Private Equity and Venture Capital

Private markets have not been immune to the macro environment, with deal volumes declining across the board. During the first half of 2022, private equity deal volume was down 26%, while venture capital markets saw a similar pullback.

Investors have become more discriminating in the deals they pursue, resulting in a flight to quality, defined as companies that have an ability to grow (albeit maybe at a slower rate) while still generating significant free cash flow. Or as Jeff Bezos has said, "Stock prices are most closely correlated with cash flow. It's such a straightforward number. Cashflow is what will drive shareholder returns."

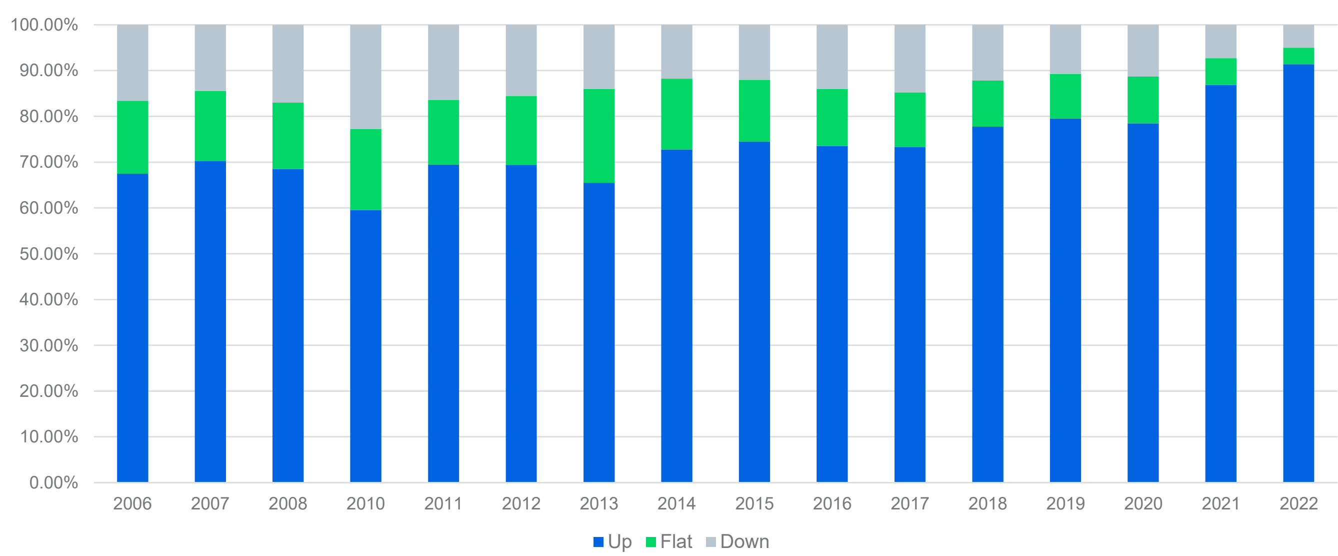
In public markets, valuation multiples are down across the board – falling 50% to 75% and reflecting the change in cost of capital and reduced risk appetite in the current environment. Nearly every venture capital firm has advised its portfolio companies to begin conserving cash to weather a potential recession, with several companies beginning the painful process of announcing cuts. Just in the last few months, Coinbase, Carvana, Compass, and Tesla have announced major layoffs, while Meta, Apple, and Uber have announced hiring freezes.

On the buyout side, several deals were re-negotiated at lower prices. This was highlighted by the take-private of Zendesk for $10.2 billion in a deal led by Hellman & Friedman, which was approved by the board in late June 2022, after a $17 billion offer was rejected in February 2022. Private equity firms are currently sitting on a record $1.8 trillion of dry powder, serving as an overhang for valuations becoming more rationalized.

Within the venture market, late-stage growth has seen the largest pullback, but there is some important context worth considering. These markets are effectively frozen and very few companies have announced new financing rounds. This is not just a reflection of the current market environment. Many companies aggressively raised capital in 2021 and came into this environment with significant cash balances, providing a cushion in the short to medium term. In surveying RockCreek's private portfolio, indications are that most companies have at least 24 months of cash runway, with very few companies having less than 12 months. As a result, it is unlikely that we will see many companies shut down in 2022.

With such little primary deal activity, private market valuations (at least in late-stage venture), are unlikely to be meaningfully revised downward over the ensuing quarters as companies leverage their strong balance sheets.

Valuations from Prior Rounds



Source: RockCreek, PitchBook

Setting aside valuations for a moment, fundamentals at many of these companies remain largely intact, particularly for software companies, but growth is slowing. Growth is still important, but growth at all costs only works when money is free. Money isn't free anymore and won't be for a long time to come. When capital becomes more expensive, a path to predictable, sustainable cashflow will drive shareholder value. In other words, profitability matters again.

It's important to note that this is the first time many venture investors have experienced a bear market on the heels of the longest bull market run in history. There is also valid concern that this correction will hit impact fund managers as well as emerging and diverse fund managers the hardest, as many LPs have communicated an intention to concentrate future commitments on re-ups with existing GP relationships. But it has been our experience that some of the better performing GP's have been with this group of traditionally passed over managers, which is why RockCreek remains committed to continuing to seek out these opportunities.

Overall, we think this correction will have some positive effects on the future valuation environment and go-forward opportunity in private equity, and we continue to be bullish on innovation, especially in areas such as life sciences and climate.

Selecting high-quality GPs and companies backed by strong, diverse teams has become more important than ever. Once the dust settles, there will likely be an incredible opportunity to deploy capital into companies with stronger business models at more attractive valuations than over the past market cycle.