Chapter 7m

23 First Look 2023

The European tech industry is heading into the second half of a tough year more able to withstand challenging macroeconomic conditions than ever before

An established ecosystem

When European tech last faced a crisis of this nature in 2000 and 2008, it was structurally weakened and that's just not the case this time round. The ecosystem is much more resilient and established. There are important structural green shoots appearing already: Europe is closing the early-stage funding gap with the US; Europe is increasing its investment in AI companies and focusing more attention on climate and other purpose-driven companies.

We should think about this period as a return to first principles. 2021 was a clear outlier, with investment volumes and valuations now returning to long-term averages.

Tom Wehmeier

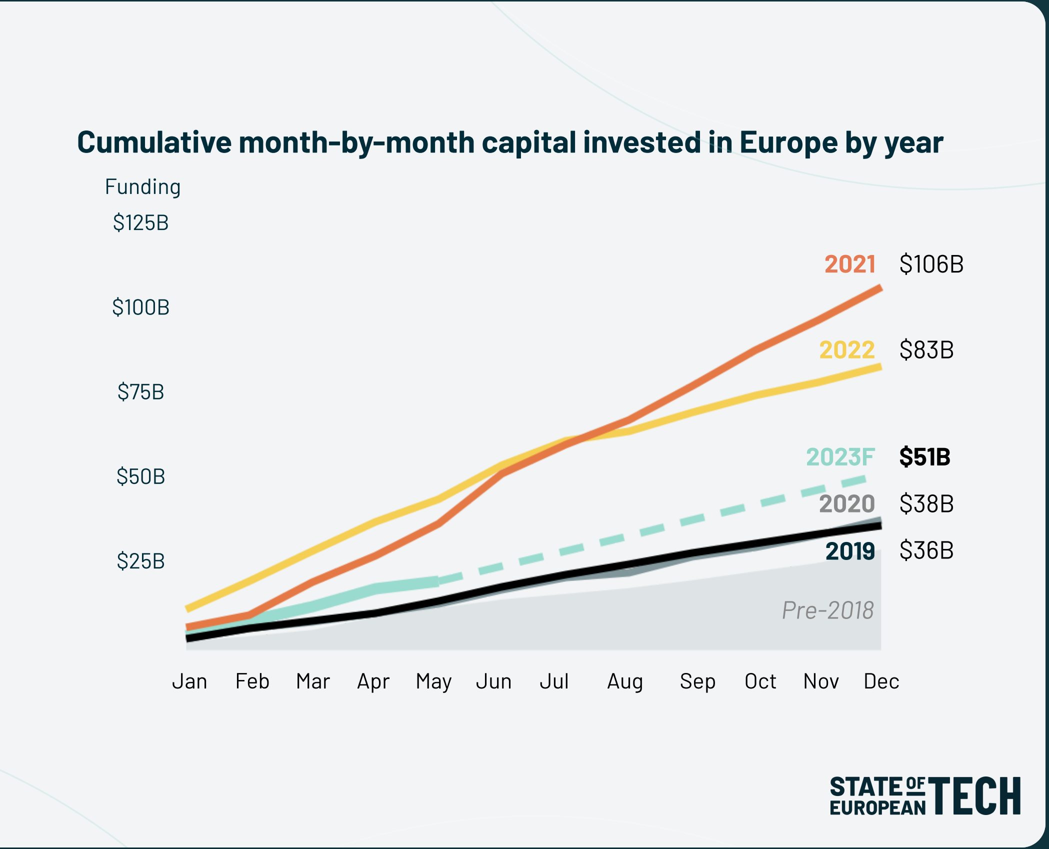
Partner, Head of Insights, Atomico

That's no bad thing, but it won't be an easy time for everyone. Down rounds will continue to feature and there could be more layoffs. Creating the right conditions for talent, plus deeper and more liquid capital markets, and a policy approach that bets on innovation while managing risk, will be crucial. The rewards could be huge. From this cycle we have the opportunity to build an even healthier ecosystem, with a clearer focus on quality. In the short-term, there will be fewer companies started, but the ones that break through will more likely be winners, with a strong foundation of senior talent and greater share of the region's resources.

The adjusted market reality is here to stay

In 2022 we reported the beginning of a new market reality. This trend has continued into the first half of 2023, as total investment volumes in Europe are set to reach around $50B+ for 2023 as a whole, based on activity to date. This represents around a 50% drop compared to the record highs of 2021, and around 38% down on 2022. However, this is still roughly 35-40% ahead of what we saw in 2020 and 2019. Even in a market downturn, Europe is on track to have its third largest year in terms of funding raised.

The adjusted market reality is here to stay



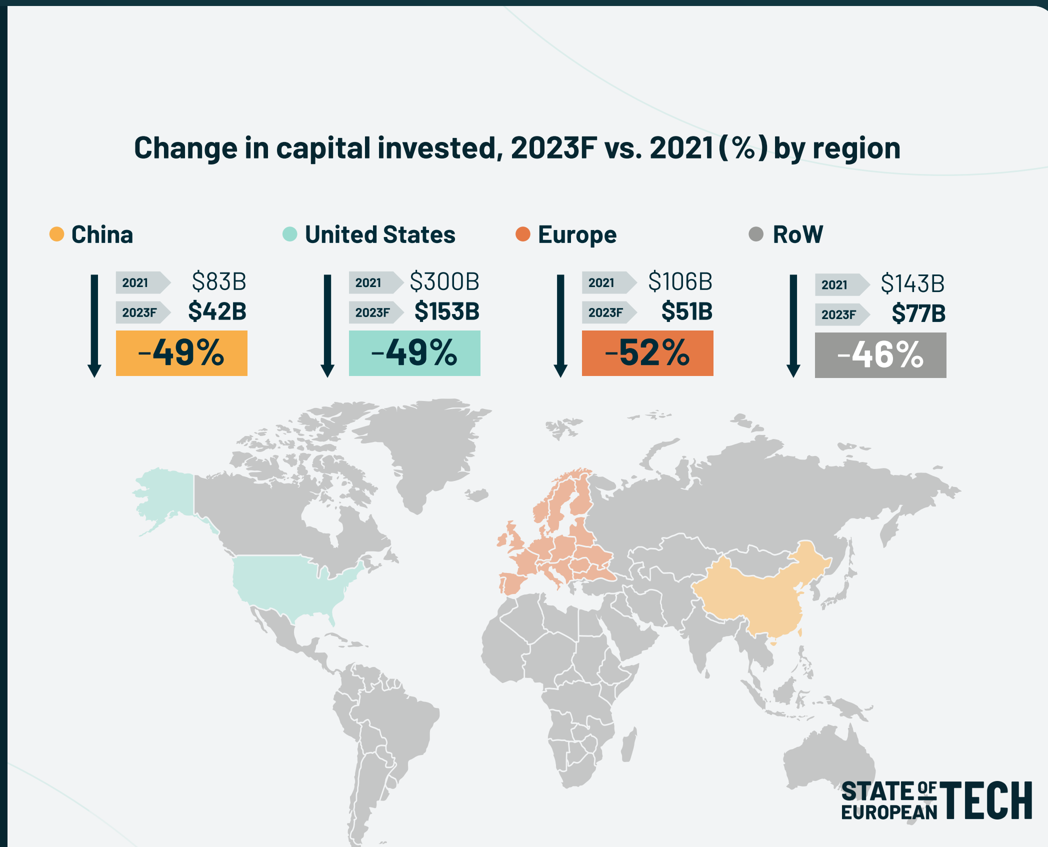
Source: Atomico (powered by Dealroom.co and Crunchbase)

