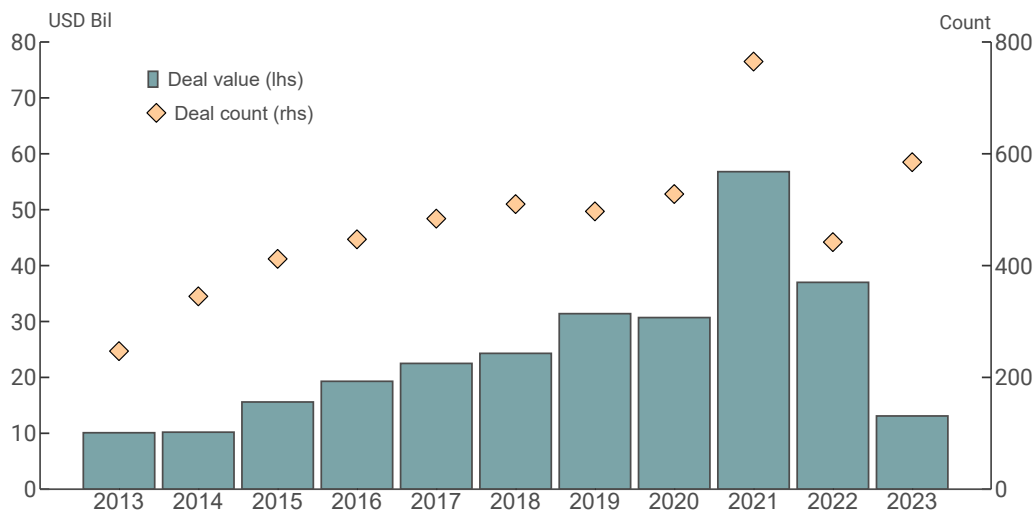


PRIVATE EQUITY & VENTURE CAPITAL

Though the US public equity markets have started the year on a positive note, bucking the trend of 2022, the venture capital and private equity ecosystem continues to search for solid footing. Venture investment pace has materially slowed, as global venture funding in the first half of 2023 has fallen 51% relative to the first half of 2022, according to [Crunchbase](#). Venture capital fundraising set an annual record for capital in 2022: \$171 billion according to [Pitchbook](#), the second consecutive year of over \$150 billion raised. However, the fundraising slowdown into the end of 2022 has persisted into 2023, as only \$33 billion has successfully closed across 233 funds in the first half of 2023 per the [Pitchbook NVCA Monitor](#), setting pace for the full-year figure to hit a six-year low.

Figure 11. Emerging manager VC fundraising weakness extends to Q2



Source: Pitchbook.

The fundraising headwinds have been most drastic for new managers, many of which are diverse and underrepresented GPs, who have closed just \$2.3 billion in commitments through mid-April 2023. Per Pitchbook, 2023 is expected to be the first year since 2016 to see new venture managers close less than \$20 billion in commitments.

Despite the slowdown in venture capital investments and fundraising, the IPO and M&A markets are seeing some green shoots. Though the total number of companies hitting the IPO market ([79 through June 30th](#)) are roughly 37% lower than the same time period in 2022, [Cava's highly successful IPO](#) has signaled a window, albeit small, of opportunity for venture and private equity backed companies to retest the public market waters. Additionally, acquisitions of venture and private equity backed companies – such as Databricks' acquisition of venture backed MosaicML and IBM's acquisition of Visa Equity Partners backed Apptio – may be an encouraging signal that the sluggish M&A market may see more activity as companies come to terms with the vastly changed market environment, and as well capitalized companies seek to take advantage of the market downturn through consolidation. According to the Financial Times, M&A sale launches on Datasite have [steadily increased month](#) over month this year. These indicators will be important signals to monitor into Q3 and the rest of 2023.

Despite a slowdown in activity, compelling and innovative investment themes continue to emerge across our portfolio companies.

