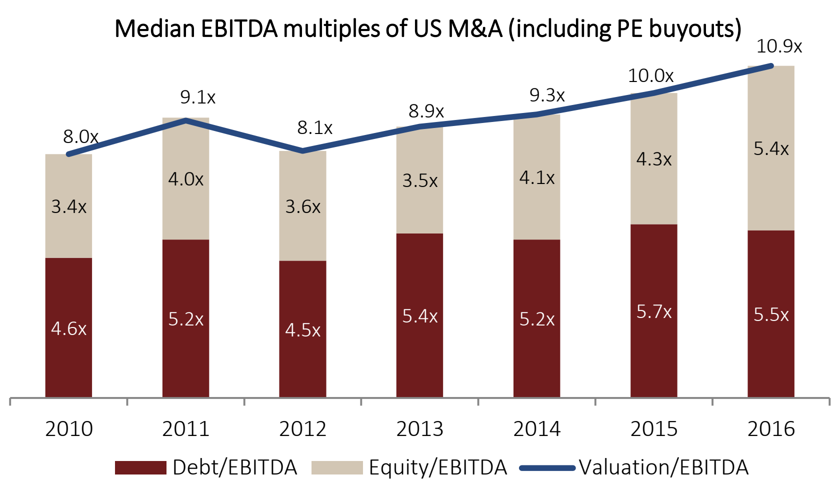
ABBOTT CAPITAL

First Half of 2017 - Review & Outlook

The positive market sentiment witnessed after the November U.S. election largely carried over into the first half of 2017. Across the developed markets, leading economic indicators such as GDP growth, inflation, unemployment, perceived volatility, and consumer sentiment remained fairly stable, while global corporate earnings continued their upward trajectory. Markets across the globe also exhibited attractive growth during the past six months, with bellwether indices such as the S&P 500 and MSCI World appreciating 8.2% and 9.6%, respectively. In all, these factors led to another active six-month period for private equity investors, particularly with regard to fundraising and exits.

Limited partner demand for private equity funds across all strategies remained strong during the first half of 2017 as institutional investors continued to view private market investing as a segment capable of generating outsized returns relative to other asset classes. According to Pitchbook, 204 private equity funds globally raised $181.3 billion during the first half of the year, compared with 218 funds that raised $162.7 billion during the first half of 2016, itself a strong year for fundraising. Given a favorable capital raising environment, fund sizes and length of fundraise continue to diverge; firms that have historically generated strong returns routinely hit their hard caps in relatively short order, with many using expedited one-and-done closes. This was particularly evident during the past six months when at least four firms, all of which were oversubscribed, each raised funds in excess of $10 billion, in total commitments. Abbott, on behalf of its clients, has committed $455 million to 11 primary funds year-to-date in 2017. It is worth noting that while these funds all have, or are anticipated to reach their hard caps, Abbott was able to receive its desired commitment to nearly every opportunity. The pipeline for new commitments going forward is robust as we are currently conducting due diligence on a number of opportunities. As a result, Abbott expects commitment activity during the second half of the year to be similar to that of the past six months. The bar for a commitment remains high, and despite frothiness in the global fundraising market, Abbott expects to commit a similar amount to the average capital committed over the past few years.



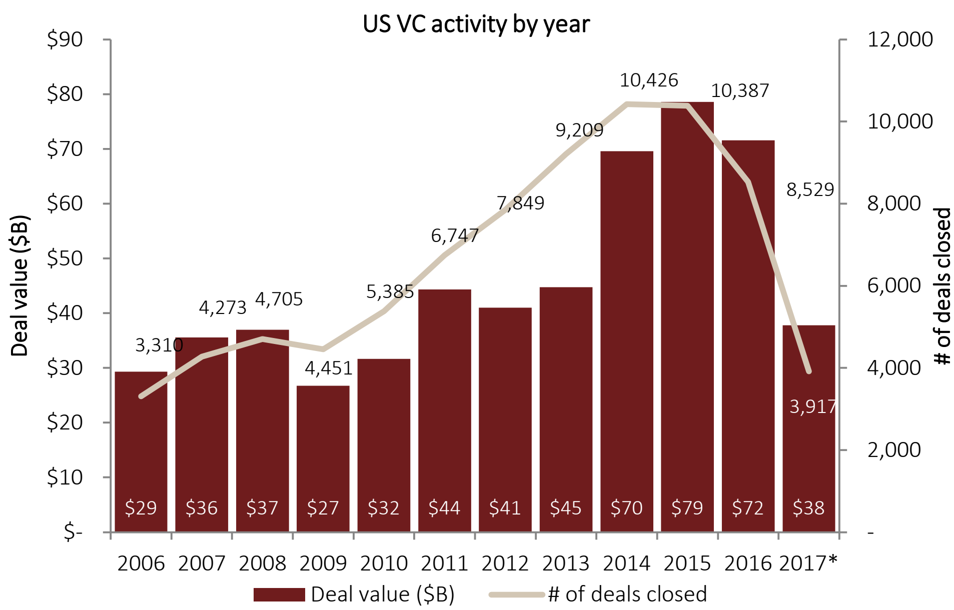
Source: Pitchbook.

