Abbott Capital Management, LLC

First Quarter 2020 Private Equity Market Overview

ABBOTT CAPITAL

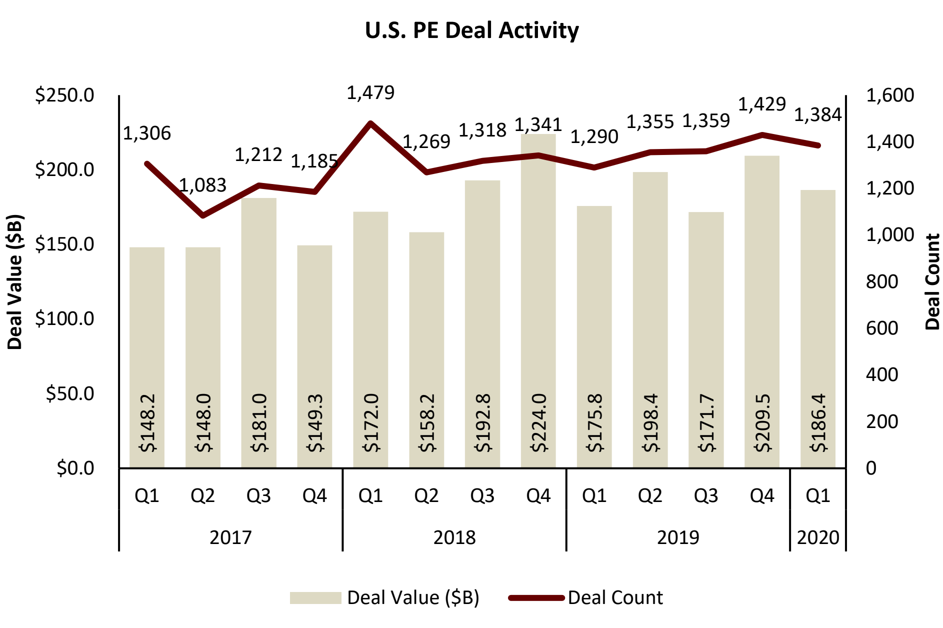
Macroeconomic Commentary

After a relatively smooth first two months of 2020, the global economy and financial markets changed markedly due to the rapid global spread of the novel coronavirus (COVID-19). Daily life was upended for much of the world, as shelter-in-place orders and business closings became the norm across the globe. Subsequently, the April unemployment rate has spiked to nearly 15% in the U.S., while unprecedented fiscal and monetary policy responses have been enacted[1]. The short-term impact of these actions has helped stabilize the equity and credit markets, at least in the U.S., although economic data in Q2 will likely paint a bleak picture and potentially indicate a recession.

The venture capital and private equity markets were also impacted by the novel coronavirus in Q1 2020. Fundraising statistics across the industry were respectable during Q1, although many of those capital raising processes commenced in late 2019 or early 2020 and thus were less impacted by the spread of the virus. Similarly, the first two months of the year were basically a continuation of 2019 with respect to transaction activity. As the quarter wore on, new investments and divestments slowed meaningfully as practitioners focused more on managing their existing portfolios rather than executing new investments in such volatile and uncertain times.

U.S. Private Equity

U.S. fundraising activity remained consistent in terms of capital raised year-over-year; $45.2 billion was raised by 46 funds in Q1 2020, compared with $45.6 billion raised by 29 funds during the same period last year. However, it is expected that 1H fundraising levels will fall meaningfully year-over-year. Private equity firms that commenced fundraising pre-COVID-19 have largely remained on track and successfully closed new partnerships, particularly those with established brand names and strong historical track records. However, others that previously planned to raise capital in 2020 have begun to postpone the timing of their fundraises, and in some cases delay them entirely until 2021. Abbott projects fundraising to be more subdued throughout the balance of the year, or at least until managers have more clarity on the economy. In the meantime, many limited partners are focusing on funding outstanding capital call obligations and managing current asset class allocations.



Data sourced from Pitchbook Q1 2020 US PE Breakdown. Chart includes estimated deal flow.

