PitchBook

Q3 2020

Private Market PlayBook

PRIVATE EQUITY IN THE AGE OF COVID-19:

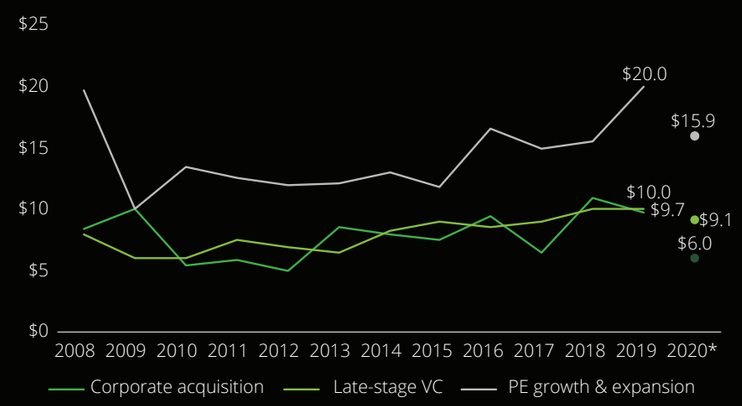
REPORTS FROM TWO FRONTS

Road to Next

A snapshot of the current environment

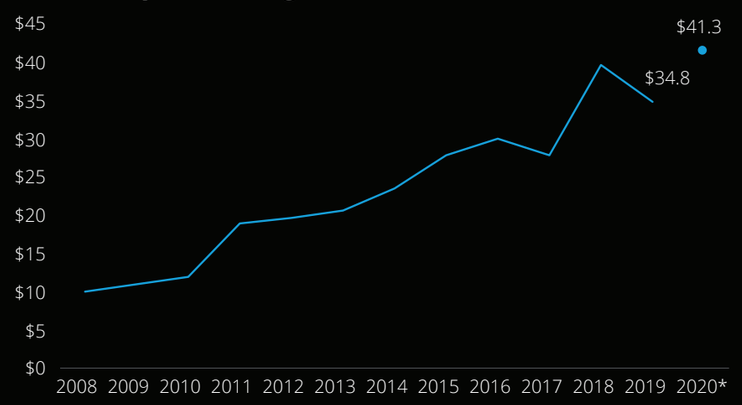
This edition of *Road to Next* explores in detail how expansion-stage companies have prepared and are preparing for the post-pandemic world during the last weeks of this summer and beyond. It considers dynamics ranging from logistic matters, such as the workflows between a mix of fully remote and headquartered employees, to proofing cash flows against potentially deteriorating economic trends. This infographic is a data-driven snapshot of the key metrics defining these businesses as they traverse the current environment.

Median expansion-stage deal size ($M) by type



Source: PitchBook | Geography: US
*As of July 23, 2020

Median expansion-stage revenue ($M) at time of deal



Source: PitchBook | Geography: US
*As of July 23, 2020

$41.3M

A remarkable high in median revenue for the companies still securing investment in 2020 to date

$15.9M

A healthy return to 2018 levels for the median growth equity deal size

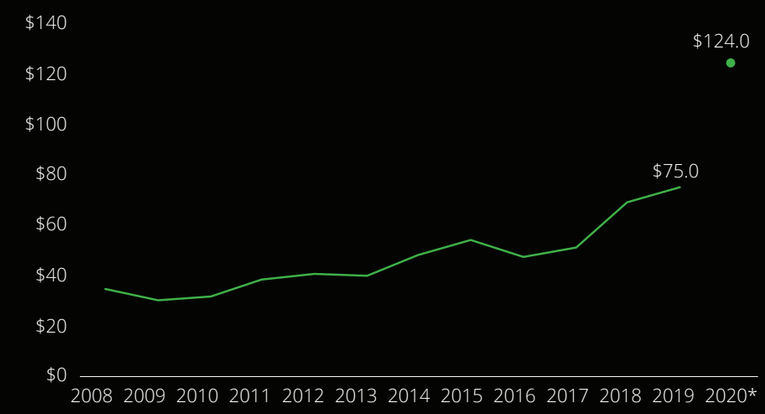
All callouts - Source: PitchBook
Geography: US | *As of April 30, 2020

Investors have dedicated **$78.0 billion** to expansion-stage companies through late July, suggesting the pandemic has hardly affected enthusiasm.

"Many companies are reaching out to discuss their businesses, taking interest in first-time audits, and considering other measures to better position themselves for stability looking forward."

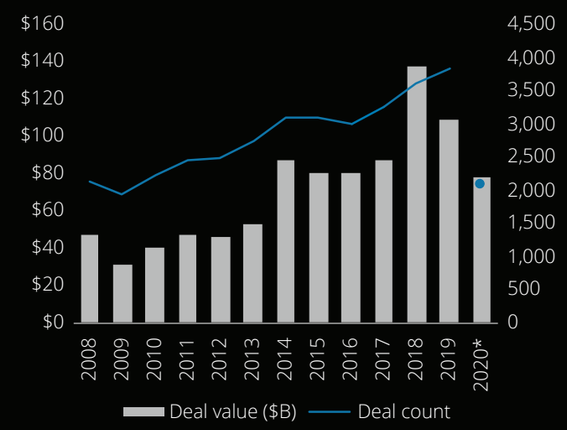
Heather Gates
Audit & Assurance Private Growth Leader
Deloitte & Touche LLP

Median expansion-stage pre-money valuations ($M)



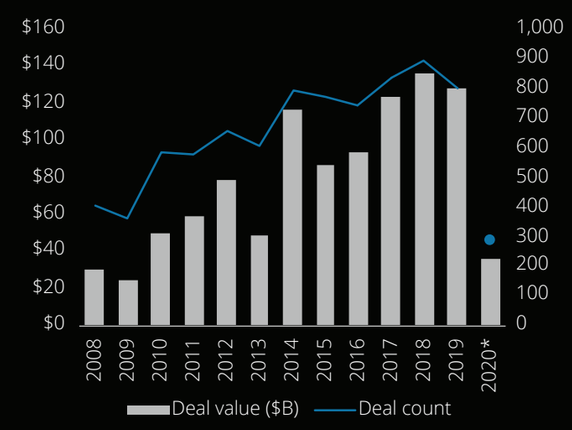
Source: PitchBook | Geography: US
*As of July 23, 2020

Expansion-stage PE and VC deal activity



Source: PitchBook | Geography: US
*As of July 23, 2020

Expansion-stage M&A activity



Source: PitchBook | Geography: US
*As of July 23, 2020

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From the Editor

Back to business.

After months of confusion and crisis-induced economic losses, people around the globe have started picking up the pieces, wearing masks and working to get back to normal—whatever normal means these days.

Normal is a relative term, now more than ever. In contrast to the frightening and chaotic early months of the crisis, some scenes from daily life now seem remarkably familiar and functioning smoothly. Some industries are adapting more easily than others, whether by trying problem-solving innovations or forming new partnerships that were once out of reach.

Your newest edition of the Private Market PlayBook explores these themes from multiple perspectives.

Our London-based writers, Leah Hodgson and Andrew Woodman, focus on ways that the pandemic is affecting private equity investors in two very different sectors. Leah shines a light on the privatization of nursing-care operators in recent years and the problems that have followed many of them since landing in PE portfolios. Andrew reports on PE firms becoming active investors for the first time in a wide range of sports assets such as hockey teams and entire national soccer leagues, which have returned to play in front of empty arenas or self-imposed "bubble worlds" to keep athletes virus-free.

Speaking of empty stadiums, the lockdown of venues has shifted plenty of entertainment dollars to the video-game world. Esports competitions already were big business pre-pandemic, so it was only a matter of time before they made a splash on college campuses (which are generally virtual these days). James Thorne reports on the pandemic-era boom in esports startups that cater to college events and recreational programs.

And as Priyamvada Mathur writes, the food industry, which was racked by supply-chain and distribution problems during the crisis, is closely watching the emerging segment of lab-grown meat producers. The "cultured meat" movement sounds compelling but still faces significant hurdles to shipping sausages to your neighborhood market.

We also size up the burst of activity surrounding special purpose acquisition companies, which put a new spin on going public. Adam Lewis traces the evolution of the "blank check" boom and the surge of buyout firms that have jumped into the fray.

Also in this edition, we're excited to launch a new feature where we introduce you to two of PitchBook's senior analysts and the current topics they cover. I hope you'll find these both engaging and informative for understanding the private markets.

Alexander Davis
Executive Editor

The Feature

Perspectives

Analyst Insights

Market Trends

Private equity plays a starring role in 2020's SPAC boom

By Adam Lewis

For most of their existence, special purpose acquisition companies were mostly unknown. But this year, they've become some of the hottest investment vehicles on Wall Street, offering companies an alternative to a traditional IPO and opening up fertile new ground for dealmakers.

Entrepreneurs, business executives, hedge fund founders, politicians and sports executives have all gotten in on the act, launching new SPACs—also called blank-check companies—that are now hunting for acquisition targets. But few segments of the financial world have been as closely intertwined with the SPAC boom as private equity.

For some firms that were early adopters, this year is the continuation of a longtime strategy. Other firms are dipping a toe into the SPAC pool for the first time. For veterans and newcomers alike, these deals have become a popular path to capitalizing on the market volatility driven by this year's pandemic. Alec Gores, the founder and CEO of The Gores Group, told CNBC in August that, because they offer sellers flexibility, efficiency and better valuation certainty, SPACs have become a great way to get to Wall Street.

SPACs essentially function as shell companies, with no operations of their own. They first raise capital from outside investors in an IPO, and then later use the proceeds of that offering to acquire a private company in a reverse merger. The target company is still subject to certain regulatory reviews, but the process offers a simpler path onto the public market than the usual IPO roadshow—particularly now, when travel and in-person meetings are much more difficult. SPACs have existed since the 1990s, but only began to come into vogue in recent years.

> "For the private equity firm, they get a large economic stake in the business for less upfront investment."
>
> Cameron Stanfill, PitchBook analyst

Few, if any, private equity executives are better positioned than Gores to speak to these vehicles' growing appeal. His firm launched its first blank-check company in 2015, raising $375 million that it deployed the next year in a merger with Hostess Brands. Gores has backed five more SPACs in the years since, including two that were active this August. That month, the firm raised $525 million from the IPO of a new vehicle, and one of its older SPACs lined up a $3.4 billion merger with Luminar Technologies, a developer of sensors for autonomous cars.

Other private equity firms have also been busy this summer. RedBird Capital Partners teamed up with famed baseball executive Billy Beane—the man who inspired "Moneyball"—to launch a SPAC that will aim to acquire a professional sports team, raising $575 million in an August IPO. Days later, Solamere Capital, which is led by Tagg Romney, Mitt Romney's son, announced plans to raise up to $300 million for a new SPAC formed in conjunction with former US Speaker of the House Paul Ryan. And it was reported in late August that TPG Capital is planning a pair of SPACs, one focusing on tech and the other on social impact deals, that will total some $700 million.

These new blank-check companies are contributing to a significant spike in SPAC deal count and capital raised. As of this writing, 85 different SPACs have gone public this year in the US, combining to raise more than $39 billion, according to PitchBook data. Those figures are already more than double the full-year totals for 2019, a year that had established new annual highs.

Why have SPACs surged in popularity, especially among private equity firms?

The structure of most reverse mergers means the deals require a more modest outlay than traditional buyouts. A private equity firm sponsoring a SPAC typically buys between 2% and 3% of the shares offered in its public listing.

"For the private equity firm, they get a large economic stake in the business for less upfront investment," said Cameron Stanfill, a venture capital analyst at PitchBook who specializes in SPAC research.

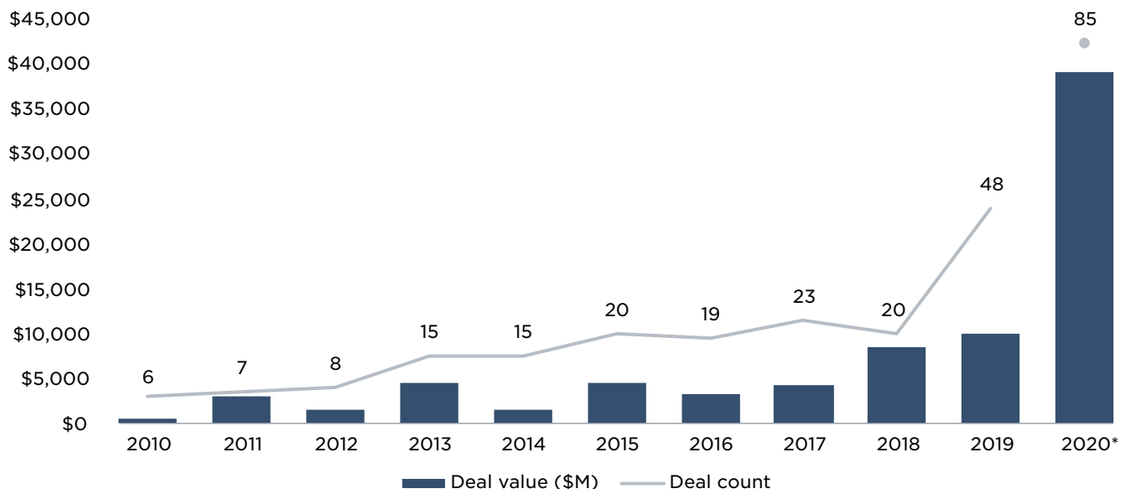
Special purpose acquisition company (SPAC)

SPACs essentially function as shell companies, with no operations of their own. They first raise capital from outside investors in an IPO, and then later use the proceeds of that offering to acquire a private company in a reverse merger.

SPAC process

Source: Broker Dealer
Infographic: Kelilah King

SPAC registration in the US over the past decade



Source: PitchBook | Geography: Global
*As of September 1, 2020

Private equity investors, of course, are very familiar with raising capital on the private market to finance future takeovers. In a SPAC, they instead draw from public backers, allowing them to broaden their investment base and eliminating the time commitment and other difficulties of raising funds from LPs.

The sponsors of a SPAC often line up an anchor commitment through a PIPE deal with an outside investor, offering possibilities for additional liquidity after the SPAC goes public. A recent example came when hedge fund Millennium Management purchased a 7.8% stake in RedBird's sports-focused SPAC shortly after its IPO.

"You've got a vehicle that already is poised for liquidity," said Jeffrey Smith, a partner at Sidley Austin who specializes in SPAC deals. "It's a public company. And your equity as a founder is structured in a way where, frankly, the warrants usually are exercisable within 30 days after the deal, and founder's shares amounts to 20% of the size of the SPAC, which is very, very significant."

SPACs also have plenty of appeal for potential targets. In a reverse merger, companies only need negotiate a price with one investor—the SPAC—rather than the wide range of prospective backers that comes with an IPO. That's especially appealing against the backdrop of a stock market that's been historically volatile during the pandemic, when the misfortune of pricing an IPO on a bad day for the market could have a negative effect on the company's valuation.

Founders also typically don't have to give up as much control when merging with a SPAC compared to a traditional buyout. What's more, several high-profile companies that have taken the SPAC route, including Virgin Galactic, DraftKings and Nikola, have seen their stock prices surge since their respective mergers. For Smith, it all adds up to an impressive body of evidence.

"Why do a SPAC?" he asked. "The economics are so good, it's almost, why not do a SPAC?"

Sponsors call for experience and reliability

As middle-market companies and their private equity sponsors seek to navigate the uncertainty brought on by COVID-19, the value of dependable partnerships is increasingly evident.

The private credit market, which prior to COVID-19 was awash with capital, is now experiencing a dearth of dry powder to support direct lending opportunities. In these unprecedented times, it has never been more important to partner with lenders that have the business models, infrastructure, resources, and expertise needed to be dependable when it is most critical.

