BOURNE PARTNERS

INSIGHT

CAPITAL MARKETS UPDATE

OCTOBER 2022

Updated October 31, 2022

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Executive Summary

Macroeconomic Uncertainty

- Mounting uncertainty is impacting every household and business alike and thrusting global recessionary concerns to the forefront. Current concerns include record high inflation, rising interest rates, geopolitical uncertainty, foreign exchange fluctuations, military conflict, global supply chain shortages, continuing COVID lockdowns, and labor shortages

Public Market Update

- As investors navigate and price the effects of higher interest rates and macroeconomic uncertainty, US equities have lost nearly all gains captured since the pandemic. The IPO market has largely been eliminated as an exit opportunity for PE firms, and credit markets have also grinded to a halt causing bond yields to spike as investors price in rate hikes and default risk due to a diminishing economic outlook

Private Market Update

- Largely, private markets have fared better than public markets. The main lifeline supporting private markets is mass amounts of Dry Powder, totaling $1.2T, in both Private Equity and Credit funds
- Private Credit funds have the capacity to fill the funding gap left by large institutions, lending support to the M&A markets and enabling good deals to close
- Through 1H 2022, Private Equity fundraising remained strong as GPs were closing more funds than ever, faster than ever, and larger than ever. This trend has abated slightly as funding velocity slowed, likely causing several funds to delay closing
- The Year of The Add-On: ~80% of 2022 YTD PE investments have been add-on acquisitions for existing platforms. These deals are easier to finance and integrate, and better received by investment committees and lenders. The average deal size for an add-on is ~$300M, increasing demand for middle market companies

Healthcare Well Positioned

- Investors view Healthcare as noncyclical and recession resilient, resulting in YTD outperformance. Particularly, Pharma Services have maintained their value throughout 2022, currently sitting ~39% above the S&P 500
- With M&A volumes down broadly, Healthcare deals are still coming to market and closing at near record multiples. For the first time since 2007, Healthcare transactions have made up the largest percentage of total M&A deal value, totaling $56B (or ~30%), while only accounting for 13% of the total number of M&A deals, through Q3 2022
- Healthy Pharma balance sheets will enable existing tailwinds with an estimated $300B of dry capital earmarked for dealmaking within the next 18 months

Macroeconomic Uncertainty

Global Economic Landscape

Geopolitics

- National governments are conducting a high-stakes balancing act; juggling record inflation, diminishing economic outlook, currency devaluation, soaring energy prices, escalating military conflict, changing of top officials, and more

Supply Chain Shortages

- The global economy is still dealing with hangover effects of COVID-19 lockdowns, as global trade is still yet to equilibrize. Added effects of labor strikes/disputes (US Railways, French oil refineries, etc.), climate effects (Mississippi river levels), commodity shortages, and price fluctuations make for a challenging business environment

War in Ukraine

- Russia's invasion of Ukraine has had global implications which were exacerbated by the largely failed economic sanctions
- The War has persisted much longer than expected and has triggered a global energy and grain crisis, as other countries rely heavily on Russian and Ukrainian exports

Inflation

- Closely related to the prior two topics, inflation has become a daily talking point throughout households, offices, and social groups around the world
- At the highest level in 4 decades, inflation concerns are a key driver of equity and credit markets, and even though there are signs of cooling, we still have a long way to go

Recession?

- The culmination of these issues has raised much concern about whether we're headed for a recession, while the GDP-based definition indicates we were in one prior to October's reading
- Notable themes to keep an eye on moving forward as it relates to recessions include the Fed's upcoming rate hikes, quarterly GDP, corporate earnings, and the debt markets

US CPI Headline Inflation

Since early 2021, U.S. inflation has surged topping 9.1% in June. This is largely the aftermath of loose monetary policy and mass stimulus injected by governments to support markets during the pandemic.

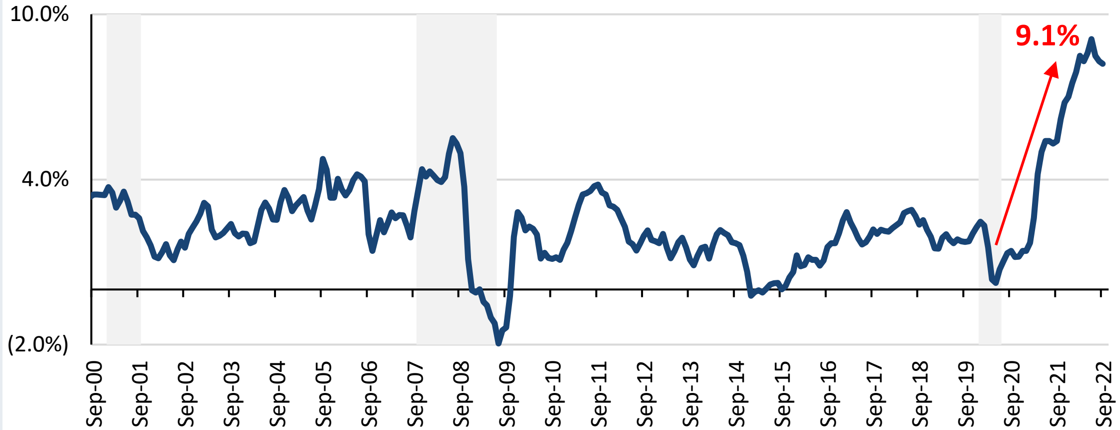
The FED's annual inflation target is ~2%. The US hasn't seen this level of inflation since the 1980s

The driving force of inflation is a culmination of **supply shortages** stemming from global lockdowns, war, trade tariffs, and more; all while **loose monetary policy and free flowing fiscal policy** bolstered corporate balance sheets and consumer checking accounts, **increasing demand**

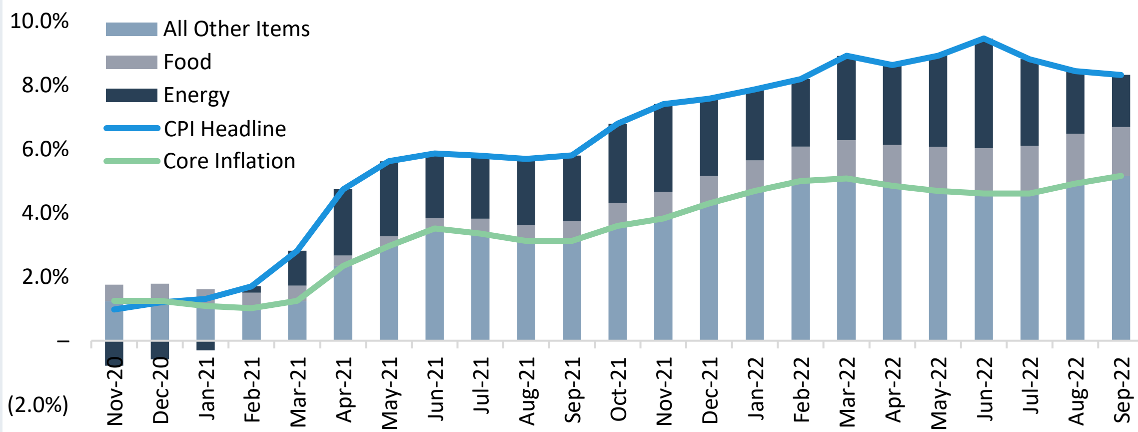
Over the course of 2020 & 2021, the **US Government injected $5.8T of stimulus in the economy**

Energy and Food has been a large contributor of inflation, but **core inflation still sits at 5.2%** as of September's report

CPI Headline Inflation (2000 – YTD)



Consumer Price Index – Inflation by Category (2020 – YTD)



