy working, albeit in an unexpected way.

One of the immediate responses to SVB and its aftermath is that investors quickly changed their view on the likely future direction of interest rates. Two-year Treasury yields had their biggest one day drop since 1987. Market consensus has swung round from the expectation of a reversion to 50bps rate increases at the next Fed meeting to a roughly 50/50 expectation of a 25bps or zero rate rise.

The Fed's support measures for the financial system are also viewed in some quarters as a form of quantitative easing by the back door.

Ultimately an end to rising interest rates is seen as a positive for the growth end of markets although the impact on NASDAQ and the S&P 500 was subdued immediately post the SVB measures.

Market volatility meanwhile is not likely to be helpful in terms of a resumption of the IPO market. IPO activity in Western markets remains subdued although there has been an expectation of a pick-up in activity in H2 2023.

On the ground conditions for venture capital fundraising are tough and the SVB happenings are not going to make it easier. Companies are still adjusting their business models to accommodate the revived focus on free cash flow and profits rather than growth. The valuation expectation gap between founders and investors remains in many cases wide. Companies continue to eke out existing resources or to seek internal rounds or debt financing to extend runway. The SVB incident and the perils that VC companies briefly faced in terms of short-term financing may have highlighted their vulnerability and could encourage decision making about the future resulting in a pick-up in M&A activity.

How has 2023 started in Venture capital?

A slow start – global venture capital deal value dropped 67% yoy in January-February 2023.

According to S&P Global Market Intelligence, global venture capital investment fell 69% yoy in January. Money raised by VC companies in January fell from $58.5bn in 2022 to $18.2bn in 2023.

The volume of funding rounds was down 53% yoy from 2,238 rounds to 1,059 rounds in January 2023. These totals were also lower than those in the preceding month. December 2022 saw $19.7bn raised in 1,104 rounds.

In February global venture capital investment fell 65% yoy from $48.2bn to $17bn. This brought the year to date total to $35bn, down 67% yoy from $107bn. The number of funding rounds in February 2023 fell 44% yoy to 1,150.

The three biggest deals ytd are:

Silicon Ranch*,* one of the largest independent power producers in the US, announced a raise of $775m. Manulife Investment Management led the round.

SpaceX (Space Exploration Technologies Corp) which designs, manufactures, and launches rockets raised $750m. Andreessen Horowitz led the round valuing the company at $137bn.

Zeekr Intelligent Technology, the luxury electric vehicle brand of China's largest private carmaker Geely, raised the largest funding round in February with a transaction value of $750m and a post money valuation of $13bn.

By sector TMT attracted 37% of the total funding raised during January/February, followed by healthcare at 18% and the industrials sector at 15%.

What's happening to Venture capital deal terms?

An interesting insight into the changing nature of venture capital financing terms is given by **the Deal Flow 3.0. report** from Orrick, one of Europe's most active law firms in VC deal financing. The report reviews European Venture Capital Deal terms based on the more than 500 transactions, with an aggregate value of $12bn, in which Orrick was involved in 2022.

The key conclusion of the Deal Flow 3.0 report is that in 2022 there was **a shift towards more investor-friendly terms**. Notably:

Founders were required to stand behind warranties in 44% of venture deals.

Only 47% of equity financings included a top-up to the option pool – as companies became more cautious of hiring and investors more reluctant to suffer the dilutive impact.

There was a ***pushback against the surge in founder veto matters seen in 2021.***

There was an ***increase in the number of board observer seats being taken up by investors***, with 64% of deals including board observer rights for investors. In 43% of deals, lead investors had both a board appointment right and an observer right.

2022 saw an uptick in investor action in terms of **rights, preferences, and protections.**

Deal Flow 3.0 reports seeing ***more aggressive and creative anti-dilution protection being negotiated by investors***. In particular anti-dilution protection remaining in force for longer in later stage companies.

95% of deals included consent rights. There was a shift in later stages to having a simple majority (75%) for drag- along agreements.