Twin Brook Capital Partners has always been dedicated to being a reliable, solutions-focused partner that will work hand-in-hand with its PE clients to execute on their value creation strategies and help their portfolio companies navigate both periods of growth and challenging times. This commitment is, and always has been, core to our strategy and is one of the many reasons that we—in partnership with Angelo Gordon—founded Twin Brook.

Our experienced team of professionals—many of whom have worked through multiple market cycles—has committed over $13.6 billion across more than 500 transactions in nearly six years, and we have served as the lead or co-lead arranger on 94% of those deals. With more than $1.2 billion of commitments approved since March and ample buying power to support current and future borrowers, we are well-prepared for this uniquely challenging environment and look forward to working together with sponsors through both the difficulties of today and toward the opportunities of tomorrow.

To learn more about Twin Brook and its cash-flow based financing solutions for the middle-market PE community, visit www.twincp.com.

Trevor Clark
Founder & Managing Partner
Twin Brook Capital Partners

Founder and Managing Partner Trevor Clark is a member of Twin Brook's Investment and Executive Committees, responsible for overall operations of the firm since its inception in 2014.

Prior to founding Twin Brook, Trevor was a co-founder and CEO of Madison Capital Funding LLC, a wholly owned subsidiary of New York Life Investments, where he oversaw all operational and strategic activities of the middle-market lending operation. Prior to forming Madison Capital, Trevor held various positions in loan underwriting and origination at Antares Capital, GE Capital, and Bank of America. He holds a BA degree from the University of Iowa, Iowa City and an MBA degree from Indiana University, Bloomington.

Diverse managers spread message of fiduciary duty and social justice

Research on underrepresented investors suffers from barriers gathering data

By Alexander Davis

This year's explosion of protests over racial inequality opened a debate that went far beyond the flaws of the criminal justice system.

It also prompted a fresh reckoning over the financial and business dimensions of race and economic opportunity in society. It has forced consumer brands, financial institutions and countless others across corporate America to open their eyes to long-standing unconscious bias in their companies and to a deficit of action that could right wrongs within their reach.

Many captains of industry are suddenly busy plotting ways to do their part—for the first time, in some cases—to promote diversity and inclusion in the workplace and beyond.

But Angela Matheny, an investment management consultant, started working years ago on a deliberate campaign to get asset owners to use their financial clout to drive change through the $70 trillion asset-management industry.

Matheny's mandate at Colonial Consulting is to raise the profile of firms run by people of color with above-average returns, warning that asset allocators risk missing out on the strength of diverse investors. And as she's quick to point out, the underlying rationale is simultaneously about social justice and fiduciary duty.

"If you want to drive change, you're going to need more people in the room that look like me," said Matheny, who is Black. "People who are willing to tackle unconscious bias, who aren't afraid to talk about the elephant in the room."

Matheny leads her firm's diverse manager initiative, which since 2016 has advised clients on investing with private equity and other asset management funds that are owned or substantially run by women and people of color.

Even with this year's renewed focus on racial inequality, few LPs are using their power to demand better representation among general partners or other managers, according to investors.

"It is our goal to build better portfolios, which will naturally lead to more racial equity and equal opportunity," she said.

Today, roughly 10% of the $37 billion in assets overseen by Colonial has been invested with diverse managers, Matheny said, compared with about $313 million in 2013. The New York firm launched the effort in 2013 after a client challenged its chief investment officer over why it didn't have more diversity among its managers.

A growing chorus of critics and activists has been asking that very question—even before the racial justice protest movement of 2020—as part of a campaign to raise awareness and change the culture of the asset management industry by putting pressure on endowments, pension funds and other limited partners that wield transformational clout.

In a profession still dominated by white male investors, many women and people of color are now well-established general partners, but they tend to remain on the margins.

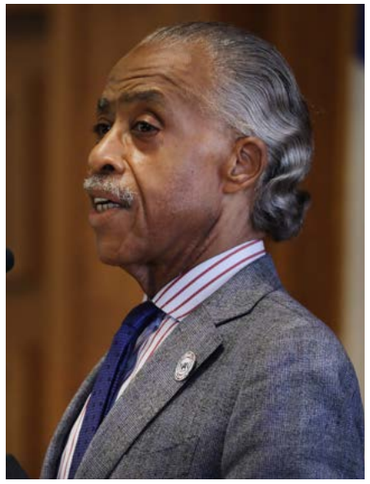
Private equity and venture capital funds led by people from underrepresented ethnic and racial backgrounds have performed as well as their industry peers, with some studies showing they have better-than-average returns. But they managed just over 1% of the capital across the industry as of 2019, according to the latest Knight Foundation study of diverse investment practices.

That low rate of participation isn't for lack of available talent. Across the private equity and venture capital industries combined, women-owned and minority-owned firms (252 in total) represented 5.2% and 3.8%, respectively, of the industry total, according to Knight Foundation data.

Advocates and scholars who have been working on the issue say the opportunity gap for underrepresented managers is mainly a result of unconscious bias and a failure to intentionally seek out investors outside of asset owners' existing, mostly white networks.

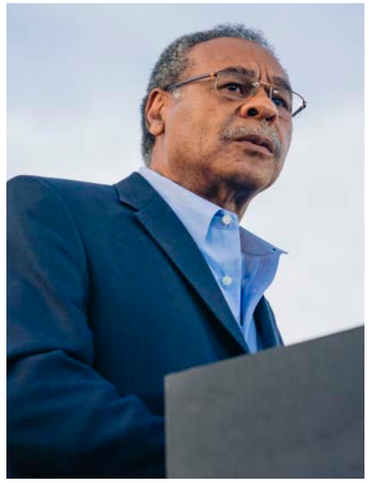
The drive for change has picked up momentum in the past couple of years, from the private sector to Congress. Robert Raben, a former Justice Department official who now runs a public affairs firm, launched an initiative to bring more transparency to how public and private asset owners select outside management firms. Even the Rev. Al Sharpton has taken up the cause, calling attention to practices at the endowments of Ivy League colleges and other elite universities.

Earlier this year, Reps. Emanuel Cleaver (D-Mo.) and Joseph P. Kennedy III (D-Mass.) confronted the nation's 25 largest university endowments seeking to learn how much they work with diverse managers.



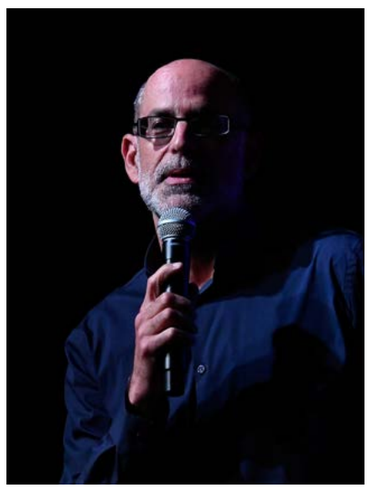
The Rev. Al Sharpton is putting pressure on pensions to focus on diversity.

Photo by Spencer Platt/Getty Images



Rep. Emanuel Cleaver (D.-Mo.) is focusing scrutiny on college endowments.

Photo by Kyle Rivas/Getty Images



Robert Raben leads a campaign pushing transparency on hiring fund managers.

Photo by Larry French /Getty Images

And the challenge of getting high-quality data across the industry is emerging as a crucial area of focus for advocates and academics who are working to illuminate the issue.

Several schools have yet to respond to the congressmen's request. Harvard University did, however, disclosing that 27% of the external firms that oversee its nearly $41 billion portfolio are majority-owned by women or people of color. That amounts to roughly one-quarter of the Harvard Management Co.'s assets.

To some extent, these types of efforts are meant to shame major asset owners into acknowledging the lack of diversity in their networks, highlighting the potential they have as limited partners to bring about change.

Even with this year's renewed focus on racial inequality, few LPs are using their power to demand better representation among general partners or other managers, according to investors.

"If they chose to act uniformly and deliberately, LPs could have a very dramatic impact on change in a very short period of time," said Robert Greene, a former pension board chairman and current CEO of the National Association of Investment Companies, a trade group for diverse managers.

Finding transparency about diversity is limited in the historically opaque private markets.

Harvard professor Josh Lerner, the author of the Knight studies, pointed out that tallying the PE and venture fund ownership proved especially difficult to measure. He said many asset allocators withhold information that would highlight their lack of working with firms led by people of color. And at least some diverse managers are reluctant to gain a higher profile. "You can't manage what you can't measure, and that certainly seems to hold true in this arena as well," Lerner said.

He has called for an open-source database that could help LPs that want to seek out diverse managers. Much of that information is closely held among private networks.

"But it doesn't really solve the problem of the fact that you have institutions interested in increasing their allocations to minority managers and not necessarily having very full information about who's out there, or where to start looking," Lerner said.

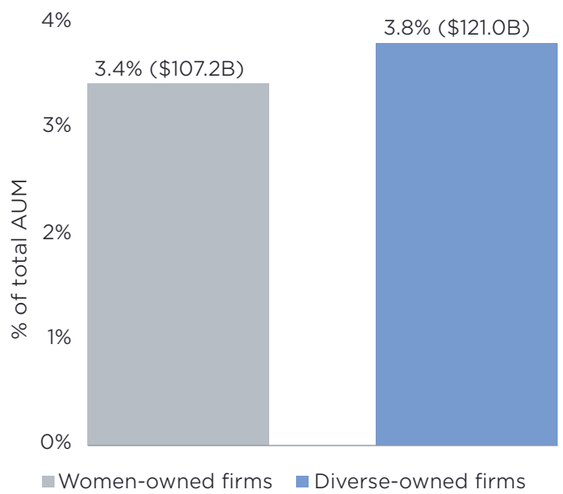
Among the hurdles in gathering data is a variety of definitions for diversity or certain racial groups, along with the fact that researchers often depend on participants to self-report their firm's data.

PitchBook, which specializes in data and tools for researching the private markets, began studying how to solve delicate methodology questions on race and ethnicity earlier this summer. The company is evaluating a change to the platform that would use self-reported information about founders' racial identity, said Peter Escher, PitchBook's vice president of research.

A few years ago, PitchBook started an initiative on tracking gender, making the company a leader on data about female founders in the venture capital ecosystem. That created something of a model for the challenge of collecting racial data, Escher said. By contrast, the data on gender relies on PitchBook's own conclusions based on other information, such as people's names or photos of them.

"What's fairly obvious to me is that we can't as a data provider create a methodology that puts people into categories where they don't see themselves," he said. "And so that creates not a challenge but an opportunity to go out and engage directly."

AUM of private equity and venture capital firms ($3.6T)



Source: Knight Foundation | Geography: Global
*As of January 2019

As live college sports take a time out, esports score big on virtual campuses

By James Thorne

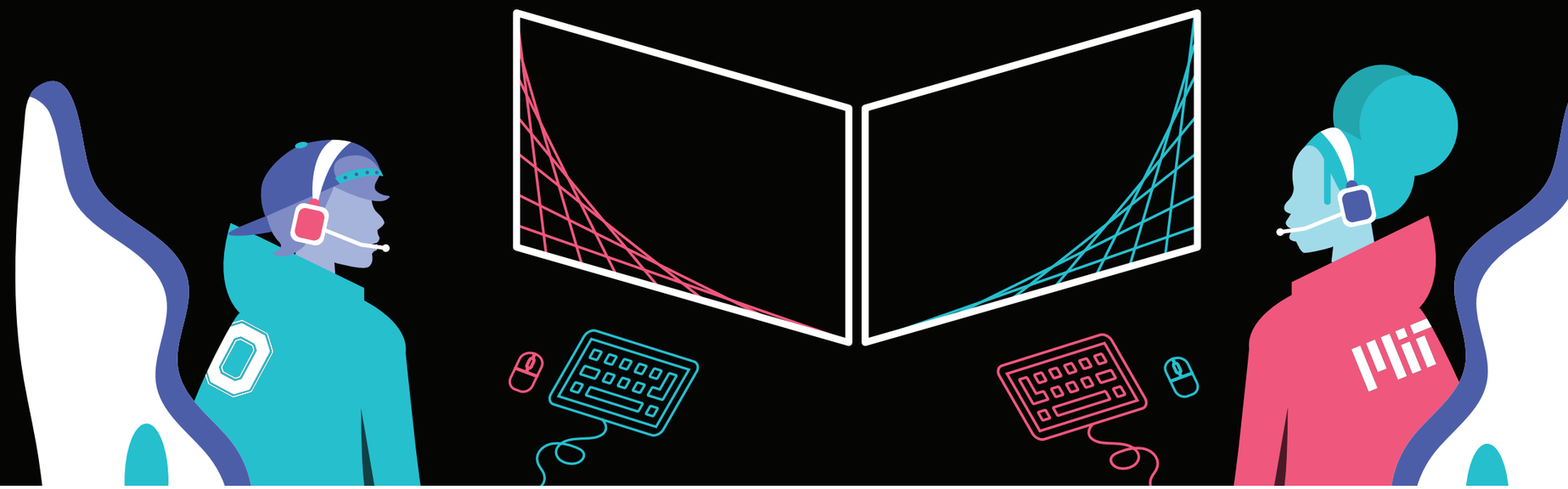


Illustration: Kelilah King

For many undergraduates, the fall semester is virtual—devoid of the dorm-room parties, clubs, football games and other hallmarks of the US college experience. In the absence of these gatherings, esports have emerged as a new social medium.

Esports offerings at colleges such as MIT and Brown University have exploded this year. MIT has expanded its offerings from a tournament featuring the online battle game League of Legends to nearly a dozen gaming leagues focused on other popular games like Rocket League, Super Smash Brothers and Mario Kart.

Brown recently added more than 300 students to its roster of esports players—about a 50% uptick since March—bringing the total to over 900 players, according to Griffin Beels, president of the university's esports club. Most of the additions have been from incoming freshmen, who have yet to make on-campus connections, Beels said.

The rise of esports at colleges was inevitable before the pandemic, said Austin Smith, founder of esports startup Mission Control. "Now it's just happening a lot faster."

Mission Control operates a platform that lets recreational leagues, such as those found on university campuses, host esports tournaments. The St. Louis startup raised $1.75 million in seed funding in July to expand its tournament platform.

"Schools are looking at esports as a way to bring some sort of competition as well as camaraderie between the students," said Sumit Gupta, CEO of startup Boom.tv, a streaming platform that focuses on events hosted by influencers and schools.

> "Schools are looking at esports as a way to bring some sort of competition as well as camaraderie between the students."
>
> Sumit Gupta, CEO, Boom.tv

Boom.tv, which raised a $10 million Series A in June, has seen user traffic grow more than 50% in the first half of 2020. It now reaches around 15 million monthly viewers—thanks in part to the American Video Game League, a college event organizer acquired by Boom.tv last year.

Investors have continued to hunt for promising new games that they hope will turn into the next League of Legends, since such standout games have given them some of their highest returns.

"[The gaming industry] really does well in downturns," said Jon Goldman, a partner at Greycroft and head of the GC VR Gaming Tracker Fund. "The last time it boomed to this extent was the financial meltdown of 2008 and the aftermath."

As of late August, esports companies had raised $2.4 billion of venture capital funding, marking the industry's second-largest haul on record, according to PitchBook data. Fortnite maker Epic Games snapped up the bulk of those dollars with a $1.8 billion round in August.

Beyond games, investors have been backing esports teams, gamer education startups, betting platforms and other companies that target the esports community. Other notable VC deals this year include broadcasting platform providers Caffeine ($113 million) and Discord ($100 million), as well as Faze Clan ($40 million), a professional esports organization with a roster of teams and influencers.

Professional esports competitions involve multimillion-dollar prize pots, an indication there's money to be made by colleges—especially if they're able to create a gaming equivalent of NCAA Division I football.