Source(s): FRED®, Federal Reserve Bank of St. Louis – YTD as of 10/31/22

Global Inflation

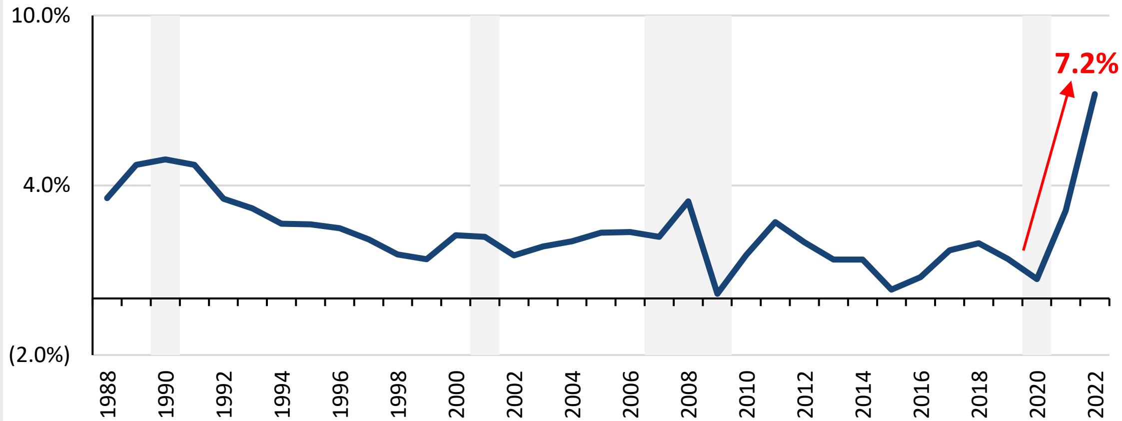
Inflation isn't just confined to the US, as prices across the globe have surged 7.2% on average. During the pandemic, Governments around the world deployed similar methods as the US – mass fiscal stimulus.

Though none as drastic as the US, total **Discretionary Fiscal spending in response to COVID-19 totaled $16.6T USD globally**

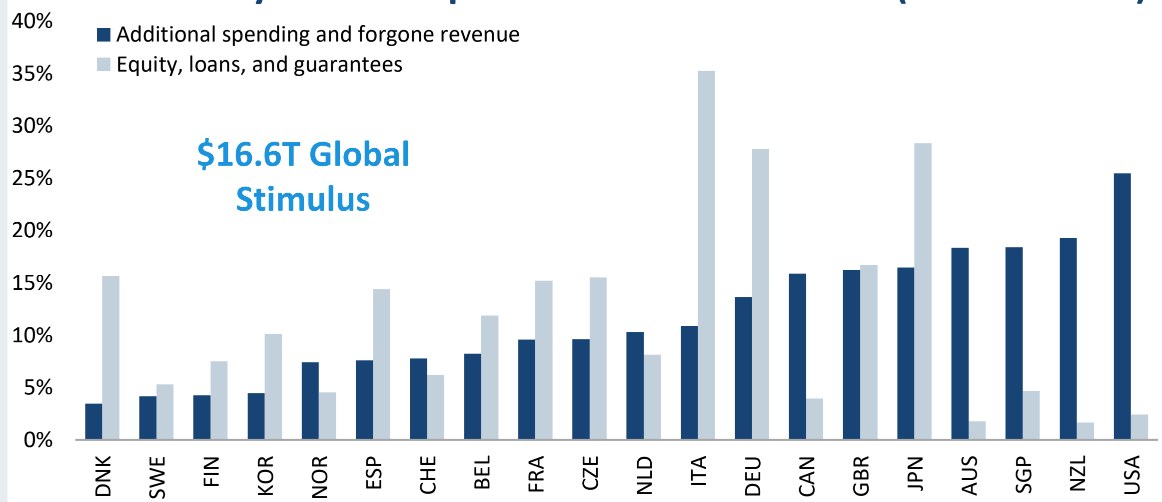
Advanced economies (shown in figure bottom-right) accounted for 84% of total Global stimulus, 35% of which was the US's $5.8T. This was deployed in the form of direct spending/forgone revenue (**decreasing Gov. assets**) and liquidity support through bailouts/market intervention (**increasing Gov. liabilities**)

The US and other countries with strong currencies had the ability to increase spending, while weaker nations were forced to provide guarantees

Global Inflation – Average Consumer Prices (1998 – YTD)



Discretionary Fiscal Response to COVID-19 Crisis (% of '20 GDP)



Source(s): International Monetary Fund – YTD as of 10/31/22 ; The World Bank

Global Inflation - continued

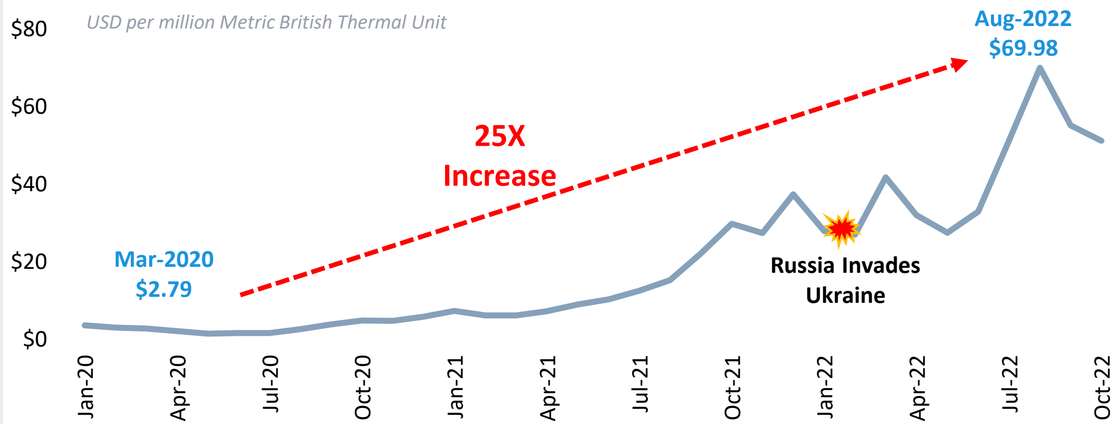
European nations and others reliant on Ukrainian and Russian exports have suffered the most since the escalation of Russo-Ukrainian War.

Global inflation was further exacerbated when **sanctions aimed to weaken Russia had unintended consequences** as Russia weaponized energy against EU nations

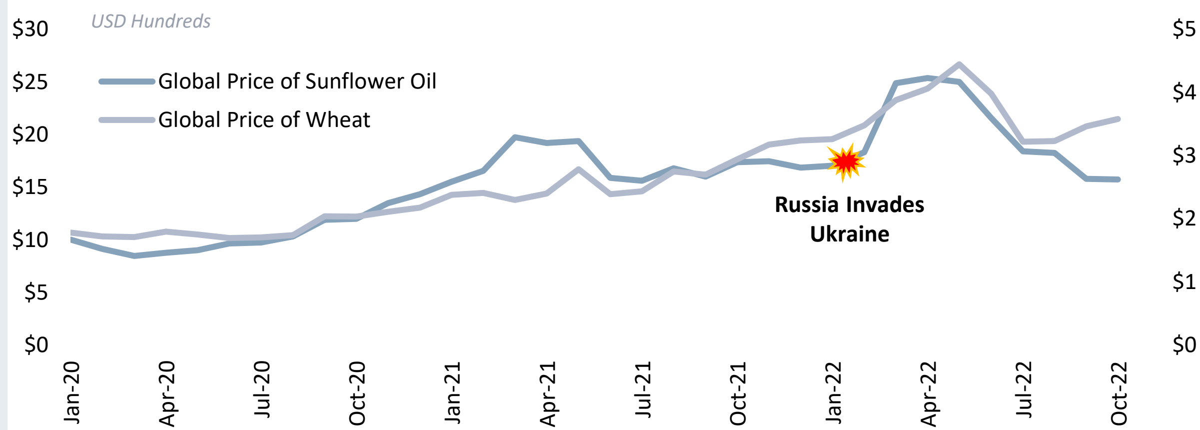
EU nations are heavily reliant on Russian energy supply. Natural Gas prices multiplied **25x since COVID-19 lockdowns** to a peak in August. Prices have since declined 27% from this high, yet prices are still forcing nations, businesses, and households to curtail utilization

Additionally, low-income African countries have suffered dramatic food shortages. **Ukraine and Russia account for 1/3rd of the world's wheat and barley production**, and 75% of sunflower oil supply

European Natural Gas Prices (2020 – YTD)



Key Agricultural Commodity Prices (2020 – YTD)



Source(s): International Monetary Fund – as of 10/31/22

FED Interest Rate Intervention

In response, The Fed is raising rates at the fastest pace in 40 years with a primary goal of taming inflation, but at risk of pushing the economy into a recession.

