



EUROPEAN INVESTOR SENTIMENT INDEX

Quarterly Survey

Q3/2022

October 28, 2022

MACROECONOMIC STRUGGLES SUPPRESS EUROPEAN VC.

European venture capital continues to decline due to overall negative macroeconomic events, since the first quarter of 2022.

The unpredictability and the unexpected extension in the duration of the war between Russia and Ukraine is the main cause of high inflation, energy shortage, and supply chain bottlenecks (European Council, 2022). The opinions of economists and central banks on recession have strongly shifted in Q3.

According to European Central Bank (2022), inflation is expected to remain similar to 10% and then decrease over two years reaching 2.3% in 2024. The highest inflation can be observed in the energy sector, where inflation can hit up to 40.8%. Prices of food, alcohol & tobacco were also recorded to be at an all-time high with an inflation rate of 10.6% in August and are expected to grow even further to 11.8% (Eurostat, 2022). Furthermore, since the Nordstream pipeline, a gas supply route from Russia to Europe, was sabotaged by an unknown party, it has further underscored the vulnerability of the European energy infrastructure.

As a result, political and economic efforts in Europe are focused on finding new opportunities to obtain energy. Since European countries have returned obsolete energy sources to operation, it will likely negatively affect Europe's efforts in the past towards sustainability (CNBC, 2022 & Reuters, 2022). In order to deal with current inflation levels and the energy crisis Europe would have to significantly cut its usage (EURACTIV, 2022). We are expecting European investors to seek out opportunities in the alternative energy sector, especially with regard to startups. For example, the September deals of a Swedish renewable energy generator SunRoof amounted to EUR 15 million as well as the one of a German clean energy startup Orca Energy totalled EUR 28.5 million, has indicated the increased investor interest in the alternative energy sector.

European ventures are significantly affected by the supply-chain crisis caused by the COVID-19 pandemic and exacerbated by the

war in Ukraine. The European Commission is currently discussing a potential bill, which will grant it influence over EU countries to control their supply chains and be able to prioritize the production of goods (Deutsche Welle, 2022).

As mentioned in the previous European Venture Sentiment Index report, investors still anticipate the market to reach the floor which is evident by the drop in index outlook from Q1 to Q3. Yet the outlook for Q3 which was recorded last quarter is still lower than the recorded sentiment in Q2.

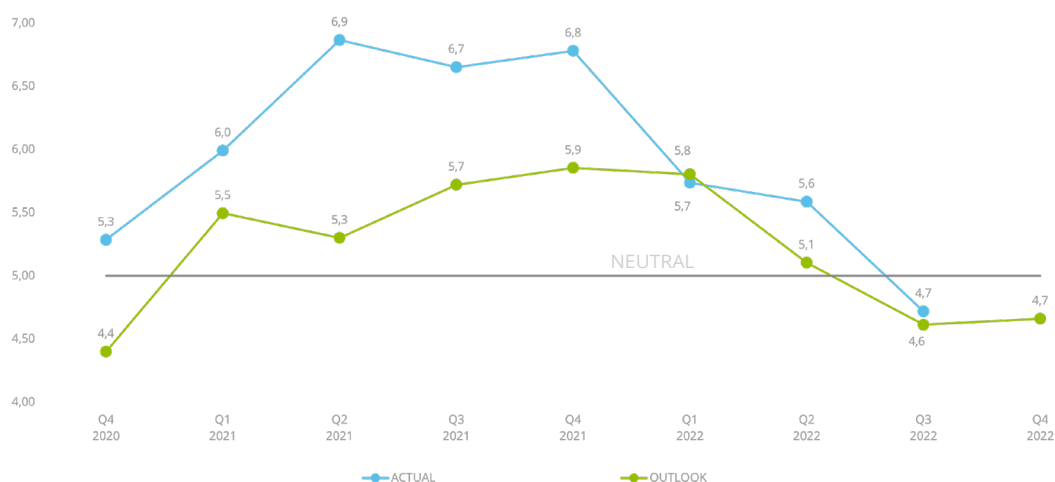
The negative development in the VC sector can be seen by the overall drop in investment volume and deal count as well as the continuous trend of tech companies' lay-offs. For instance, the Swedish-based Neobank cut staff by 10% in June, the buy now, pay later service provider Klarna confirmed laying off up to 100 employees in September, and the German creativity startup Pitch laid off close to 30% of employees in September (Sifted, 2022).



