OVERVIEW

The second quarter of 2023 opened with the twin Silicon Valley and Signature Bank failures in the rearview mirror, but First Republic held on until May before being acquired by J.P. Morgan. Less than a month later, the U.S. approached the precipice of default with gyrations over the federal debt ceiling. The U.S. Federal Reserve raised rates yet again in May, signaling (and then following through with) a pause in June as the quarter closed. The June headline inflation figure came in at 3.0%, while core inflation (which excludes food and energy) was 4.8%. Both of those numbers beat consensus estimates, with the CPI at its lowest level in two years.

In the United Kingdom, GDP growth remained tepid. While inflation stood well above the Bank of England's (BoE) target, core inflation did ease somewhat in June from the prior month's 31-year high. The BoE continued its tightening regime in the quarter (and again in August). In the Eurozone, headline inflation eased, and GDP grew 0.3% in the second quarter, led by France and Spain.

With this economic backdrop, the U.S. equity markets soared in the first half of 2023: both the NASDAQ and S&P closed at levels not seen in the prior 14 months -- before the Federal Reserve started raising rates in earnest. European (STOXX 600) and world (MSCI ex-U.S.) shares lagged their U.S. counterparts, advancing over 7% in the first half, while the FTSE was basically flat for the first half of the year.

In the U.S., much of the stock market performance was driven by the technology sector, and indeed the tech-heavy NASDAQ handily outpaced the broader S&P during the period. If markets and the media ended the first quarter captivated by bank failures, they ended the second quarter focused on the newest New Thing: artificial intelligence (AI), or more specifically generative-AI. Companies, and especially chipmakers, who stand to gain from an AI revolution saw their share prices surge, as exemplified by NVIDIA (NVDA), which nearly doubled in the first half.

[Full disclosure: Abbott asked ChatGPT to write this market overview, and while the resulting text was both readable and quickly produced, it lacked a certain…accuracy.]

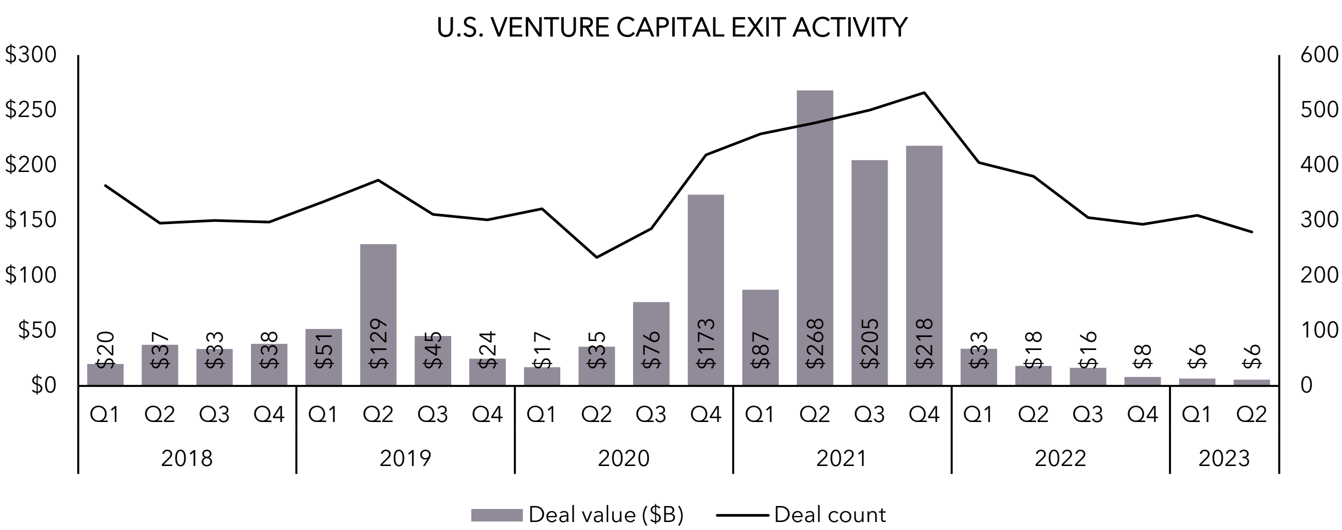
The private equity markets appear to have been in a bit of a holding pattern during the first half of the year. Fundraising activity was mixed, while new deal and exit activity remained depressed. A stabilizing inflationary and interest rate environment should, we believe, increase new-deal activity in the second half of 2023. This may positively impact exits for smaller and mid-market buyouts, as larger funds acquire companies from smaller funds. Exits (certainly public exits) at the top end of the market and for venture capital-backed companies will, in Abbott's opinion, likely remain muted through the end of the year.