Fewer earlier-stage deals include a founder veto**.** The vast majority of deals had drag-along rights, with founder veto prevalent in earlier stages and dropping off in later stages. However, compared to 2021, in 2022 it saw fewer earlier-stage deals include a founder veto.

Orrick's 2021 Deal Flow 2.0 report had seen the UK market move away from ***founder-backed warranties***. Its 2022 Deal Flow 3.0 report saw investors shift back to requiring founders to stand behind the warranties on investment rounds. This was especially prevalent in the early stages (52% at Seed), with this dropping off in later stages.

Liquidation Preferences Orrick continued to see the traditional 1x non-participating liquidation preference as the norm. Of the transactions that did have a liquidation preference, 83% had a 1x nonparticipating preference. Outlier transactions saw up to a 5x liquidation preference.

Venture Financing Deal Trends in 2022

Series B

Liquidation preferences	Anti-dilution protections	Drag-along rights	Board of directors	Secondary*
100%	84%	21%	65% 2-7	34%
100% of deals had a liquidation preference, **12%** 1x participating, **88%** 1lx non participating	**16%** had no AD protection, of the deals hat did **83%** broad-based AD protection	**21%** of deals where the drag threshold includes a founder veto	Ranged from **2 to 7** seats. **Over 65%** of Series B deals had **5 or more** Board members	**34%** had a secondary

Series C

Liquidation preferences	Anti-dilution protections	Drag-along rights	Board of directors	Secondary*
100%	83%	18%	70% 3-8	23%
100% of deals had a liq pref, **11%** 1x participating, **83%** 1x non-participating, **1 deal** with 2x non-participating	**17%** no AD protection, **70%** deals had broad-based AD protection, **1 deal** had full ratchet if down round in first year, **1 deal** had narrow-based AD protection on most senior class of share	**18%** of deals where the drag threshold includes a founder veto	Ranged from **3 to 8** seats **Over 70%** of Series C deals had **5 or 6** Board members	**23%** had a secondary

Series D and Beyond

Liquidation preferences	Anti-dilution protections	Drag-along rights	Board of directors	Secondary*
100%	75%	14%	100% 3-9	66%
Only **1** of the 2 Series D deals had a liq. pref. (1x non-participating) Beyond Series D: **100%** of deals had a liq. pref., **25%** 1x participating, **75%** 1x non-participating	Series D: **25%** had no AD protection, **75%** broad-based weighted average,. Beyond Series D: **75%** broad-based weighted average, **25%** no AD protection	**14%** of deals where the drag threshold includes a founder veto	100% of Series D+ deals had between **3 and 9** seats.	Series D: **66%** had a secondary Beyond Series D: **no secondary**

Series B

Observer rights	ESG	Option pool	Consent rights	Warranties
55%	30%	81%	77%	38%
55% had at least one observer seat	**30%** of deals have ESG undertakings	**81%** of these deals had a top-up to the option-pool as part of the transaction	IMC (4%) IDC (4%) both (77%) other (15%)	**38%** of deals founders stood behind the warranties

Series C

Observer rights	ESG	Option pool	Consent rights	Warranties
52%	5%	37%	44%	44%
52% had at least one observer seat	**5%** of deals have ESG undertakings	**37%** of these deals had a top-up to the option-pool as part of the transaction	IMC (39%) IDC(0%) both(44%) other (17%)	**44%** of deals founders stood behind the warranties

Series D and Beyond

Observer rights	ESG	Option pool	Consent rights	Warranties
75%	25%	75%	13%	25%
Series D: **75%** had at least one observer seat Beyond Series D: **50%** had at least one observer seat	Beyond Series D: **25%**	Series D: **75%** of these deals had a top-up to the option-pool as part of the transaction Beyond Series D: **25%** of these deals had a top-up to the option-pool as part of the transaction	IMC (50%) IDC (13%) both (13%) other (25%)	**25%** of deals founders stood behind the warranties

Source: Deal Flow 3.0 - European Venture Capital Deal Term Review 2022 - Orrick

Venture Debt financings

The Deal Flow 3.0 report observes a notable uptick in the volume, size and value of venture debt deals. 2022 saw increased competition between lenders, with new funds and banks breaking into the European market, including venture debt funds from the US.