With Europe heading towards a recession and central banks hiking interest rates, private markets are shrinking. Institutional investors continue to stay passive and to observe the market waiting for a more favorable environment. This impacted later-stage investment in Q2 and continues so in Q3. However, early stage is also seeing a decline in traction and this is worrisome for the ecosystem. Investors in our network are concerned with helping portfolio startups due to the difficult fundraising environment therefore less active in new opportunities. Even though the outlook for Q4 seems to be on a similar level to the index actual for Q3, markets remain cautious with regards to downside risks while feedback and interviews indicate that we are close to reaching the floor.

Berthold Baurek-Karlic

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SENTIMENT DECREASES FOR A THIRD QUARTER IN A ROW. OUTLOOK FOR Q4 INCREASES.

In Q3 2022, we recorded another decrease in the index actual continuing the trend from Q1 and Q2. The index dropped from 5.6 in Q2 to 4.7 in Q3 entering negative grounds. This represents a 15.5% decrease on a QoQ basis as well as a 29.1% decrease on a YoY basis. So far, this quarter is the second lowest recorded actual since the launching of the index. The only lower value recorded for the index actual was in Q3 2020 when the index actual was measured at 4.65. Back then, the COVID-19 pandemic raised investors' concerns with regard to healthcare (development of vaccines), global economic slowdown (lockdowns) and supply chain shortages (international trade closing down). Similarly, the outlook for Q4 2022 (4.66) is very close to the outlook for Q4 2020 (4.40).

This quarter's actual has almost matched the outlook of 4.6 that was anticipated in Q2 2022 for Q3 2022. We suggested in our Q2 report

that VC and PE are a good hedge against high inflation. However, with recession becoming more certain and the ECB hiking interest rates money available for private investments is becoming more obsolete. Even though in Q1 and Q2 economic slow-down did not seem to affect early-stage investment, in Q3 we observe a decline also in this area. Early-stage funding went down by 38.9% on a QoQ basis and 43.6% on a YoY basis.

The overall decrease in European VC investment volume and number of deals over the quarter can largely be attributed to early-stage significantly losing traction. Other stages have experienced smaller and proportional decreases. The most vital reductions in the index actual come from 29% higher competition on current deals and a 15.3% lower perception of current valuations compared to the previous quarter. Participants reported a slightly lower sentiment for deal flow quality and a significantly more difficult fundraising environment. It puts high pressure on investors, as the worse quality of fundraising startups and higher complexity of collecting funds are expected combined with a negative outlook on the overall market trend. This is understandable as there are much fewer available funds at the moment.

EUROPEAN VENTURE CAPITAL DASHBOARD



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The outlook for Q4 2022 has increased with 1% QoQ, therefore, putting an end to the downtrend which started in Q4 2021. The main influence on the outlook was a positive perception of valuations in Q4 2022 (6.85% increase). Therefore, investors expect valuations to go higher again, despite the fact that they were decreasing over the last two quarters. Even though this can be seen as a short-term optimism it should be approached with caution as the difference between the actual and the outlook is very small, and it might be just a small deviation.

Participants have indicated they are primarily concerned with the energy crisis followed by the war in Ukraine, the rising inflation, and supply-chain bottlenecks. Additionally, investors reported lower deal flow quality as well as fewer new startups that are fundraising in the current landscape.

SLOWDOWN IN EUROPEAN VC ACTIVITY.

In Q3 European startups raised EUR 15.8 billion in 1142 deals. This represents a staggering 34% decrease in investment volume on a QoQ basis and 44% on a YoY basis. The decrease in deal count is more moderate yet significant. It fell from 1349 deals in Q2 which is a 15.3% decrease QoQ and 31.7% decrease YoY (Crunchbase, 2022). This is the lowest point since the beginning of the COVID-19 pandemic in Q3 2020. This parallel is also present in the sentiment index.

