Macroeconomic Commentary

As the world carefully navigated the second year of the pandemic, optimism grew as vaccines became more widely available across much of the developed world, leading to what appeared to be a way out of the pandemic phase of the COVID-19 health crisis. However, that optimism quickly faded once the Omicron variant was identified in South Africa and began its rapid spread across the globe in late November. Subsequently, global case numbers have surged and then receded, ultimately leaving a record number of hospitalizations, staffing shortages, and supply chain issues in their wake. Inflation has also reached levels not seen since the early 1980s, increasing the likelihood of multiple interest rate increases in 2022. Together, these factors have led to a volatile start to 2022.

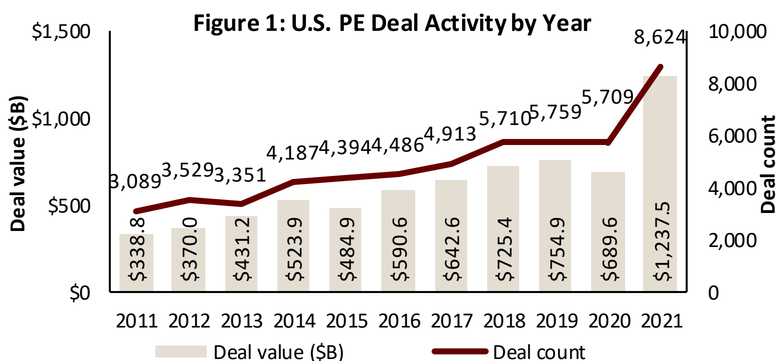
The public markets demonstrated strong appreciation in 2021. Despite some choppiness to close the year, the S&P 500 appreciated almost 27%, while the NASDAQ increased *only* 21% due to the previously noted fourth quarter declines. 2021 also marked the first year where the broader market index outperformed the technology-heavy index since 2016. This trend has continued through early 2022, with the NASDAQ now wavering in bear market territory as the increased likelihood of higher interest rates has disproportionately impacted valuations of high-growth companies. Continuing a trend of the recent past, other geographies' public market performance significantly underperformed the S&P 500 and NASDAQ, with the MSCI AC World Index (ex-U.S.) appreciating only 5.5%. Overall economic activity also rebounded from the pandemic-impacted lows of 2020, with global growth reaching 5.5% in 2021. Growth was led by China and the U.S. at 8.0% and 5.6%, respectively, with the Eurozone growing modestly lower at 5.2%. Private equity and venture capital activity was robust in 2021, with record-breaking levels of activity across nearly all industry metrics. Fundraising boomed industry-wide, as institutional investors continued to gravitate towards investments in alternative, higher potential returning assets. The past year also proved to be a record year for distributions as the IPO market was open for high-growth companies and private equity practitioners sought liquidity in what remained a relatively high valuation environment. While these conditions would appear to represent a more challenging environment for new investments, it did not stop venture capitalists and private equity general partners from investing significant amounts of capital over the year. As further discussed below, underlying strategies, sectors of focus, and value creation initiatives continued to evolve across the industry as practitioners adapted to the ever-changing environment.

The following sections provide a further breakdown of 2021 private equity, venture capital and growth equity, and secondary market activity, as well as a preview of what investors may experience in 2022.