New investment activity in the U.S. was strong during the first two months of 2020 but declined sharply by the end of March. The U.S. saw 1,384 transactions representing $186.4 billion in deal value during the quarter, or year-over-year increases of 7% and 6%, respectively. However, due to the novel coronavirus, new deal activity in the coming months is expected to slow to levels not seen since the global financial crisis as private equity firms shift their attention to managing their existing portfolios. In addition, uncertainly regarding the economic outlook has also given creditors pause with respect to lending, another potential impediment to private equity-backed investments. Anecdotally, the spread between buyer and seller expectations remains wide at this point. In the coming quarters deal types may shift to more opportunistic transactions, including distressed buyouts, private investments in public equity ("PIPEs"), minority investments, corporate carve-outs, and add-on acquisitions.

[1] Source: U.S. Bureau of Labor Statistics.

Similar to the trend observed during 2019, private equity-backed exits in the U.S. remained down pre-COVID-19. In the first quarter of 2020, U.S. exits totaled $61 billion across 265 transactions with the number of exits flat and the value down 37% year-over-year. Exit activity is expected to diminish significantly as private equity firms hold investments rather than sell at reduced market multiples. Larger deals dependent on the syndicated bank market or reliant on exits via the public markets are expected to be more limited relative to smaller deals financed by the private credit market.

European Private Equity

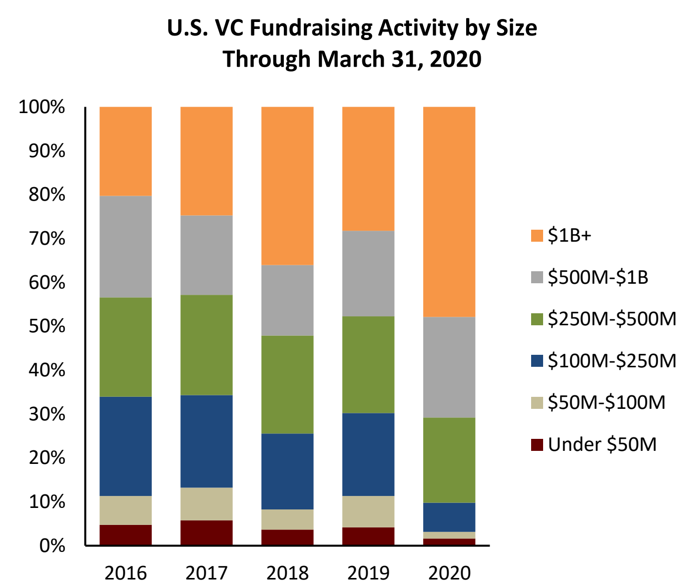
European PE fundraising declined significantly in Q1 2020 with €10.9 billion raised across 20 vehicles. Travel restrictions related to COVID-19 made it difficult for LPs to perform onsite due diligence from late February onwards, as the social response to the virus took hold earlier in Europe than in the U.S. However, Abbott expects fundraising activity to tick upwards during the remainder of the year as several larger European managers such as CVC, Ardian, and EQT Partners hold closes on their current offerings.

European private equity deal activity spiked in Q1 as a result of a significant number of deals negotiated in a pre COVID-19 environment. One thousand twenty-five deals with total deal value of €132.9 billion closed during the quarter, representing year-over-year increases of 6% and 40% in deal number and total value, respectively. Subsequent to Q1, however, deal activity declined sharply given lockdowns across Europe. Also, the broader European economic situation is tenuous at best, with the Eurozone's two largest economies, France and Germany, already officially in a recession.

Lastly, private equity exit activity in Europe continued its declining trajectory in Q1 2020, totaling €35.7 billion across 210 liquidity events, representing year-over-year declines of 17% and 22%, respectively. Similar to the levels of new investments that closed, many of the exits in Q1 were from deals that were negotiated prior to the full outbreak of COVID-19 in Europe. Sale processes that were started in Q1 were by and large postponed until later in the year or when there is more clarity with respect to the true impact of the crisis.

Venture Capital and Growth Equity

Many of the trends noted in past market reviews held true during the first quarter of 2020, as momentum established in the venture capital and growth equity markets before the coronavirus pandemic largely continued. Although this segment of the private equity ecosystem appears to have been less affected to date, Abbott expects overall activity to decline as the full effects of the pandemic are more known.



Data sourced from Q1 2020 Pitchbook-NVCA Venture Monitor.

