



Houlihan Lokey

Portfolio Valuation and Fund Advisory Services

# GROWTH EQUITY VALUATION SNAPSHOT—EUROPE

MARKET UPDATE **SUMMER 2022**



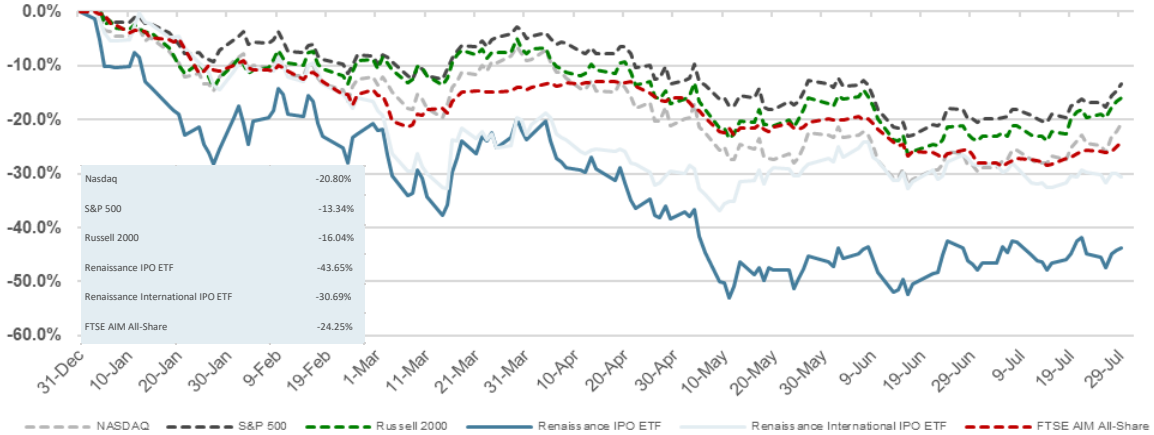
# Houlihan Lokey's Growth Equity Valuation Snapshot

## Summer 2022

Houlihan Lokey is pleased to present a summary of growth equity observations from its valuation professionals based on real-time market and valuation insights.

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### Benchmark Performance Since 2021



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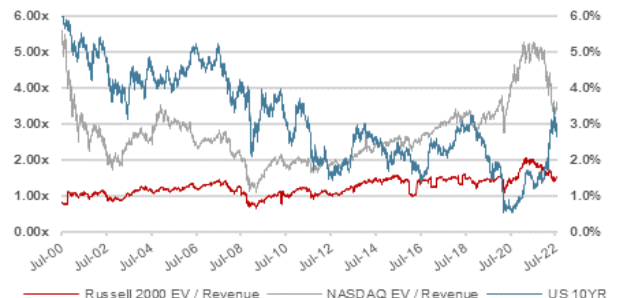
### Multiple Compression

- Since 2020, the UK's money supply has increased 24% and the Bank of England's balance sheet has increased from £550 billion to £945 billion. Correspondingly, the bank rate was initially cut to 0.1% at the onset of the pandemic and then was gradually increased, standing at 1.75% at the beginning of August 2022. In mid-2020, UK 10-year government bonds dropped to an unprecedented level of 0.1%, gradually rising to about 2.6%, then levelling off at 1.9% at the end of July 2022. Inflation in July 2022 reached 9.6% in the UK and is expected to hit 13% by the end of the year. The bank rate is expected to increase to 2.5% by Q1 2023.
- Between Q1 2019 and Q1 2022, German 10-year government bonds were yielding negative values, bottoming out at approximately 0.9%. Yields increased over Q2 2022 to about 1.7%, standing at 0.8% at the end of July 2022. In July 2022, the European Central Bank (ECB) raised interest rates by 50 basis points, to 0.0%, for the first time in over a decade. Further hikes are expected: 1.3% in Q1 2023 and 1.8% in 2024. These interest rate hikes are an answer to increasing inflation, which reached 8.6% in June 2022 in the Eurozone and is forecast to slow down to 7.3% in 2022, before declining to 3.6% in 2023 and converging towards the ECB's inflation target in 2024.
- The EV/Revenue multiple of the Russell 2000 Composite Index spiked at 2.1x in 2021, ending the year at 1.8x, then falling to 1.6x at the end of July 2022, or down 13%. Correspondingly, the EV/Revenue multiple of the Nasdaq Composite Index spiked at 5.3x in 2021 and fell to 3.6x at the end of July 2022. For comparison, the US 10-year treasury bonds ended 2021 at 1.5%, then rose to 2.7% at the end of July.
- Investments in growth-oriented businesses or those with long-term cash flow potential run the risk of increasing interest rates, as profitability may be years away. Generally speaking, discounting a longer-dated stream of cash flows at a higher discount rate can materially impact valuation multiples.