Like fundraising, private equity-led transaction activity was strong during the first half of 2017. Practitioners continue to believe the market is geared more towards selling given persistently high market multiples, which for many industries remain well in excess of 10x LTM EBITDA, and readily available, borrower-friendly credit. As such, Abbott continued to witness a disproportionate number of exits relative to new investments during the first half of the year, a dynamic frequently referenced in recent quarterly market reviews. Confirmatory market data was not yet available as of the time of this review; however, Abbott clients' collective cash flow information serves as a useful proxy and provides some level of validation. Through June 30th, Abbott clients' collective distributions were over 60% greater than their cumulative capital calls during the same time period. This trend of aggregate Abbott client distributions exceeding aggregate capital calls has persisted since 2012. It is also worth noting the circular effect increased distributions have on private equity fundraising. Meaningful private equity distributions and resulting declines in net asset values have caused some institutional investors to become underweight in private equity. To remedy this interim development, many investors have re-deployed these distributions back into the asset class, a major reason for the robust demand for new primary private equity fund issuances discussed above.

The converse of the perception of a seller's market is the relatively challenging environment private equity managers face with regard to executing new investments. Anecdotally, sponsors employing buyout and/or special situation strategies focused on value investing have increasingly seen their investment paces slow, whereas growth-oriented firms have deployed capital at more consistent paces. Another trend in the market has been larger funds dropping down and acquiring lower and middle-market businesses given sized-based pricing discrepancies. These firms then seek to increase scale and capital deployed over time through add-on acquisitions to their initial platform company. As a result, consolidations of fragmented industries – multi-site healthcare practice management companies, in particular – have seen significant interest by private equity firms. In contrast, more cyclical, industrial companies and plain vanilla traditional leveraged buyout opportunities are less in favor today. Moreover, increased competition from long-term focused institutional investors has added further complexity to transacting. Many non-traditional private equity investors, including family offices, sovereign wealth funds, insurance companies and public pensions, have increasingly made direct company investments. Many of these investors underwrite to lower returns over longer or indefinite hold periods, thus making private equity bids less competitive.

Regarding venture capital and growth equity, fundraising also remained strong after a record amount raised in 2016. According to the NVCA, 119 venture capital funds raised $19.1 billion during the first six months of 2017, which when annualized would be slightly below the record $41 billion raised during the full-year 2016. A phenomenon that has persisted into 2017 is the desire and ability of early stage-focused venture capitalists to also raise opportunity/overage funds to target investments in later stages of their existing portfolio companies. The trend of venture-backed companies staying private longer has been well-discussed over the past few years, and these pools of capital give venture capitalists more ammunition to invest across a company's lifecycle.

Dollars invested by venture capitalists also appear to be stabilizing after peaking in 2015. Through the first six months of the year, venture capitalists invested $37.8 billion into 3,876 companies, which puts the industry on a pace to match or slightly exceed the amount of capital invested in 2016. Illustrating the aforementioned point about opportunity funds and companies staying private longer, over 20% of total dollars invested went into the 10 largest later-stage deals during the past six months. Moreover, 12 new venture-backed companies in the U.S. raised capital at valuations of $1 billion or more. From a sector perspective, software/SaaS continued to comprise the largest amount of venture dollars invested, while biotech/pharmaceuticals, IT services and digital health also exhibited meaningful inflows.



Source: Pitchbook. *As of June 30, 2017.

Lastly, the IPO market is a key barometer of the health of the U.S. venture market. Year-to-date, 27 venture-backed companies have publicly listed in the United States, which includes a modest eight during the first quarter and 19 during the second quarter. Of note, five of these offerings were "unicorns," or companies that had previously raised private capital at enterprise values in excess of $1 billion. Interestingly, however, in the second quarter two such companies, Cloudera and Blue Apron, went public at valuations less than their last round of financing. Similarly, the post-IPO trading performance of some high-profile, venture-backed companies softened during the second quarter, which has created uncertainty as to whether some of the notable current "unicorns" such as Airbnb, Uber, Palantir, and SpaceX will seek to go public. At the same time, the M&A market for venture-backed companies softened only modestly during the first half of the year, with 348 exits with a total value of $25.1 billion. Numerous large, publicly-traded technology companies continue to have significant sums of cash on their balance sheets. This cash, along with relatively high share prices, could serve as acquisition currency for venture-backed companies during the balance of the year.

Summary & Outlook

The first half of 2017 was largely a continuation of the market forces witnessed during the fourth quarter of 2016. However, despite what was mostly a strong time period for investors, increased uncertainty with regard to various political and economic factors across the globe led to an increase in perceived market volatility towards the tail end of the second quarter. Many of these concerns, among them easing of accommodative monetary policies in the U.S. and potential easing in Europe, "Brexit," and potential healthcare and tax reform in the U.S., could meaningfully affect the public and private equity markets during the second half of the year. It is worth noting, that increased volatility within the financial markets is not necessarily an impediment to private equity activity. Increased volatility could lead to interesting new investment opportunities for many practitioners, while also expediting sales processes as managers seek to monetize investments in advance of any potential market downturn.

Given the interesting and somewhat uncertain current environment, it is worth re-iterating Abbott's core investment strategy. Abbott does not seek to time the markets, and instead employs a bottom-up approach that seeks to build diversified venture capital, growth equity and private equity portfolios managed by cycle-tested, high-quality general partners across multiple vintage years.

END NOTES

The views expressed are Abbott's as of 6/30/2017 and are in part based on market themes noted by Abbott while researching potential investments for clients.

The information and charts presented in this document were generally sourced from the following materials:

- Yahoo! Finance.
- Pitchbook, "A Look at Global PE Activity in 2Q 2017."
- Pitchbook, 2016 Annual U.S. PE Breakdown. "Pricing Pressures Take Toll."
- National Venture Capital Association/Pitchbook. July 11, 2017 press release, "Venture Activity Holds Steady with Over $21.78 Billion Invested in Close to 2,000 Companies in Second Quarter."
- Cision PR Newswire with data provided by PwC US and CB Insights. July 12, 2017.

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