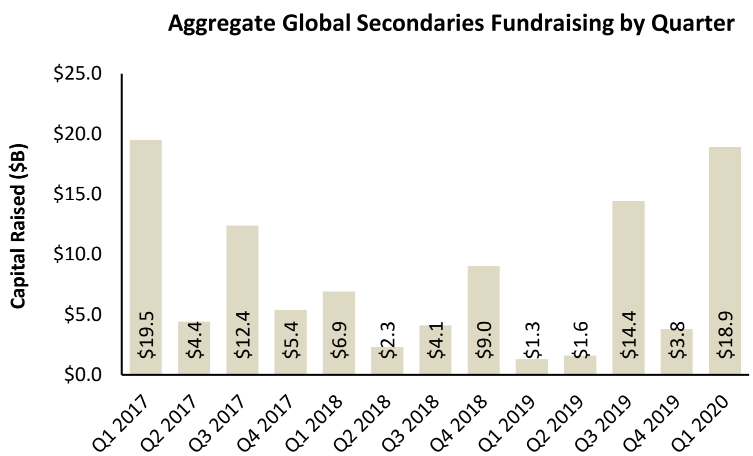
Fundraising remained robust in Q1 2020 and is on pace to again surpass $50 billion. Overall, $21 billion was raised across 62 funds, far exceeding the $9.6 billion raised across 37 funds during the same time period last year. The increase in amount raised can be attributed to several mega-funds ($1 billion or more in size) that were raised during the quarter. These funds represented approximately 50% of total capital raised during the quarter, which if annualized, would be the highest percentage on record. Conversely, first-time fundraising had a more challenging start to the year. Abbott expects first-time fundraising to remain depressed due to COVID-19.

At the same time, venture capitalists invested $34.2 billion in Q1 2020, which puts the year on an early pace to match the last two years' record levels in terms of deal value. Valuations across all stages of deals remained elevated and 49 late-stage mega-deals ($100 million+) closed in 2020 through Q1. While large rounds continued to dominate and increase aggregate deal volume, deal count declined 27% in Q1 2020 with 2,298 closed versus 3,612 in Q1 2019. Before COVID-19 hit, round sizes and valuations were getting larger and more expensive. While valuations have not shifted much yet, early indications from the NVCA suggest that aggregate deal volume and valuations for companies seeking capital are likely to be affected in the coming quarters.

Coming off an outlier year for exits, 2020 started off at a slower pace. Exit conditions largely remained favorable in Q1 2020, which saw total exit volume at $19.3 billion across 183 transactions. In contrast to the last couple of years, acquisitions, not IPOs, made up the majority of capital exited during the quarter. This was largely driven by Visa's $5.3 billion acquisition of Plaid and Google's $2.6 billion acquisition of Looker. The slowdown in public listings observed in Q4 2019 continued in 2020 and was further hampered by the volatility in the public markets due to the ongoing COVID-19 crisis. Ten venture-backed IPOs raised $5.6 billion in Q1 2020, compared with 14 that raised $26.1 billion during the same period last year. Public market volatility and the current economic climate is expected to put a damper on VC-backed exits through the short- to medium-term.

Secondaries

The turbulent times that began in March 2020 also had a significant impact on the secondaries market. Statistics from Preqin show a strong first quarter in terms of fundraising, with approximately $19 billion of capital closed by secondaries funds. However, this number is skewed by a single mega fund that closed on $14.4 billion in early January 2020. Since the beginning of March, only two funds were able to hold final closes as investors have been focused more on portfolio management and less on new commitments. Abbott expects fundraising for secondaries to remain muted in the near-term, with activity likely to pick up in the second half of 2020 as investors will seek to partner with firms that have strong GP relationships and are well-positioned to take advantage of attractive entry conditions.



Data sourced from Preqin, May 2020.

Following a strong 2019, the secondaries market appeared promising in early 2020 until the start of the COVID-19 crisis in late February. According to Lazard, the market for secondary LP interests saw a steep decline in the weeks that followed the outbreak of the pandemic as buyers were predominantly focused on managing their portfolios and less focused on evaluating new deals. At the same time, headline discounts widened since transactions were priced based on high Q3 or Q4 2019 valuation marks. Lazard expects that volumes may continue to be depressed until Q1 or even Q2 2020 valuations have been published and buyers have more visibility regarding the long-term impact of COVID-19 on the respective portfolios. Deal volume is expected to rebound during the second half of the year as more supply should come to market, driven by denominator effect concerns coupled with a slowdown in distributions, as well as continuously strong demand from secondary funds that have significant dry powder and are looking to deploy through the cycle.

