

## A WORD FROM J.P. MORGAN

# Our views on venture

### Europe has avoided a recession this year, and there is cautious optimism for an economic soft landing.

Most macroeconomic indicators across Europe suggest activity levels that are modestly better than expected. But even though recessionary conditions have not developed, momentum has not necessarily been regained, leaving the preservation of a soft landing uncertain. The region has navigated several political developments and spells of market volatility. Regionally, the underperformance of Europe's largest economy—Germany—stands out as higher interest rates and shifting global trade flows have weighed on its manufacturing sector.

The easing cycle is underway, providing some optimism around the outlook. Following the European Central Bank's (ECB's) quarter-point cut to policy rates in June, and the Bank of England's (BOE's) cut of 25 basis points in August, the long-awaited easing cycle officially started in the US as well with a decisive cut of 50 basis points in September. Even though inflation could remain above target into next year, central banks in developed markets are dialing back the restrictiveness of monetary policy. Looking ahead, we expect both the ECB and BOE to end the year 25 basis points below current levels with policy rates of 3.50% and 4.75%, respectively. We think the US Federal Reserve could move at an orderly but also brisk pace to bring rates to a neutral, nonrestrictive stance. We will watch for another 75 basis points of cuts before year-end and a Federal Funds target rate around 3% by mid-2025.

In addition to putting less restraint on the demand side of the economy, sustained lower interest rates should benefit company valuations, with high-growth profiles receiving the most lift. There is some early evidence of this playing out across the US and Europe's public equity markets, with smaller caps outperforming large caps by over 550 basis points since July. Given expected lag between public and private markets of nine months to 12 months, lower interest rates could filter through the venture capital ecosystem over the course of 2025.

### There are signs of recovery across Europe's venture ecosystem, while some challenges linger.

Across early-stage startups, deal activity has been stable to improving, and there is less pressure on valuations. While hype around the AI sector has been less pronounced



#### Ginger Chambless

Head of Research, Commercial Banking

*Ginger Chambless is a Managing Director and Head of Research for JPMorgan Chase Commercial Banking. In this role, she produces curated thought leadership content for commercial banking clients and internal teams. Her content focuses on economic and market insights, industry trends, and the capital markets.*

Additional contributors:

#### Rosh Wijayarathna

Co-Head of EMEA Innovation Economy

#### Manuel Costescu

Co-Head of EMEA Innovation Economy

in Europe than in the US, it has been an important theme, and we have seen a number of regional winners emerge across Europe.

Valuation overhangs generally remain a headwind for later-stage companies that previously raised rounds in 2021-2022. Where deals are successful, there is a clear focus on product, ability to prove scalability, and the creation of intellectual property. With those attributes, raising outside capital becomes an easier lift, but founders must also think strategically about which investors or partners are the best fit over the long run. This decision is often based on the founder's strategy, such as preparing to go to market or preparing to build the technology further.

Some situations have been complicated by having multiple investors with varying portfolio mixes and board seat involvement.

### Despite some public market turbulence, private capital markets have been resilient.

It has been an eventful year, with an evolving economic outlook and elevated geopolitical tensions. Public markets have experienced a few bouts of volatility driven by technical market factors and investor positioning, like the yen carry trade, more so than fundamentals. Despite some noise, global private capital markets activity has been robust, with volumes up roughly 30% YTD compared with the same period in 2023.

According to Udit Mohta, executive director in J.P. Morgan's EMEA Private Capital Markets group, Europe has seen an increasing number of growth companies evaluating primary and secondary transactions, with many others starting preparation for a 2025 capital raise. Within technology, sectors such as software, consumer, and fintech have been increasingly active. While there is the usual focus on primary activity in high-growth companies, secondary transactions that provide liquidity to early investors and monetization to financial sponsors for more mature businesses have become more prominent with the quiet IPO market. Beyond tech, valuation expectations continue to normalize in sectors such as healthcare and energy transition.

It is important for founders to fully appreciate the tradeoffs between valuation and structure when raising late-stage capital. In the current market, investors remain highly selective, and we are seeing increased levels of both down and structured rounds as investors seek stronger protections and returns in exchange for their participation. One example is that transactions with a liquidation preference multiplier greater than 1x have reached a multiyear high. Liquidation preferences determine the payout order and amount investors receive in a liquidation event, such as an exit, sale, or bankruptcy. In the case where preferred shares do not convert to common shares upon exit, the liquidation preference multiplier stipulates how much the fund's initial investment will pay out ahead of common shareholders, such as founders or employees.

A 1x liquidation preference is considered typical in venture. In the case of a 1x liquidation preference, a fund is entitled to the amount equal to its initial investment before the remaining exit value is distributed to common shareholders. Liquidation preferences greater than 1x entitle investors to a multiple of their initial investment, ahead of common shareholders.

**Further recovery in US IPO markets in 2025 may set the tone for global venture-backed capital markets activity.**

According to Matt Gehl, head of EMEA technology investment banking, many European tech startups view the

US market as strategic, and if an IPO is a realistic exit path, they will seek to list in the US. Driving this dynamic is the significant depth of US capital markets, including a broad investor base that international companies can benefit from. Greater liquidity often leads to lower trading costs and better valuations.

However, founders should appreciate that it is not as simple as cultivating a business presence in the US. Startups will be well served to distinguish themselves from a size and growth perspective, as well as demonstrate a differentiated business model to attract focus and support from US investors. From a scale perspective, Gehl adds that European companies listing in the US may need to have at least a valuation of \$5 billion to \$10 billion to start the process, at least in the early stages of this next IPO cycle.

The timing of an IPO, regardless of listing domicile, is also key. That is why preparing well in advance of a market window will improve opportunities for success. Along these lines, there has been elevated dialogue around the composition of cap tables. This includes evaluating potential opportunities to provide capital to early investors through a pre-IPO round. This can help alleviate some of the timing pressure on an IPO while also bringing in new investors for the pre-IPO round who can also then invest in the IPO.

With regards to trends in M&A in the startup ecosystem, overall activity levels remain subdued but are ramping. While strategics have been sidelined due to a disconnect on buyer-versus-seller value expectation, we are starting to see a ramp in strategic interest in many transactions. Private equity M&A activity remains elevated and is expected to remain so going forward. Some corporates are doing larger deeptech rounds, an indication that they might look to acquire those companies down the road. Surrounding early-stage transactions, there is increased dialogue about mergers, which can increase scale and improve attractiveness to potential buyers and/or provide a faster path to an M&A exit.