Prominent colleges appear to see the potential in this space. Ohio State, which brought in nearly $211 million in revenue from its sports programs last year, built an arena dedicated to esports competition and is developing a degree program for esports and games. Illinois State, the University of North Carolina and the University of Washington also have esports arenas.

The National Association of Collegiate Esports has attracted more than 170 schools to its ranks as more intramural leagues continue to sprout up. The industry has even garnered the attention of Twitch, the Amazon-owned game streaming platform. The company is helping to form an esports league for historically Black colleges and universities.

Despite these developments, the NCAA voted last year against governing esports.

College esports leagues also face institutional hurdles. Schools tend to favor their cash-cow athletics departments—or at least programs that contribute to students' physical health—when it comes time to decide where to allocate resources. There's also a generational gap: Today's college esports competitions are unlikely to appeal to older alumni spectators, who have donated millions of dollars to college sports programs.

"[Live sports are] not just a social activity for kids for universities like Ohio State," Goldman said. "It's the sponsorship dollars, it's the alumni donation. It's all those things that are reinforcing mechanisms for football, basketball, the top sports. I don't think that esports yet can drive that kind of financial ecosystem for the colleges."

Instead, universities are investing in esports programs today as a way to connect and entertain students.

Over the summer, MIT hosted a Super Smash Bros. competition that was streamed with live color commentary on Discord's platform.

The winner was an incoming freshman, who traded typical first-year icebreakers for bragging rights among the school's gaming community.

> "A random League of Legends team doesn't stand for anything. ... If you get a sense of loyalty to a school, it turns into something much stronger."
>
> Jens Hilgers, Founding General Partner, Bitkraft

"No one knew who this guy was," said Nick Jewell, an intramural administrator at MIT. "He came in, he won the whole thing. That was really fun to see."

It's the social and entertainment aspects of esports that make investors think there's plenty of opportunity for innovation.

"We just fundamentally believe from our fund investment thesis the fun, the engagement, the community, the participatory [element] is more important for us to focus on" than competitive gaming, said Kai Bond, a partner at Courtside Ventures who leads gaming investments.

Games are rapidly building experiences outside of competitive gameplay. In April, when the live music scene was effectively canceled, Fortnite hosted a virtual Travis Scott concert that drew more than 27 million players.

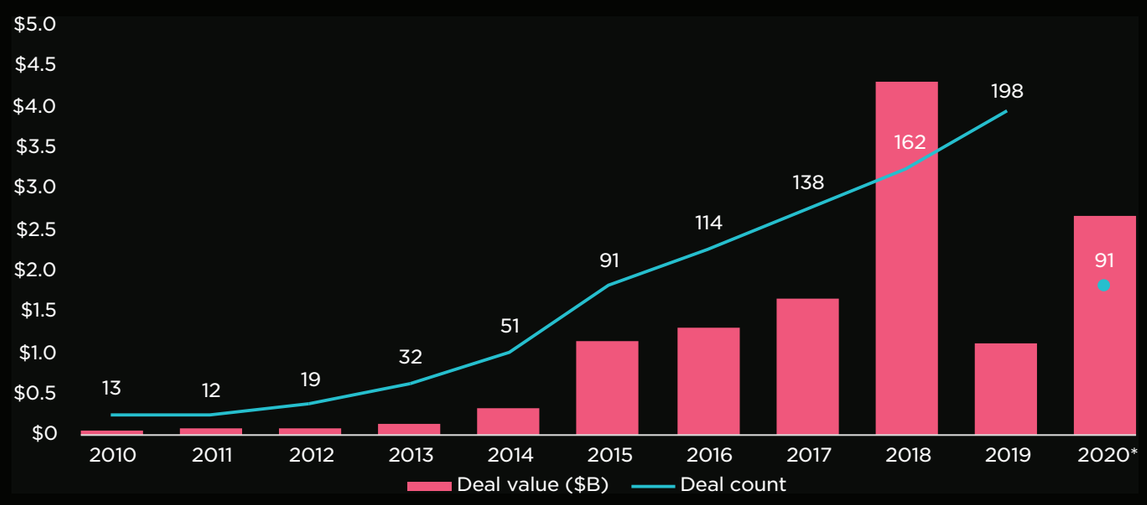
Fortnite has also been at the forefront of monetizing the social gaming experience. For a fee, players can upgrade their avatar—such as costumes and dance moves—that have little to do with gameplay.

"Fortnite stands out as something that people are playing just for the ability to look cooler in front of their friends online," Goldman said.

As the pandemic goes on, colleges will continue to grapple with how to build rapport among students isolated from campus life. Esports leagues may be one of the keys to help them do just that.

"A random League of Legends team doesn't stand for anything." Jens Hilgers, a founding general partner at gaming-focused VC firm Bitkraft. "If you get a sense of loyalty to a school, it turns into something much stronger."

VC deal activity in esports



Source: PitchBook | Geography: Global
*As of September 4, 2020

Lab-grown meat is full of promise but years away from dinner plates

By Priyamvada Mathur

Illustration: Julia Midkiff

Several months ago, when the pandemic disrupted production at US meatpacking plants and caused panic about a potential meat shortage, some consumers may have turned toward plant-based alternatives from Beyond Meat, Impossible Foods and others.

But many might not know about the burgeoning lab-grown meat industry, and the companies looking to deliver a knock-out product designed to dethrone the likes of a filet mignon or T-bone steak.

The pandemic-induced panic around meat production could have posed a unique opportunity for many cultivated meat startups to make their way into the industry limelight as viable protein alternatives. But at this point in their journeys, many of those companies are years away from having anything market-ready, and consumers will likely have to wait awhile to see lab-grown chorizo or cultured salmon on their dinner plates.

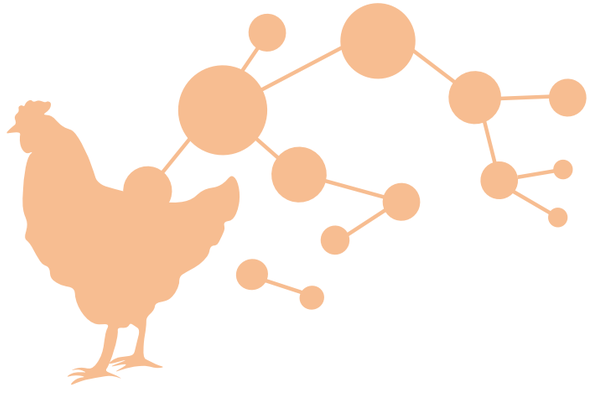
"Novel technologies in the past, such as cell phones, took awhile to fully enter the market in a very significant way, and it is going to take a long time for the benefits of cultivated meat to reach a tipping point and become ubiquitous," said Nick Cooney, managing partner at Lever VC, an investor in alternative protein companies.

That's partially because the production of such a game-changing product requires the right recipe: streamlined technology, good flavor and a retail cost that can compete with conventional beef, chicken, pork and fish. Many startups in the space just aren't quite ready to deliver their product at scale yet.

So what else has prevented meat-loving customers from seeing lab-grown chicken, pork or beef on the shelves of their local grocery stores?

Many alternative food startups get one real shot at convincing their target audience to warm up to an innovative product. And many of them don't necessarily want to reach the market first with only an average product. They want an exceptional one.

"It is very important to make sure that we launch a good product and we are not rushing to release," said Aleph Farms co-founder and CEO Didier Toubia.



"Culinary and sensory qualities are as important as nutritional value."

Aleph Farms hopes to develop cultivated beef steaks by mimicking cows' muscle-tissue regeneration. The Israel-based company grabbed headlines in October 2019 when it became the first company to produce meat in a 3D bioprinting experiment on the International Space Station, collaborating with Finless Foods, Russia-based 3D Bioprinting Solutions and others.

One of the biggest challenges facing cultivated meat products is the replication of conventional meat's texture, taste and nutritional characteristics.

For startups, that means lots of R&D costs, according to Matthew Walker, managing director at S2G Ventures, a VC firm that invests in sustainable foodtech and agriculture companies.

To develop lab-grown meat, scientists must isolate stem cells from an animal and allow them to multiply in a lab, regenerating muscle, fat and tissues.

A few companies are spending $100 to $150 per pound to develop products, but hope to reduce costs to around $5 to $10 per pound to compete with the conventional animal protein market, Cooney said.

"On average, companies expect about three weeks of production to cultivate the same amount of meat you would get from a beef cow that had to live for 18 months," he said.

To help their cultivated meat products become a household name, some founders are seeking support for technologies and supply-chain processes designed specifically to create their products.

Brian Frank, a general partner at sustainable food-focused firm FTW Ventures, said cultivated meat startups essentially need "Amazon Web Services for biology" to scale production. Processes need to be automated and tracked through software and services, he said.

"Right now, most founders have no one they can go to and say: 'I have the design, can you build an infrastructure and produce the product for me?'" Frank said.

The coronavirus pandemic has raised questions about food sustainability and the reliability of supply chains. That could result in beneficial attention for alternative food startups.

Memphis Meats co-founder Uma Valeti said consumers are now more eager to hear about what cultivated meat startups are doing than they were in the past. That heightened interest has snowballed into venture funding. Venture capital investment in cultivated meat startups for 2020 has so far jumped

> **"Consumer polls are helping investors recognize the opportunity of getting behind a scalable product."**
> Uma Valeti, co-founder, Memphis Meats

about 116% compared to last year's total, according to PitchBook data.

Investors have also gauged interest in alternative protein products from market research studies and consumer surveys.

"Consumer feedback has been great for a product that virtually no one has been able to see, taste or touch yet," said Cooney.

Government regulations present another hurdle for startups, as authorities still have a lot of ground to cover in the development of firm frameworks. In March 2019, the US Department of Agriculture and the Food and Drug Administration agreed to share regulatory responsibility for cell-cultured livestock and poultry products in what was a breakthrough for the industry.

The FDA is expected to regulate processes involving cell collection, cell banks and cell growth, while the USDA will oversee the production and labeling of cultivated meat products.

Because most of the product development takes place in a lab, the FDA will play a larger role in cultured meat regulation than it does for conventional meats, which are largely governed by the USDA. And on the flip side, lab-grown meat won't have to go through inspections for things such as bacterial contamination or be subject to slaughter regulations, like conventional meat.

Memphis Meats doesn't have a product on the market yet. But Valeti said that during the pandemic, his team has intentionally made an effort to increase brand awareness by educating consumers about how they create their products, hosting tasting experiences with food experts and using consumer surveys to understand potential demand.

"Consumer polls are helping investors recognize the opportunity of getting behind a scalable product," Valeti said.

But will that exposure among investors ultimately translate into mass production?

Cell-based meat companies won't just have to compete with the skyrocketing popularity of plant-based products. They'll also face consumer skepticism around whether lab-grown meat can be just as good as conventional meat, and whether it will whet their appetites in the same way.

"Cultivated meat companies will need to do a good job of making clear to consumers that their products are real meat and not another plant-based replica," Cooney said.

Despite a rise in demand for plant-based products, BlueNalu president and CEO Lou Cooperhouse remains skeptical, pointing out that while those products offer a vegan solution, they're often made with highly processed ingredients.

"Cell-based meat is the holy grail to make an animal product without an animal—truly, extraordinarily disruptive," he said.

BlueNalu develops cell-based seafood made directly from fish cells and tissue. The company says its products are free of plastics, pathogens, toxins and other contaminants.

Cooperhouse has ambitious goals for his company, and anticipates that in the next five years, its first factory will be producing 10 million pounds of lab-grown fish annually.

That's the kind of production rate that cultivated meat startups will need in order to compete with other, cheaper proteins.

"Most startups are pretty far off from competing with a $2 McDonald's burger, and a lot of work needs to happen to achieve that price point," said Frank. "No one can make a baby in one month."

The GP staking competitive landscape

By Wylie Fernyhough

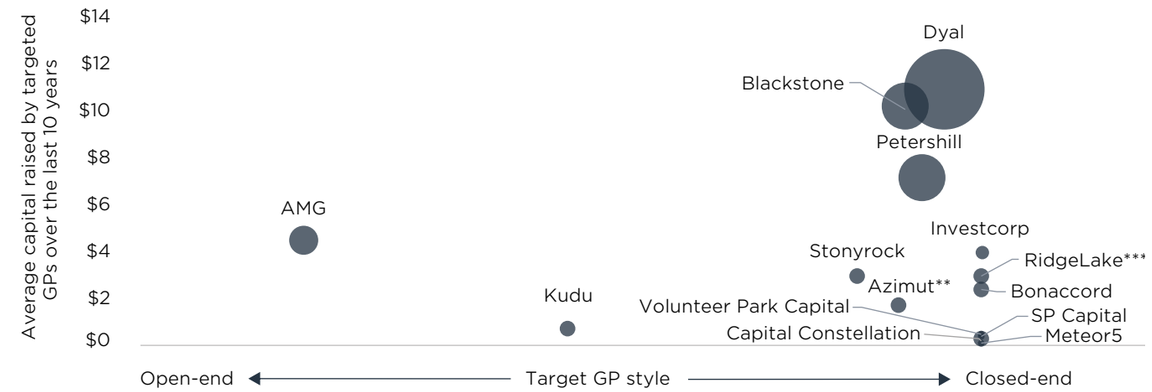
The following was adapted from the The GP Staking Competitive Landscape, published July 8, 2020.

The GP staking competitive landscape is in flux as capital continues to pour into the space. We have seen the top three players, Dyal, Blackstone and Petershill, cement their spots atop the industry, raising tens of billions of dollars and investing in the largest managers, such as Permira, Silver Lake and BC Partners. While the top GP stakes firms have been deploying capital with the largest 100 or so managers, smaller GP staking firms, targeting middle-market, emerging and/or spinout managers, have been popping up to fill the void.

Each GP staking firm targeting these managers is coming to market with a unique offering and trying to avoid the mistakes of previous managers that have failed. Three of the first GP stakes managers to target the middle market are fundraising for their first funds, all between $750 million and $1 billion, and have teamed up with global institutional asset managers to help bring value to the managers in which they invest. Bonaccord has teamed up with Aberdeen Standard Investments, Investcorp Strategic Capital Partners has teamed up with Investcorp, and Stonyrock has teamed up with Leucadia Asset Management, a division of Jefferies. Two more nascent middle-market staking firms have taken different approaches. Azimut Alternative Capital Partners (AACP) is investing in minority stakes off of Azimut's balance sheet to help the firm grow its alternatives exposure, while RidgeLake is a joint venture between New York Life-owned PA Capital and Ottawa Avenue Private Capital (OAPC), the investment arm of a large family office. Some of these firms are taking an operationally intensive approach, while others are planning on being more passive.

