# Insights from Pieter Himpe

## Mastering Growth and Profitability to Achieve Premium Valuations in Today's Market

Pieter is the Managing Director EMEA Internet Investment banking at JPMorgan. Pieter runs the JPMorgan franchise in EMEA focused on IPO's, mergers & acquisitions, private capital raises and debt financing across ecommerce, marketplaces, food delivery, online travel, SaaS and range of other Tech verticals.

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# A positive momentum for equity markets

Equity markets are up 40% since January 2023. The "Magnificent Seven", the seven largest US technology companies, are up 130%, give or take. Positive developments are good news for equities, private fundraising and debt: as markets improve, growth trickles down to IPOs and private fundraising. Valuations are lower than they were in 2020/21, but deals are being done. Software companies that have a lot of predictability and a good combination of growth and profitability are doing well. Because that balance is important to investors and that is what they like to focus on.

**A snapshot of today's market and the factors shaping the macro environment**

- **Interest rates** are still high at around 4.25% in Europe and around 5.25% in the US, but are expected to come down.
- At 2.5%, **inflation** in Europe is much lower than a year ago, which in turn should have a positive impact on interest rates.
- **Growth** is good and the chance of a meaningful recession is lowering. Consumers are more positive, so growth is improving.
- **Geopolitics** remains challenging and the situations in Ukraine and Israel continue to be on investors' minds.

**"Companies must show a path to sustainable profitability."**

## 1.

### GROWTH VS. PROFIT – WHAT TO OPTIMIZE FOR

The rule of 40 generally still applies. Growth is still the main driver of valuation although increasingly investors are looking for profitability. Especially for US Tech IPO's, we've seen investors looking for 20–25%+ growth with proven profitability. In 2020/21, 1% growth was equivalent to 10% margin. Investing in margin made no sense, it was all growth, growth, growth. Today, 1% of growth is like 1.5% of margin, which means that ideally, if you can choose between 1% of growth or 1% of margin, you should choose growth.

## 2.

### SMALLER COMPANIES NEED TO AIM FOR (MORE) GROWTH

For smaller companies, however, bigger and higher growth is more important. You need to grow to build scale and, especially if you are private, investors expect you to capture the market. A company with a 100% growth rate that's still burning a lot of cash can be OK if it can prove that the growth is sustainable and profitable long term.

## 3.

### DO COMPANIES NEED TO BE PROFITABLE TO RAISE MONEY?

Absolutely not. But companies must show a path to sustainable profitability. Software companies are often not profitable yet, but they have strong metrics that show they are investing in sales, marketing and R&D to get to profitability. That is what really matters.

## 4.

### VALUATIONS US VS. EUROPE

Within the tech sector for large companies the average PE multiple is around 25. In Europe everything rotates around 15 times, so there's a valuation gap versus what you see in the US vs. Europe given US is more skewed towards big Tech companies which are driving the high PE multiple.

Networking in a private setting: CEO Drinks Reception at the NOAH Conference in London with our speaker Pieter Himpe

## 5.

### STRUCTURE TO BRIDGE THE VALUATION GAP

There is more structure coming into private deals to bridge a still persistent valuation gap. However if you structure too onerously with high eg 2–3x liquidation preference and purely optimise for valuation you could get hamstrung to be able to do an up-round during the next fundraise. You can optimize and structure for the price you want to achieve but this could hamstring yourself for a for a future raise.

## 6.

### PRIVATE FUNDING ROUNDS IN 2023

In 2023, a lot of companies were not externally valued and venture rounds were done internally. A lot of the fundraising activity was under the radar to keep valuations private because many of these rounds were done to save the company. Raising external funding was difficult, so the alternative was to do an internal round where you pivot to profitability and plan to raise when the markets come back. In the private markets so far, $20 billion have been raised in Europe in the first five months of the year, that's more than the first half of last year.

## 7.

### THE SENTIMENT IN FRANCE, GERMANY AND THE UK

France is doing very well because they have a huge focus on French Tech and a lot of companies in FinTech, software, deep tech, so it's a good pipeline of strong companies and a founder ecosystem. The same goes for Germany, with a wide range of different companies. The UK also has strengths in particular in FinTech with neobanks like Monzo, Revolut, Starling and some deep tech like Wayve and other fast growing AI companies. But continental Europe has made a big leap in terms of startup activity vs 10 years ago.

## 8.

### METRICS OF CLEAN TECH COMPANIES

Clean tech and/or AI companies often require huge upfront investments in physical infrastructure, which we haven't seen in more traditional software, fintech or consumer internet companies, making it trickier for VCs as they have to invest larger amounts upfront. A lot of money is flowing into impact investments in green technology, Northvolt for example. However, there are not that many companies at that scale. So, in terms of metrics it's more technology driven vs more generic KPI's we see in other segments. Investors do look at traditional metrics like revenue, order book or other ways to substantiate future cashflows.

## 9.

### THE ROLE OF PUBLIC FUNDING

Several European governments have put up substantial funds to support R&D in technology. Receiving these funds can be helpful for companies and give a positive bias towards investors. However, they are generally smaller in size and will not replace funding from the private sector.

**"In the private markets $20 billion have been raised in Europe in the first five months of this year."**

## 10.

### FROM PUBLIC TO PRIVATE

There is a trend of Public-to-Private where public companies are being taken private again after having originally listed often time driven by low valuations, low liquidity or private equity looking to deploy capital whereby the valuation gap is easier to bridge given the ability to price it based on a certain premium vs the existing share price. That trend is likely going to continue although increasing valuations are resulting in lower level of dislocation in the market vs eg 1–2 years ago.

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**Dwight Cribb
Personalberatung GmbH**

Dornbusch 2
20095 Hamburg

Tel. +49 (0) 40 34 96 06 0

info@cribb.de

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