A recent trend relates to younger vintages being brought to market as sellers aim to reduce the amount of unfunded commitments in their portfolios. In some of these cases, strip sales offer a valuable alternative to a full sale since a seller can realize partial liquidity while maintaining the GP relationship. In addition to strip sales, buyers and sellers are exploring other alternative liquidity structures including preferred equity solutions, senior debt financing, and structured joint ventures. In contrast, GP-led deals that involve the sale of assets into a continuation SPV have been largely paused since the start of the pandemic. Many transactions that were launched prior to the outbreak were priced off of Q3 or Q4 2019 valuations, and for most of these deals a significant re-repricing has proven to be difficult. In general, buyers and sellers appear to be in a holding pattern until Q1 or Q2 2020 valuations become available and there is more visibility regarding the long-term outlook of the underlying businesses.

In terms of leverage, the recent events will likely lead to pressure on existing portfolios that secondary buyers acquired with significant transaction-based leverage. As *Secondaries Investor* pointed out back in September 2019, some secondaries funds employ fund-level leverage, additional transaction-based leverage, and operate with an LP credit facility. The result is a complex picture of five intertwined leverage levels when adding these three forms of secondary acquisition financing on top of the debt burden at the underlying company level and a PE manager's own capital call facility. While the magnitude of the impact is difficult to predict, the shakeout from the pandemic will likely expose differences between secondary funds that relied too heavily on financial engineering compared to those that are more focused on generating returns through capital appreciation from high-quality assets.

SOURCES CONSULTED

With respect to private equity information, information was sourced through: Pitchbook Q1 2019 US PE Breakdown; Pitchbook Q1 2020 US PE Breakdown; Pitchbook Q1 2019 European PE Breakdown; Pitchbook Q1 2020 European PE Breakdown.

With respect to venture capital information, information was sourced through: Q1 2019 Pitchbook-NVCA Venture Monitor; Q1 2020 Pitchbook-NVCA Venture Monitor.

With respect to secondary investment information, information was sourced through: Secondaries Investor, Secondaries: Avoiding the Hidden Risks (September 2019); Preqin; Elm Capital USA Limited, Private Markets Review (May 2020); Lazard, Impact of Covid-19 on the LP Secondary Market

The views expressed are Abbott's opinion as of May 2020 and are subject to change without notice.

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Coronavirus Outbreak Risks. The recent global outbreak of the 2019 novel coronavirus ("COVID-19"), together with resulting voluntary and U.S. federal and state and non-U.S. governmental actions, including, without limitation, mandatory business closures, public gathering limitations, restrictions on travel and quarantines, has meaningfully disrupted the global economy and markets. Although the long-term economic fallout of COVID-19 is difficult to predict, it has and is expected to continue to have ongoing material adverse effects across many, if not all, aspects of the regional, national and global economies. In particular, the COVID-19 outbreak has already, and will continue to, adversely affect many private equity investments and many of the industries in which private equity managers operate. The ability to operate effectively, including the ability of personnel or service providers and other contractors to function, communicate and travel to the extent necessary to carry out investment strategies and objectives and business, has been, and will continue to be, impaired. Markets are experiencing very high levels of volatility and generally stressed conditions. Businesses across the United States and the world, and across most sectors, are experiencing significant challenges to their revenues and business, which could make it difficult for businesses to continue as a going concern. Unemployment is likely to rise significantly and reduced revenues may reduce profits or lead to losses. Many governments--federal, state, local, and non-United States--have imposed limitations on businesses and intervened in markets in an effort to ensure they continue to function. It is unclear how long these conditions will continue and, the longer these conditions continue, the risk of a long term adverse effect increases. The extent of COVID-19's impact will depend on many factors, including the ultimate duration and scope of the public health emergency and the restrictive countermeasures being undertaken, as well as the effectiveness of other governmental, legislative and financial and monetary policy interventions designed to mitigate the crisis and address its negative externalities, all of which are evolving rapidly and may have unpredictable results. Even if and as the spread of the COVID-19 virus itself is substantially contained and economies are able to "re-open", it will be difficult to assess what the longer-term impacts of an extended period of unprecedented economic dislocation and disruption will be on future macro-and micro- economic developments, the health of certain industries and businesses, and commercial and consumer behavior.