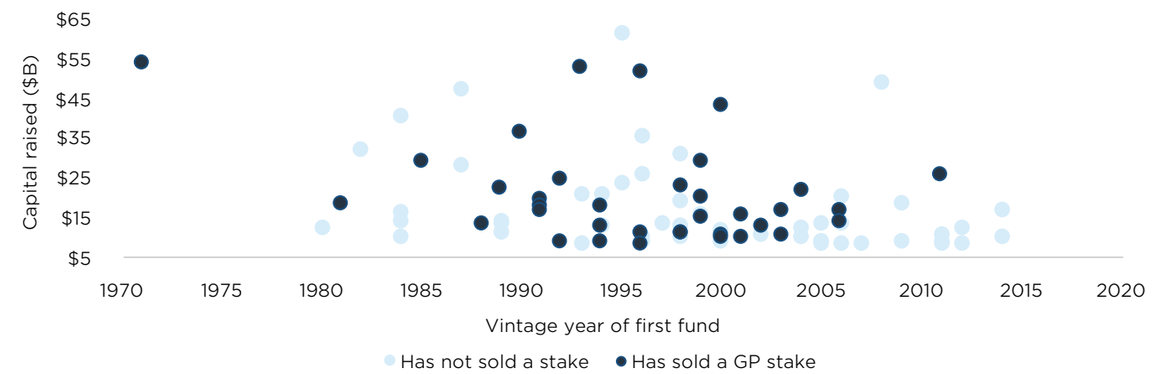
The only major firm targeting this subset of managers that is not seeking to raise an initial fund is SP Capital, which is affiliated with placement agent Sixpoint Partners. Only Volunteer Park Capital—a part of London-based Goodhart Partners—is seeking to raise money through a traditional closed end fund structure. Capital Constellation is one of the more novel approaches, because it is owned by a group of LPs. The firm, with members including Alaska Permanent and Wafra, seeks to invest in nascent private capital managers and invest its capital alongside these firms as LPs. Lastly, we have Kudu Investment Management, which is seeking to raise capital through its balance sheet and deploy in minority equity stakes. Which of these strategies will find the most traction with the GPs selling minority stakes and with potential LPs is unknown, but we believe LPs looking to invest in the space must be aware of the competitive landscape and how each firm's offerings vary.

Competitive landscape*



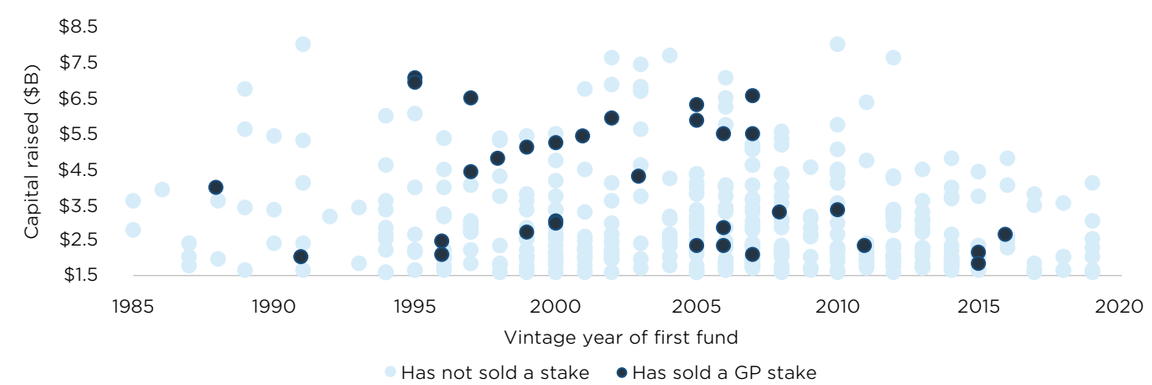
Source: PitchBook | Geography: Global
*As of September 2, 2020
**Azimut is not raising a fund, and this is the midpoint of a PitchBook analyst estimate for capital available to deploy.
***RidgeLake has not formally announced its fund size, so we used the midpoint of a PitchBook analyst estimate for eventual fund size.

Top-end GPs by total capital raised in the past decade and current backing status*



Source: PitchBook | Geography: Global
*As of May 31, 2020

Middle-market GPs by total capital raised in the past decade and current backing status*



Source: PitchBook | Geography: Global
*As of May 31, 2020

Robinhood shifts trading to the masses

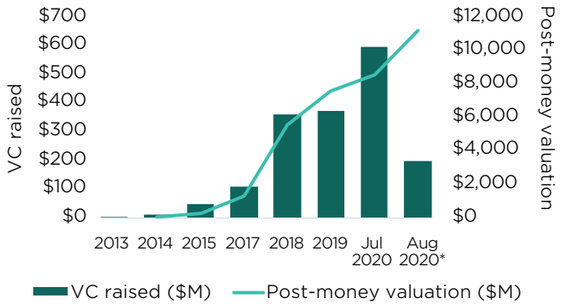
By Robert Le

The following was adapted from Robinhood Shifts Trading to the Masses, published August 24, 2020.

In today's volatile market, new traders are seeking ways to profit from the swings in stock prices spurred by COVID-19, which has helped to validate the Robinhood business model. The company experienced a dramatic surge in new account growth and trading activity during the pandemic, gaining a 3x increase in trading volume compared to the same period the prior year. The spike in trading followed the addition of 3 million new accounts in Q1 2020 (a 30% increase from the end of 2019) and in March saw a 10x increase in net deposits compared to the monthly average for the previous quarter. Robinhood is now one of the largest retail brokerages in terms of accounts and holds a private market valuation of over $11 billion.

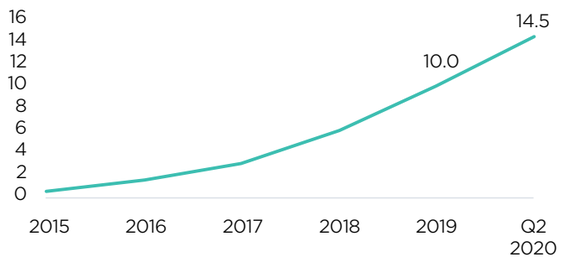
Robinhood remains focused on the younger demographic and has a relatively narrow product offering compared to incumbents. However, with fresh financing in the bank, and with an expanded management team of technology and finance veterans, we believe the stage is set for more aggressive expansion over the next year, both organically and via M&A. We expect this will include not only a wider array of trading products but more traditional financial management tools as well. Even though the company seems to have no issues raising capital in the private markets, we believe it could seek an IPO within the next 12-18 months to capitalize on its 2020 momentum.

Robinhood venture financing history



Source: PitchBook
*As of August 19, 2020

Robinhood's open accounts (millions) since 2015



Source: Robinhood, PitchBook estimates

Transforming clinical-trial patient recruitment and retention

By Kaia Colban

The following was adapted from Transforming Clinical-Trial Patient Recruitment and Retention, published July 23, 2020.

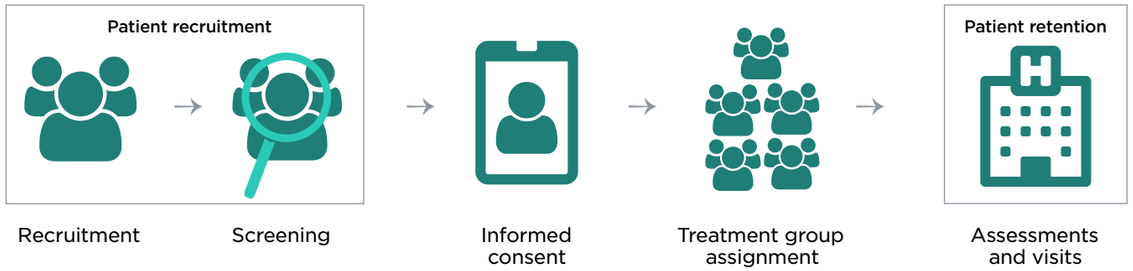
Clinical trials are critical to the development of pharmaceutical drugs and treatments, but the process can be complex and costly. Not only must developers find thousands of candidates willing and able to participate, they must ensure participants document and complete the trial. Up to 86% of trials fail to reach recruitment goals in the targeted timeframe,[1] and dropout rates are around 30%.[2] Delays in product launch due to sponsors' inability to recruit or retain patients are common and increase cost, deplete resources and prolong time to market. As the pace of drug development hastens, the trial process is proving to be fertile territory for VC-backed startups.

Researchers spend over $2 billion annually on recruitment,[3] and we believe the market is growing at a rate of 16% annually, fueled by increasing study complexities, regulatory requirements, and competition to retain patients.

Startups facilitate recruitment by finding patients, determining eligibility and enabling communication between patients and researchers throughout enrollment. Deep 6 AI uses artificial intelligence to analyze structured and unstructured clinical data into new data points that can be used to match clinical trial criteria, making it easier for researchers to identify and contact potential participants. TrialSpark developed an online platform aiming to increase trial access to patients who are unlikely to be referred to trials through their healthcare provider. SubjectWell offers an online and mobile application that enables patients to search for and apply for trials, while also giving researchers the ability to manage enrollment status, schedule screening appointments and send appointment and eligibility notifications.

Other startups focus on ensuring retention by creating medication adherence and tracking technology, biometric monitoring devices, AI-powered direct observational therapy, and personalized platforms. Medisafe made a comprehensive mobile app that alerts patients and other stakeholders when doses are missed. Empatica created a wearable device with clinical quality sensing designed to track human behavior in daily life. Its devices are used to analyze and monitor autonomic nervous system disruptions and heart rate variability and to detect unusual events such as convulsive seizures in real time. Empatica was the fifth-most-used BMD in clinical trials as of April 2019.[4] AiCure's AI-powered direct observational therapy uses picture and facial recognition algorithms to track adherence.

Steps in conducting a clinical trial



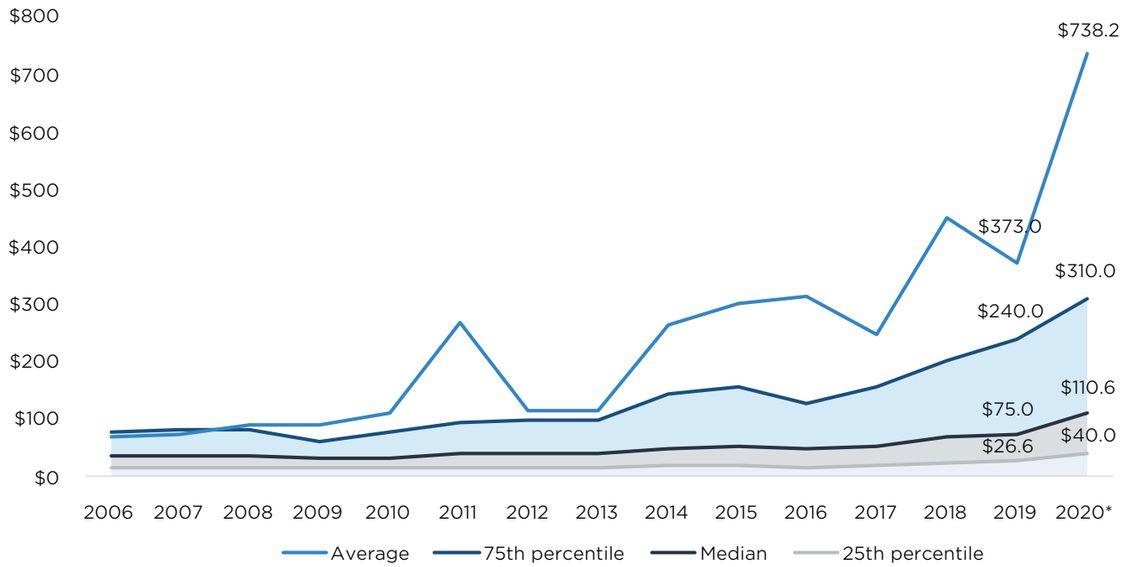
1: "Clinical Trials Recruitment Planning: A Proposed Framework From the Clinical Trials Transformation Initiative," Contemporary Clinical Trials, Grant D. Huang, et al., January 9, 2018.
2: "Patient Recruitment and Retention Services Market, 2019-2030 (COVID-19 Series)," Roots Analysis, February 2019.
3: "Successful Patient Recruitment Calls for a Calculated Approach," Beroe, Sapna Rani, July 17, 2017.
4: "Wearables in Clinical Trials: Opportunities and Challenges," Valencell, Ryan Kraudel, April 1, 2019.

US late-stage VC operating through pandemic as normal

By Kyle Stanford

Looking at late-stage venture data from the first half of 2020, it's near impossible to see any negative impact from the COVID-19 pandemic. Deal activity is up year-over-year, deal sizes have continued at heightened levels, and valuations have showed no signs of slipping. Unlike other areas of venture, challenges due to economic lockdowns and social distancing procedures haven't had the same effect on the late stage. During the public-market sell-off in March, late-stage companies finally looked exposed to the run-up in valuations that had occurred over the past decade. Late-stage fundraising has instead been as strong as ever. What changed? What factors are leading the strong activity amid the economic headwinds?

Late-stage VC pre-money valuations ($M)



Source: PitchBook | Geography: US
*As of June 30, 2020

Through Q2, late-stage VC deal count is tracking at a higher pace than in 2019, which set a record number of completed late-stage VC financings in the US. 1,575 late-stage deals closed through the first half of 2020, well above the figure reported at the same point last year. In addition, more than $48 billion has been invested into late-stage companies. It's true in this climate that there is a bifurcated impact on companies operating in different sectors. However, companies both struggling and thriving have been able to raise late-stage capital. Those experiencing roadblocks to growth have been able to raise unplanned and planned rounds in order to bridge the gap in normalcy, while thriving companies have been able to raise due to shifts in their projected growth. Late-stage companies are, in theory, the closest to exit and also the largest investments in portfolios. When the pandemic's full force hit the US, investors worked quickly to triage their portfolios, allocating capital to double down on their thriving investments and reserving capital to help their large investments that began to struggle.

High late-stage deal sizes have abided the surge in dealmaking. We have spoken to exhaustion about the high level of dry powder available to the industry; as of December 31, 2019, US VC firms controlled roughly $117 billion in dry powder, and 2020 has only added more firepower to that figure. But maybe even more important to late-stage VC, large, nontraditional investors have continued to be active through the beginning of the pandemic. We estimate that this group of investors has between $240 billion and $340 billion available for venture investments, a figure that, at its minimum, is double the most recent dry powder numbers. The past few years have brought about an explosion in mega-deals at sizes that preclude investment solely from VCs. H1 2020 has already seen 115 late-stage mega-deals, a pace well ahead of 2019, in which 175 were completed over the whole year. It should come with little surprise that nontraditional investors participated in 109 of those, flexing their size and their massive importance to the current mechanics of late-stage VC.

As a result of this confluence of factors, late-stage VC valuations have not declined at the rate many feared during the COVID-19-induced lockdowns and the economic turmoil that has pervaded Q2. In fact, US VC valuations for late-stage companies have seen continued strength and growth across quartile ranges. Valuations may have been the area of most

Through Q2, late-stage VC deal count is tracking at a higher pace than in 2019, which set a record number of completed late-stage VC financings in the US.

interest at the outset of the pandemic. Years of valuation growth have led to an ever-growing stable of companies remaining private and raising rounds at enormous valuations only to then face increased scrutiny when looking to move public. The median late-stage VC pre-money valuation through H1 2020 reached $110.6 million, while the average has so far doubled the full-year 2019 figure, reaching $738.2 million due to the surplus of those completed VC mega-deals. The rebound of the public markets has helped keep late-stage valuations afloat, but there is more at play. We haven't seen the number of down rounds grow in proportion to up or flat rounds, suggesting that companies raising unplanned rounds due to declines in revenues have been able to raise them from existing investors. Though the amount of capital available and nontraditional investors have played a role in certain trends, from a valuation standpoint the continued support of existing investors could be the overbearing component.

The US venture industry has remained resilient in the face of the current economic climate. And while there could still be occurrences that knock the industry off track, that the market is currently working almost as smoothly as normal is evidence of just how much the market has changed since the global financial crisis. The late-stage is just one component of the overall venture industry, but its current muscle illustrates that venture may push through the current crisis a relatively unscathed market.

Private market fundraising overview

By Hilary Wiek

The following was excerpted from PitchBook's Q2 2020 Private Fund Strategies Report, published on August 20, 2020.

When last we addressed the global private market fundraising environment, we were reporting on a pre-COVID-19 world during the early days of the crisis. We made many predictions about how the year would play out in this unprecedented situation, and our data through the end of June largely bears out our assumptions thus far, especially when we look beyond the headlines.