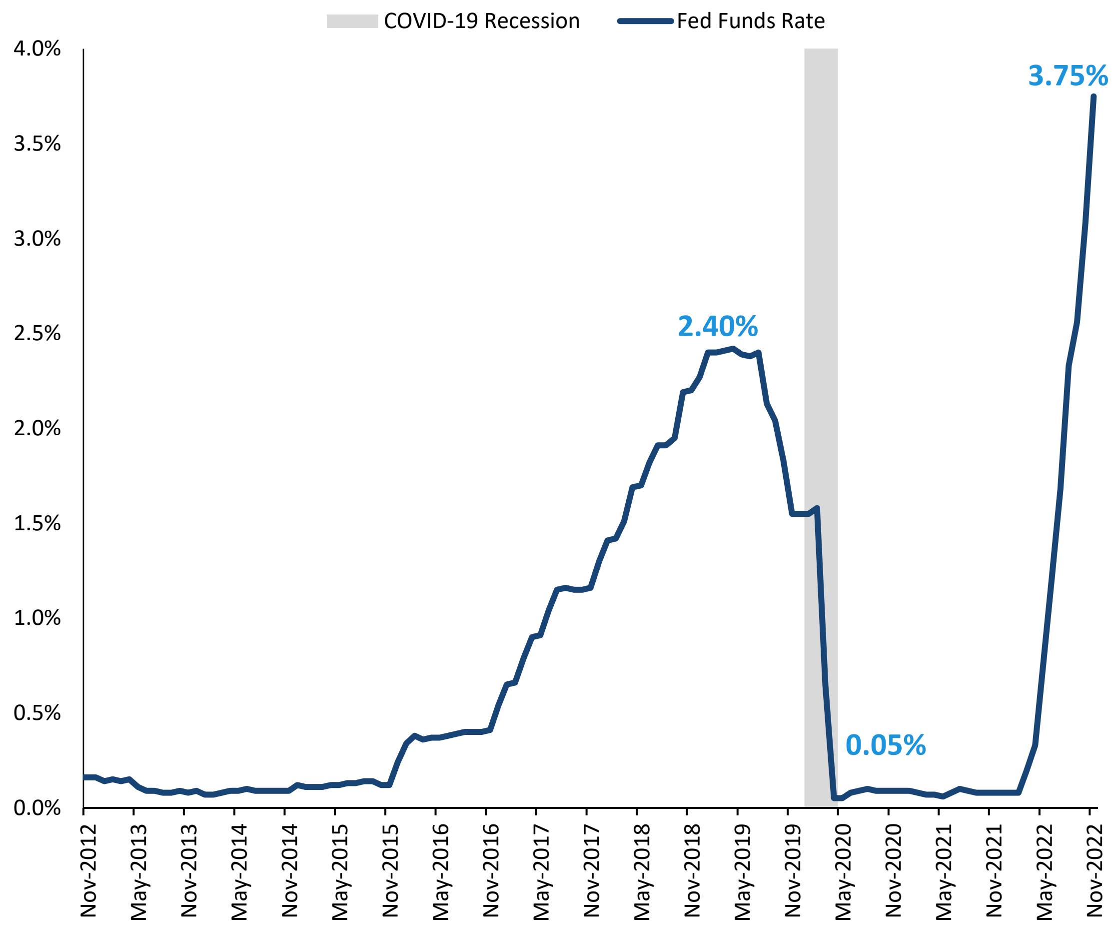
After **6 rate hikes**, the Federal Funds Rate sits at 3.75% as of November's FOMC meeting

The FED clarified it aims to start cutting rates upon seeing "compelling evidence" of inflation falling toward 2%, implying rate hikes could end meaningfully before that

Markets predict the pace of hikes to slow to 50bps, even as the Chairman still seems adamant on stamping out inflation, despite the **increasing likelihood of pushing the economy into a recession**

As a result of these hikes, the average **30-year mortgage rate reached 7.1%**

Federal Funds Rate (2020 – YTD)



Source(s): FRED®, Federal Reserve Bank of St. Louis – as of 10/31/22

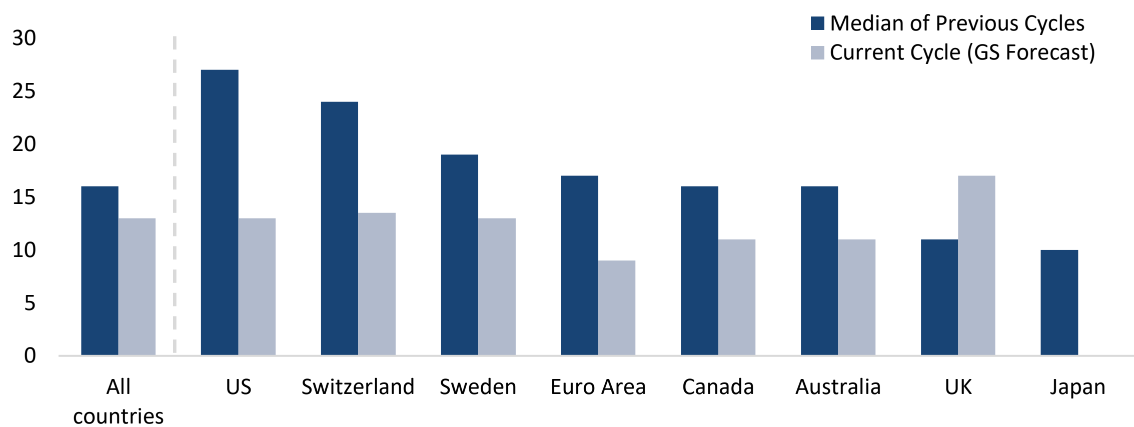
Global Interest Rate Intervention

Other G10 Nations are also raising rates alongside the US. This poses the question that many investors are grappling with – how much longer will the rate hiking cycle continue and when will central banks start to cut rates?

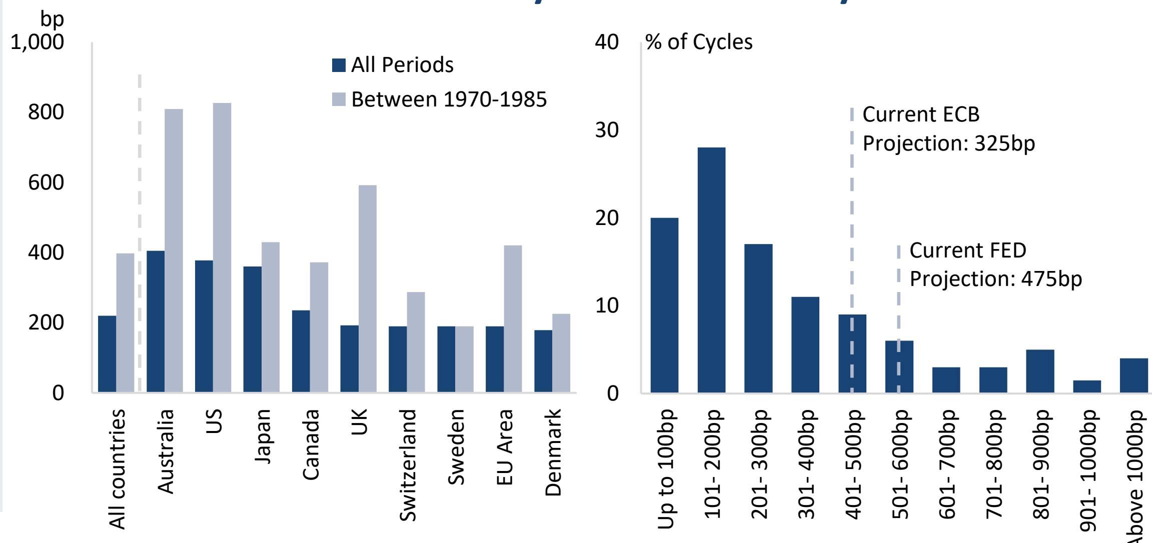
According to a Goldman Sachs report that analyzed 85 prior hiking and subsequent easing cycles from 1960 – 2019 across G10 economies…

1. G10 **hiking cycles lasted just over 15 months** on average, and 70% of historical cycles lasted longer than a year
2. Central banks tend to **stop hiking when year-over-year inflation is still relatively close to its peak** without necessarily having fallen significantly
3. **Rates increased by 200bp in the median G10 hiking cycle**, and by only 400bp in the 1970s. And **75% of hiking cycles featured a pause**
4. **Large rate cuts tend to come soon after the hiking cycle ends**

Length of Hiking Cycles Across Countries



Increase in Policy Rate Over the Cycle



Source(s): Goldman Sachs' Global Economics Analyst, G10 Hiking and Cutting Cycles: Lessons from History (Bhushan)

Strengthening US Dollar

As rates rise, US federal debt and currency investments look more attractive, causing the U.S. Dollar to surge in value, and increasing concerns over its negative impact on foreign economies.