As we mentioned in our previous report, Europe is not the only venture investment ecosystem adversely affected by macroeconomic developments. In the U.S. investment volume decreased by 32% (QoQ) and 52% (YoY). In Asia investment volume decreased by 33% (QoQ) and 60% (YoY). Global investment distribution by stage remains largely unchanged compared to YTD, which indicates the overall proportional decrease across all stages.

However, according to the European results, the only exception is early-stage funding, which has unproportionally decreased by 42% on a QoQ basis and 44% on a YoY basis (CBInsights, 2022 & Crunchbase, 2022). Despite such negative changes, as our previous report mentioned, we continue to underscore that with upcoming market changes, the market will not only return to a position similar to Q1 2022 but probably surpass its previous performance.

THE UK LEADS IN VC ACTIVITY AMID HEAVY ECONOMIC AND POLITICAL CRISIS.

Despite remaining the most active ecosystem in Europe, the UK has experienced a much stronger decrease than the average for the Continent with investment volume. The UK recorded USD 3.3 billion in transactions which represents a 55% (QoQ) and 59% (YoY) drop. This is the lowest investment volume recorded in the UK since Q1 2020. The energy crisis on the island is much more severe than in the rest of Europe and the economic crisis has spilt into a currency crisis which seems to only deepen over time, especially with the recent political downturns. As a result, many foreign investors took out their funds from the UK. The short-term outlook for the UK does not seem optimistic. Meanwhile in Q2 France once again came up second in Europe in terms of investment volume with USD 2.1 billion in overall funding. Although this attracted investment volume has granted the country its second place, surpassing Germany, it still marks a 38% decrease on a QoQ basis and 45% on a YoY basis. The third place, as mentioned before, was taken by Germany with USD 1.7 billion total investment volume, which is represented by 50% (QoQ) and 41% (YoY) decreases (CBInsights, 2022). With the crisis in the UK deepening and the pound getting weaker, this might lead to Germany or France to surpass the UK in VC activity in the coming quarters.

We observed three notable deals in Europe in the third quarter of 2022. Namely, a Swedish-based lithium-ion battery manufacturer with a focus on supplying eco-friendly batteries, Northvolt, has raised the largest equity investment round in Europe through a convertible note of USD 1.1 billion in July. This is the second investment above the USD 1 billion mark which the company raises in 2022. Earlier in June Northvolt raised USD 2.75 billion at a USD 11.75 billion valuation.

The second largest round for the quarter was raised by Klarna in a private equity round. For the Swedish-based e-commerce payment solutions provider, this represents a down round which raised USD 800 million with a valuation of USD 6.7 billion in July 2022. However, it was almost a 10x decrease in valuation since the previous investment round of USD 639 million with a valuation of USD 44.9 billion in June 2021.

The third largest deal was Celonis, a German-based execution management system, which raised USD 400 million as part of a Series D investment round in August (DealMatrix, 2022; CBInsights, 2022; Crunchbase, 2022).

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METHODOLOGY

Over 4000 highly experienced investors (business angels, (corporate) venture fund managers and family offices) from 8 European countries were invited to participate in May and June 2022 in the European Venture Sentiment Survey, conducted by Venionaire Capital. Venionaire Capital collects answers from a focus group in computer-assisted personal interviews and a much smaller control group to assess the indices based on a quarterly recurring survey. Those datasets are collected in two waves and finally merged. In both groups, Venionaire has aligned similar sets of investors, ranging from business angels to large corporate venture units as well as early- to later-stage venture capital funds from all over Europe (incl. Switzerland and the UK).

The indices for current sentiment and projected outlook are weighted indices, with emphasis on the ability/willingness of investors to invest, the perception of startup valuations and the quality of deal flow.