Interest Rates. Global and UK interest rates held steady between 9-12% although in Q3 and Q4 2022 interest rates on fixed rate loans tended to the higher end of the expected spectrum. There were more floating rate loans with a floor on loans that would historically have been fixed.

Payment Penalties. Companies heavily negotiated the prepayment and end of loan fees. Although lenders have retained these Orrick observes a wider variation of fees applicable and with prepayment being ratcheted down over the life of the loan.

Board Observer Rights. Now more common in the venture debt market. Some borrowers have resisted and, in some cases, have negotiated that board observer rights kick-in following an event of default only.

Minimum Return Covenants. Increasingly, lenders are considering the minimum return amount expected from venture deals. The approach has been to look at the totality of the expected return between the debt and any warrant kickers to ensure a minimum return on the aggregate investment.

Recurring Revenue. Increasingly, lenders are using recurring revenue as a monitoring and funding release mechanism in between equity financings.

Minimum Cash Covenants. Lenders appear increasingly concerned about cash leakage, especially with highly acquisitive companies or companies using acquisitions of companies and assets to achieve growth.

Use of convertibles

In 2022 Deal Flow 3.0 reports a sharp rise in the number of convertible debt financings versus 2021. As we have discussed in previous Growth Equity Reviews, the recent popularity of convertibles may lie in them being a practical instrument in a time of valuation dislocation, allowing investors/founders to kick the can down the road on valuation. Convertibles are also relatively quick to arrange for a company needing to raise money fast.

Pre-emption rights: 51% of the convertible debt financings in which Orrick was involved in 2022 included pre-emption rights, giving the investor the right to participate in the company's next equity financing.

Convertible investors have traditionally not obtained consent rights on their investment as they are not equity shareholders at the time of investment. That ***24% of Orrick's 2022 convertible debt financings included consent rights*** for the investors is an indicator of a move towards more investor-friendly terms in 2022.

Director Rights: 29% of the convertible debt financings in 2022 included either director or observer appointment rights for the investors.

The ***discounts*** observed by Orrick ranged between 15%-35%, with the upper end being a noticeable uplift from the upper end in 2021 (which was closer to 20%). ***Interest rates on CLNs ranged between 6% – 10%.***

What Orrick expects to happen to deal terms in 2023

In the UK Orrick anticipates:

The ***aggregate number of deals and deal value will be higher in H2 2023*** than H1 2023, as the companies which raised large rounds in 2021 reach the end of their runway and come to market to raise further capital.

It anticipates ***fewer bridge rounds*** compared with 2022, as investors will be reluctant to back underperforming companies.

It expects the ***prevalence of the traditional 1x non-participating preference to come under pressure*** as investor uncertainty brings the use of coupons and innovative structures in liquidation preferences.

There will be ***continued pressure on the size of option pools*** as companies' hiring plans continue to be put on hold.

The ***percentage of deals which include ESG undertakings will increase*** as investors focus more attention on ESG within their portfolios.

It expects an ***increase in the use of performance-based warrant instruments***, giving investors greater protection in poorly performing companies.

It also expects ***longer diligence processes*** following the likes of FTX.

It anticipates an ***increased prevalence of venture debt.***

In **Germany** it expects:

The ***shift towards more investor-friendly terms,*** with respect to lock-ups, founder vesting, protective provisions, and control rights, to continue.

It anticipates further internal-led rounds or convertible note financings but also expects ***an eventual increase in down-rounds*** or at least rounds with more structuring.

In the growth stages, it expects even ***more aggressive liquidation preferences*** to support up- or at least flat-rounds. Some companies might also offer KPI or milestone-based valuations with a true-up mechanism after six to twelve months; these structures were already apparent in late-stage deals in 2022.

