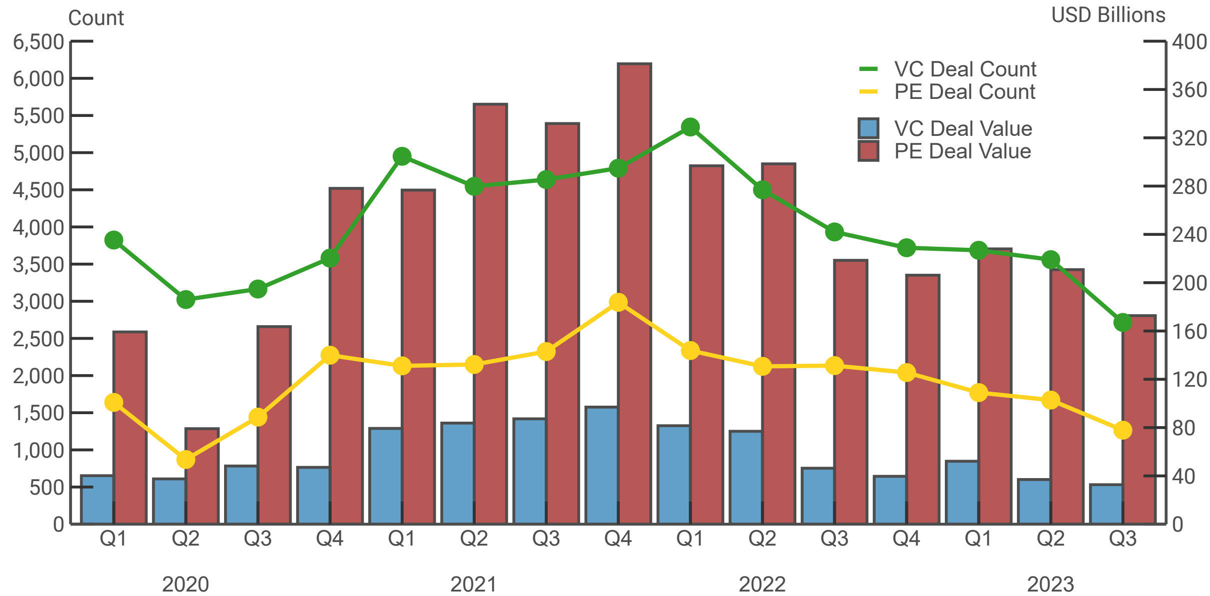
PRIVATE EQUITY & VENTURE CAPITAL

The third quarter represented both the persistence of existing trends and long anticipated signs of new developments within the venture capital (VC) and private equity (PE) markets. With regards to existing trends, deal values have reached recent lows, fundraising velocity continued to languish as investment dollars shifted towards larger and more established funds, artificial intelligence startups continued to buck broader venture capital fundraising trends, and late-stage venture rounds remained sparse.

The quarter’s deal activity highlights the massive slowdown that has occurred within the venture and private equity worlds (Figure 11). Deal values for VC fell to the lowest figure since mid-2018, and deal value for this year is pacing towards the lowest year since 2019. One notable exception to the poor performance across stages was late-stage, where deal volume was buoyed by large corporate-backed deals within the Generative Artificial Intelligence (AI) space. Global private equity valuations have dropped nearly 15% year to date, and the number of transactions has fallen over 30% over the same time period. Just three LBOs have been valued at more than $10 billion this year.

Similarly, fundraising activity continued its downward trend since the beginning of 2022. According to Pitchbook and NVCA, venture capital fundraising through the third quarter is on pace to set a nine-year low. Over the 17 months ending in May of 2023, the ten largest venture capital firms raised 28% of capital commitments, up from 10% during the four-year period from 2018 to 2021. Similarly, the ten largest private equity managers raised 30% of commitments, up from 17% from 2018 to 2022. Funds are now forced to hold more closes, as “one and done” closes have largely gone the way of the dodo bird.

Figure 11. Pace of private equity and venture capital dealmaking continues to grind lower



Source: RockCreek, Pitchbook.