Notes: Data is as of 14th of May, with May total extrapolated based first half of the month data. Full year extrapolated based on year to date data. Excludes the following: biotech, secondary transactions, debt, lending capital, and grants.

It’s a global phenomenon

Though Europe’s investment volume has dropped significantly, it is important to note that this is not unique to Europe; rather, this is a global trend that is mirrored in the US, China, and the rest of the world, each of which record a decrease of roughly 50% when comparing 2021 investment volumes to the 2023 full year forecasts.

It’s a global phenomenon



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Once the IPO window opens, there will be a strong pipeline of high growth firms - and tens of billions in unrealised value - waiting.

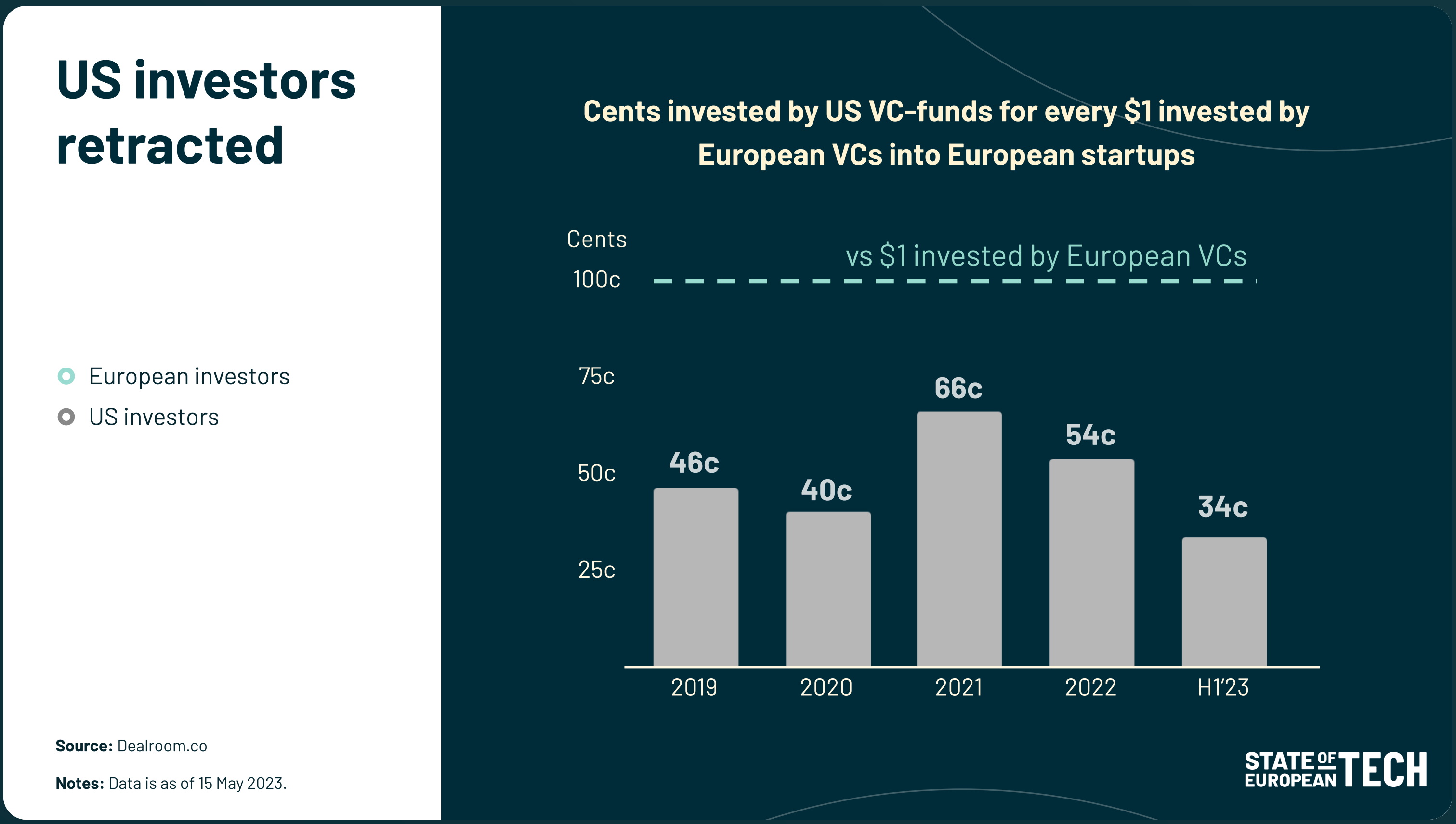
Sarah Guemouri

Principal, Atomico

Over the past five years, European tech has delivered in excess of $500 billion in exit value. However, this year, like last year, remains stagnant. This creates obvious liquidity challenges at every level - for founders, tech employees, LPs - all of which rely on the flywheel of recycled capital and talent for the progression of our ecosystem. ARM's plans for a Nasdaq listing, alongside hints from the likes of Vinted and Visma, suggest the IPO window could re-open later this year. Once this window opens, there will be a stong pipeline of high growth firms - and tens of billions in unrealised value - waiting.