As the USD strengthens, other currencies lose buying power, furthering the energy crisis, inflation, debt burden, and ultimately leading to a global economic crisis if left unchecked

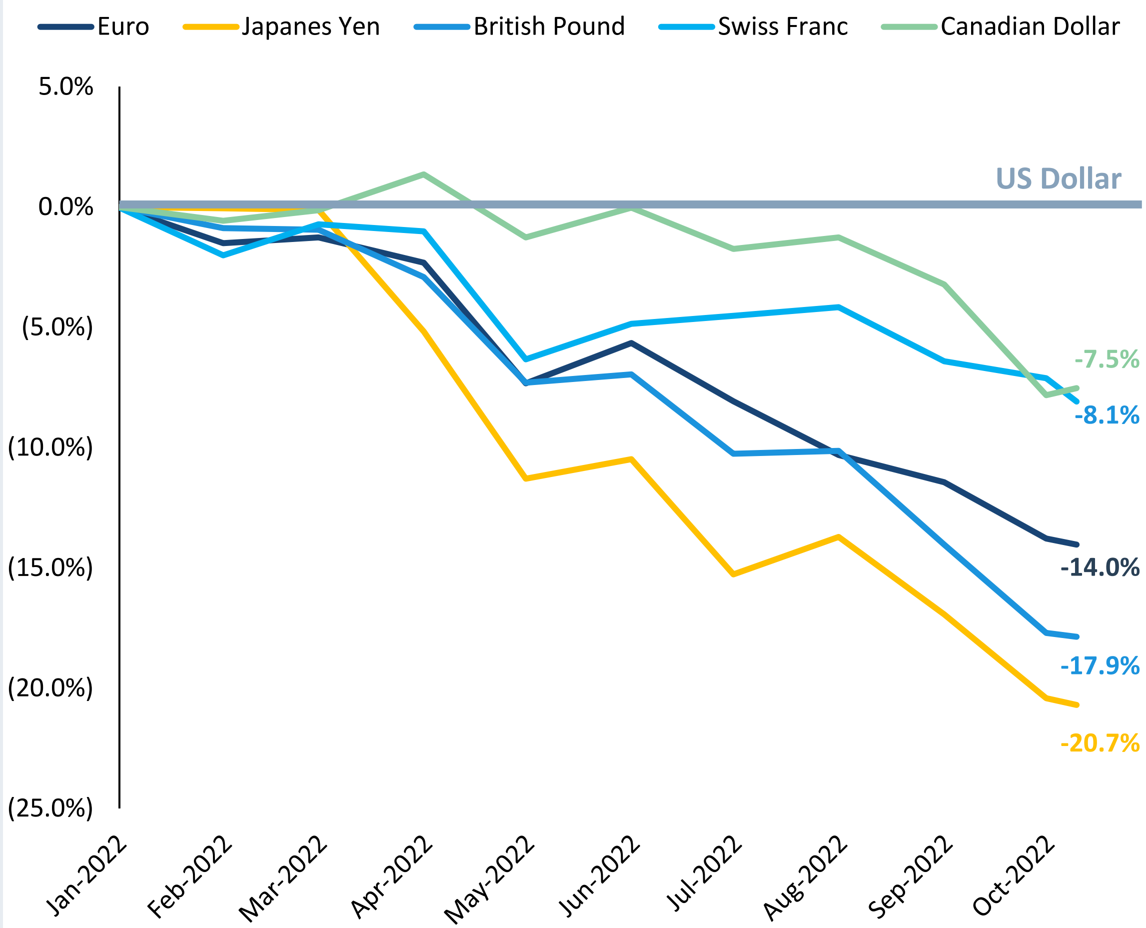
Why this is important?

The US dollar lubricates the global economy as the global reserve currency. Meaning the **cost of doing business has increased 20x** for many nations and businesses!

Global Trade by the Numbers

80% of global trade is settled in USD
60% of foreign debt is denoted in USD
100% of oil is settled in USD

Major Currencies vs. USD (YTD*)



Source(s): International Monetary Fund – as of 10/15/22

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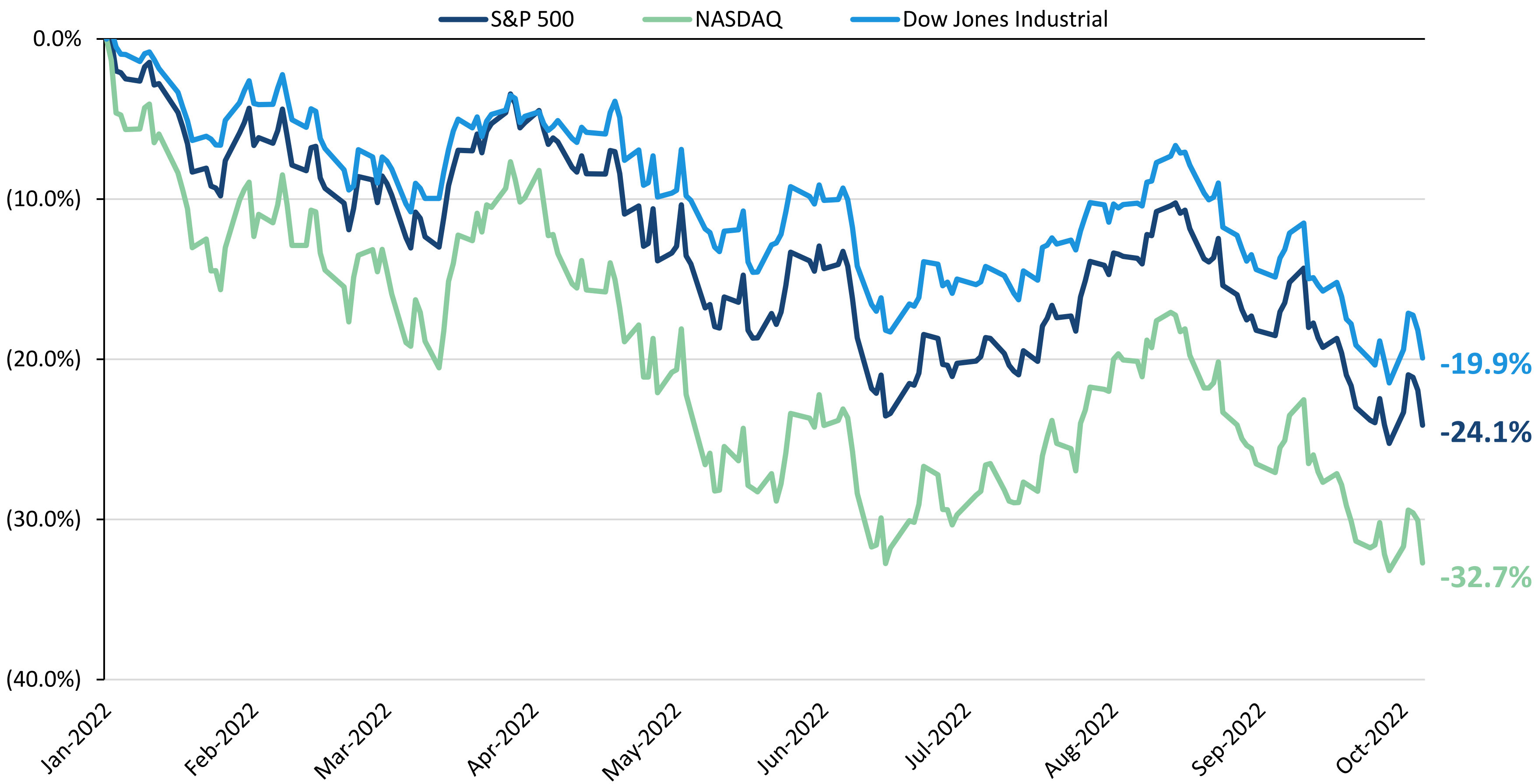
Public Markets

Major Indices Sell-Off

All major indices have posted substantial declines in 2022 as investors navigate and price the effects of higher interest rates and macroeconomic uncertainty. After a pandemic boom that resulted in record highs, US equities have declined to near pre-pandemic levels, forfeiting nearly all 2020 & 2021 gains.