In **France** its expectation is:

The shift from founder-friendly terms towards ***more investor-friendly terms*** will persist.

In late-stage transactions, Orrick expect to see ***more liquidation preferences*** with a multiple higher than 1x.

Valuations may be further challenged based on revenue KPIs and profitability, which will therefore result in an ***increased use of valuation adjustment mechanisms*** in transactions.

Due diligence processes will become longer and may, in certain instances, trigger valuation adjustments late in the fundraising process.

The ***number of transactions including convertibles or venture debt with equity kickers will increase*** as investors will want to limit their risk.

See: *https://www.orrick.com/en/Insights/2023/03/Deal-Flow-3-5-Things-We-Learned-About-European-Tech-Deal-Terms-in-2022*

How were those Klarna numbers?

Looking at the performance post the May 2022 strategy pivot.

Back in our Growth Equity update in July 2022 we reported on the $800m fundraising at Klarna which valued the business at around $6bn pre money and $6.7bn post money. Most of the commentary at the time focused on the fall away from the peak valuation reached by Klarna of $45.6bn in June 2021.

The $800m round was led by the Canada Pension Plan Investment Board (CPPIB) and the Abu Dhabi state investment fund, Mubadala alongside existing Klarna investors including Sequoia Capital and Commonwealth Bank of Australia.

At the time Michael Moritz, Partner at Sequoia and on the Board at Klarna commented: *'The shift in Klarna's valuation is entirely due to investors suddenly voting in the opposite manner to the way they voted for the past few years. …… Eventually, after investors emerge from their bunkers, the stocks of Klarna and other first-rate companies will receive the attention they deserve'.*

Klarna has just produced its Report and Accounts for 2022. How did it get on?

Klarna shifted its business focus in May 2022, reducing its staff numbers by 10%.

'The ….shift in investor sentiment from a total focus on growth to profitability has also had wide-ranging effects. At Klarna, it has required some hard but necessary decisions. The most difficult by far was taking early and pre-emptive action back in May, re-evaluating our organization and our focus so we could meet our goals in light of the changes we were seeing externally.' Sebastian Siemiatkowski CEO and Co-Founder of Klarna.

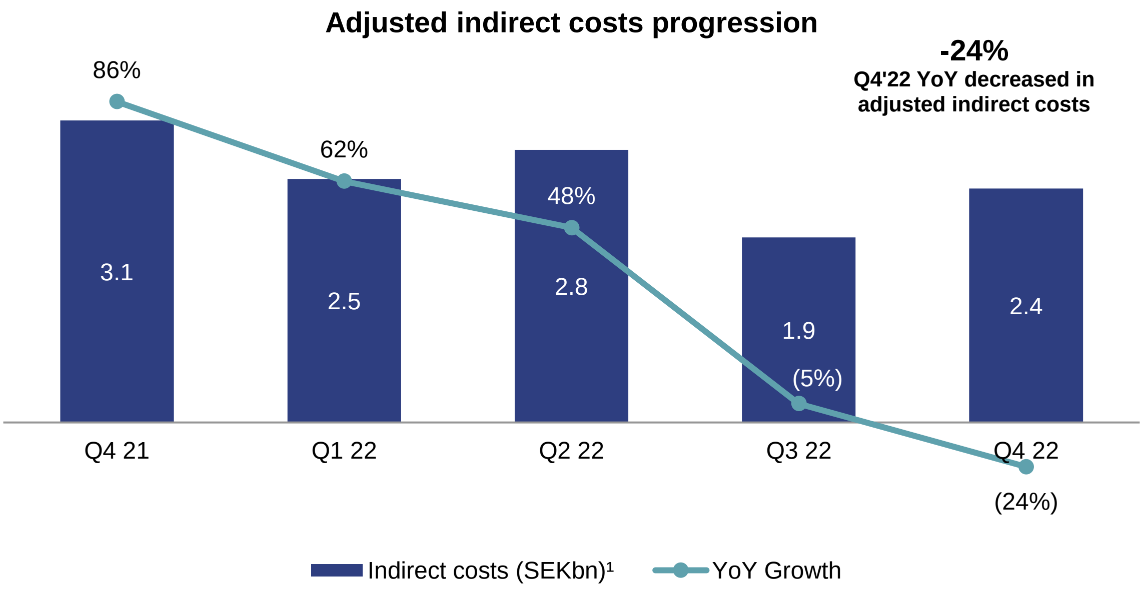
FY22 total net operating income rose by 20% to SEK 16.7bn (2021 +38% to SEK 13.95bn). The operating result was a loss of SEK 10.5bn, up 62% from a loss of SEK 6.5bn in 2021.