US investors retracting

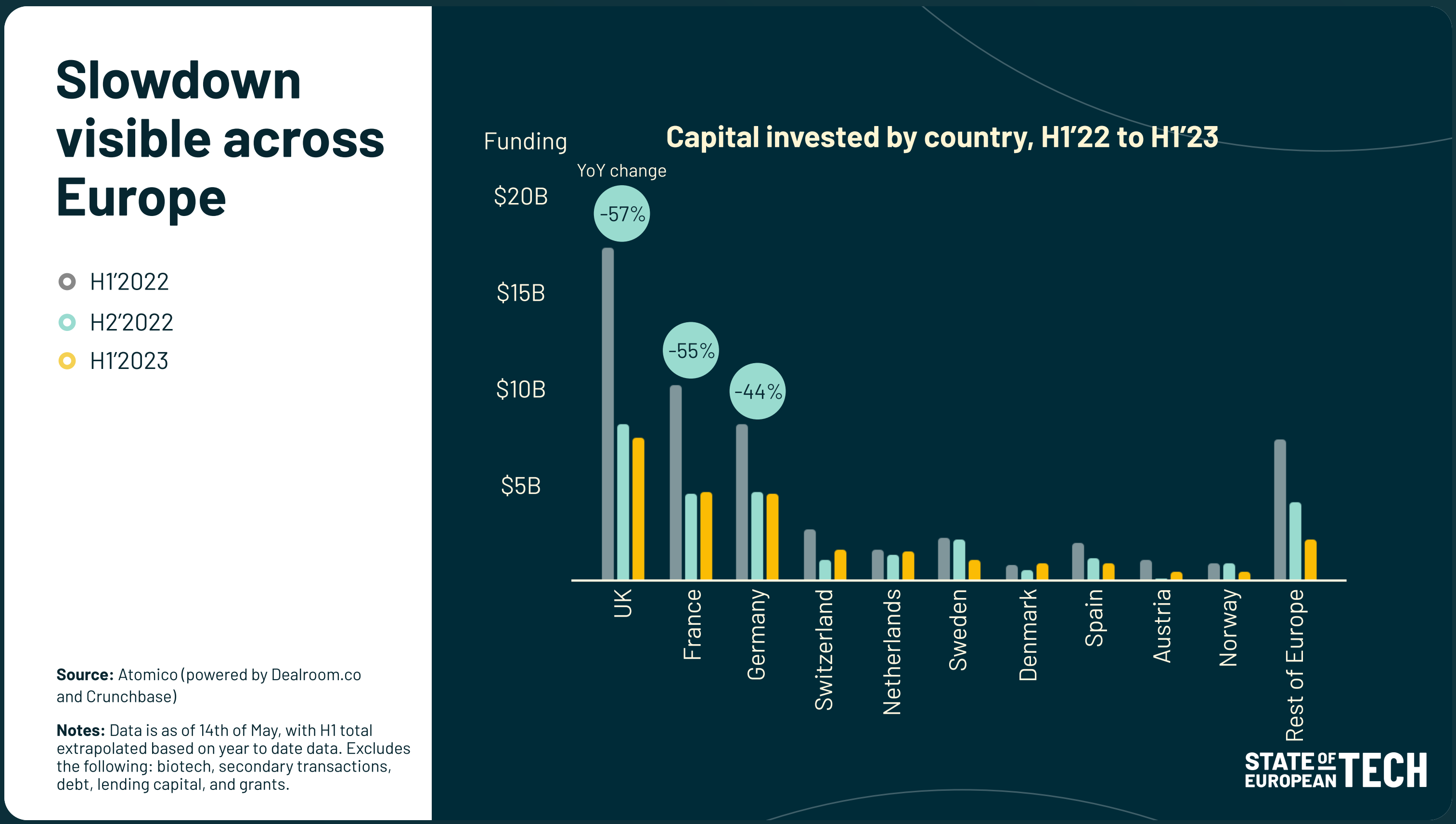
The global retraction in investment volumes has a knock-on effect on the flow of capital between regions. In Europe, this has meant a reduction in the volume of capital originating from US investors. At the peak in 2021, each dollar invested by European investors was matched by 66 cents from the US. This is down to around 40% so far in 2023. Later-stage founders raising larger rounds will feel this the most.



Slowdown visible across Europe

Looking across Europe, the slowdown is visible in almost all countries when we compare tech investment in the first half of the year to the same period in 2022. While the Netherlands and Denmark provide some exceptions, we have seen a steep decline in investment levels. The UK has seen a 57% fall, with 55% in France and 44% in Germany.

However, when looking at the tech slowdown in H2'22, and comparing those numbers to the first half of this year, we see a degree of stabilisation. Moreover, despite funding having fallen significantly, the ecosystem remains diversified with over a dozen countries on track for annualised investment levels in excess of a billion.



Founders are responding to the adjusted reality

The funding landscape remains muted and valuation multiples have stayed resolutely low. In the public markets, median enterprise value to revenue multiples for the largest SaaS companies have come down to 5.0x, well below the long term pre covid average of 7.8x.

As a result, founders are adjusting to the new normal. This meant layoffs accelerated at the start of this year. Q1 alone saw 185,000 redundancies globally - 6% of which were in Europe. This compares with just under 10,000 in Q1 22, and 165,000 in the whole of last year.

And as founders finally go out to fundraise, the down rounds we anticipated are beginning to show through in the data. 1 in 5 venture fundraises in Q1 this year were down rounds, compared to barely 1 in 20 a year ago. That's a 3.6x uptick.

Founders are responding to the adjusted reality

Valuation reset

Median EV/NTM revenue multiple of public SaaS companies has fallen to **5.0x**, below the long-term average of **7.8x**

Layoffs

There were over **185,000** global tech layoffs in Q1 23, with 6% in Europe, compared to almost **165,000** in the whole of 2022

Down rounds

20% of global venture rounds raised in Q1 23 were down rounds - **3.6x** higher than in Q1 22