COMPARABILITY

Sentiment surveys and indices are nothing new. They have been around for decades to quantify how a specific group of people feel about a market or economy. One of the most notable examples is the Consumer Confidence Index (CCI), which provides an indication of future consumption and saving of households. There are also surveys that focus on a specific market, or even an individual security. How can the results of these market sentiment surveys help market participants?

Let's look at the venture capital industry. This general economic information can greatly benefit both the investor and start-ups within a market. Investors can compare their own views and opinions to those of the general market or across different geographical regions and industry verticals. This will help them to adjust their investment behavior. Start-ups can use this information when growing their business internationally, when they prepare for fundraising or to slow down their business (return to bootstrapping – ahead of time) if the economic environment worsens. Market sentiment indicators are important for us in all industries and markets. Nevertheless, there is a limited number of market sentiment indices for the venture capital or start-up market available, which we found useful to work with.

Most indices available focus on a specific region, investors group or industry. Take EIF's VC Survey, which targets a highly professional group of regulated investors across Europe, but does not take accelerators or business angels into account. Our partners of Deutsche Börse Venture Network conducted a great report on market sentiment during the COVID-19 pandemic. It offers great insights, but it was a onetime publication.

We have developed our own "European Venture Sentiment Index", which shows in one simple number the general state of sentiment today and shows the current outlook in a second number.

THE EUROPEAN INVESTOR SENTIMENT INDEX

The index is based on feedback from different economic regions, as well as start-up sectors and reflects the general European Venture Sentiment. The methodology of the index was designed by Venionaire Capital in mid-2019. The project was led by its founder and managing partner, Berthold Baurek- Karlic, a serial entrepreneur and leading venture capital expert from Vienna, Austria. Berthold started his career in the statistics department of the Austrian Central Bank (OeNB).

"We attach great importance to providing our investors with an actual overview of the current investment climate in the European start-up sector. After this index has proven to be an important tool for our clients - including start-ups as well as investors - we have decided to make the results available to the public for the first time during the COVID-19 pandemic in the first quarter of 2020. Our aim was to draw public attention to the threatening situation of innovative young companies in Europe", explains Berthold Baurek-Karlic.

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Berthold Baurek-Karlic is the founder and managing director of Venionaire Capital, which specializes in M&A and venture capital. The Venionaire Group also includes the investment company MOTEC VENTURES (motec.vc) and the software provider DEALMATRIX (dealmatrix.com).

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David is responsible for the identification, screening, and evaluation of startups. Furthermore, David specializes in financial modelling; he supports Venionaire's clients with deal structuring, financial engineering and valuations. Before joining the team at Venionaire, he gained experience by accompanying a tyrolean startup in a leading position as Controller & Financial Analyst from early-stage through a Series A round up to a Share Deal exit. David has a Bachelor degree in Business Management & Entrepreneurship from the FH Wien der WKW.



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Samuel manages deal flow, analyses business models and prepares investment decisions. Prior to Venionaire, Samuel has gained professional experience in London, Sofia, Vienna and Berlin.



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Denis supports our analysts regarding deal flow, analyses business models and prepares investment decisions. He has gained professional experience working on international projects between Russia and China. Denis is currently pursuing an undergraduate degree in International Business Administration with a finance major in Lauder Business School.

ABOUT



The European Venture Sentiment Survey is conducted with the lead of Venionaire Capital. Venionaire is a entrepreneurial partner for investors, founders and institutionals. Our partners and team are specialized in venture capital and private equity investments, with an extensive over a decade-long track-record. We offer transaction and corporate advisory services – from due-diligence, valuation, deal structuring, (ghost) negotiating to alternative fund management – for investors, corporates, public entities and growth companies (startups / scaleups). Our track-record as entrepreneurs, advisors and investors shows deals in fields of corporate finance (M&A), (Corporate) venture capital, corporate startup engagement (CSE), digital transformation and high-tech innovation with a total volume of more than a billion Euros. In addition we serve as trusted partners for scouting, screening, technology-, market- and competitive analysis and valuation for bespoke investors and accelerators in Europe. We are proud of our performance within managed portfolios and increase our high-tech footprint everyday to support a future-proof economy.

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