VENTURE CAPITAL

U.S. venture capital funds raised $33.3 billion through Q2 2023, such that 2023 is tracking to be the lowest fundraising year since 2017. Following the fundraising frenzy of 2021 and 2022, venture capital funds are sitting on ample dry powder. Collectively, 2021 and 2022 vintage year funds have $214.9 billion of unfunded capital. This continues to be exacerbated by the recent softness in deployment. Year-to-date deployment hit $85.6 billion, representing approximately 31% of the total dry powder ($279.8 billion).

With $85.6 billion in venture deal value, H1 2023 was well behind the pace of the last two years but comparable to each of H1 2018-2020. With 8,195 deals in the first half (includes estimated deal count of 1,681), deal volume was also strong by historic standards. During Q2, data suggests that over 14% of completed transactions were down-rounds (i.e., at a lower valuation than the prior financing round), and it is likely that figure will increase throughout the remainder of 2023. J.P. Morgan estimated that 50% of Series A and B rounds in 1H 2023 were bridge rounds, providing insiders with the opportunity to hold valuations steady. While seed activity continued to decline by dollars invested and number of deals, pre-money valuations and median deal size both increased. Early-stage investment fell for the sixth consecutive quarter to an 11-quarter low in terms of dollars raised, while deal count was comparable to 2021. Late-stage investment is on track to reach a four-year annual low, as companies in this segment of the market have not needed immediate fundraising. Several late-stage companies raised large rounds in 2021 and early 2022, which, combined with cost-cutting, extended their cash runway and allowed them to delay fundraising.

Exit activity remained muted with Q2 2023 hitting a decade low. Year-to-date 2023 exit value hit $12.0 billion across 588 transactions (includes estimated exit count of 117) compared with 2022's full year exit value of $75.7 billion from 1,383 transactions (includes estimated exit count of 37). Furthermore, the IPO market remained effectively closed for the 17th consecutive month. Although Cava's recent IPO on the New York Stock Exchange brings hope for recovery, H1 2023 witnessed a shy 31 listings compared with the record high of 307 in 2021. At $69 million, public listing median exit values were only a shadow of the figures for 2022 and 2021 at $241 million and $718 million, respectively.