U.S. Private Equity

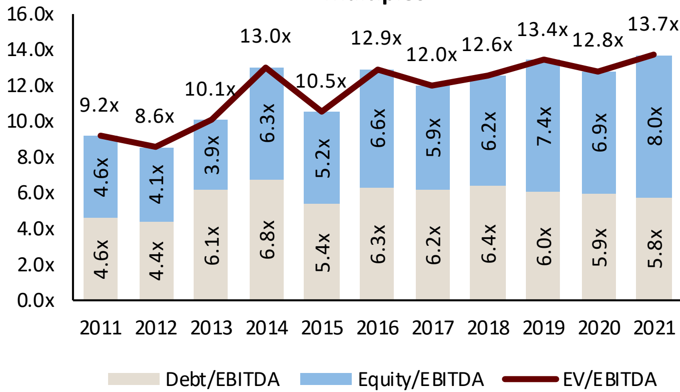
U.S. private equity fundraising remained strong in 2021, supplanting 2020 as the second largest fundraising year to date, and ending the year only slightly below the previous record high set in 2019. During 2021, 389 funds closed on $301 billion, which represented an approximate 11% year-over-year increase in capital raised. The demand for private equity remained robust given the attractive historical returns in the asset class, with many leading institutional investors increasing their target allocations to the space. It is notable that fundraising over the last two years occurred with nearly all diligence being conducted remotely. General and limited partners alike have successfully adapted to the current environment and future, post-pandemic diligence processes will likely be a hybrid of in-person and virtual.

U.S. private equity deal activity set a new record in 2021, with 8,624 investments totaling over $1.2 trillion in estimated deal value[1]. This represented an 80% increase over 2020 in terms of deal value, and a 60% increase over the prior record of $755 billion invested in 2019. Numerous factors contributed to this stark increase, including continued low interest rates and the availability of credit, more clarity regarding the impact of COVID-19 on a number of sectors, the threat of potential



[1] Estimated deal value is calculated by PitchBook for reference only and is subject to change.

tax rate changes in the U.S., and significant private equity dry powder available for investment. Notably, the rapid investment activity by many funds, especially those that are growth-oriented, has led to shorter investment periods, with many of these funds now operating on 18-to-24 month cycles. This dynamic has had a pronounced effect on fundraising as well, with groups seeking to raise capital after shorter and shorter intervals. A less discussed, potentially negative consequence of these shorter investment cycles is the lessening effect it may have on limited partner vintage year diversification.



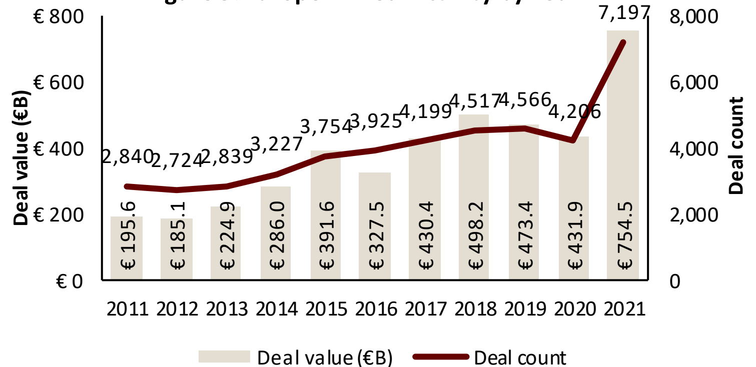
In terms of strategy, buy-and-build consolidation plays within fragmented industries, which enable sponsors to gain scale and reduce aggregate purchase prices through accretive acquisitions, remained a predominant industry-wide theme. Add-ons by private equity-backed companies themselves totaled over 70% of transactions in 2021. Regarding sectors, information technology, software in particular, and B2B services accounted for an increased share of transactions, while healthcare services remained a consistently strong core area for investment. Median private equity buyout multiples also increased year-over-year, from 12.8x to 13.7x EBITDA. The relatively high median pricing remained reflective of the types of investments that have been executed, with more durable business models and recurring revenue streams transacting during the COVID-19 environment.

Similarly, private equity-backed exit activity also set a record in 2021, with 1,731 companies exited for $854 billion, which more than doubled the prior record of $413 billion exited in 2018. The same trends discussed above contributed to this increase, with strategic and secondary buyouts, IPOs, partial recaps, and GP-led transactions (see secondary section below) providing general partners with ample liquidity options.