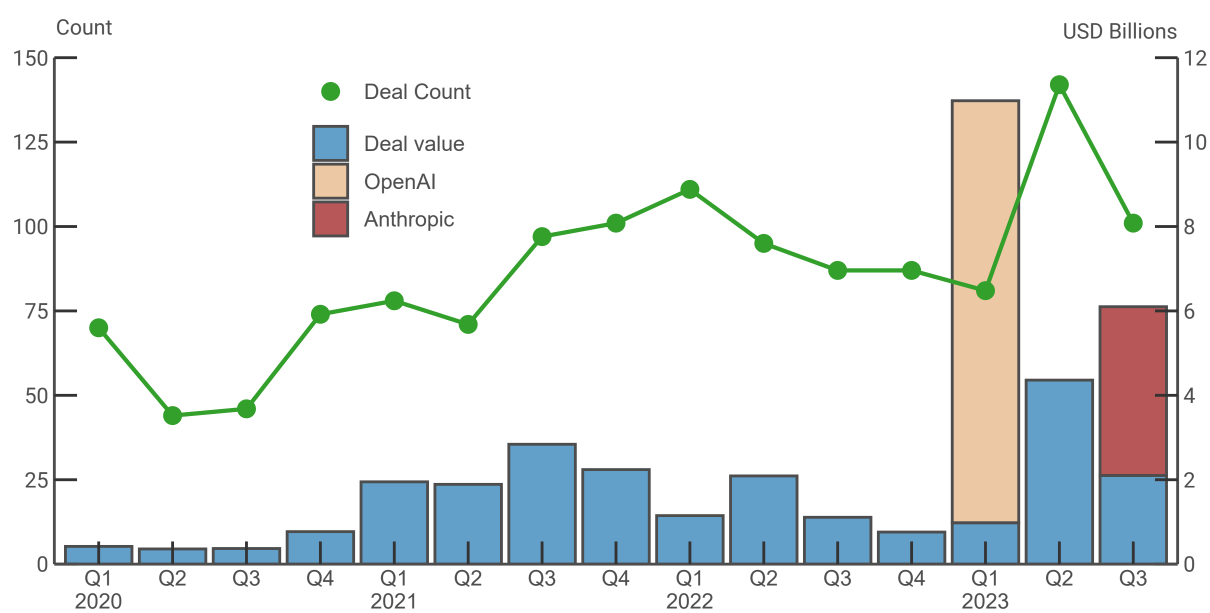
Amid the funding doldrums, Artificial Intelligence (AI) remained the one bright spot. This trend is expected to persist, with an estimated $200 billion invested into AI companies by 2025. One notable development this year has been big tech's investment in generative AI, highlighted by Amazon's $4 billion investment in ChatGPT's rival Anthropic at the end of the quarter. VC investment into Generative AI companies totals roughly $21 billion across over 300 deals through Q3 (Figure 12). However, the hype around this space has led investors in both public companies and startups to wonder if AI is the next big bubble.

And yet, there are signs of a light at the end of the tunnel within the VC ecosystem. One of the largest stories in August was the opening of the IPO window. As we noted in a recent weekly letter, Klaviyo shares have made solid gains while Arm Holdings and Instacart were more or less flat from their respective IPO prices. These exits represent some reprieve for investors who have seen liquidity in their private equity portfolios dry up. According to a report from Ernst & Young, LP distributions as a percentage of NAV have fallen to their lowest levels since the Global Financial Crisis. Per Pitchbook, estimates suggest that there are roughly 75 companies waiting to go public, and the hope is that this pipeline will start to flow in 2024. Much of the IPO forward calendar looks more SaaS heavy, with private markets behemoth Databricks being closely watched. While much has been written in the press about how these companies are coming public at valuations well south of their most recent private rounds (e.g., Instacart's IPO priced at a $10 billion valuation, down from a $39 billion peak), we shared in our above mentioned note that we are encouraged by the fact that the recent IPO class represents a broad swath of sectors while in the case of Instacart, the company is trading at a discount to both DoorDash and Uber on an EV/sales basis.

Similarly, while year-to-date global M&A activity at its lowest level in a decade according to LSEG, U.S. M&A activity in Q3 actually saw a 17% increase year over year. One recent bright spot was Thomson Reuter's $650 million acquisition of Casetext, an AI company which builds automated workflows and tools for legal teams. Casetext was a part of Y Combinator's S13 batch and previously raised $64 million in venture funding from leading VCs including Union Square, Susa Ventures, and 8VC.

While the venture capital and private equity industries are by no means out of the woods after a rough 21-month stint, green shoots are finally appearing, indicating that 2024 may see more positive developments than 2023.

Figure 12. VC funding for AI sees banner year in 2023



Source: RockCreek, Pitchbook.