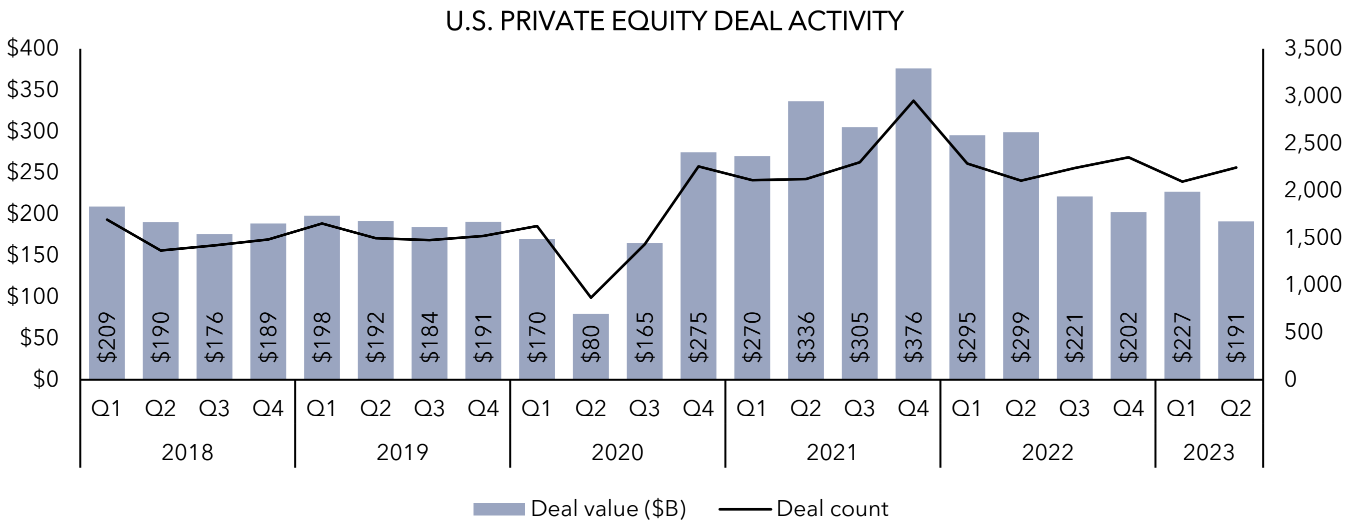
Data Source Q2 2023 PitchBook-NVCA Venture Monitor. Q3 2022 – Q2 2023 includes estimated deal count of 12, 25, 45, and 72, respectively.

U.S. PRIVATE EQUITY

U.S. private equity fundraising in H1 2023 tracked somewhat below H1 2022's haul on both a capital and count basis. Although 2022 represented a record figure, and 2023 yielded a relatively decent first half, recent performance could be a lagging indicator as fundraising processes may have commenced under more favorable market conditions. The imbalance between exits and investments, which continued its slide to plumb a post-GFC low ratio of 0.32x, may presage further capital formation softness during the year's second half. Accordingly, with limited capital distributions returning to investors, commitments to the asset class may encounter headwinds. Similar to the exit-to-investment ratio, the supply of LP allocations compared to GPs' fundraising demand is at its tightest levels experienced since the GFC[1]. One bright spot is the potential denominator effect easing, following public market rebounds.

[1] https://www.bain.com/insights/stuck-in-place-private-equity-midyear-report-2023/

Through 2023's first half, U.S. dealmaking performed in line with pre-COVID averages by volume but considerably ahead by count. Add-on acquisitions were particularly active across the market, comprising 52% of value and 61% of the count. Their prominence among U.S. private equity buyouts was even higher, having marched upwards to 78%. These transactions may have proven popular given their smaller sizes, deploying capital accompanied by a less arduous transaction financing process.



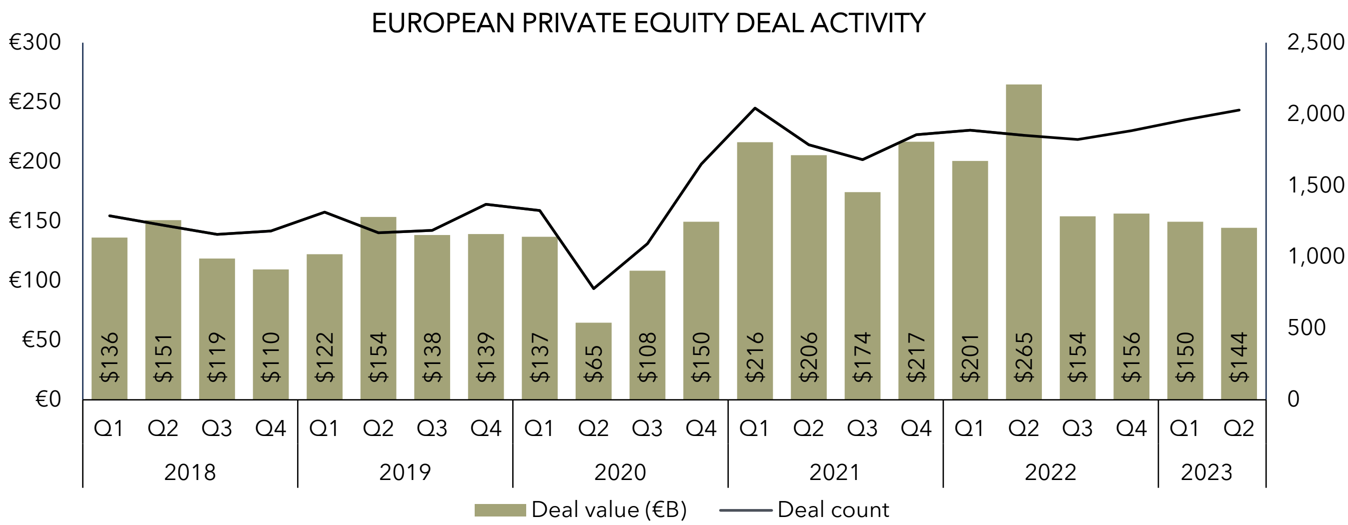
Data Source: PitchBook's Q2 2023 U.S. PE Breakdown. Q3 2022 – Q2 2023 includes estimated deal count of 121, 343, 466, and 861, respectively.