US Equities Shed ~20-35% of Value YTD*

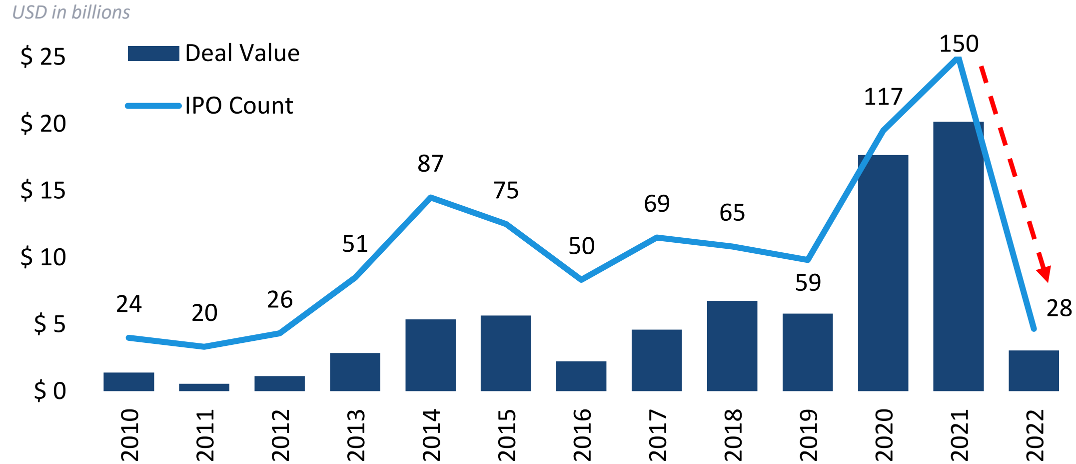


*Source(s): S&P Capital IQ – *as of 10/15/22*

The IPO Window has Shut

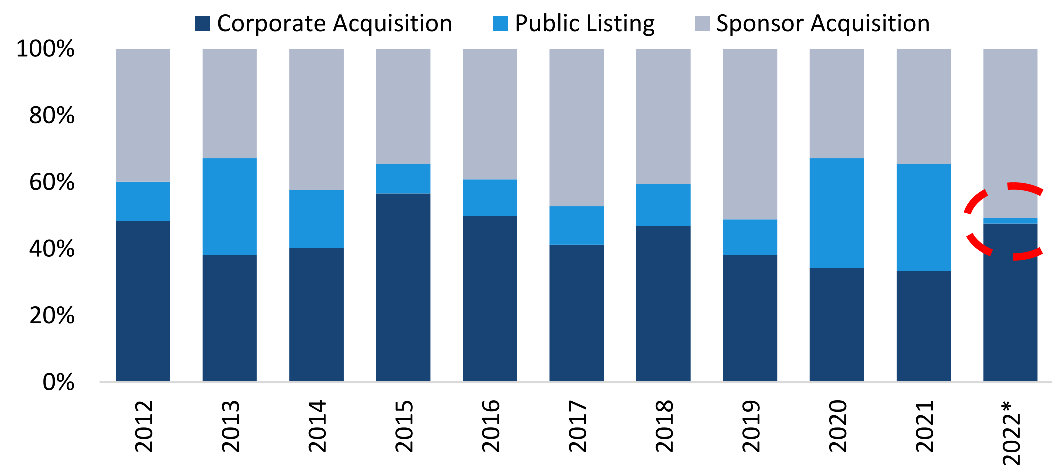
Very few companies have IPO'd in 2022 compared with the prior two years. Biotech IPO's have seemingly come to a halt with deal count and deal value settling at or below pre-COVID levels

Biotech IPO Count and Deal Value (2010 – YTD)



Through Q3 2022, PE-backed IPOs as a % of PE Exits reached their lowest level ever, making up just 1.6%, while Sponsor-to-Sponsor transactions gained steam, making up half of PE Exits

PE Exits by Type – Total Dollar Amount (2012 – YTD)



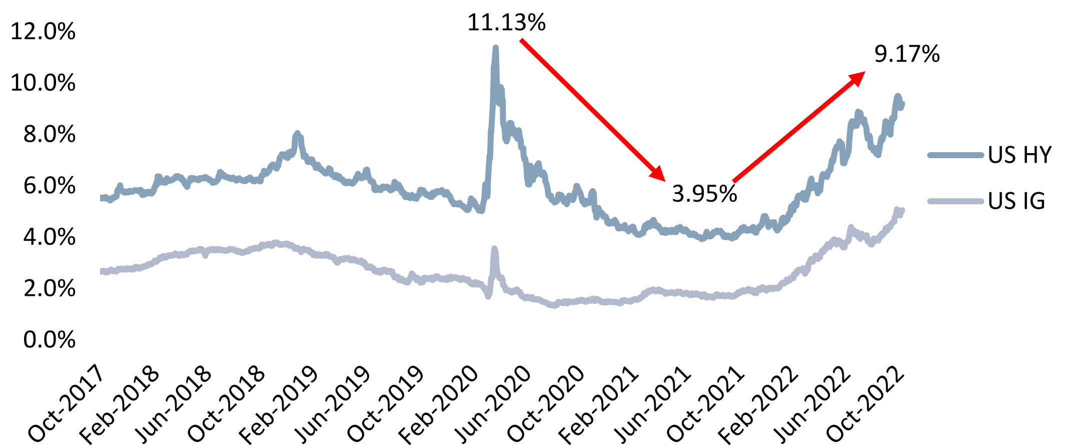
Source(s): Pitchbook: US PE Q3 Update; S&P Capital IQ

**Data as of 10/15/2022*

Credit Market Volatility & Tightening

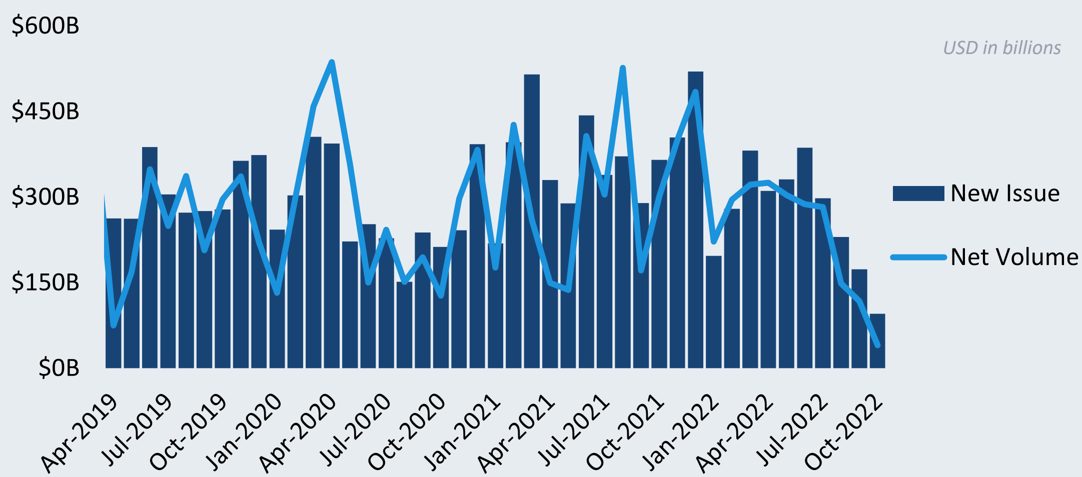
Bond yields have jumped as investors price in rate hikes...