European Private Equity

European private equity fundraising activity in 2021 was essentially flat year-over-year, with €90 billion raised compared with €93 billion raised in 2020. At the same time, the number of funds that successfully raised capital declined meaningfully to their lowest level in nine years; private equity firms closed on 145 funds in 2021, a year-over-year decrease of 27% from 2020 when 199 funds were raised. This trend further illustrates the desire of many limited partners to build more concentrated portfolios across Europe. Consequently, this has also led to an increase in average private equity fund size. Over 40% of all capital raised in 2021 across Europe was committed to only *four* funds,

Fueled by continued strong credit markets, significant private equity dry powder, and fiscal stimuli by multiple European governments to combat the effects of the pandemic, investment activity across the continent had a robust year in 2021, setting new annual records by a substantial amount. During 2021, 7,197 deals closed with a total deal value of €755 billion, which represented year-over-year increases of 71% and 75%, respectively. Similar to their U.S. counterparts, European general partners focused on business models that have proved more resilient, managed to demonstrate continued growth, and sustained attractive margins throughout the pandemic. Accordingly, information technology, healthcare, and financial services investments reached deal value and volume peaks. However, somewhat surprising was that broader market pricing declined to a median of 12.6x TTM EBITDA in 2021, from 15.4x in 2020. This decline was driven by



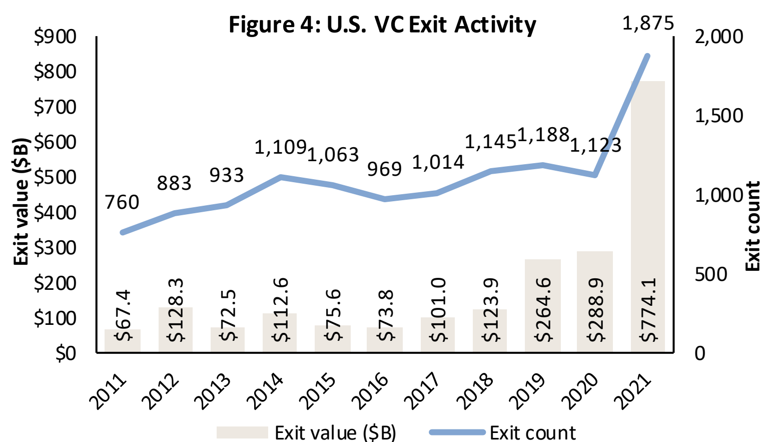
increased investment activity in traditionally lower priced, more cyclical sectors, like leisure, travel and energy, which saw limited investment activity in 2020.

Similar to investment activity, the reported number of European private equity-backed exits in 2021 reached record highs, supported by a strong IPO market, sponsor-to-sponsor exits and private equity-led recaps. Over the course of the year, there were 1,957 liquidity events reported in 2021 that totaled €445 billion in exit value, a year-over-year increase of 132%in value.

Venture Capital

"Record-breaking" pretty much sums up the year for the venture capital industry in 2021. Fundraising by U.S. venture capitalists surpassed $100 billion for the first time, with $128 billion raised by 730 funds across all stages in 2021. Capital raised by $1 billion-plus partnerships accounted for almost 40% of dollars raised, the highest share ever, furthering an ongoing trend of consolidation of limited partner capital around the most established brand name firms in Silicon Valley. Moreover, numerous traditional early stage firms also continued to also raise "Select" or "Overage" vehicles to predominantly invest in later rounds of their most promising assets. This capital, along with non-traditional players entering the space, led to significant increases investment activity and valuations.

U.S. venture capitalists invested an astounding $330 billion in 17,054 companies in 2021, almost doubling the $167 billion invested in 12,173 enterprises in 2020. Early stage investment, generally defined as series A and B rounds, accounted for $84 billion of that amount, or double the $42 billion invested in those rounds in 2020. Late stage investments totaled the vast majority of the difference, at $228 billion, which is also essentially double the amount invested in those rounds in 2020. Non-traditional investors, including hedge funds, private equity firms, sovereign wealth funds, family offices and corporate venture funds, remained substantial players in the market, particularly in late stage financings, having participated in 64% of venture investments by deal count. The increased participation by these investor types, and therefore competition for deals, was the primary reason for surging valuations in late stage rounds. The average pre-money, late stage valuation rose to $775 million in 2021, compared with $431 million in 2020, which itself was a record high over the last decade.