The first half of 2023 produced a paucity of exits, extending a trend which began in early 2022. Although Q2 2023's exit volumes slightly recovered over the first quarter's ($87.3 billion versus $52.3 billion), both the count and volume notched below their pre-pandemic (2017-2019) averages. Between the Q2 2021 peak and Q1 2023 trough, exit value fell by 75%. As observed in prior letters over the past year, rising interest rates (now at a 22-year high in the U.S. following the Fed's latest hike), persistent macroeconomic uncertainty, and regional banking instability have all contributed to dampened realizations. However, amid rebounding public markets, the IPO window may have finally, albeit narrowly, cracked open. Despite their traditionally small importance by volume to overall realizations relative to corporate or sponsor acquisitions, IPOs are sometimes viewed as an indicator of the broader exit environment's health. Towards the end of June 2023, a handful of sponsor-backed companies made their public market debuts, bringing H1 2023's total public listing value to $5.7 billion, which, if annualized, would reflect an increase over 2022's historically weak full-year tally of $8.7 billion.

EUROPE PRIVATE EQUITY

The European private equity fundraising environment improved in H1 2023 with €49.0 billion raised across 51 vehicles, which puts 2023 capital raised on track to come in above 2022's total of €68.2 billion across 126 funds. Larger funds with sizes of above €5.0 billion appear to have been more successful in raising capital, with €24.1 billion raised in H1 2023 compared to €27.2 billion in the whole of 2022, implying that these funds are likely to exceed 2022's total by the end of the year. Smaller funds of €100-500 million in H1 2023 lagged the fundraising pace seen in 2022, with €4.3 billion raised year to date versus €10.6 billion in 2022. This development is in line with long-term trends of LPs expecting to make fewer, but larger commitments to GPs and the fact that larger, more established managers often have longer and better-known track records and therefore find it easier to attract capital.

While fundraising has seen improvements in 2023, deal activity continued to decline in H1 2023 compared to H1 2022. In the first half of the year, 3,988 deals (includes estimated count of 1,317) worth €294.0 billion closed, marking year-over-year decreases in deal value of 30% from H1 2021 and 37% from H1 2022. The decrease may be attributed to a mix of tougher macro conditions including continued high rates of inflation as well as the corresponding increases of interest rates by the European Central Bank and BoE, leading to higher financing costs for private equity investors.