In the first quarter, we predicted that existing GPs would find more success in 2020 than new fund strategies due to the lighter lift of diligence required. Partly because of this, we forecasted that larger funds would garner an even more outsized share of total fundraising than we have previously seen. We also anticipated that strategies perceived to be well-positioned for the current times (that is, behaving opportunistically) would be more successful in their fundraising efforts than those positioned for a more normal environment. Finally, we expected that LPs would likely slow their commitment pacing in 2020 but would overall be unlikely to feel enough stress to force secondary sales.

The total number of funds raised in H1 2020 continued a decline that began in 2018. In the first half of 2019, 857 funds were raised across all private market segments, so 2020 was well off that pace at 643. However, dollars[1] raised told a different story: H1 2019 saw $438.4 billion raised, so H1 2020 outraised 2019 by $6.0 billion with 214 fewer funds. Astonishingly, Q2 2020 saw an uptick in dollars closed upon from the first quarter, with market participants continuing to sign commitments despite worldwide economic shutdowns. Although six more months of data have yet to be recorded for 2020, our prediction that LP commitments would slow during the COVID-19 crisis has not held up at the aggregate level thus far.

H1 2019 saw $438.4 billion raised, so H1 2020 outraised 2019 by $6.0 billion with 214 fewer funds.

The drop in fund counts and the increase in dollars raised illustrates a confirmation of our expectation that larger funds would find more success in a period with suspended due diligence travel causing LPs to commit to entities better known to them. Of the 14 funds that each closed on more than $5 billion in the first half of 2020, 10 were at least the fifth fund the GP had raised for the strategy, highlighting how funds with long track records were able to close on vast sums, even in a crisis. Interestingly, 80.7% of the funds closed in 2020 have managed to increase their size from their predecessors—those funds were 43.4% larger, on a median basis. Across the private markets, more money is going to fewer and larger funds.

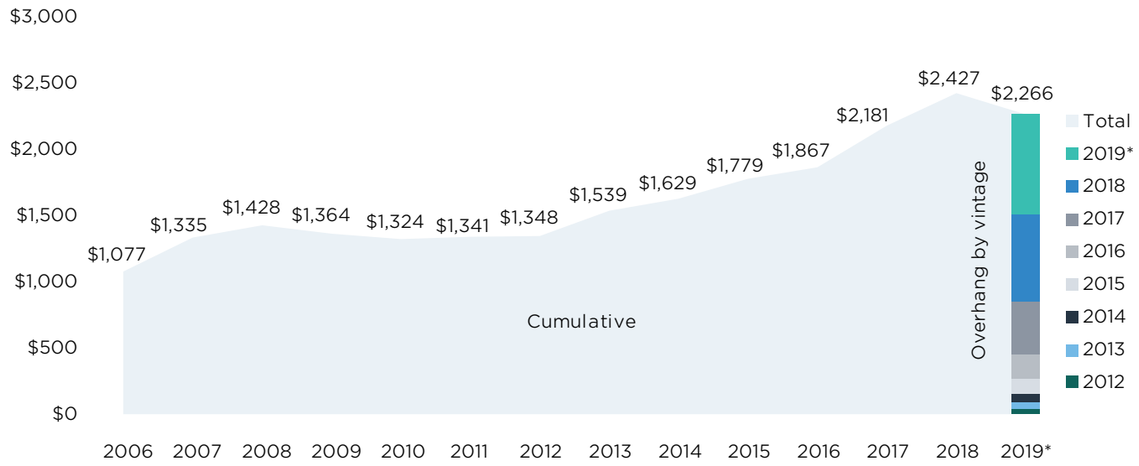
Charting the overall figures by size bucket, we can see the magnitude of this phenomenon in greater detail. While only 19.5% of the funds raised in H1 2020 were $1 billion or larger, they represented 73.9% of dollars committed. This was a record combined share for $1 billion+ funds on the back of records set in each of the previous three calendar years. Beyond the motivations driving LPs to these larger funds, GPs also have a real interest in growing fund sizes. In an extended record-low interest rate environment, PE returns may not provide the spread over an 8% hurdle rate that they once did. Funds must thus be larger to provide similar levels of dollar compensation to GPs.

As market dislocations emerged, a number of nimble GPs were able to go to market with repurposed or newly created funds to attract LPs hoping to invest opportunistically during the crisis. This was particularly true for private debt, where fundraising dropped overall, but several funds pivoted for the new reality. H1 2020 also saw an uptick in the share of secondaries; it reached 10.5% of private market commitments, almost double the 2009 share as the global financial crisis was playing out. VC also hit a recent high, reaching 13.7% of dollars committed in the first half of 2020. PE still took in the most in commitments, but its 37.6% share so far in 2020 was well off 2019's 51.3%.

Through year-end 2019, we saw dry powder tip down from a long-running upward trend. However, the first half of 2020 did see some impressively large fund closings and slowing deal activity, so we expect this trend to reverse as the cash flow numbers come in later in 2020.

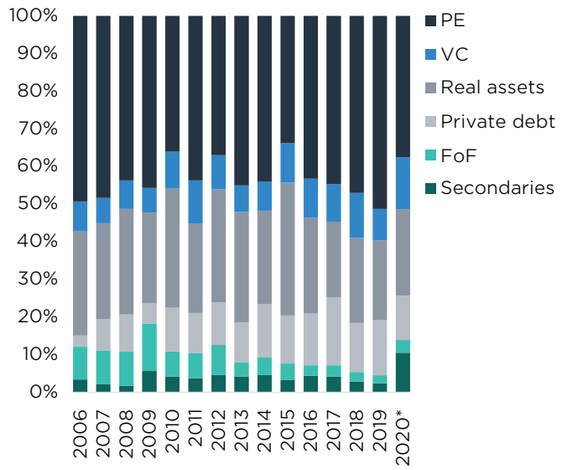
1: While the report from which this segment is sourced utilizes a global universe, PitchBook has converted all non-dollar fund amounts into the US dollar for comparison purposes.

Private capital overhang ($B)



Source: PitchBook | Geography: Global
*As of December 31, 2019

Private capital funds ($) by type



Source: PitchBook | Geography: Global
*As of December 31, 2019

What's moving AI and cybersecurity markets?

Meet Brendan Burke, senior PitchBook analyst covering emerging technology

Interviewed by Alexander Davis

One of the fast-growing areas of venture investment is in so-called deep-tech categories like artificial intelligence and cybersecurity. That's the domain specialty of senior PitchBook analyst Brendan Burke. Executive Editor Alexander Davis recently spoke with Burke about security budgets during the pandemic, Zoom's security breakdown, Palantir's pending IPO and election-security intrigue.

You cover artificial intelligence, machine learning, and cybersecurity. Where do you get your insights into those markets?

I really try to focus on a few signals in a sea of noise to find the leading growth areas in each of those sectors. There are a couple focal areas that best indicate the size and trajectory of those markets, the first being leading market research studies. Then there's PitchBook's data on valuation growth for private companies and funding trends for private companies, which is a proxy for the actual growth of the underlying companies. And then the third is industry surveys of enterprise buyers in terms of their priorities and preferences.

How is the pandemic affecting how security leaders think about their budgets?

Our research suggests that enterprises are increasing their focus on security given increasing challenges, and viewing it as a requirement rather than a luxury —particularly large enterprises. Part of this is the reality that cybersecurity is a greater threat during times of crisis. A primary driver of breaches is social engineering, which preys on psychological biases and behaviors. There's a recognition that employees and customers are increasingly vulnerable during times of crisis. And the second piece of this is there's a greater volume of devices and networks to be covered during this time period.

During the shutdown, Zoom suffered a big reputation hit when the world realized that it had security vulnerabilities. What are the lessons from the Zoom case?

Zoom became an increased focal point for security researchers as a result of its popularity. The misleading claims it made about end-to-end encryption that were disproven by security researchers might also be similarly misleading at other enterprise software vendors.

> **"There are a lot of concerns about data privacy for many third-party enterprise vendors, and that's become an increased area of focus for information security officers."**

A number of tech companies have been started without prioritizing data privacy. There are a lot of concerns about data privacy for many third-party enterprise vendors, and that's become an increased area of focus for information security officers.

Has Zoom's exposure forced other companies to take special new measures to make sure they're not the next Zoom?

Yes, it definitely goes to one of the growth areas in information security, which is data security and the need for companies to be able to prove the privacy of their data and the access controls on it as a growth driver for their business. That's why data privacy and compliance has been one of the highest growth areas in cybersecurity venture investment. It's increasingly seen as a requirement for doing business—to comply with privacy laws and be able to prove to customers that data is anonymized and encrypted. That was already in the works because of increased regulations, and these public failures have highlighted the reputational risks as well.

What trends are driving opportunity in the infosec sector and which deals lately illustrate that?

The dissolution of the firewall-based environment is leading to a full stack of network security solutions to replace firewalls at the cloud, remote and IoT layers. Firewall appliances that are installed within enterprise data centers are no longer able to capture most of the traffic within the enterprise network. That legacy industry is being disrupted by cloud-delivered network access controls and identity-based perimeters. Companies that are supplying cloud-delivered network security solutions generally are seeing high growth some are achieving unicorn valuations. One deal during Q2 that highlighted this was Cato Networks' $77 million round, which was raised on the back of 220% bookings growth in 2019. That company shows that software-defined wide area networks, which are under 10% of the networking solutions used by enterprises today to deal with remote work, are increasingly replacing firewalled environments, including VPNs. Netskope's mega-deal in Q1 followed that trend as well.

> **"A holy grail for startups is to identify novel nation-state-based advanced persistent threats, or APTs."**

It's election season, so which companies might be in the spotlight around the issue of hacking political operations?

A holy grail for startups is to identify novel nation-state-based advanced persistent threats. There are some startups that have accomplished that including Cybereason and CrowdStrike. It certainly has been a focal point of endpoint security startups to build a library of nation-state attacks that can be used to block them across their footprint.

Palantir is moving toward an IPO as early as October. What should the market look for in that deal?

Palantir is a litmus test for the ability of data analytics companies to leverage their data models to power AI algorithms and create a sustainable competitive advantage in AI.

If Palantir is successful in using its learnings from government and large enterprise environments to be able to develop easily customizable AI models for a range of enterprises, it could be a leader in pioneering the commercialization of AI.

Guardians of the purse

Senior analyst Hilary Wiek says limited partners are showing their faith in the private markets, and sticking with their tried-and-true GPs

Interviewed by Joshua Mayers

What has stood out to the you in the latest fundraising data, especially in this time of COVID-19?

Honestly, we predicted this pretty well in the Q1 report, but bigger funds are obviously getting the most attention. I say, "obviously." Maybe it's not obvious to everyone, but when you think about a world where LPs can't hop on a plane and kick the tires of a GP that's not known to them, and those LPs still have an allocation they want to make to keep their vintage-year diversification program going, it's pretty obvious that they're going to re-up with their same GPs—and maybe re-up with larger amounts. That's definitely benefiting the larger and more established managers. Another beneficiary of the current environment are the firms who pivoted their approach to be more opportunistic. One large fund manager was having a hard time raising a debt fund last year, but 2020 comes around and suddenly they're a distressed debt fund and had absolutely no problem garnering billions of dollars. If you can position yourself as being the right strategy for the times, you've got an opportunity to do well. LPs have shown that they've not been paralyzed by this moment. Some people thought that they might pull their chips off the table and ride out the year without making new commitments, but the dollar sizes going into these asset classes are still very large.

Is there anything first-time or smaller managers can consider right now when trying to fundraise?

> **"LPs have shown that they've not been paralyzed by this moment. Some people thought that they might pull their chips off the table and ride out the year without making new commitments, but the dollar sizes going into these asset classes are still very large."**

The first thing is patience. Fund managers who don't have name recognition or a successful fund they can launch off of are going to have to keep pounding the pavement. It goes back to normal sales rules: You go to your existing customers and see if they will give you more money or give you a referral. Another area is related to terms. A lot of people know about 2-and-20—your management fee and your carry—but how those are calculated is ridiculously complicated, and there are ways to tilt it in the favor of LPs. The GPs struggling to capture attention may have to think about how to make their terms more LP-friendly. That could be offering discounts for early investors or sizable investors. It could be making sure that you're not getting rid of your hurdle. It could be sharing carried interest. There's a variety of ways you can provide an advantage to your LPs in the long term. And then also the idea I mentioned earlier that a differentiated strategy should have a better shot right now, if they seem particularly well-positioned for what's going on.

> **"The GPs struggling to capture attention may have to think about how to make their terms more LP-friendly."**

How do LPs react when news reports and academic research call into question PE fund performance and whether the returns justify the fees?

This is my opinion, but I feel like the LP community thinks of the private markets in a sort of faith-based methodology or construct: If they've decided that they're going to allocate, they stick with it. They've been told, "If you weren't in vintage year 2008, you missed out on some great returns." And so we're seeing a lot of that this year and a ton of money pouring in at a time that feels distressed, whether the stock market shows it or not. They have two rationalizations when it comes to the evidence and, if not ignoring it, at least keeping it back of mind and not letting it affect their behavior. First, they think they can find the top-quartile managers that are going to beat the odds. I've never heard of an LP who says, "I'm going for the average," or, "Even if I get bottom-quartile, I'll still be good." They all think that they're going to be able to select the good managers. The second point is, "Past performance may not be indicative of future performance, so why do I need to pay attention to this report that's looking backward?" It's pretty easy for LPs to step around this evidence.

What's your view on the secondaries space and why does a lot money seem to be flowing into that strategy?

Secondaries requires a unique skill set that not everybody can bring to the table. They tend to spin out of or be part of fund-of-funds groups, but instead of just investing in blind pool funds, they're buying mature fund interests from LPs, so they actually get to put a value on specific assets already held in these funds. You might also have to look at a broad portfolio, as one LP might be trying to sell interests in many funds in one sale. There's a ton of data, a ton of knowledge, a ton of modeling, just a ton of work that goes into it, and that has really limited the pool of people capable of doing this well. Only 14 secondaries funds closed in the first half of this year, and when you have a sample size that small, you're going to get some lumpy numbers. If there are only a few big managers doing secondaries, sometimes they line up and close funds in the same year and it's not because they think that year is necessarily the best market environment. The other part is that the fundraising cycles are extended, and our data marks the entire fund size at one point in time. In PE, there's always going to be a bunch of mega-funds that smooth out that effect, but if the big secondaries funds all happen to close in 2020, but they were really fundraising in 2018 and 2019, it impacts how the data looks.

You're working on a survey-driven report on sustainable investing, which covers impact investing and using ESG factors to better understand risk. What has caught your eye in the responses?

The biggest cause for excitement was that we got such a big turnout. We got 368 completed responses and 650 people at least started the survey, so we're really delighted. And it was global. We got responses, a handful or more, from every region except the Caribbean. We have so much rich data, including from dozens of people who have no ESG efforts at their company, from which we can see some trends that will be statistically significant. One takeaway is that there still needs to be some agreement about how one measures impact and how one reports impact. I was looking through the answers and it's all over the place—whether they're using something internally created or something created by the United Nations or a consultant. That said, we're starting to see a lot of GPs out there getting pressure from LPs to do something in this area, and they want to know what they need to do. There's definitely been an uptick of interest—and not just interest, but action.

OPEN SEASON

Hard-hit sports world finds its newest fans: PE firms

By Andrew Woodman

CVC Capital Partners, Bain Capital and Cinven are among the private equity investors that have been circling Serie A, Italy's top-flight soccer league, for a possible stake in recent months. The promise of new capital couldn't arrive at a better time.

Serie A canceled months' worth of matches due to the coronavirus and has been feeling the pinch. Its revenue for the season is expected to drop to €2.1 billion (around $2.4 billion) from €2.5 billion the previous year, according to a forecast by Deloitte analysts. Even larger declines are expected across other top leagues in Europe, including England's Premier League, which expects to see revenue plummet from €5.9 billion to €4.9 billion.