Exit value for venture-backed companies in 2021 was even more notable. Venture capitalists exited approximately $775 billion during the past year, $682 billion of which was attributed to 296 IPOs, representing a 168% year-over-year growth from the $289 billion exited in 2020. The past year was the strongest year for IPOs since 2000 and venture capitalists aimed to capitalize from increased public investor demand for higher growth assets. Unlike some prior years where large IPOs contributed greatly to exit value, exit sizes were relatively broad-based, with the majority of exits falling in the $50-$500 million deal size range. Comparatively, less than 20% of exits were $500 million or greater.

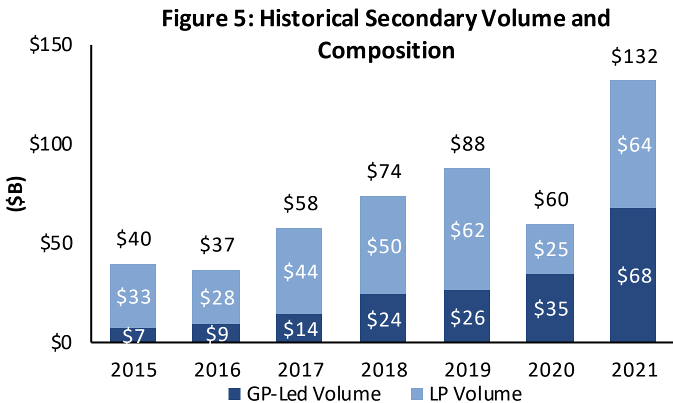
Abbott frequently notes that venture-backed IPOs do not necessarily lead to immediate liquidity for limited partners in venture capital funds. As discussed below, the recent share price declines of publicly-traded technology companies will likely impact the valuations for venture capital funds in early 2022.

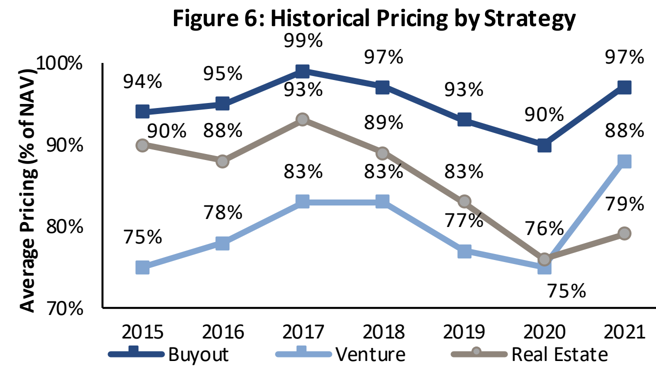
Secondaries

The secondary market volume in 2021 saw a strong bounce back after a softer 2020, when market activity was muted during the first year of the Covid-19 pandemic. During 2021, the secondary market surpassed $100 billion for the first time as both LP transactions and GP-led deals set record volume levels for the year. As per intermediary Jefferies, GP-led volume of $68 billion was slightly higher than LP volume of $64 billion for the year. The driver behind the strong market growth continues

to be GP-led activity with volumes growing 94% year-over-year in 2021. That growth coupled with LP volumes recovering to approximately pre-Covid levels led to a record-breaking $132 billion secondary market volume in 2021.

On the GP-led side, 2021 was characterized by a continued increase in single-asset continuation fund transactions. Jefferies reports that about 48% of all GP-led deals in 2021 were single-asset deals, whereas Lazard pegs this number at about 52%. At roughly half of the GP-led market, it is fair to say that 2021 saw $30+ billion in single-asset transaction volume, an astonishing number considering that the entire GP-led market volume was only about $7 billion just six years ago. For 2022, GP-led transactions including single asset-deals will likely continue to play an important role in the market. More and more GPs are planning to either engage in repeat transactions or are considering launching their first GP-led transaction and buyer appetite for these opportunities remains high.