Revenue, Klarna's preferred measure of top line progress, rose in FY22 by 18% to SEK 19.3bn (2021 SEK 15.9bn). Revenue excludes interest and commission expense.

The adjusted FY22 operating result was a loss of SEK 7.8bn, up by 50% on the 2021 loss of SEK 5.2bn. The adjusted result excludes restructuring costs (SEK 500m in 2022 vs SEK 6m in 2021), share based payments (SEK 523m vs SEK 623m in 2021) and depreciation (SEK 1.6bn vs SEK 746m in 2021).

Interestingly Klarna's performance improved in the last two quarters of the year. Revenue stepped up to SEK 5.6bn in Q4, yoy growth of 19%. Each of Q4 credit losses and opex fell by SEK 300m yoy. In total adjusted indirect costs fell 24% yoy.

Klarna -Q4 22 adjusted indirect costs drop 24% yoy



Source: Klarna

This meant that the adjusted operating loss, which was between SEK 2.2bn and SEK 2.8bn per quarter between Q4 21 and Q2 22 (and which fell to SEK1.6bn in Q3 22) reduced to SEK1.2bn ($113m) in Q4 22.

The net result, which was a loss of SEK 4.6bn in Q4 2021, dropped to SEK 1.9bn in Q4 2022.

Klarna – Key financials – FY 21 and FY22 and quarterly 2022 progress

Amounts in SEKbn	FY 2022	FY 2021	Q421	Q122	Q222	Q322	Q422
Gross merchandise volume	837.3	689.1	202.7	187.0	209.2	199.0	242.0
Income statement							
Total net operating income	16.7	13.9	4.1	3.6	4.0	4.1	5.0
Revenue	19.3	15.9	4.7	4.4	4.7	4.6	5.6
Credit losses	(5.7)	(4.6)	(1.7)	(1.2)	(1.7)	(1.5)	(1.4)
Total operating expenses before credit losses	(21.5)	(15.9)	(5.9)	(5.0)	(6.1)	(4.8)	(5.6)
Adjusted Operating Results (Non-IFRS)¹	**(7.8)**	**(5.2)**	**(2.8)**	**(2.2)**	**(2.8)**	**(1.6)**	**(1.2)**
Net result for the year	(10.4)	(7.1)	(4.6)	(2.6)	(3.8)	(2.2)	(1.9)

Source: Klarna

The key operating ratios also improved. Klarna reduced its staff numbers by 10% during the year. Given the short life span of Klarna loans the changes to its underwriting approach had quick results. While maintaining revenue growth, Klarna had declining credit losses in Q3 and Q4 despite these including the peak shopping periods of Black Week and Christmas. Its credit loss rate (credit losses as a % of GMV) improved by 30% yoy to 0.58% in Q422.

Klarna- Key operating ratios

Amounts in SEKbn	FY 2022	FY 2021	Q421	Q122	Q222	Q322	Q422
Gross merchandise volume	837.3	689.1	202.7	187.0	209.2	199.0	242.0
Key ratios							
Take Rate (Revenue/GMV)	2.31%	2.31%	2.32%	2.34%	2.26%	2.31%	2.33%
Credit loss rate (credit loss/GMV)	(0.68%)	(0.67%)	(0.84%)	(0.64%)	(0.80%)	(0.74%)	(0.58%)
Cost income ratio[2]	(128%)	(114%)	(145%)	139%	(152%)	(116%)	(112%)

Source: Klarna

Overall, following the change in strategy in May, Klarna's adjusted operating result improved 44% H2 22 vs H1. Second half sequential GMV grew 22% and the credit loss rates reduced by 16%. In the US credit loss rates fell 30% in H2 22 vs H1, and 45% yoy.