22-Year: EV/Revenue vs. UK10yr



22-Year: EV/Revenue vs. US10yr



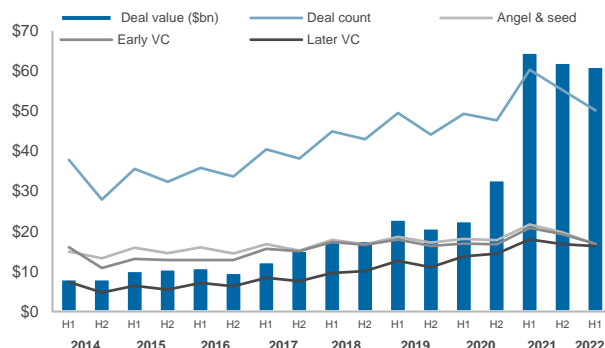
Note: EV refers to Enterprise Value.  
Sources: Capital IQ, Bank of England, ECB.

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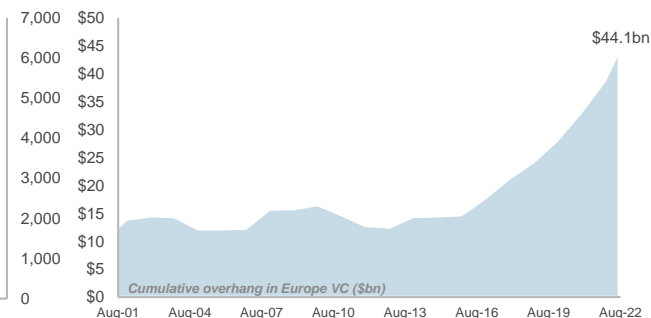
## 3 Funding Reports

### VC Financing in Europe



Sources: PitchBook, KPMG.

### Dry Powder Reserves



## 4 NAV Support and Valuation Considerations

### Downside Protection

- Understanding the various terms and features attached to each security class in a company's capital structure is essential to security valuation. Seniority, liquidation preferences, dividends, ratchets, conversion ratios, and other variables are highly impactful economic features that provide downside protection.
- Common best-practice private valuation methods include valuing stock on a common stock equivalent, or as-converted basis (the typical post-money valuation method observed in public press releases) and a waterfall basis (which can also apply option pricing methodology). The two methods often produce materially different results, which is why it is important to understand the various downside protections and equity distribution waterfall. If an asset is materially impaired or has underperformed since last-round valuation (LRV), the waterfall approach will often reflect higher security values for senior classes vs. junior classes due to the downside protections. For instance, current per-share valuations of prior secondary purchases of junior shares at primary round prices (a common occurrence in 2021) will often diverge from those of senior primary classes due to the seniority and waterfall features.
- Additionally, expectations around IPO vs. M&A may have shifted due to current macro environment concerns so common stock equivalent approaches may not be as appropriate as they were at LRV.

### Performance: Portfolio Company vs. Market

- Calibrating against representative metrics at LRV can be helpful for valuation support: What is the portfolio company's over/underperformance vs. underwriting forecasts?; Did the portfolio company beat its budget?; How have the unit economics changed since LRV?; How does the portfolio company's YTD YoY growth benchmark against public comparable companies?
- Public comparable companies can be highly informative in making market-based valuation adjustments. However, there may not be a 1:1 correlation with private company valuations. Have public comparable companies' enterprise or market values deteriorated since LRV?; Are certain public companies more comparable than others due to end customers, end markets, or country of operations?; How does the portfolio company benchmark against growth, margin, and size to the overall public comparable set?
- It is critical to assess cash runway and burn in bear markets. Will the portfolio company need to raise additional capital at unfavourable terms in the near term?

### Income Approach








- Utilising a discounted cash flow analysis with updated forecasts (reflective of current macro and inflationary expectations) and revised weighted average cost of capital (WACC) assumptions can be considered to corroborate portfolio company value.

### Secondary Transactions

- Recent secondary transactions may also be weighed in valuation, with particular consideration on price, size, security class, recency, and circumstances pertaining to the buyer(s) and/or seller(s).

# Houlihan Lokey's Growth Equity Expertise

Houlihan Lokey has a successful track record and robust experience in assisting its clients—including private equity, venture capital, hedge fund, sovereign wealth fund and family office—with ongoing portfolio valuation work and fund-related transactions.

-  We have deep **valuation expertise** in investment, NAV reporting, and fund-related transaction matters.
-  We advise **boards of directors and valuation committees** as they navigate audit reviews, regulatory challenges, and new fund formations, including valuation policy and procedures.
-  We value large portfolios of **highly structured, venture-backed “unicorn”** investments for various investors across the globe.
-  Our industry-leading Fund Opinions practice provides valuation and fairness opinions to many **financial sponsors** annually in connection with cross-fund, spin-out, and other conflict-of-interest transactions.
-  Our Capital Markets team has **substantive private placement experience in structuring and raising capital** with leading industry participants in growth and structured equity.
-  Our valuation practice has deep technical expertise and market presence across various industries and asset classes. This is further enhanced with access to **the firm's dedicated industry groups in the investment banking practice**, which provides an unmatched level of expertise and transaction experience to inform the valuation process.
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