Market uncertainty is most evident by the **whiplash effect seen in US High Yield** bonds, largely due to higher interest rates and the increased likelihood of defaults during an economic downturn



...and lenders have dramatically slowed New Loan Issuance

Lenders are incedingly more hesitant to issue new loans, leading to **tighter pricing, more OID fees, and the overall decline in volumes**



Source(s): Bloomberg

**Data as of 10/10/2022*

Private Markets

Private Credit to The Rescue

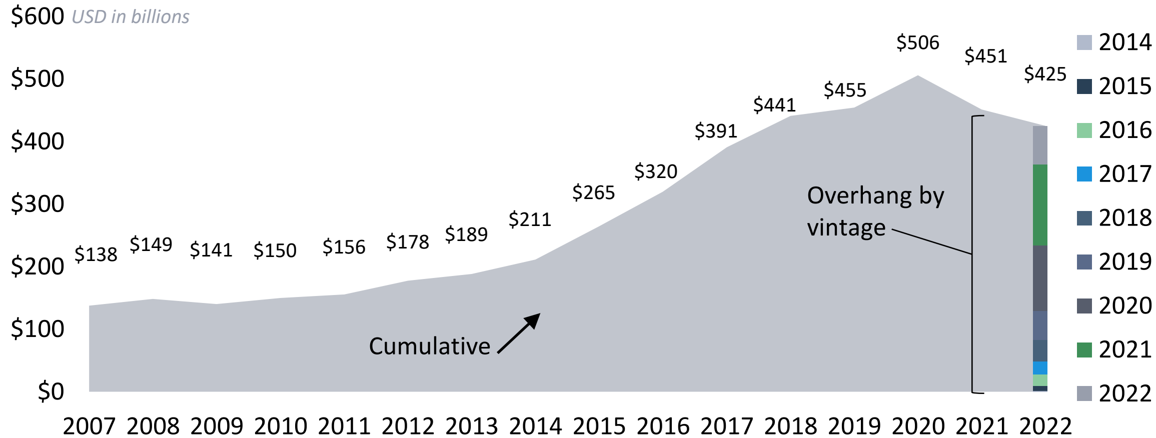
Private Credit funds have substantial dry power to deploy…

Globally, Private Credit funds have the willingness and capacity to step up and fill the large funding gap left by institutions. The direct lending market alone has **nearly $169B of dry powder**, providing a base of capital which should continue to support M&A activity

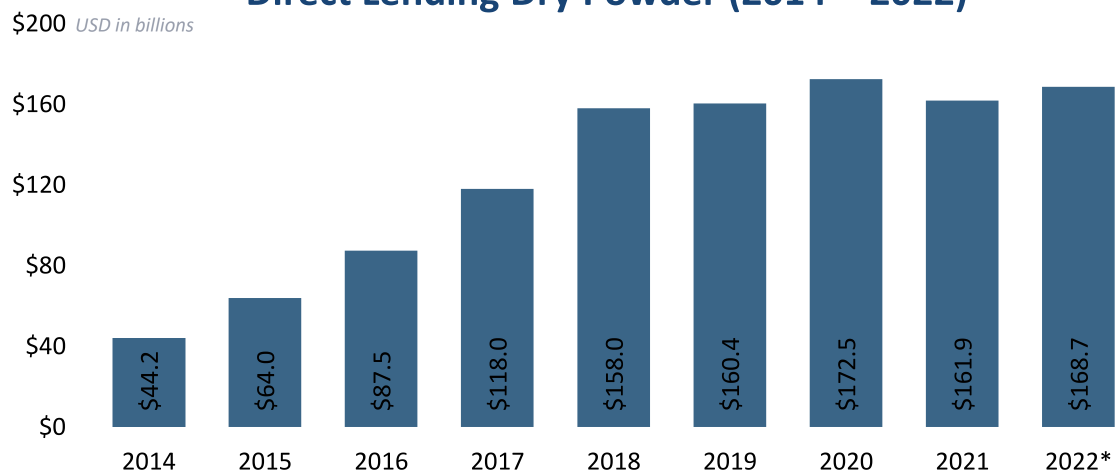
…and an increased likelihood to lend

Direct lenders have remained active and for the first time on record, **3Q direct lending outpaced syndications**

Private Credit Dry Powder (2007 – 2022)



Direct Lending Dry Powder (2014 – 2022)



Source(s): Pitchbook Private Credit Q3 Update

**Data as of 9/30/2022*

Private Equity Deal Volumes

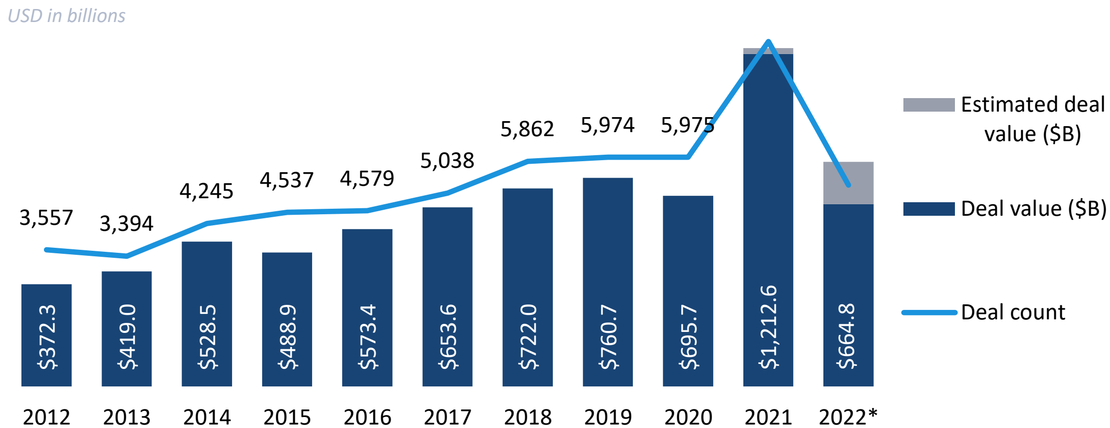
YTD 2022 US PE Deal Volumes have declined from a record 2021…

Q3 reports showed the **third consecutive decline** for both total deal volumes and value, yet annualized data indicates **volumes and deal value are on par/above 2019 levels**, a fairer comparison

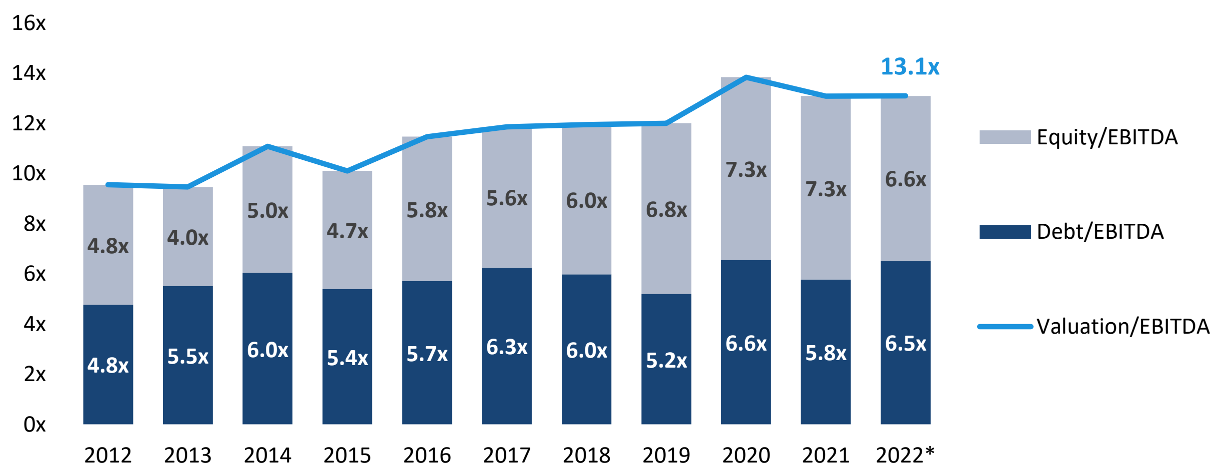
…but Median PE Transaction Multiples remain historically elevated