Source: Clouded Judgement, Layoffs.fyi, Carta

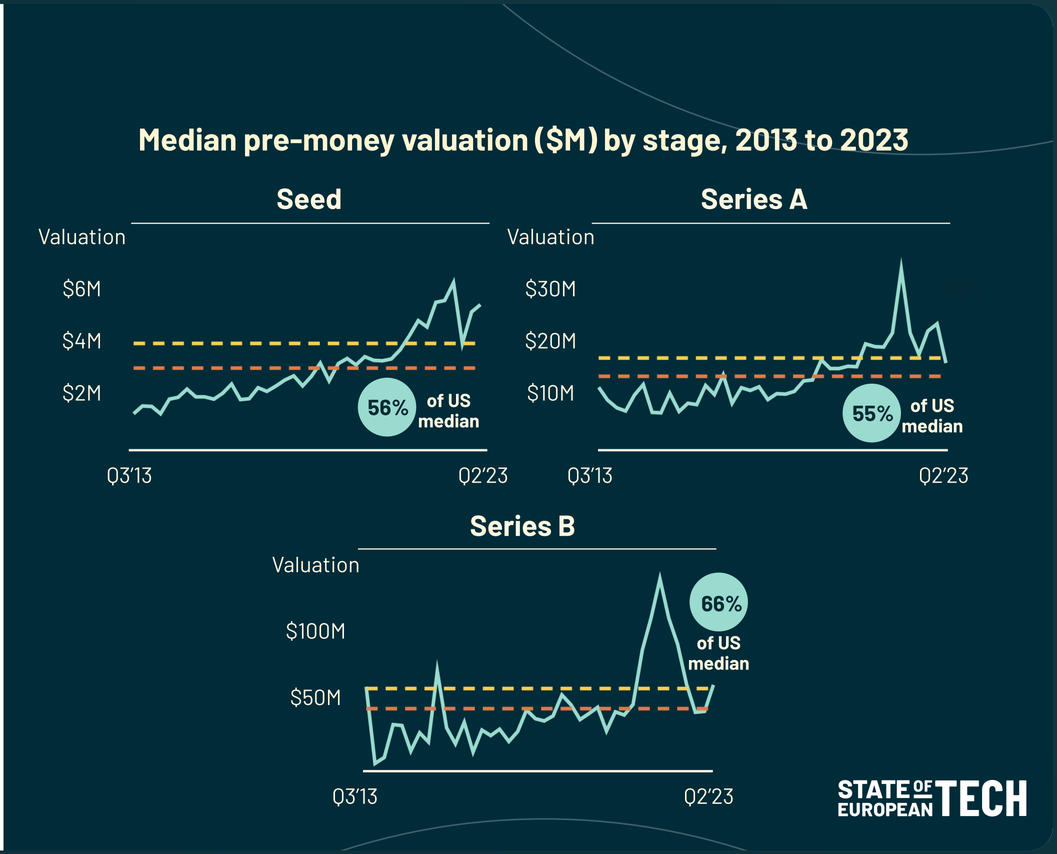
STATE OF EUROPEAN TECH

Private market valuations reset to long-term averages

Valuations are now hovering between 5 and 10 year averages, clearly displaying 2021 as the outlier year in this context. Seed valuations display the most resilience, despite volatility in recent quarters. This reversion to longer-term averages also reflects the situation in the US, albeit with median valuations in Europe consistently around 50% lower across stages.

Private market valuations reset to long-term averages

- Median
- 10YR average
- 5YR average



Source: Pitchbook

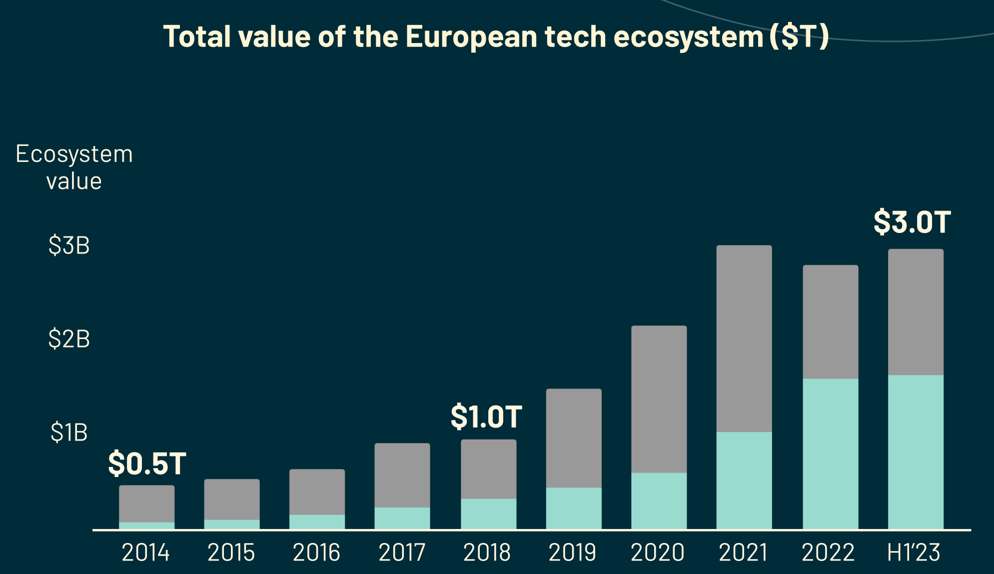
Notes: Data is as of 15 May 2023.

Ecosystem value levelled out at $3 trillion

The combined value of private and public European tech companies has bounced back to its 2021 year end high at $3T. While growth has been stagnant for the past two years, the ecosystem has added $2T in value since 2017 and for the past ten years grown at an average rate of 23% per year.

Ecosystem value levelled out at $3 trillion

- Public market
- Private market



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Source: S&P Global Market Intelligence, Dealroom.co

Notes: Private market data from Dealroom.co excludes the following: biotech, secondary transactions, debt, lending capital, and grants. Based on data up to 15 May 2023. Public markets data as per S&P Capital IQ Platform, as of date 15 May 2023, for illustrative purposes only. Please also note that the data excludes Israel.

Investing across vintages for blended stable returns

Over both a long and a short-term time horizon, European VC returns match the US. On a ten year horizon, Europe is outperforming as of Q1. In many cases VC in both markets is ahead of buyout.

European VC returns outperforming over long-term

Horizon pooled return (net) by fund index, December 31, 2022

	20 Year	15 Year	10 Year	5 Year	3 Year	1 Year
Europe Developed Venture Capital Index	**12.1**	**12.7**	**20.0**	**27.5**	**30.1**	**-18.8**
US Venture Capital Index	12.2	12.7	18.7	22.5	25.0	-20.8
Europe Developed Private Equity Index	14.7	10.9	15.2	16.0	17.9	-6.1
MSCI Europe Index	5.3	2.4	4.6	2.1	1.5	-14.0

Source: Cambridge Associates

Notes: Data is as of 31 December 2022. 2022 MSCI Europe Index is derived from the CA Modified Public Market Equivalent (mPME), which replicates private investment performance under public market conditions.