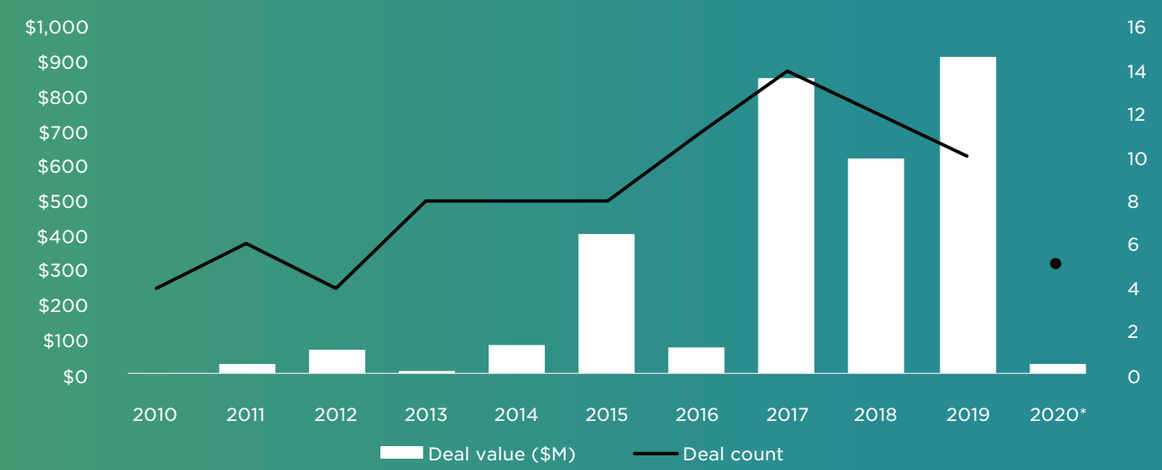
Serie A is just one of the world's many pandemic-plagued sports leagues forging new links to private equity. After playing out most noticeably in Europe, the trend has also taken hold across the Atlantic as the coronavirus ravages the finances of professional sports everywhere.

"COVID-19 has left leagues across the world—and their stakeholders—with significant revenue shortfalls and working capital needs, and third-party capital can fill this gap," said Andrew Umbers, a partner with UK sports-focused consultancy Oakwell, which advised Luxembourg-based CVC on its bid to buy a 14.5% stake in the Six Nations Rugby tournament.

In terms of total deal value, PitchBook data shows that 2019 was a record year for PE investment in Europe's sports market, with around $911 million injected across 10 deals—more than half of that representing Silicon Valley-based Silver Lake's $500 million purchase of a 10% stake in the vaunted English soccer club Manchester City.

Taking the field

PE deal activity in sports



Source: PitchBook | Geography: Europe
*As of September 1, 2020

New players

After decades of barring PE firms from taking stakes in franchises in many top leagues, the field is starting to open up. In the US, where $1.2 billion was invested across eight deals in 2019, Major League Baseball ruled last October that funds would be allowed to hold positions in multiple teams. Earlier this year, in a watershed moment for investors, Major League Soccer followed suit with plans to allow private equity to invest in teams, many of which have lost money during the pandemic.

The shift is significant because many sports have traditionally been closed to institutional investors, reflecting long-standing fears that third-party providers of capital could have undue influence. For many years, those rules may not have mattered because investments in the space were generally not as lucrative as they are today. Team ownership was typically the province of high-net-worth individuals drawn in more by the prestige of the asset than its profitability.

Joseph DaGrosa, chairman of the recently formed Kapital Football Group, said historically many leagues have appeared, in some respects, like an old boys' club, unwilling to open to a larger universe of investors that can cut far bigger checks than any individual. Now there is a paradigm shift. He said, "There's a recognition that capital is needed, and the only way that capital can come in, is in large doses through the institutional marketplace."

Adam Sommerfeld, managing partner at Certus Capital Partners, which advises several Premier League teams, said the fact that multiple established funds are already investing in pro sports is more likely to attract new investors. He points to examples such as CVC, which helped set the trend as far back as 2006 when it bought a stake in motor sports league Formula One. More recently, the firm is expanding its influence in rugby, augmenting its Six Nations deal in May with the purchase of a stake in the Pro14 league. That same month, CVC and Silver Lake were said to be in talks with New Zealand Rugby, a rugby union governing body.

"You're seeing a base that is very well-regarded, with respected investors making a statement of intent that others are looking to circle behind," Sommerfeld said. "It provides a comfort blanket."

Another big factor that has driven the need for new capital in sport is technology, which is opening up new growth areas. It is no coincidence, for example, that Silver Lake, one of the most well-known technology-focused PE investors, is backing a Premier League team.

"[Technology] is connecting every element of the sports value chain," explained Peter Hanton, a lawyer with Clifford Chance in London, which has advised several sporting bodies. "Whether it's on the pitch and using live data analysis around your players and training to assess how performance improvements can be enhanced, or using data analytics around your fan engagement."

"Content is king"

Broadcasters, generally the top source of sports income, have been upended by the arrival of streaming platforms such as Amazon and YouTube. And fans, who increasingly consume media on mobile devices, are changing the way they engage with sports teams. New capital is needed to take advantage of these opportunities.

DaGrosa said private equity groups are treating sports as a proxy for content at a time when demand is soaring. "Private equity firms see that content is king and clubs provide that content," he said.

He added that the likes of Amazon and Netflix, partly due to lockdowns during the pandemic, are running out of fresh content. So while these businesses have seen their customer base grow in recent months, the rate at which they are able to produce new shows to meet growing demand is likely to hit a wall.

"The only way you keep subscribers happy is with new content, and sports provides new content all time," DaGrosa said. "There are only so many times you can see a movie, but there's an infinite number of times you can watch your favorite team play."

Pandemics aside, there are still risks associated with investing in sports, and these vary both from deal

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> **I THINK PEOPLE ARE REALIZING THAT THE COMMERCIAL, MAJOR OPPORTUNITIES AROUND SPORTS ARE GROWING FAR MORE THAN THEY EVER HAVE.**
>
> **Adam Sommerfeld**
> Managing Partner, Certus Capital Partners

to deal and by region. For example, in Europe, the lowest-performing soccer teams face relegation, which may impact the long-term value of an investment. Performance can also dictate a team's entry into international competitions—and thus access to additional sponsorship deals. Governing sports bodies can also hold sway over the success of an investment.

In one recent case, the Union of European Football Associations hit Silver Lake-backed Manchester City with a €30 million fine and a two-year ban from European club competitions after it was accused of masking equity funds as sponsorship revenue. This would have put the team in breach of financial fair-play rules barring clubs from spending more than they earn.

The ban was later overturned and the fine reduced to €10 million by the Court of Arbitration for Sport. But regulatory oversight isn't necessarily a bad thing for investors. DaGrosa pointed out that sport regulations, such as financial rules that stop teams from spending unlimited amounts on players, give investors comfort that everyone has to play by the same rules and there are consequences for breaking them.

"Uncertainty scares investors," he said. "The more certainty you have—even if you don't like the certainty—the more comfortable you are."

For this reason, investors are increasingly attracted to US leagues such as MLS, which is far younger than its counterparts and has developed differently. The structure is more centralized. MLS operates as a single entity that centrally owns the teams and the player contracts, and shares the broadcasting rights. Unlike in Europe, teams do not face the risk of relegation, offering investors a more controlled environment where losses are limited. Match-day revenues are also greater for MLS in a country where fans are willing to pay more for an average ticket, DaGrosa said.

"On balance it certainly justifies paying a higher multiple of revenues for an MLS team relative to a European football team," he added.

However, sports investors on both sides of the Atlantic still face the risk of a COVID-19 resurgence and more lockdowns. The concern is significant enough that CVC is said to have added a coronavirus clause to its Six Nations deal, allowing the firm to withhold capital—to be paid in a series of installments—should further disruption occur.

Many aspects of pro sports remain appealing to traditional private equity investors. Sports leagues make most of their money from broadcasting rights, and many are locked into two- to five-year contracts, roughly corresponding to portfolio company holding periods. In addition, there are income streams from sponsorship, match-day revenue such as ticket sales and increasing digital revenue from things such as advertising on online content.

Oakwell's Umbers said more institutional investors, such as PE firms, are interested in backing sports. However, he stressed the importance of finding the right firm that both understands the sport in question and can align its interests with other stakeholders.

"Sports needs to be very careful who it chooses as its financial partner. There are multiple sources of capital, and private equity is just one of them," he said. "There are significant differences in culture sometimes, which won't always fit a particular sport to third-party capital."

Nevertheless, private equity investment in sports is only expected to grow. In April, Oakwell issued a report advising that the English Cricket Board consider opening up to funds. Certus' Sommerfeld, meanwhile, said investors are now expressing interest in even more diverse categories of sports—including swimming.

"I think people are realizing that the commercial, major opportunities around sports are growing far more than they ever have," he said. "Even COVID-19 has shown just how reliant people are on live content and having live sports to watch."

ESPORTS: A LEAGUE OF THEIR OWN

By Andrew Woodman

Kyle Giersdorf, a 16-year-old professional video game player, made headlines last year when he won $3 million in the inaugural World Cup tournament playing the popular shooter game Fortnite.

That prize was on par with the £2.35 million (about $3.1 million at today's conversion rate) won by tennis champion Novak Djokovic in his 2019 Wimbledon men's singles victory, showcasing the big-money heights attained by the once-fringe esports market.

"That has piqued people's interest in esports as a serious business, and the viewer numbers are increasing," said James Cranston, a lawyer with Clifford Chance who advises the sports and esports industries. "It is something that [investors] can get into early, and therefore reasonably cheaply, and by doing so can assist with setting the regulatory makeup around it."

Fortnite developer Epic Games—which private investors recently valued at $17 billion—had a prize pool totaling $100 million for last year's tournament. And it's widely expected to match that amount for future competitions.

Since esports leagues came on the scene around 20 years ago, the business has been dominated by game developers who use tournaments as an additional revenue stream—and as an effective way to boost their marketing profiles. Now, traditional sports brands are getting in on the act.

English soccer clubs such as Manchester United and Arsenal have teams dedicated to esports. The ePremier League, which launched in October 2018, is now into its second season and offering a £20,000 grand prize. It also ran the inaugural ePL Invitational, inviting Premier League soccer players on hiatus from lockdown to compete in a knockout tournament playing EA Sports FIFA 20. The event attracted more than 150 million viewers across platforms such as Facebook, YouTube and Twitch, and it was carried on TV by Sky Sports.

"For clubs, it's a great platform through which they engage with a younger fan base and cross-sell their digital content and existing products," explained Gregory Scott, a private equity lawyer with Clifford Chance.

Despite their virtual existence, esports haven't been totally immune to the impact of lockdown. Some major competitions take place in large stadiums where crowds gather to watch their favorite players compete across giant screens. For example, the 2019-2020 season ePL finals that had originally been set to take place at Gfinity Arena in London were postponed from March to August. The 2020 Fortnite World Cup was canceled altogether.

Nevertheless, if a second wave of coronavirus breaks out, esports will likely be better insulated than conventional sports. Epic Games has already decided to take its remaining tournaments online. For Wimbledon, meanwhile, an entirely virtual alternative isn't an option—yet.

UNSUSTAINABLE CARE?

Private equity's troubled bet on UK nursing homes

By Leah Hodgson

The coronavirus affects all ages but hits the elderly hardest. Those over 70 are the most at risk of developing severe symptoms, and this is painfully apparent in the UK nursing home sector. As of June, almost 19,400 elderly people in care have died from COVID-19, according to government estimates, meaning the virus accounts for 29% of all nursing home deaths. It is the worst crisis the sector has seen, and the numbers are only expected to rise.

The toll from the pandemic has exposed the vulnerability of the sector and its shaky financial condition. Nursing homes in the UK face more than £6.6 billion ($8.8 billion) in extra costs stemming from COVID-19 and £714 million in lost revenue by the end of September, according to an analysis by the Association of Directors of Adult Social Services, a nonprofit advocacy group.

To see the effects, one need look no further than the plight of the UK's largest operator, HC-One. In April, the company—currently backed by Formation Capital and Safand—warned that it was struggling to repay debt as falling occupancy and the cost of virus-related protective equipment for staff cut into its income. After uncovering safety lapses in some of its homes, regulators in Scotland called into question HC-One's license to operate Home Farm, one of its facilities.

Cases such as HC-One's are showing up across the industry as the pandemic magnifies health and financial problems that surfaced at nursing homes in the aftermath of PE investors swooping in to reshape the industry in recent years.

Over the past decade, PE firms have piled into a sector beset with financial stress brought on by the global financial crisis. Government austerity measures decimated local budgets. Between 2010 and 2018, public spending on adult care fell by £700 million, and the cost of care rose 6.6% from 2015 to last year, according to The King's Fund, a health-care think tank. Private equity investors were attracted to the industry, sensing potential for high returns in a traditionally stable sector serving an aging population.

> "There are fundamental flaws to the business model of the privatization and operation of care homes."
>
> **John Spellar,** Labour MP

Since 2010, PE firms invested more than £1.7 billion across 64 retirement and nursing homes deals, according to PitchBook data. Today more than 8 in 10 nursing homes in the UK are owned by for-profit operators, according to research by the Institute for Public Policy Research.

But with new capital often comes more debt. Ownership of HC-One changed hands three times in under a decade, each time becoming more indebted. Faced with low levels of local government aid, some PE backers are struggling to service portfolio companies' growing debt, leading some to skimp on operating budgets to maximize returns. Research from the Institute for Public Policy Research suggests that private operators provide less training and lower pay for staff and have a higher staff turnover, contributing to a lower quality of care.

Stress on privately owned nursing homes also has consequences for the public sector. By law, if a large provider fails, local authorities temporarily take on financial responsibility to ensure continuity of care.

"There are fundamental flaws to the business model of the privatization and operation of nursing homes," said John Spellar, a Labour member of Parliament who has railed for several years against PE involvement in the industry.

> **There are only so many patients and earning potential is limited, so piling on debt can mean disaster.**
>
> **Sameer Rizvi**
> CEO, RD Capital Partners

"Many nursing homes operate in an environment of profiteering, cost and corner cutting, all the while their owners are loading them up on debt with high interest rates and expecting the taxpayer to pay when it fails," he said. "You can't tar everyone with the same brush, but a lot are there to make a quick buck and get out before the music stops."

Dire circumstances

Spellar urged the government to take a deeper look into the sector's financial condition following the collapse in 2011 of home operator Southern Cross. Under PE ownership, the company turned into a billion-pound business. But after rapid expansion based in part on selling off some properties, Southern Cross was unable to meet rent payments.

In 2019, another large operator, Four Seasons, entered administration after failing to keep up with its heavy debt load. Like HC-One, the company changed owners several times before it was sold to Terra Firma in 2012 for £825 million, including a reported £500 million in debt.

"There are only so many patients and earning potential is limited, so piling on debt can mean disaster," said Sameer Rizvi, CEO of RD Capital Partners, a healthcare-focused buyout firm that owns several facilities. "Some nursing homes change hands two or three times and it cripples them. It doesn't work if investors go into the sector looking to exit after five years and they end up doing foolish things to make good returns."

Rizvi said that the sector faces a slew of bankruptcies mirroring Four Seasons. He added that the way PE investors operate homes is unsustainable because of firms' shorter holding periods. Pressure from investors looking to exit after five or six years puts pressure on home operators to focus on short-term results and scale back operations at the expense of long-term viability, he said.

But the reality is that the UK's nursing home sector is in dire need of capital; without a significant amount of public money, it depends on private investors.