Publicly available transaction multiples are difficult to source, yet data indicates Q3 buyout multiples are only slightly off record highs, indicating **good deals are still getting done at historically high valuations**

US Total PE Deals (2012 - 2022)



Global PE Transaction Multiples (2012 - 2022)



Source(s): Pitchbook: US PE Q3 Update

**Data as of 9/30/2022*

Private Equity Exits

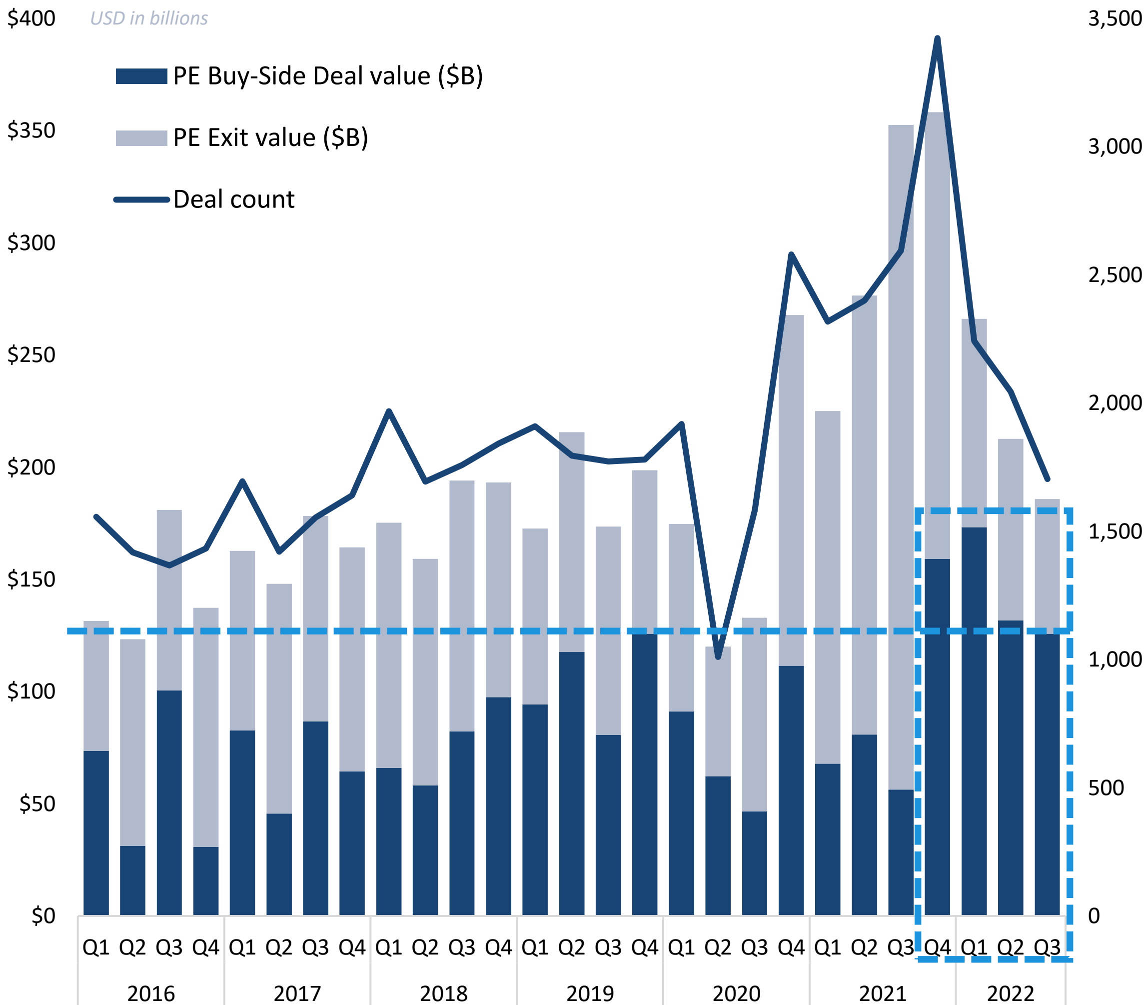
YTD 2022 US PE Exit Values have declined significantly, disproportionate to total deal values…

Q3 Exit values decline 80% from YoY Q3 2021, while **PE buy-side deal values increase 126% YoY**

…as PE Buy-Side Deal Value is still at record highs

This divergence between buy-side deals and sell-side exits shows **Investors are still cautiously deploying capital** despite the lack of exits opportunities. A large contribution of suppressed exits is the nonexistent IPO market

Total US PE Deals (2016 – 2022)



Source(s): Pitchbook: US PE Q3 Update

**Data as of 9/30/2022*

Private Equity Investments-to-Exit Ratio

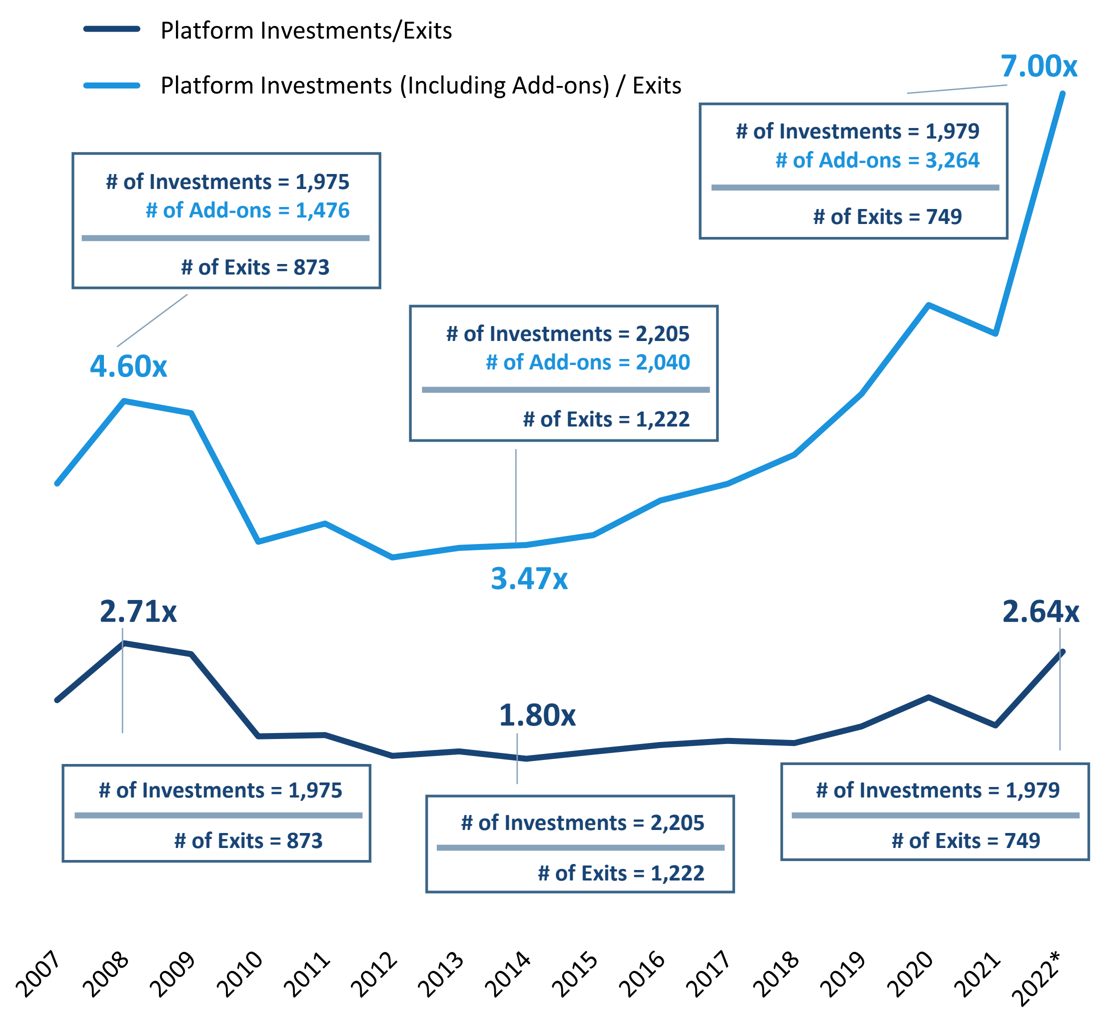
2022 YTD US PE Exits are at their lowest rate since 2008…