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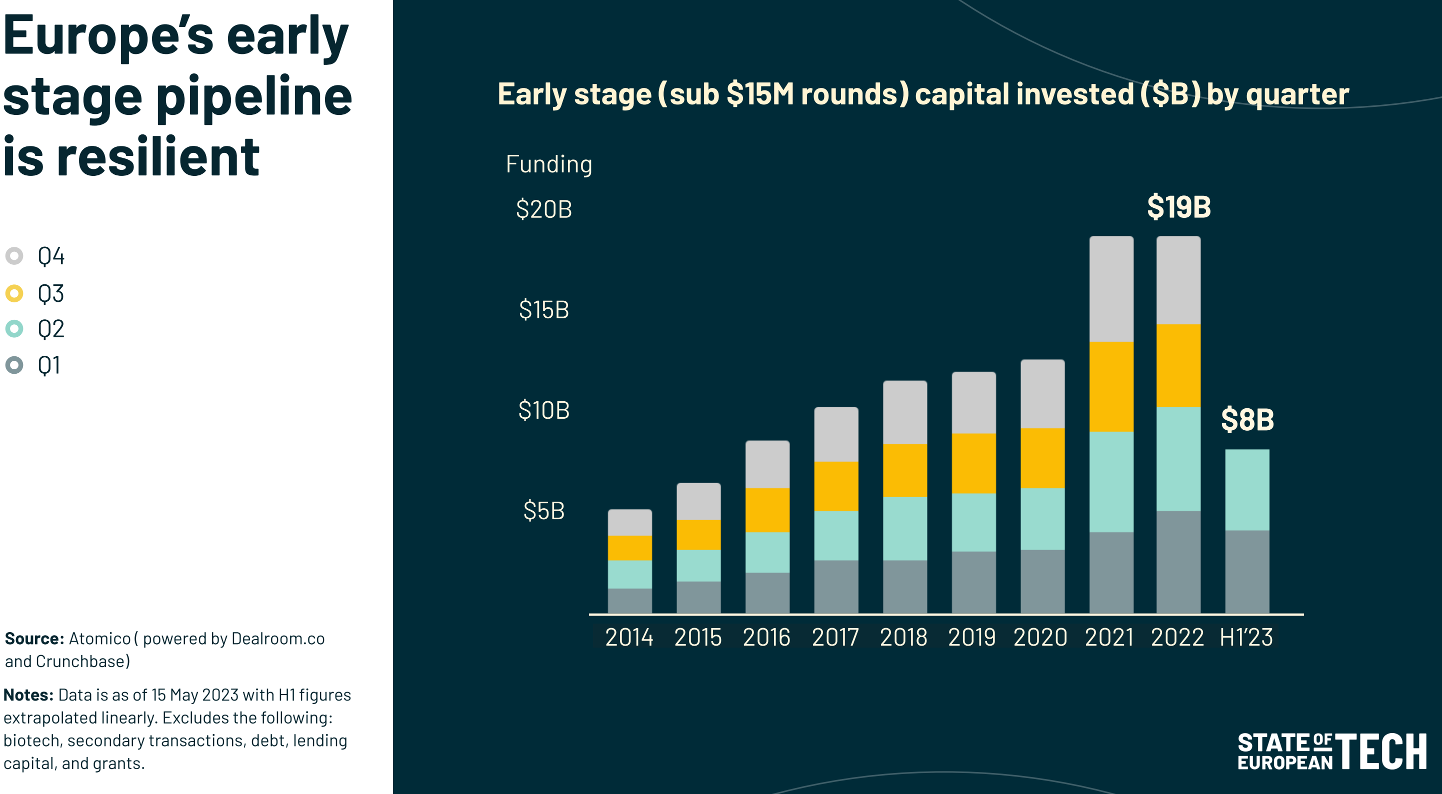
Europe’s early stage pipeline is resilient

Amidst the funding slowdown, European early stage or sub $15M round funding has stayed resilient. Compared to H1’22, the early stage funding in Europe for the first half year of 2023 is down only 21% from around $10.3B to $8.2B. Yet, the funding slowdown in Europe has largely been driven by later stage rounds.

Europe’s early stage pipeline is resilient



Source: Atomico (powered by Dealroom.co and Crunchbase)

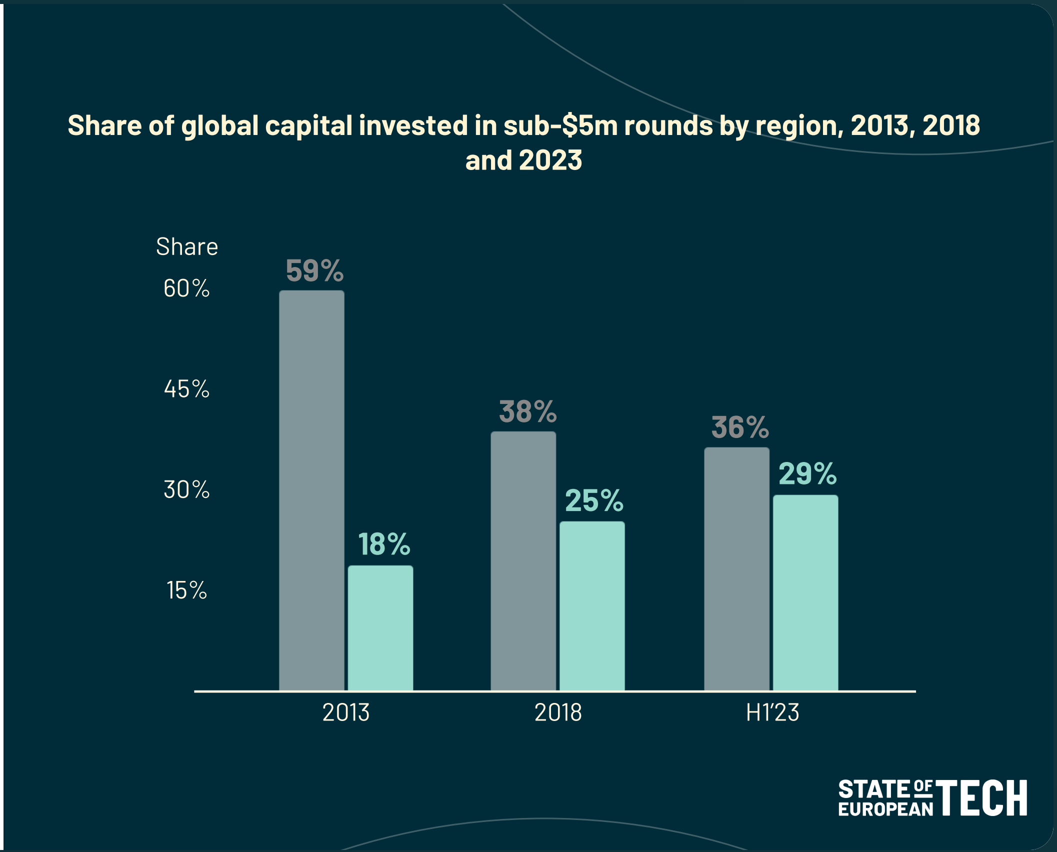
Notes: Data is as of 15 May 2023 with H1 figures extrapolated linearly. Excludes the following: biotech, secondary transactions, debt, lending capital, and grants.