The strong overall market volume was coupled with a rebound in pricing levels for LP portfolios. Venture and buyout funds saw sharp increases in average pricing to 88% and 97% of NAV, respectively. For venture funds, robust secondary pricing was driven by exceptionally high technology multiples and exits via IPO or SPAC mergers that boosted broad appetite for venture funds with mature assets. For buyout funds, pricing increased during 2021 as buyers continued to frequently pay premiums for attractive portfolios managed by high-quality GPs.

While average pricing data highlights broad market trends, it is important to keep in mind that individual pricing for LP positions tends to be very fund-specific and can vary greatly depending on the portfolio assets, GP-quality, and vintage year. For example, Jefferies reports that in 2021 about 27% of all funds priced at a premium whereas 15% of all funds priced below 70% of NAV. In general, buyers are paying higher prices for recent vintages with more perceived upside compared to older tail-end funds. Average buyout fund pricing in 2021 stood at 97% of NAV but when comparing buyout fund pricing by vintage year, Jefferies' data shows that pre-2010 buyout vintages priced at around 93% on average whereas more recent vintages (post 2015) priced on average at 101% of NAV.

2022 Outlook

After a banner 2021, market conditions have reversed course in early 2022, leading to an overall lack of clarity regarding the outlook for the coming year. Unlike last year, where nearly all focus was squarely on the market effects of COVID-19, investors will be forced to deal with a number of new variables in the coming year, most notably interest rate increases and the resulting impact on market multiples, the global reduction in monetary stimulus, inflationary outlook, ongoing geo-political conflicts, the and resolution of supply chain disruptions. Moreover, staffing and labor shortages, due to both COVID-19 infections and the well-publicized "Great Resignation," have forced numerous companies to adjust how they operate. The overall market outlook in the near-term is also cloudier as a result of these factors despite corporate earnings that have generally remained solid through mid-February and the relatively strong growth projected by most economic prognosticators. With that said, ongoing and unexpected geopolitical concerns regarding Russia and the Ukraine have also recently arisen. Any prolonged or escalated conflict will likely have a further negative impact on the global markets and economy, with commodity prices already rising sharply.

Despite some indicators that may portend softening demand, broad investor interest in alternatives will likely remain high in 2022. However, any decrease in demand will not be due to views regarding future return potential of the asset class. Instead, many larger, high-profile institutional investors find themselves dealing with the "high-class" problem of being at or above their target allocations to alternatives, including venture capital and private equity. In some ways, this problem speaks to the strength of the asset class, as the "overexposure" was largely derived from significant valuation appreciation over the recent past. Presently, asset allocations are also being skewed by public market declines in early 2022. The lagging nature of venture and private equity valuations further exacerbates this concern, and in the interim some limited partners may be forced to make difficult portfolio management considerations, that could include portfolio sales, reduced commitment sizes, or in the most draconian of scenarios, reduced new commitments. Further, as previously mentioned, a significant number of managers are scheduled to commence fundraising in 2022. As one high-profile buyout general partner told Abbott, "flat may be the new up" with respect to individual limited partner allocation sizes, thus some target fund sizes and caps may wind up being more aspirational than in years prior. While these considerations may cap total capital be raised in 2022, investors with capital to commit may find themselves able to access firms, on the primary side, that were previously unavailable to new investors.