Generative AI has been all the buzz in 2023, with [\\$1.7 billion invested across 46 deals](#) in Q1 2023, not including Microsoft's \$10 billion investment in OpenAI (see [Box 5](#)). From Y Combinator's W23 cohort, which graduated in April, 22% are building generative-AI focused startups. While the broader technology market has cooled, valuations in the generative AI space have exploded, accentuated by the \$260 million valuation ascribed to the seed round of Mistral AI, which was founded less than six months ago. Granted, the company appears to have a world-class team and an investor group comprised of a who's who of reputable venture firms, but it is always prudent to question if the GAI renaissance, as the market sees it, is permanent, or the next bubble waiting to burst. Addressing the naysayers, McKinsey [recently released a report](#) which concluded that "generative AI is poised to unleash the next wave of productivity" and "could add the equivalent of \$2.6 trillion to \$4.4 trillion annually..." with potential use cases largely concentrated in

customer operations, marketing and sales, software engineering, and R&D. The report highlights banking, high tech, and life sciences as among the industries that could see the biggest impact as a percentage of their revenues.

Another theme that has the potential to be equally transformative to society, but has received less attention from the press, is the emergence of value-based healthcare providers. The U.S. currently spends over \$4 trillion per year on healthcare, of which less than 10% is on medications. A significant portion of this spend is payments to hospitals, physicians, and personal healthcare, and value-based care has emerged as one of the most promising ways to reduce this cost by providing financial incentives to care providers to take accountability for the cost of care delivery. There is significant evidence that primary care providers are most effective at providing value-based care, and the next generation of primary care companies are currently being built in private markets. This includes companies like Devoted Health, which earlier this year launched its own value-based primary care effort, [Devoted Medical](#).

We are also paying close attention to the private equity opportunity set in Japan. In 2022, total private equity deal value in Japan exceeded \$25 billion, the second highest year since 2012, according to Dealogic data. The private equity opportunity largely mirrors the public markets opportunity set, which is seeking to invest in improved corporate governance and return on equity. As publicly listed companies seek to improve their ROE, we expect an increase in the number of corporate spin-offs and divestitures of non-core businesses, whereas the Japanese private equity opportunity set has historically centered around founder successions. For example, the board of Toshiba recently accepted the \$15.2 billion buyout offer from an investor group led by Japan Industrial Partners. Similarly, Bain Capital and KKR have entered advanced discussions to acquire the air conditioner manufacturing unit from Fujitsu, which is expected to be valued at \$1.3 billion.

BOX 5. GENERATIVE AI

Artificial intelligence is booming. Equity valuations and venture funding for the AI sector have increased since the public release of OpenAI's ChatGPT tool late last year, which introduced "generative AI" to the broader population and delivered highly context-specific outputs from unstructured data in a user-friendly format.

Indeed, we believe that investor interest in AI stems more from generative AI terminals like ChatGPT bringing existing natural language processing (NLP) capabilities to non-expert users for general use-cases, rather than a watershed moment in computational innovation. Estimates on macro impacts range wildly depending on assumptions, whereas we see narrower, near-term impacts on markets that can be more rigorously justified.

Firstly, the deployment of more capable AI engines emphasizes the need for businesses to focus on technology integration. Prior to the current boom, principal customers of GAI engines were firms operating in a restricted set of industries, such as quantitative finance. The advent of GAI has opened a host of capabilities for all other industries leaving firms [scrambling to adopt efficient methods](#) of storing and sorting their suddenly valuable data for use in training AI models.

In many cases, collected data may be sensitive or legally protected, which creates an opening for firms like Granica that recently closed a \$45 million Series A round for its data-management-for-LLMs services for new customers of AI integration. However, demand isn't entirely serviceable by external SaaS startups: when data management is so baked-in to internal system architectures, it's more likely that firms will choose in-house solutions with cloud providers like Azure and AWS, or through hiring a new crop of data scientists specialized in managing data for AI integration.

This leads us to our second prediction: an industry-wide realignment within the big-tech sector. Microsoft is an easy winner to pick: they stand to gain from their existing – and extensive – integration with OpenAI's platform, giving them a monopoly on GAI integration on cloud, business, and consumer. Unless open-source alternatives can be reliably integrated into firm-specific architectures on cloud (which provides another avenue for Amazon, Google, and Meta to impose restrictions on integrations with their APIs), it's likely that demand will be captured by these existing providers of cloud services.

Finally, hardware. NVIDIA's stock has tripled to a current P/E of more than 230x as of 20th July, indicating investors believe in the firm's dominance, but the history of the semiconductor industry shows periods of similar commercial dominance ended with spinoffs, defections, and diversification. Given the burgeoning amount of public investment in semiconductor talent and research post-CHIPS Act, it's likely that the innovation space for AI processing hardware will diversify outside NVIDIA, rather than being contained within it.