Europe closing the gap with the US

As entrepreneurial ecosystems continue to be built and grow all across the region, the global share of funding going to early-stage companies in Europe is now at 29%. This is almost at parity with the US, after having nearly halved the gap in the last five years and gained more than 10 percentage points since 2013.

Europe closing the gap with the US

- Europe
- United States

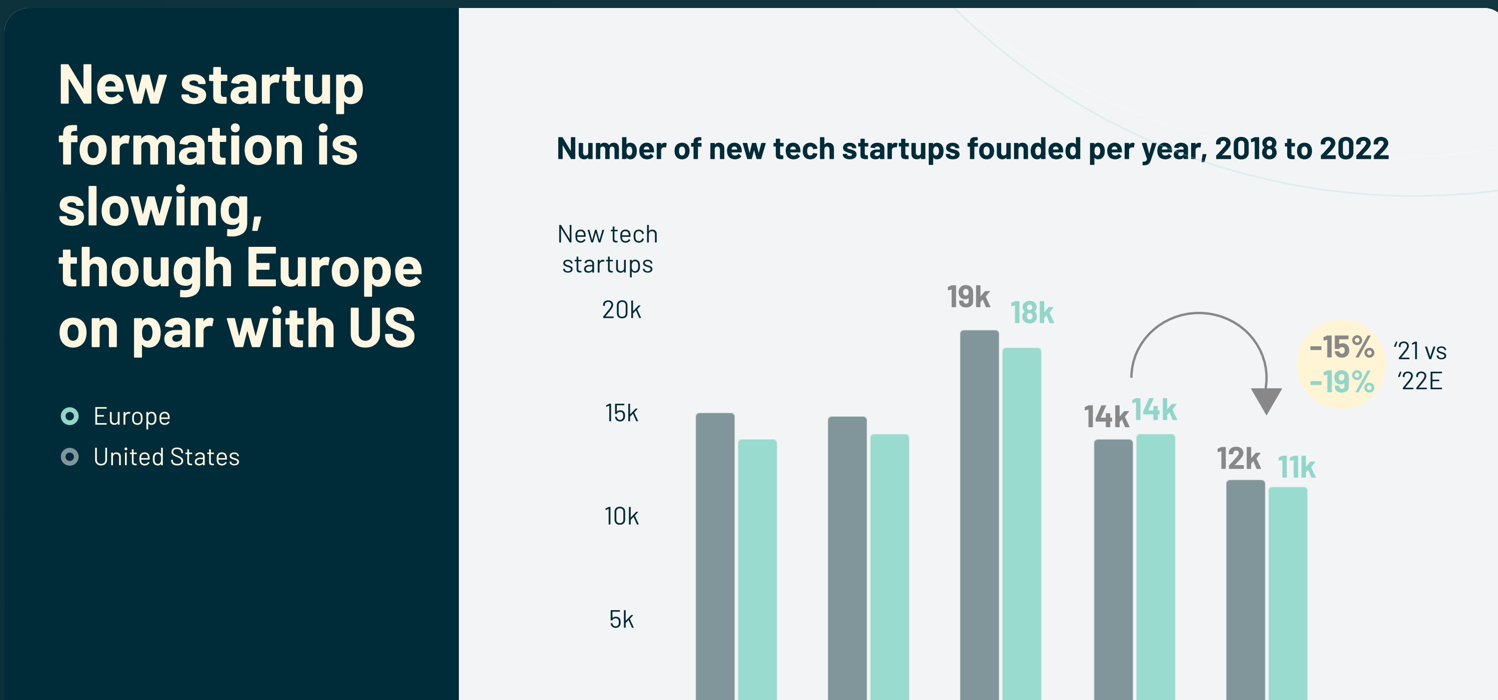


Source: Atomico (powered by Dealroom.co and Crunchbase)

Notes: Data is as of 15 May 2023. Excludes the following: biotech, secondary transactions, debt, lending capital, and grants.

New startup formation is slowing, though Europe on par with US

The market downturn is reflected in fewer new tech startups being created. Based on analysis of over 500 million LinkedIn profiles, about 15-20% fewer companies have been created year-on-year, and we're even further off the Covid-fuelled peak of 2020.