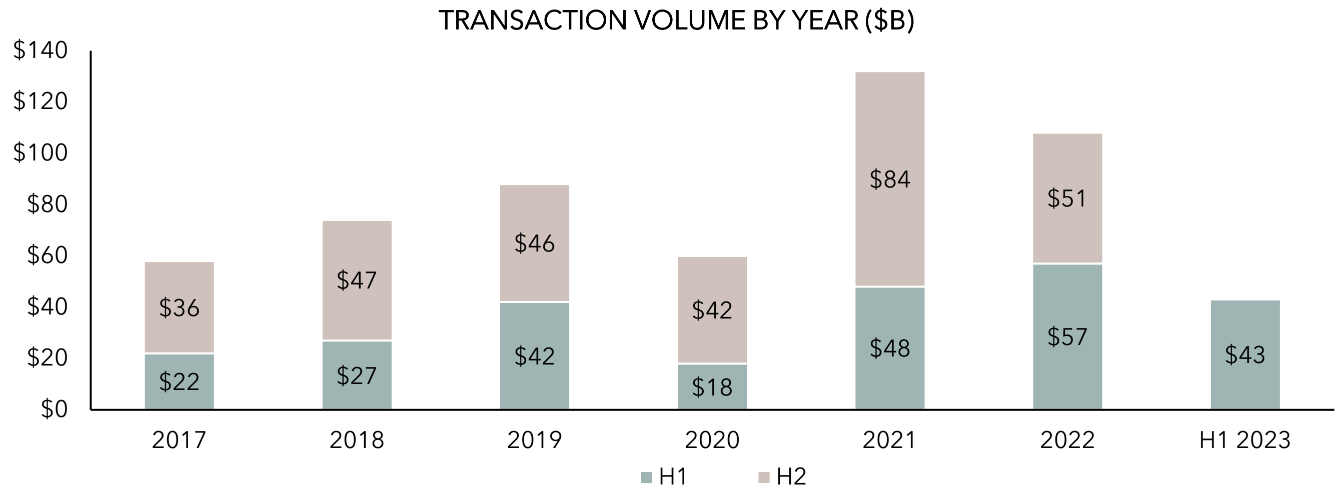


Data Source: PitchBook's Q2 2023 European PE Breakdown. Q3 2022 – Q2 2023 includes estimated deal count of 132, 336, 523, and 794, respectively.

With respect to realizations, activity slowed during the first six months of the year. In H1 2023, 763 PE-backed companies (includes estimated count of 317) exited for a cumulative value of €120.8 billion, marking a year-over-year decrease of 33% in exit value compared to H1 2022. As with investment activity, the sharp decline in exit value was likely a result of the perceived discrepancy in valuations between sellers and buyers caused by continued inflationary pressures and continent-wide monetary tightening.