Last year, the industry saw two nursing home closures for every opening, according to a study by CSI Market Intelligence. Private equity has become an important source of capital to fund new beds and upgrade assets that the UK increasingly will rely on as the population ages.

Some of the problems stem from light regulatory oversight. After Southern Cross's collapse, legislation in 2014 mandated that larger nursing home providers, typically privately owned, must disclose financial information to the Care Quality Commission, a UK regulatory body. Although the commission monitors quality standards, it can't force companies to improve their financial position.

Chris Thomas, senior research fellow at IPPR, said that problems in the sector have been well known for years but, despite much government debate about reform, very little has been done.

"Social care reform historically hasn't been an area that wins voters over, but with COVID-19 that has started to change," Thomas said. "The pandemic has really forced a lot of the public to simultaneously come to grips with what social care is and the value that social care workers bring. People will stop tolerating the idea that social care is a kind of political no man's land. Questions around access, quality and price are growing stronger."

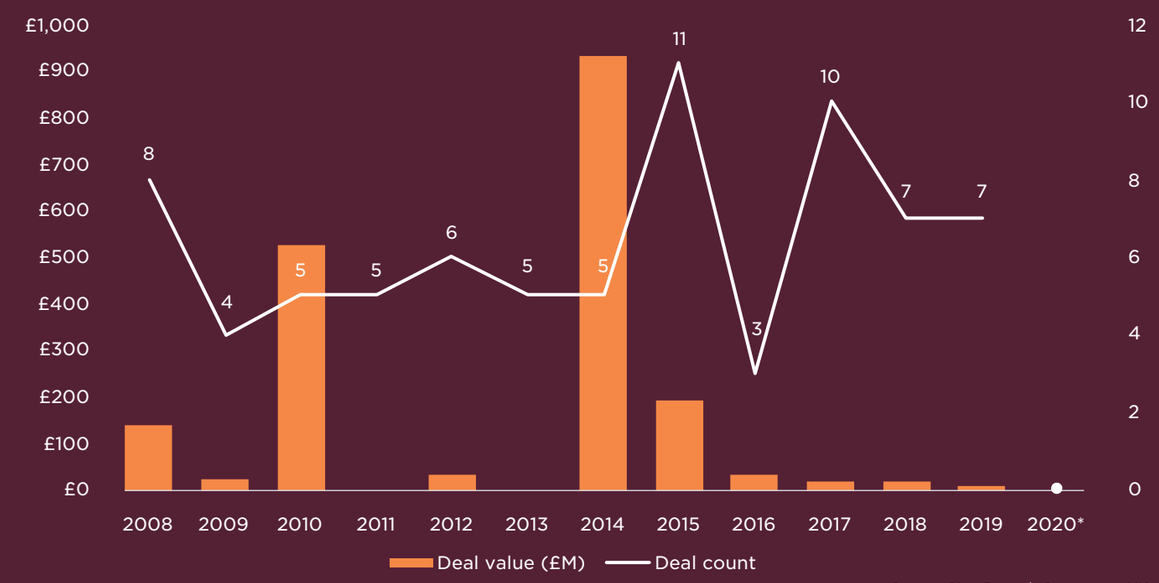
Thomas argued for a national care regulator to focus solely on the financial health of the industry and establish clear standards, including maintaining cash reserves in case of crisis.

Patient capital

"Without a sustainable funding model, things will continue to deteriorate," Thomas said. "This by no means, means that private equity shouldn't be involved, but we need to redress the balance."

Aiming for profit

PE investment in adult care homes



Source: PitchBook | Geography: UK
*As of August 18, 2020

8 out of 10
care homes in the UK owned by for-profit operators

£1.9B
private equity investment in retirement and nursing homes

6,500
homes at risk of closure over the next five years

Rizvi said nursing home investors should be required to hold their assets at least 20 years. The idea, which upends the 10-year lifespan of most PE funds, would likely involve an evergreen fund that has no termination date and allows investors to recycle capital from realized returns. Extending holding periods, according to Rivzi, would ease pressure on operators and provide capital to finance acquisitions and invest in technology without relying on more debt.

RD Capital Partners says it has a long-term investment horizon. In 2016, the firm set up a subsidiary that takes stakes in nursing homes with a view to building a larger business. Bridges Fund Management, an impact investor, launched a £50 million evergreen fund in 2016. It has used the vehicle to invest in healthcare companies, including residential and nursing care provider Shaw Healthcare.

"A lot of [nursing homes] are really in need of funding and you can get attractive assets at a bargain price," Rizvi said. "At the end of the day, we have an aging population and really a captive market. The big mistake to avoid is not overleveraging, because if you don't have to focus on repaying debt, you can invest more into nursing homes, which means better care for patients and higher returns for investors."

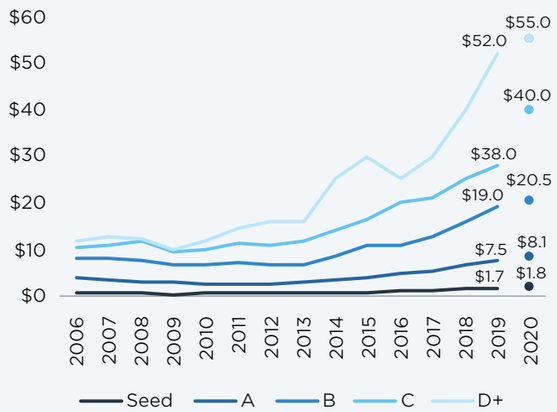
Market Trends

Venture capital

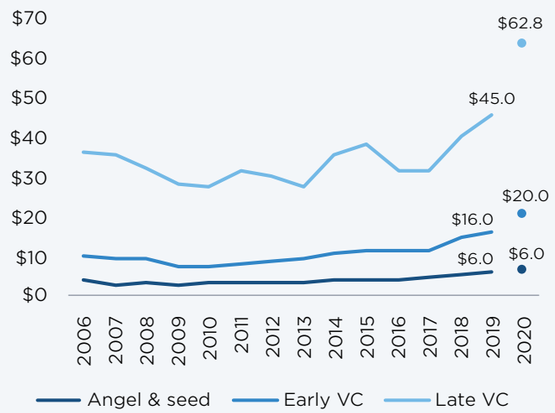
Once again, given the unique environment persisting in 2020, we opted to present a high-level overview of key trends across three primary segments of private markets: M&A, private equity, and venture capital. In addition, rather than sourcing from extant industry reports, we updated datasets to as recently as possible in order to provide a better sense of any momentum across key trends heading into the final stretch of 2020.

Data pull date: August 12, 2020 | Geography: North America and Europe

Median VC deal size ($M) by series



Median VC pre-money valuation ($M) by stage



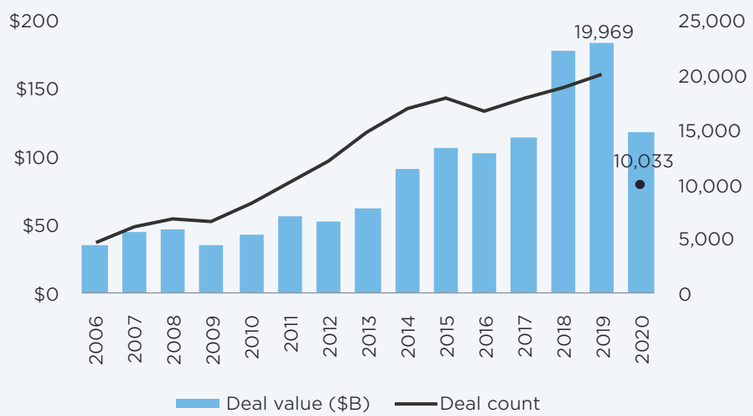
$117.4B
VC deal value hits third-highest annual tally of the decade by mid-August

$40.0M
Median Series C financing size surges to highest level on record

$62.3B
Capital commitments on pace for second-highest mark of the past 10 years

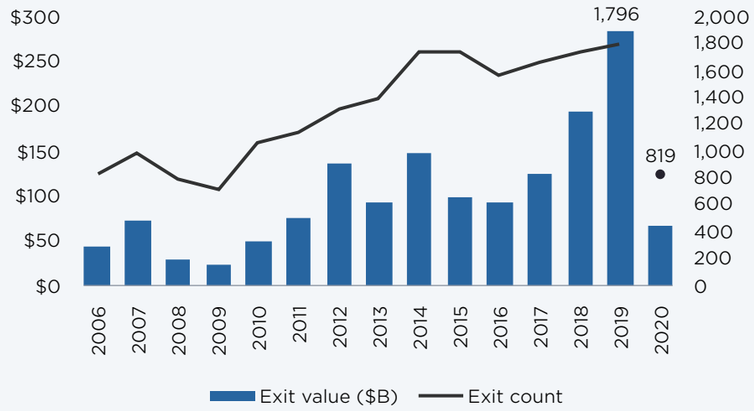
Unlike other arenas of private markets, pockets of venture have remained resilient through mid-August 2020. Deal value neared $120 billion, already the third-highest annual tally of the past 15 years, even as volume just barely eclipsed half of 2019's level. Investors favoring safe bets with mature companies during times of uncertainty partially explains these trends, as seen by the larger proportion of late-stage deals in 2020 than in years prior. However, as every single series of VC financing notched new highs, investors are clearly pricing in upsides and the longer term.

VC deal activity

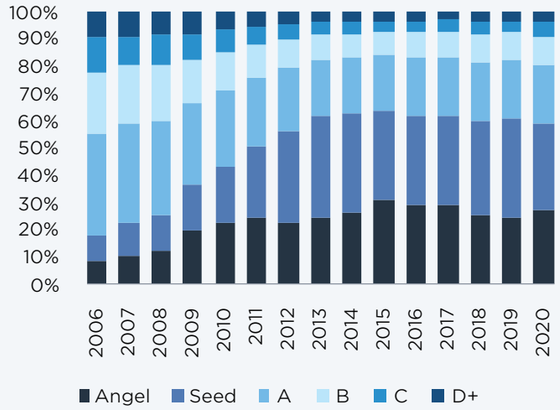


Venture-backed exit volume has not completely plunged off a cliff, but associated exit values have, at least relative to 2018 and 2019. Much of that is due to postponed IPOs by the largest VC-backed unicorns, although given the relative equanimity of public equity markets thus far, a few may still list this year. For example, Airbnb filed IPO paperwork with the SEC in August despite a record loss in Q2 2020. Much like for PE firms, overall, liquidity may not be a challenge for many venture backers, but unicorns' exit timelines may be less flexible than most, and some companies may be forced to list or seek other sources of liquidity or funding.

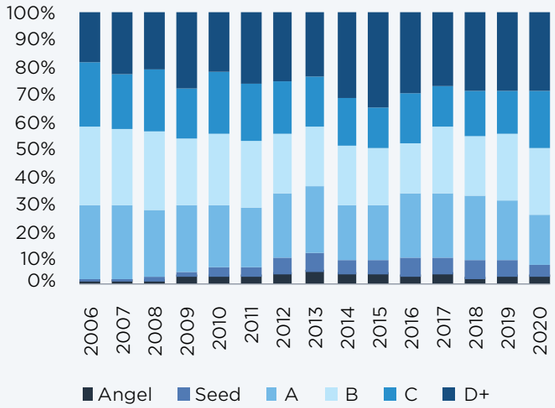
VC exit activity



VC deals (#) by series

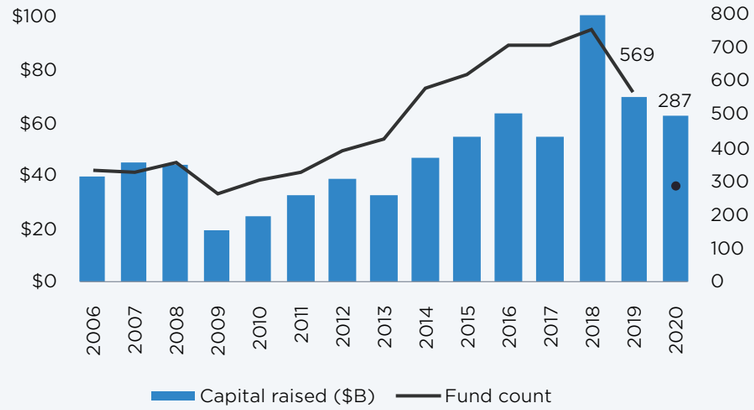


VC deals ($) by series



It would appear LPs have taken the pandemic and its impacts to date in stride, given they have committed no less than $62.3 billion already across nearly 300 venture funds. However, there are nuances that need to be unpacked. After total annual fund count reached a peak in 2018, last year saw a significant decline, likely due to the natural lumpiness of fundraising data. There is still significant appetite for exposure to venture—but the largest and most experienced fund managers have been able to close in 2020 thus far. Cyclicality is at play, and thus it may be some time before such heights are reached again.

VC fundraising activity



These figures will likely be revised upward, drawing from additional estimates, in our quarterly market updates due out in the first month of Q4 2020.

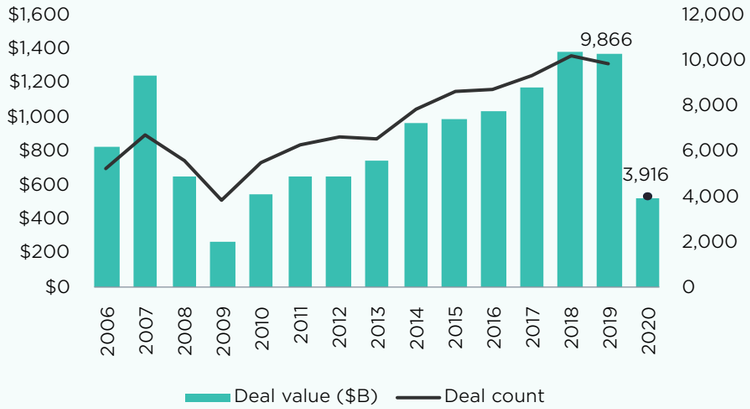
Private equity

Data pull date: August 12, 2020 | Geography: North America and Europe

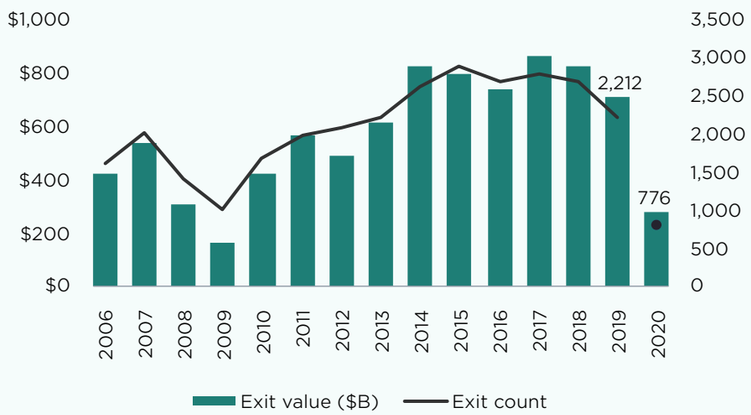
Deals are still closing, but PE fund managers have by and large retrenched significantly. Granted, 2018 and 2019 were record highs in terms of both deal volume and value, so the levels of investment recorded in 2020 to date are not historically atypical. Moreover, with the average deal size remaining quite high even as the median has slumped relatively more, PE buyers are clearly still willing to pay up for the right business. Anecdotally, due diligence has become more protracted, but exploratory processes are still underway, hinting at relatively steady if subdued investment activity going forward via alternative deal structures, such as growth equity.