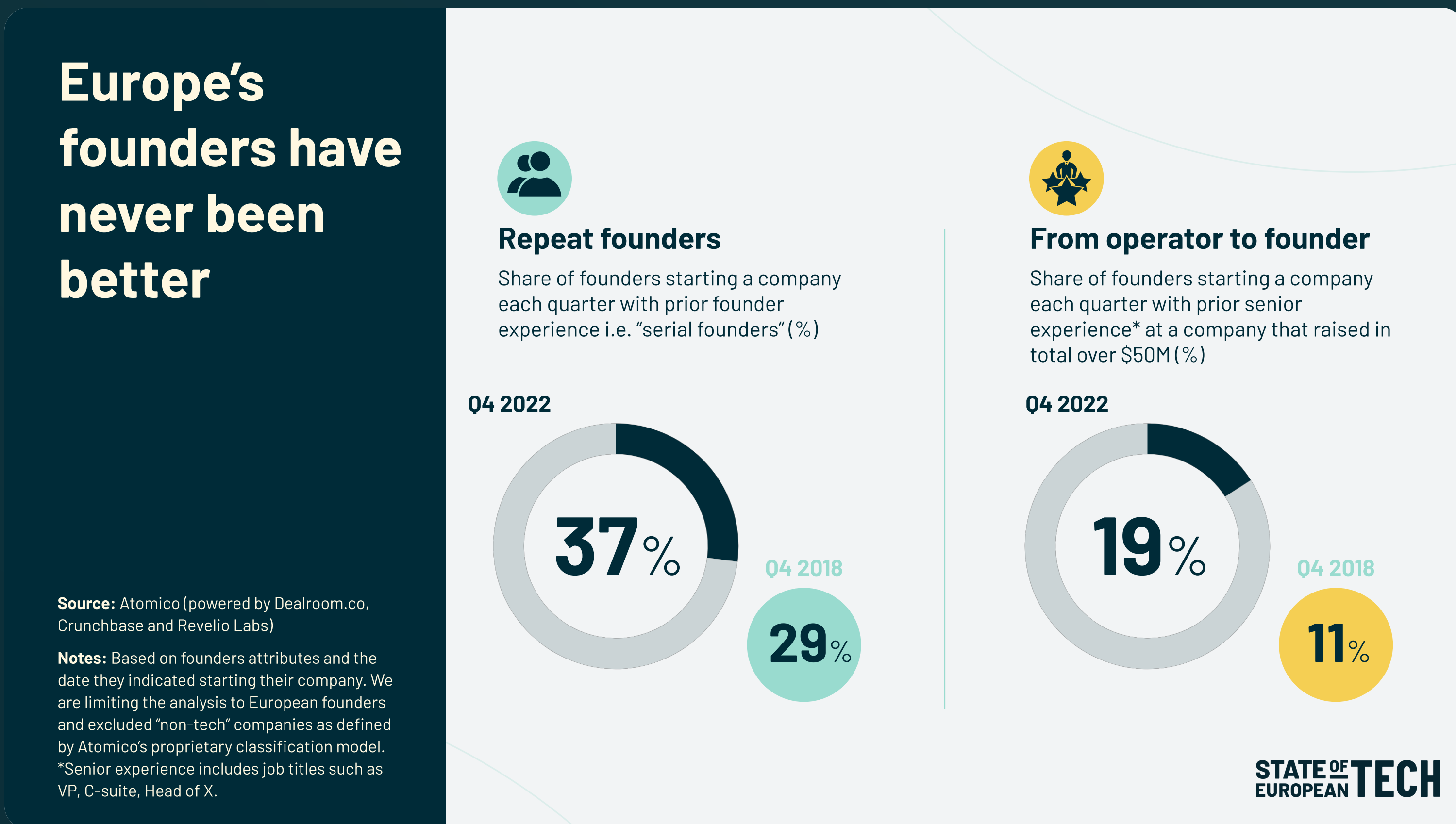


Source: Revelio Labs

Notes: 2022 estimates adjusted for reporting lag (extrapolated based on snapshots at different points in time).

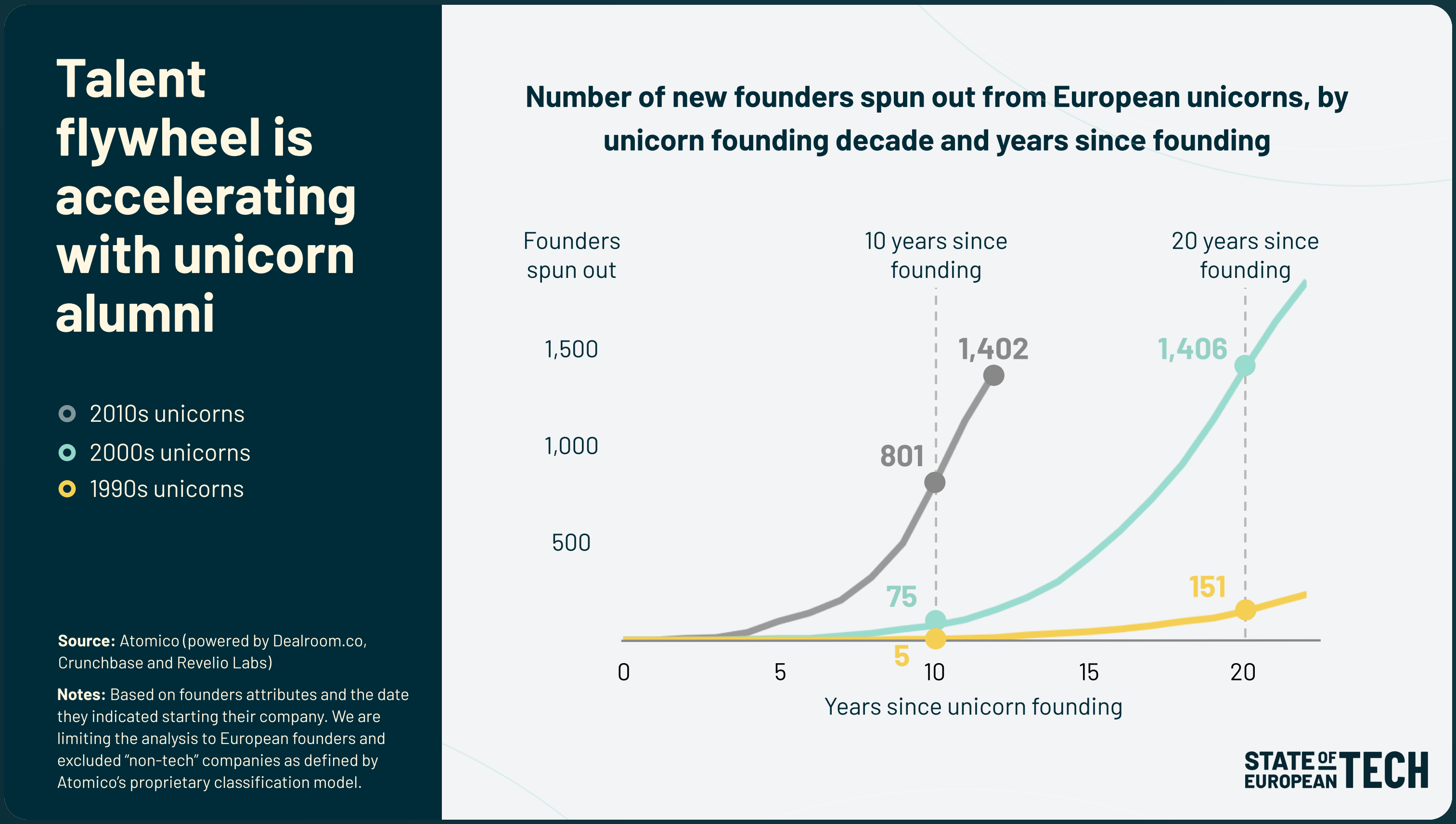
Europe’s founders have never been better

The share of companies being started today by repeat founders, and by experienced operators, are at all-time highs for the European ecosystem. 37% of new founders in the most recent quarter were repeat founders, up materially in just a few years. Similarly, the share of founders that have prior work experience as senior operators has also increased by 8 percentage points from 2018 to 2022.



Talent flywheel is accelerating with unicorn alumni

The European tech talent flywheel is spinning faster than ever. While ten years after founding, the 1990s unicorn cohort employees had started five new startups, then looking at the employees of unicorns born in the 2000s, the number of new startups spun out jumps to 75 ten years after founding. The equivalent goes up to 801 for the 2010s unicorn cohort with the pace of startup creation not showing any signs of slowdown also after.



Emerging AI leaders, while purpose-driven tech grows in share

Generative AI seems to be top of mind for many in 2023 and it has also had a record year in terms of funding. While Artificial Intelligence and Machine Learning has been a staple in Europe for years, capturing 12-17% of all funding per year of the last five years, the share of this funding going to Generative AI has picked up significantly. This year to date Generative AI companies have captured 35% of all funding going to European AI/ML companies, the highest share ever, having previously expanded from 1% in 2019 to 5% in 2022.