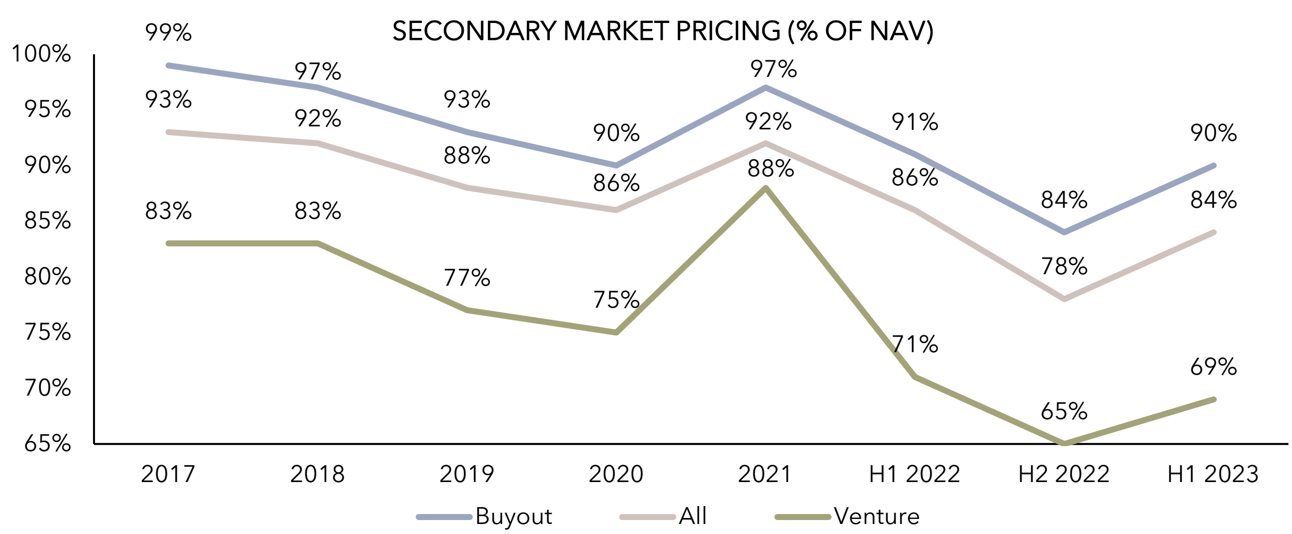
SECONDARIES

While still elevated from pre-pandemic levels, secondaries volume in 2023 started slower when compared to a record-setting 2021 and 2022. The first half of 2023 saw $43 billion in transaction volume, down 25% from $57 billion in H1 2022. While market activity continued to be robust, especially gaining momentum in Q2 2023, the lower transaction volume is largely attributed to a decline in LP portfolio sales. As public markets appreciated, sellers' concerns over the denominator effect were likely mitigated somewhat, leading to an increase in pricing expectations. This led to a slow start to the year, as the bid-ask spread between buyers and sellers remained significant. In Q2 2023, this spread became less prevalent as the public markets remained resilient and buyers may have sought diversification from LP portfolios. In total, LP deals totaled $25 billion, or 58%, of H1 2023 volume. GP-led deal flow continued to remain strong, with investors appearing to show a preference for conservatively levered assets in recession-resilient sectors. With an eye towards the current interest rate environment, buyers have continued to remain selective and are likely focused on high-quality assets with low execution risk from GPs.



Data Source: Jefferies LLC, Global Secondary Market Review, July 2023

The GP-led market remained robust in H1 2023, albeit at lower levels compared to the same period in 2021 and 2022. Continuation funds remained the most popular transaction type, as the GP-led secondary market saw strong supply while the IPO and M&A markets remained challenging. Consistent with prior quarters, the deals that were easiest to complete appeared to be those involving high-quality, recession-resistant assets. In total, GP-led volume came in at $18 billion in H1 2023, a 25% decline from H1 2022. Single-asset continuation funds continued to represent the plurality of transactions, accounting for approximately 40% of GP-led deals in H1 2023. A prevalent theme in 2023 has been a preference towards middle-market continuation funds, which according to Jefferies, stemmed from perceived lower execution risk and shorter marketing processes. GP alignment continued to be paramount, with roughly 90% of continuation funds having sponsors roll at least 100% of crystalized carry. Furthermore, approximately 40% of continuation funds received cross-fund investments in H1 2023, compared to approximately 25% in 2022.



Data Source: Jefferies LLC, Global Secondary Market Review, July 2023

After a correction in 2022, pricing in H1 2023 started to rebound as public markets appreciated and buyers may have sought diversification in their portfolio mix. This was especially relevant in Q2 2023, as buyers appeared willing to increase their bids in light of relatively strong underlying portfolio company performance and rising comparable public company multiples. In H1 2023, LP portfolio pricing across all strategies increased 600 basis points when compared to H2 2022. Buyout portfolios continued to price the highest, reaching an average of 90% of NAV in H1 2023. However, less than 5% of buyout portfolios priced above 95% of NAV, likely reflecting buyers' continued wariness of overpaying. Pricing for venture funds remained depressed at 69% of NAV, though still up 400 basis points when compared to H2 2022. Across all strategies, the average vintage year sold was 2016, which represents the youngest fund age (seven years) in a decade. In addition to younger vintages, investors also showed a clear preference towards North American funds, which represented 69% of total volume.

OUTLOOK

After 12 months of unsettling economic and market headlines, punctuated by aggressive central bank action, investors may have more reason for optimism as the second half of 2023 unfolds. Rates are likely to stabilize, inflation appears to be falling, and growth is visible in most regions. Private equity investors have not seen the valuation declines that accompanied some prior periods of distress, although some downside valuation pressures likely remain, especially for some venture-backed companies. Each of the public market indices discussed earlier are up over 5% -- in some cases well over 5% -- from H1 2022, which should contribute to the lessening of the denominator effect concerns for many private equity LPs. Nevertheless, for fundraising levels to approach that of recent periods, investors will likely need to see increased exit activity from their private equity and venture capital investment funds.