In the US Klarna's 2022 growth outpaced that of the eCommerce market. GMV growth of 71% in FY22 outstripped e-commerce market growth of c5%. This was combined with a 37% improvement in the credit loss rates.

Sebastian Siemiatkowski, Klarna's CEO and cofounder commented *'We are making concrete progress towards profitability, simultaneously driving growth well ahead of ecommerce and reducing credit losses and costs.'*

At the Q3 stage at the end of November he had said:

'Klarna has made huge progress on our path to profitability, which we expect to hit on a monthly basis in the second half of 2023.'

While the H2, and particularly the Q4 indicators, look positive the CEO did not repeat this guidance with the FY results. In a separate statement, commenting on Klarna's performance in the US, he did observe that *'We're thrilled at the growth and momentum we've achieved in the US and are confident in our path towards profitability.'*

UK Government support for technology investment

The UK government has announced it is to commit £370m (c$445m) to support technology investment in a bid to make the UK a *"science and technology superpower"* by 2030.

The Secretary of State at the newly formed Department for Science, Innovation, and Technology, Michelle Donelan commented:
'The Science and Technology Framework is a strategic vision which sets out ten key actions to achieve this goal by 2030. We must attract the best talent from around the world, build a skilled workforce for tomorrow's industries, provide infrastructure and investment to bring technologies to market, and encourage a regulatory environment that supports innovation.'

The UK government has identified five critical technologies it wants to promote:

Artificial intelligence (AI) –It will develop a pro-innovation approach to regulating AI, which will be detailed in a White Paper to be published in early 2023

Engineering biology – the application of rigorous engineering principles to the design of biological systems.

Future telecommunications - evolutions of the infrastructure for digitised data and communications.

Semiconductors

Quantum technologies

The government intends to publish UK strategies for semiconductors and quantum technologies in early 2023 and will also issue a Wireless Infrastructure Strategy, to set out R&D priorities for future telecoms including 6G.

In terms of financing the UK Science and Technology Framework observes that it is looking to reduce *'the financing gap to the United States, particularly for scale ups at later funding rounds, capitalising upon our mature, open financial markets to support the UK's most innovative companies.'*

Interestingly it suggests that the UK government *'will engage closely with institutional investors, particularly defined contribution pension schemes, to address any remaining barriers to investment in innovative UK* *companies. This will ensure that UK pension savers stand to benefit from higher potential returns and that our most promising companies can access domestic sources of capital to scale up and remain in the UK.'*

As part of this it pledges support for the activity of the British Business Bank. Separately the British Business Bank's new CEO, Louis Taylor, has stated that he wants to model the institution as a *'sovereign growth fund'*, able to reinvest proceeds from its venture capital investments.

The venture capital arm of the British Business bank, British Patient Capital, was established with £2.5bn of funding and a 10-year mandate to 2028 to provide long term finance to start-up companies. British Patient Capital now manages assets with a value of £3.1bn. Total commitments, including capital from other institutional investors, are now more than £10.7bn.

The UK government intends to develop a system of regulation that is '*pro-innovation, easy to navigate and facilitates widespread commercial science and technology applications.*' It intends to *'move fast relative to others to establish rules for critical technologies and, where appropriate, regulations to increase certainty for innovators in these areas.'*

Initially the plan includes £370m of new government funding to boost infrastructure, investment, and skills. This includes:

£250m of investment in *three truly transformational technologies* to build on the UK's position in AI, quantum technologies and engineering biology.