Europe is known to be a hotbed for Fintech companies and Financial Services continues to claim the top seat with the biggest share of funding raised in the first half year. Yet Europe is diversifying with other sectors catching up. A year of Financial Services captured 29% of all funding, this has come down to 20% in 2023.

Finally, Europe continues to lead in 'purpose-driven tech' - technologies that meet UN Sustainability Goals. Climate and Purpose is the third largest investment theme in 2023 for far. Furthermore, it has secured its highest share of all funding ever at 18%, a significant climb from 15% in the first half year in 2022.

Emerging AI leaders, while purpose-driven tech grows in share

Generative AI

... accounts for **35% of all AI/ML** funding year to date, the highest share ever and a significant jump from its 5% high last year

Financial Services

... remains the largest sector in H1 with 20% of all funding captured, yet this **has shrunk** from 29% in H1'22

Climate / Purpose

... remains the **third largest theme** after Software at 18% of all funding, up 3ppt from 15% in H1'22

Source: Data as of 15 May 2023. GenAI data based on Pitchbook 'Gen AI' curated list. Fintech and Climate / Purpose capital invested based on Atomico data (powered by Dealroom.co and Crunchbase)

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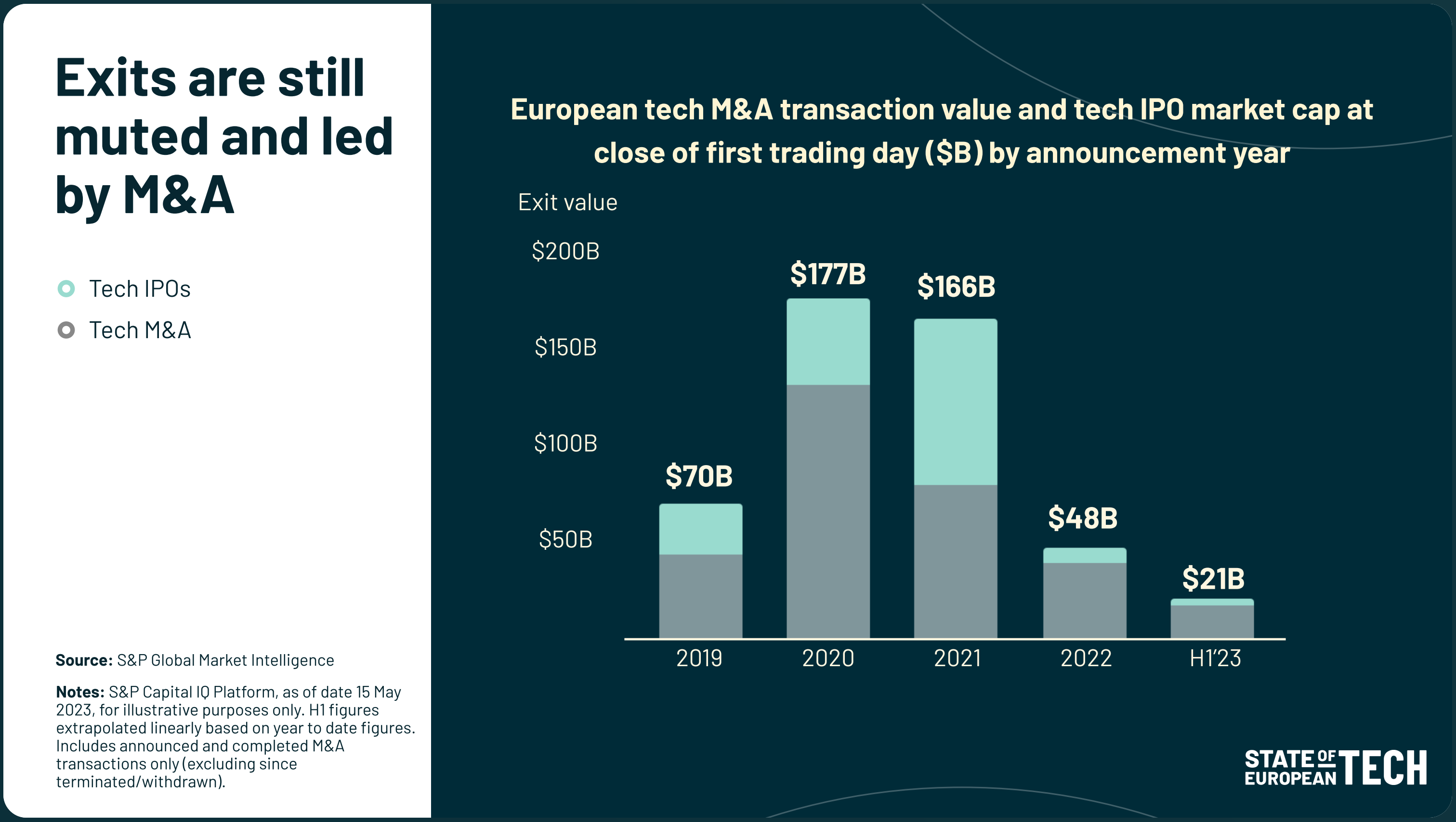
Exits are still muted and led by M&A

Over the past rolling 5 years, European tech has delivered in excess of $500 billion in exit value across M&A and IPO activity. However, this year, like last year, remains stagnant. So far, we've seen $21 billion of exit value in '23, mostly via M&A. This includes some larger transactions, such as Transporeon, Reward Gateway and Instadeep. The decrease creates obvious liquidity challenges, placing stress on the 'flywheel' which powers the evolution of our ecosystem and the recycling of capital and talent.



Source: S&P Global Market Intelligence

Notes: S&P Capital IQ Platform, as of date 15 May 2023, for illustrative purposes only. H1 figures extrapolated linearly based on year to date figures. Includes announced and completed M&A transactions only (excluding since terminated/withdrawn).

2023 outlook

The more restrained funding environment won't go anywhere. We expect to see:

1. Challenging macro will persist, but the reset has created a healthier ecosystem as the industry is stripped back to first principles

2. More founders will return to market in H2 as runways narrow, sustaining investment volumes, but also more down rounds and consolidation

3. Exit market could re-open at the end of the year, with a potential IPO window in Q4. Strong pipeline of companies waiting in readiness

4. Quality of talent at both founder and operator level will continue to strengthen, as fewer, but higher quality new companies are created

5. AI supercycle to drive a golden age of innovation. European tech will have a key role, and the potential for huge value creation