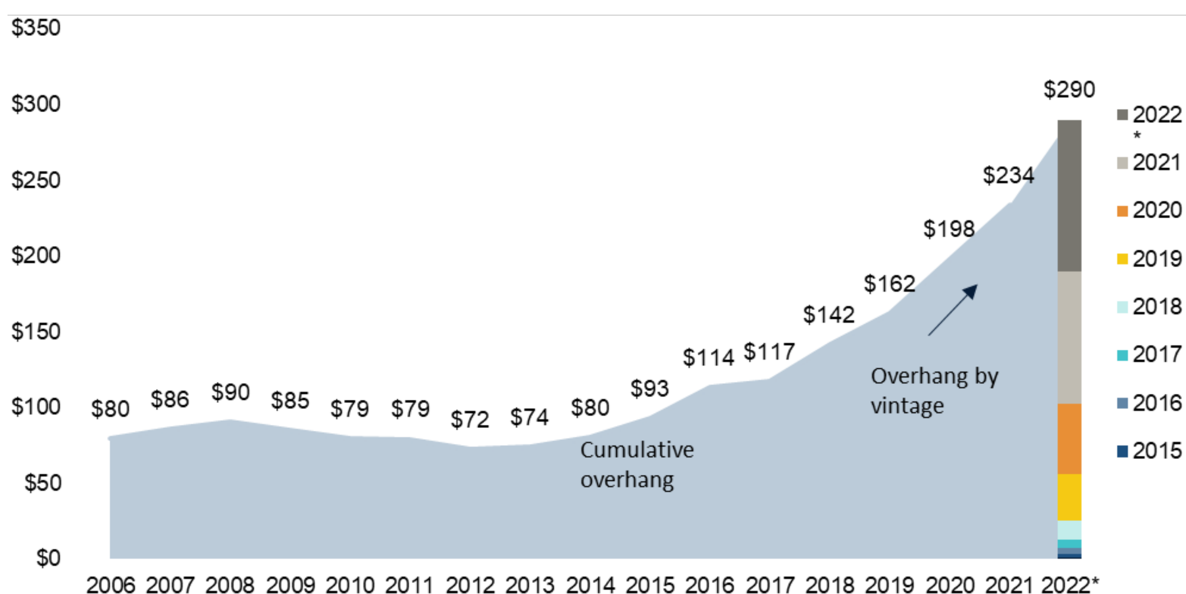
Private Equity and Venture Capital

Private markets remained relatively frozen during the summer months, with the volume of U.S. venture capital deals down approximately 20% from the quarterly record high achieved in Q1, and the lightest quarter in terms of dollar value since Q2 2020. Private equity markets saw an even larger pullback, as global M&A volume declined more than 40% from the prior quarter, representing the slowest third quarter in a decade.

As we noted last quarter, these markets are being buoyed by record amounts of dry powder. Decibel Partners, a venture capital firm created in partnership with Cisco, estimates that venture capital funds are currently sitting on $290 billion of dry powder, of which approximately $160 billion is being earmarked for new investments. With primary activity in a lull, our expectation was that venture firms would refrain from marking their portfolios down until the end of this year or early 2023 at the earliest; however, it appears as though many late-stage venture and growth-oriented firms have reduced their valuations of late-stage private companies by 15-25% from prior marks.



Source: Pitchbook

In addition to public market comps being down significantly, we suspect that many mutual funds with high allocations to illiquid investments are under pressure to reduce the valuations of their private holdings. Such a reduction would help remain below their mandated illiquidity thresholds, putting further pressure on the valuations of private companies that are being reported in the press. With the IPO window remaining shut, we expect many venture-backed companies to focus on M&A exits. A recent Pitchbook report suggests that there are expectations for significant M&A activity in the $200mm to $1.0bn range, with Big Tech companies among the most likely acquirers. A welcomed bright spot in our portfolio during the third quarter was the $20 billion acquisition of Figma by Adobe, representing one of the largest ever exits in RockCreek’s portfolio.

Despite this environment, fundraising figures look stronger than ever, as 2022 has already set a new annual high for US venture capital fundraising, with over $150 billion raised through the third quarter. That said, this is largely being driven by fewer firms raising ever-larger funds. Take-privates are emerging as an attractive opportunity in the buyout space, with high profile deals like Citrix (being taken private by Vista) and the ongoing, off-and-on saga of Twitter (being taken private by Elon Musk) taking the limelight. We expect to see more companies being taken private going forward, assuming choppy debt markets aren't an overhang.

Among the areas where our team has spent time is biotech, with both a focus on public and private markets as the last 12 months have seen a significant dislocation in the sector, with the Nasdaq Biotechnology Index down more than 30% since August 2021. Capital markets were wide open in 2021 and many early-stage biotech companies rushed to go public, often before key clinical milestones. Disappointing clinical data coupled with broader negative sentiment in the technology sector resulted in many of these companies trading below their cash balances, and according to some estimates there are now more than 200 of these stocks.

Accordingly, early-stage biotech investors are contemplating launching hybrid private structure funds intended to provide PIPE financings into a certain subset of these companies. Similarly, many crossover biotech funds are currently allocating a greater percentage of their funds into public securities, though many of these companies are still considered to be early stage from a milestone standpoint. Despite tepid capital markets, innovation remains robust, as the number of new drugs approved by the FDA in 2022 is on track to achieve the same historically high levels that have been reached in each of the last five years, and we continue to be long-term bullish on the sector, both in public and private markets.

Another sector we continue to watch, with careful consideration of valuations, is enterprise software, particularly around AI, automation, and cybersecurity, as software is likely to be the primary tool companies utilize to combat wage inflation and declining growth. The software sector has always been considered "expensive", and while valuations are still elevated relative to historical levels, revenue growth and fundamentals remain strong, and the pace of new company formation in the sector remains strong, so we continue to find opportunities to invest in software. Conversely,

we remain more cautious on software and technology companies primarily serving consumers, and these companies are facing increasing marketing spend and have been hit the hardest in public markets.

Another notable event during the third quarter was the merge of the Ethereum network from a proof-of-work consensus mechanism to proof-of-stake – a much less energy intensive method for securing the network. We continue to embrace technologies and innovation that are driving towards a more sustainable world and will focus on investment opportunities across the climate sector. Investment in the climate tech sector was relatively insulated during the summer slowdown. RockCreek Private Market and Venture Capital team member Drew Reid recently interviewed Andrew Beebe, a managing partner at Obvious Ventures, one of RockCreek's co-investments, about key topics including carbon accounting, electrification trends, and the impact of the Inflation Reduction Act on the climate landscape.