With respect to the outlook for private equity, the pipeline of U.S. and European private equity funds currently or expected to raise capital in 2022 is robust, and the market volatility and potential limited partner overexposure has not *yet* exhibited an impact in fundraising activity. While the target fund sizes of many of these groups currently remain above their successor partnerships, it remains to be seen how successful they will be at reaching these targets as the year progresses. Thus far, early 2022 transaction activity has been more modest than in recent years, likely a result of robust activity during Q4 2021. General expectations call for continued elevated deal activity in 2022 given the significant amount of capital that has been raised by private equity firms over the preceding years. With the number of greater than $5 billion, "mega funds" raised in the recent past and continued evolution of the secondary market and GP-led transactions reducing the number of potential acquisition targets, the size of transactions will likely become more bifurcated. On one hand, many larger private equity firms will seek to acquire smaller companies than their fund size may suggest, and ultimately layer in more invested capital over time through accretive, M&A strategies. At the same time, some of the largest funds may seek to benefit from the decline in overall public stock prices, particularly in the technology sector, and seek to take larger companies private. Club deals, where multiple private equity firms partner on transactions, have also increased in popularity recently as these types of deals allows groups to deploy significant amounts of capital into larger companies. While this may be an efficient way to deploy capital for mega private equity funds, limited partners have not always benefitted from these types of arrangements as evidenced by mediocre returns from a number of club deals executed prior to the Global Financial Crisis.

Investors are also expected to have to contend with a rising interest rate environment in 2022, something not experienced by market participants in 16 years. As of this writing, the threat of higher interest rates does not appear to have affected private sector valuations, although it is likely too soon to tell. Nonetheless, even with three of four rate hikes, interest rates will likely remain relatively low in historical terms, and with approximately $1.3 trillion in dry powder available for investment as of September 2021, private market valuations will likely remain elevated regardless.

After a record-breaking 2021, the reversal in market conditions has been most pronounced in the venture capital and growth equity market. The looming threat of higher interest rates has resulted in a "risk-off" mentality within the public markets, which has negatively impacted public valuations for unprofitable, but rapidly growing technology assets. This change has effectively shut the IPO window for other comparable venture-backed companies, leaving the path to liquidity far less certain for many companies in the near-term. The ripple effects of this development have not necessarily been seen within the broader venture ecosystem yet, with fundraising still robust for both early and late stage funds. In terms of new investment activity, some anecdotal discussion has taken place regarding repricing of rounds. In what could be a new valuation environment, the leverage pendulum may swing to a more term-friendly environment for venture capitalists instead of entrepreneurs. However, with significant dry powder searching for deals, competition for the next great technology, be it web 3.0, metaverse, cleantech, robotics, AI or even new crypto- and blockchain-related ideas, will undoubtedly be fierce, and the most promising assets will continue to get funded.

Perhaps most relevant for 2022 is degree to which the change in public market pricing will effect valuations of existing later stage assets. For venture-backed companies that publicly listed in the recent past, the declines have likely already been felt. Approximately 50% of 2021 venture-backed IPOs were trading below their IPO prices as of December 2021. In addition, many privately-held, late stage assets raised large rounds at high valuations in 2021, and were planning for near-term public offerings at even higher valuations. Those plans are likely now on hold for the foreseeable future, while investors' shift their goals to cash preservation mode to ensure those companies aren't forced to raise capital in the near-term at significantly lower valuations.

With respect to the secondary market, after a year of rebounding volumes and recovering pricing levels, the secondary market is expected to continue its growth trend in the future. GP-led deals are likely to remain a key portion of the market as increasing numbers of general partners are expected to launch single or multi-asset processes in the near-term. At the same time, diversified LP portfolios are expected to continue to come to market as large institutional investors actively manage and rebalance their portfolios, some of which will be undoubtedly due to the overallocations discussed above. A market survey conducted by Lazard indicates that assuming current market trends continue, total secondary market volume could surpass $200 billion by 2025. With a growing supply of deals, secondary investors with strong networks and relationships in the private equity industry should be well positioned to identify attractive secondary transactions in 2022 and beyond.

Abbott will continue to monitor all of the various macro-economic, venture capital and private equity developments and looks forward to providing continued quarterly updates.

SOURCES CONSULTED

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IMPORTANT INFORMATION

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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.