Exits by PE fund managers have declined significantly, with marginally more of a decrease concentrated in secondary buyouts as opposed to sales to strategic acquirers. Liquidity may not yet be a challenge for sponsors of some aging portfolio companies, but depending on their pre-pandemic exit strategies, some firms are reassessing their prospects through a more sober lens. No investor wants to take a haircut on their exits, so most are adopting a wait-and-see approach before hard choices must be made. Consequently, a focus on portfolio management and any necessary triage is paramount instead.

PE deal activity



PE exit activity

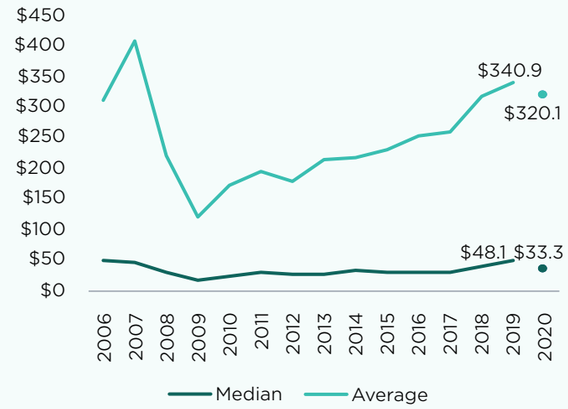


$311.6M
As fundraising volume contracts, the median fund size rises

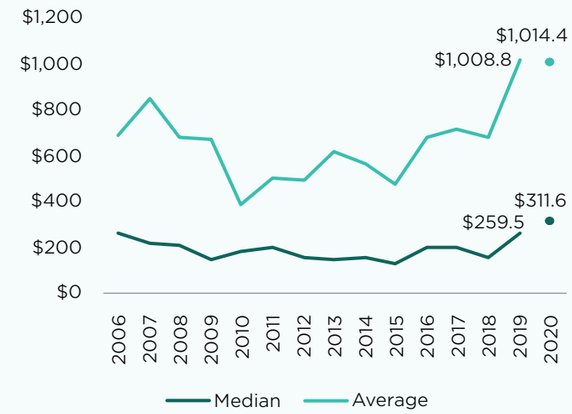
35.0%
Exit volume is at far less than half of 2019's tally, as of mid-August

9.6x
After three straight years of double-digit tallies, the EV/EBITDA buyout multiple retreats

Median and average PE deal size ($M)

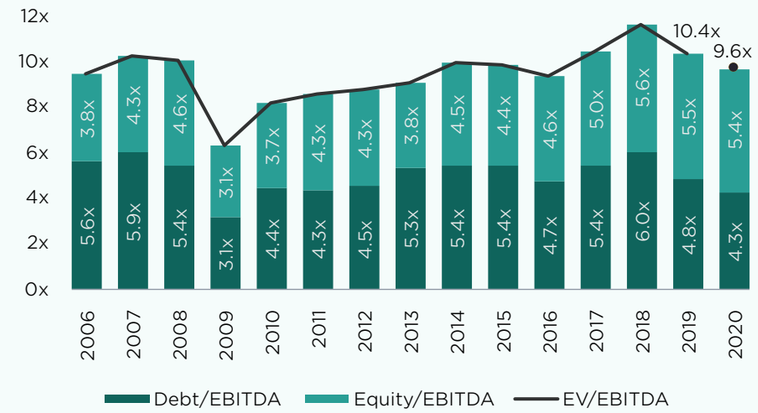


Median and average PE fund size ($M)

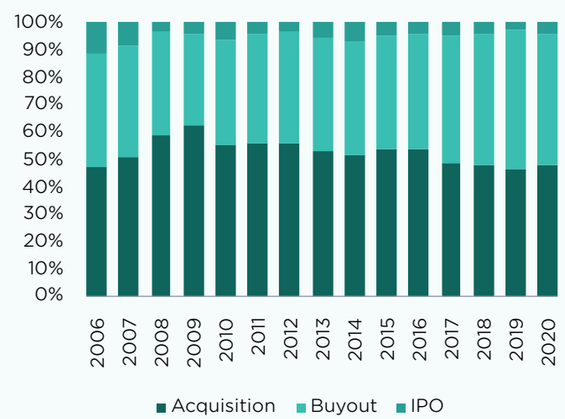


At $190.7 billion through mid-August, PE capital raised is relatively strong even across just 195 vehicles. Again, these figures are robust by historical standards, barring the 2017-2019 period, which saw records for both capital committed and number of vehicles closed. Less clear is whether fundraising volume will slide further or remain steady; as the median fund size hit a record high, larger firms were evidently still able to close on commitments. Whether LPs' appetite will continue fueling the flow of commitments through the rest of the year remains to be seen.

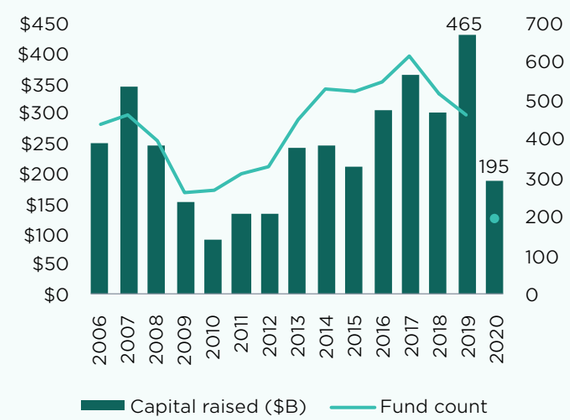
Median PE buyout EV/EBITDA multiples



PE exits (#) by type



PE fundraising activity



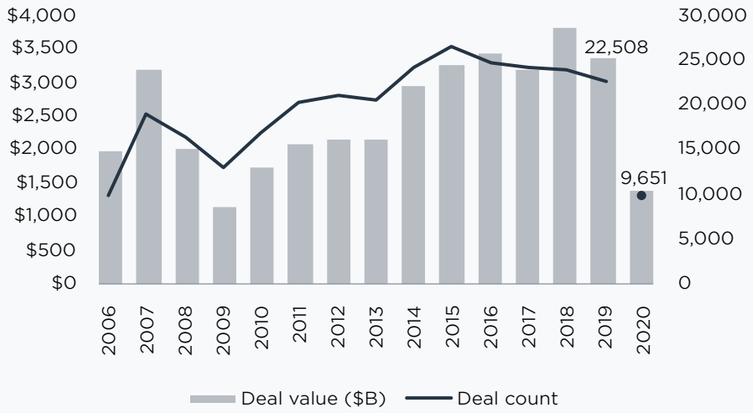
These figures will likely be revised upward, drawing from additional estimates, in our quarterly market updates due out in the first month of Q4 2020.

M&A

Data pull date: August 12, 2020 | Geography: North America and Europe

Across Europe and North America, dealmaking has subsided in the face of uncertainty. Both deal volume and value are pacing off the halfway marks of 2019, registering potential shortfalls by double-digit percentages relative to highs notched last year. Regardless of nations' varying levels of success in combating the COVID-19 pandemic, the full extent of economic ramifications remains unclear. Even if additional fiscal and policy measures are enacted to address economic hardships, it is likely that dealmaking will remain muted for the remainder of the year.

M&A activity

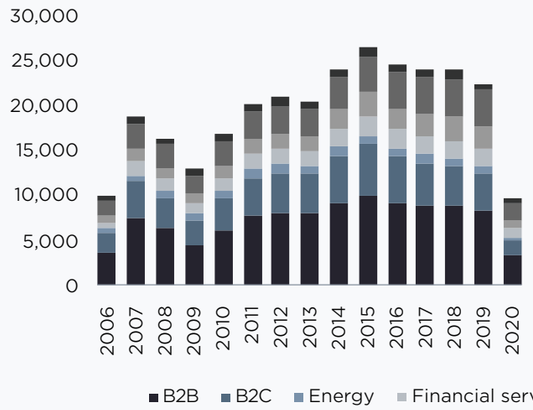


$285.1B
Mega-deals in IT have still propelled aggregate deal value forward

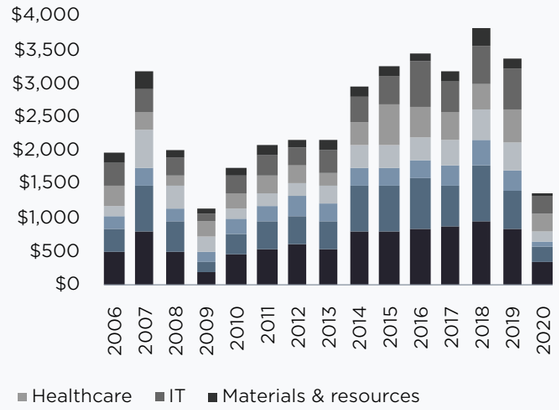
$92.9M
The median PE buyout size has dropped for the first time in years

30.0%
As of mid-August, M&A volume was on pace for a 30.0% decline relative to 2019

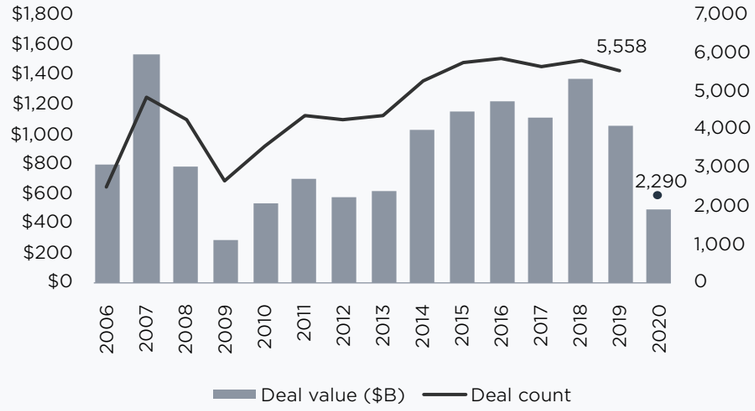
M&A (#) by sector



M&A ($B) by sector



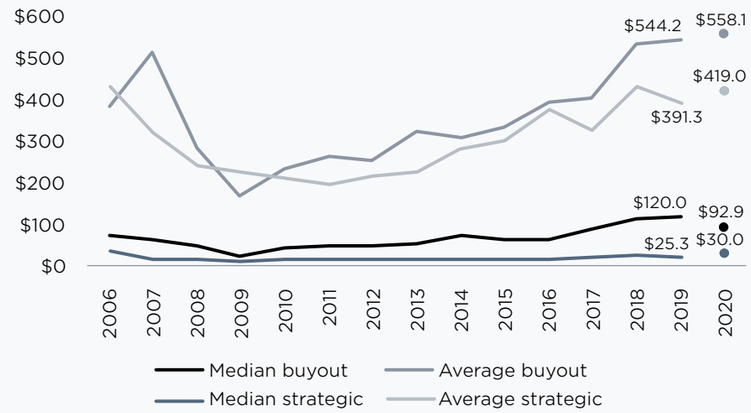
Cross-border M&A activity



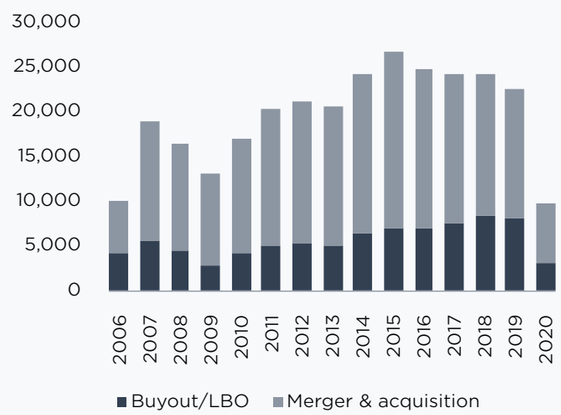
Among sectors, consumer and energy have seen the greatest slowdown in overall M&A, particularly the latter. Financial services and IT are the closest to matching last year's pace; the latter's resilience is understandable given increased reliance on digital tools for remote communications and associated workflows. Further consolidation is likely across other sectors as the pandemic endures, given some businesses will be relatively better placed to weather hardships and thus take over smaller, harder-hit competitors. Alternatively, others will opt to merge.

Buyout volume is pacing behind strategic M&A, likely due to protracted PE timelines and greater uncertainty across credit markets. Consolidation and opportunistic investments are still occurring, but as caution still reigns supreme, the pacing is not as vigorous yet. However, PE fund managers could become more active as time goes on, looking for relative bargains amid hard-hit sectors.

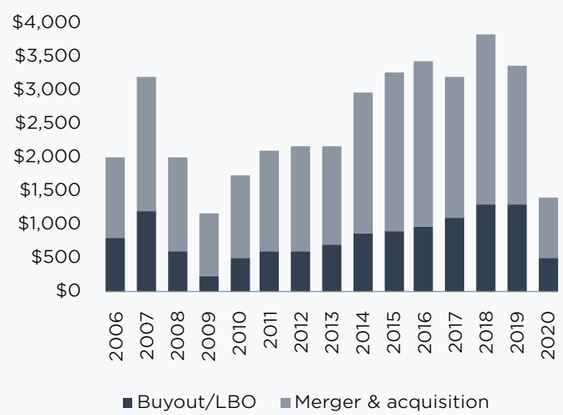
Median and average M&A size ($M) by type



M&A (#) by type



M&A ($B) by type



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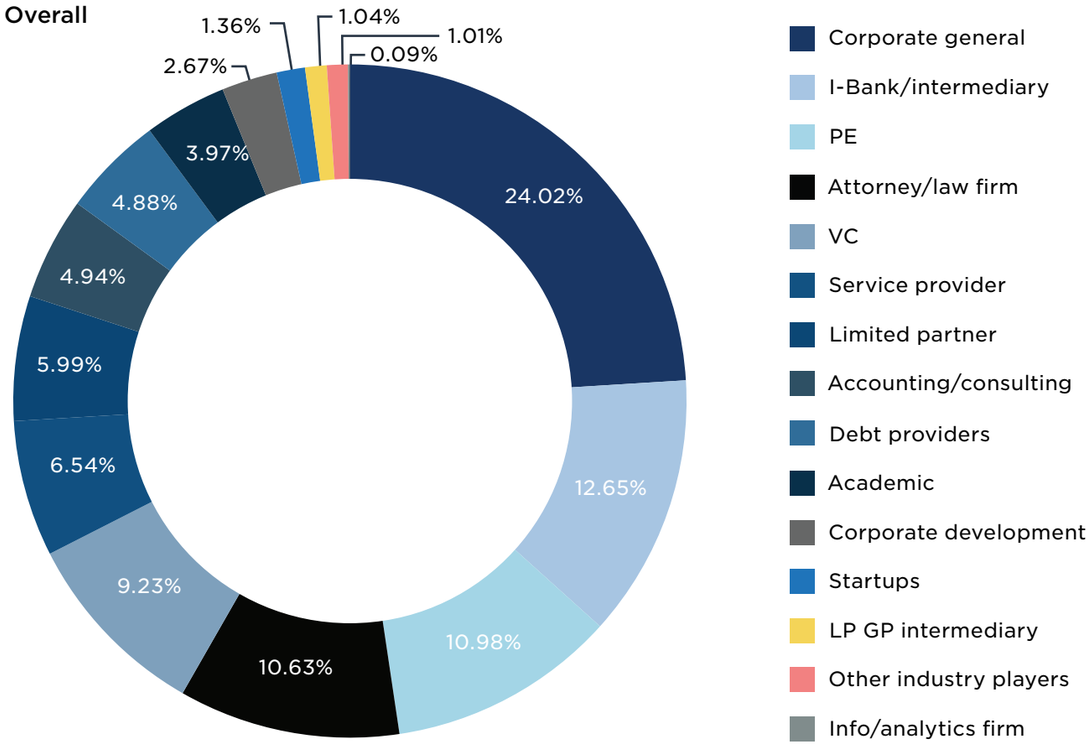
Overall



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