Up to £50m to spur co-investment - from the private sector and philanthropists - subject to business cases. The government is talking to Schmidt Futures, the philanthropic vehicle of former Google CEO Eric Schmidt as part of this.

A £50m uplift to World Class Labs funding to help research institutes and universities to improve facilities.

A £10m increase in the UK Innovation and Science Seed Fund.

£9m in government funding to support the establishment of a quantum computing research centre by PsiQuantum in Daresbury in the North-West.

In February this year **Germany** unveiled a new €1bn fund, ***the DeepTech & Climate Fonds (DTCF),*** to boost deeptech and climate tech growth-stage companies. It is intended that the DTCF will invest in sectors such as Industry 4.0, robotics, artificial intelligence, quantum computing and process automation. It will also invest in companies with a technology-based business model such as digital health, new energy, smart cities, new materials and selected biotech areas.

In January the ***French*** government announced it will invest another ***€500m*** in order to create 500 deeptech start-ups per year and as part of its plan to reach 100 unicorns in France by 2030. It will use ***Bpifrance*** as its agent for this investment, which is part of the c€30bn France 2030 plan launched in October 2021.

In February ***the EU launched a €3.75bn fund of funds*** to support European tech companies. The European Tech Champions Initiative (ETCI) is designed to "*support the birth and growth of new European unicorns"* according to Werner Hoyer, president of the European Investment Bank (EIB).

The fund intends to invest money provided by the EIB and five EU member states into venture capital funds that will support late-stage growth phase companies. The aspiration is that an initial €1bn of funding will leverage €10bn of total investment in start-ups.

Initially the European Investment Bank will contribute €500m to the scheme, alongside investments from Spain, Germany, and France (each at €1bn), Italy (€150m) and Belgium (€100m).

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) There is a sense that well placed companies continue to defer raises in 2023

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

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

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 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 fell 55% in 2022 (and is about flat ytd in 2023). Our summary of the outlook is;

- The deterioration in the interest rate, inflation and macro-economic environment has had a sharp impact on valuations in private markets. The scale of the fall in the Refinitiv VC index in 2022 was much more substantial than the 33% fall on NASDAQ. This has been reflected in some big valuation falls on some high-profile VC rounds
- There is substantial dry powder in the VC industry at c$585bn.This may now be prioritised to supporting existing rather than new investments
- Best-in-class companies, addressing critical rather than nice-to-have requirements, continue to attract support. There are still hotspots for investment notably in climate tech and software. Certain investors remain very active in the space with substantial funds to deploy
- There will likely be a growing number of down rounds in 2023, albeit the substantial fund raising of 2021 and the ability of companies to eke out existing resources may limit the immediate number of these
- 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
- In recent months the number of big late-stage deals has slowed down substantially. The strongest part of the market in terms of appetite appears to be in Seed and Series A where there is less immediate pressure on valuation
- Funding for the VCs themselves remains strong which is a positive indicator into 2023
- The dislocation caused by the collapse of Silicon Valley Bank may further hamper conditions in the venture capital market
- 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 remained stubbornly resilient. 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 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 deals in Growth Equity and Private Capital

A selection of recent deals on which we have advised.

Skyroot: $51m Series B

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

YuLife: c $800m Series C

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

Carsome: US$290m Series E

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

Marwyn Acquisition Company II: £500m equity raise

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

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

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

Insight Partners: strategic investment in Precisely

- Led investment in a recap of Precisely Software Incorporated, in an investor group that will also include Partners Group, Clearlake Capital, TA Associates, and Centerbridge Partners
- Precisely is a leading data integrity and infrastructure software company

Kpler: Minority stake Acquisition

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

Harmay: US$90m Series D

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

SEBA Bank: CHF110m raise

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

First Digital Bank: US$120m capital raise

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

Fibrus: £270m seven-year debt package

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

Neuberger: US$4.8bn valuation Getty Images combination

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

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

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

Gousto: £240m primary and secondary rounds

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

GreenWay: €85m Series C

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

Diabeloop: €37m Series C

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

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

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