…however, add-ons have increased 2x and now represent the majority of PE activity

This is largely due to General Partners raising bigger funds with more deployable capital executing more "roll-ups" and more add-ons[1] per platform; further amplifying the Investment/Exit ratio

Slide 23 further examines the persistent add-on trend in private markets, but this chart depicts it well. **Despite delaying exits, Investors have not slowed their deployment of capital and have continued to increase add-on acquisition activity**

US PE Investment / Exit Ratio (2007 – 2022)



Source(s): Pitchbook

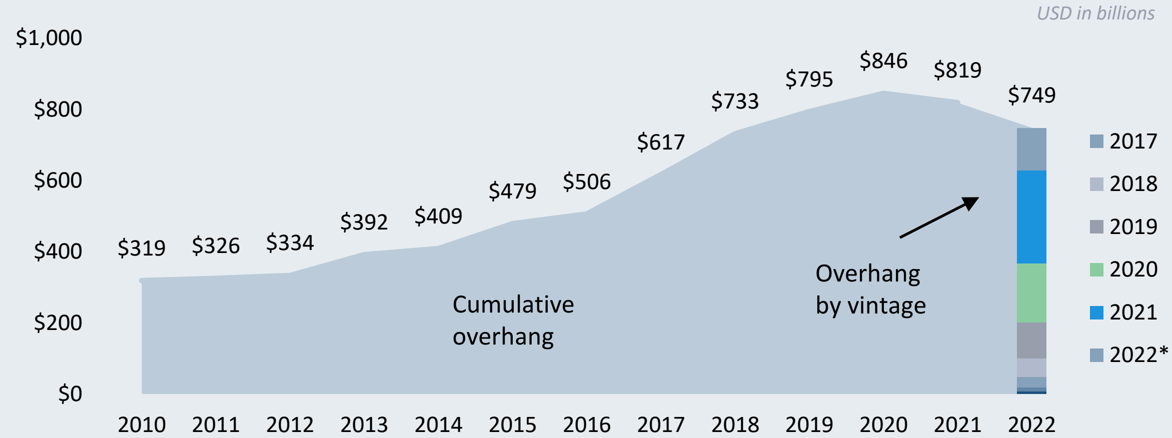
**Data as of 9/30/2022*

*1) **Add-On Acquisition**: When a private equity firm acquires a company to add onto an existing portfolio company. In add-on deals, the existing portfolio company is called the platform and the private equity firm is called the sponsor.*

Private Equity Dry Power

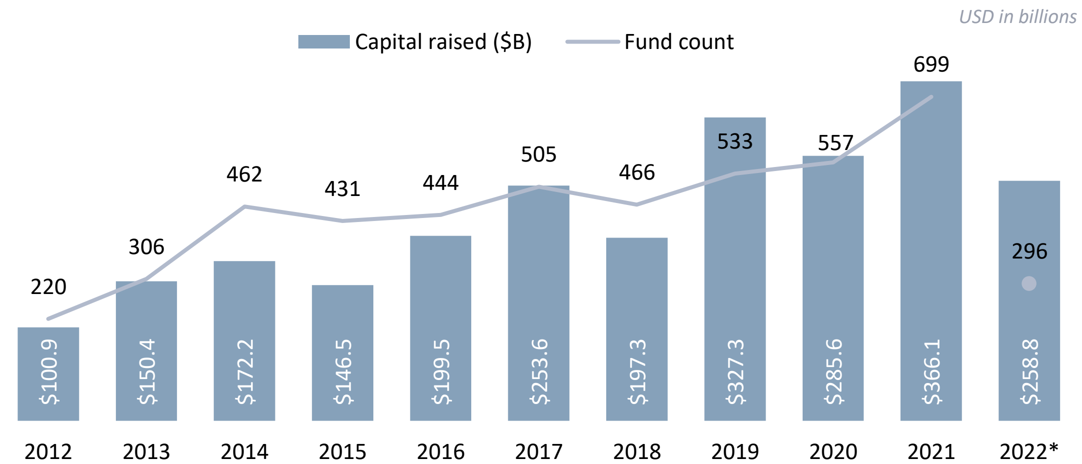
Private Equity still has billions in Dry Powder to deploy…

The driving force behind elevated buyout multiples is the near **historically high levels of capital** in Private Equity coffers



…and Private Equity fundraising is still strong

Private Equity fundraising was on track to match last year's high-water mark through 1H 2022, but **Q3 showed the first signs of slowing fundraising,** disproportionality effecting middle market funds. Albeit, PE firms should sustain a significant capital overhang in 2024



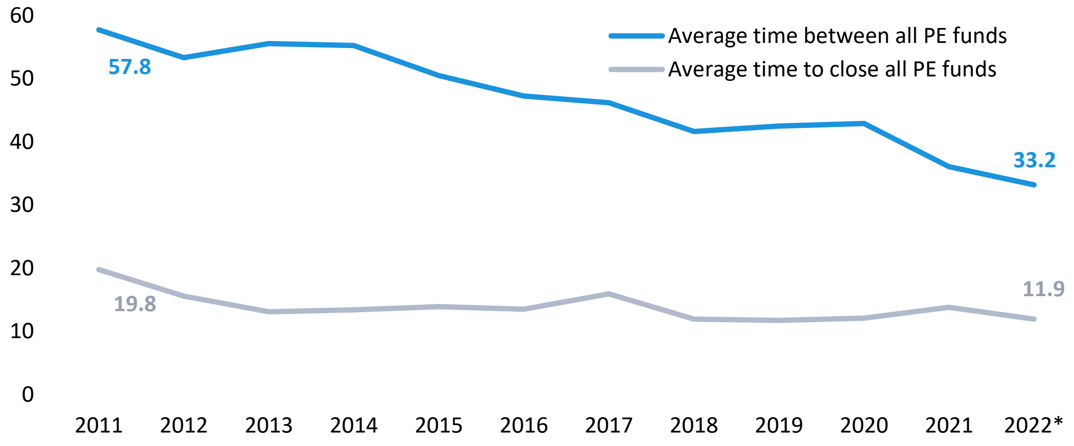
Source(s): Pitchbook

**Data as of 6/30/2022 (top-right) & 9/30/2022 (bottom-right)*

Private Equity Fundraising

Time to Close (months) and Time between Funds (months) are at historical lows…

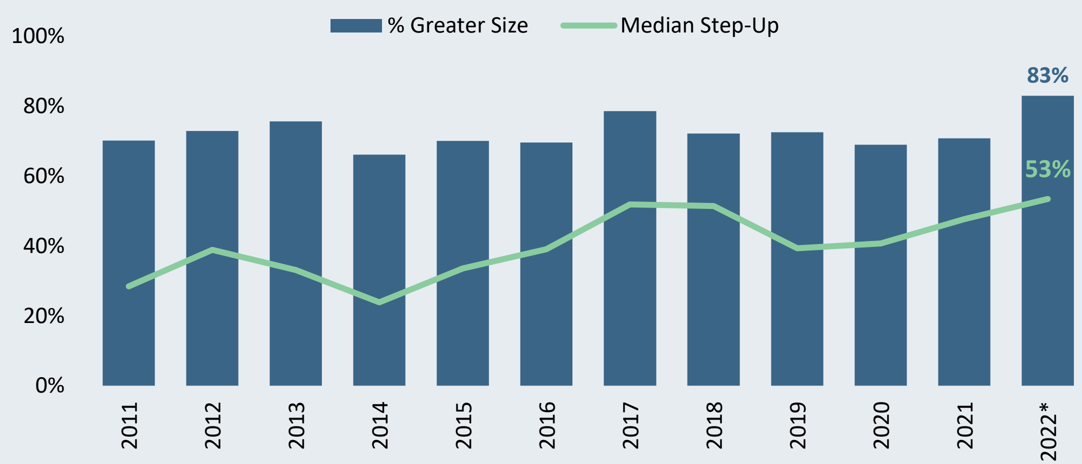
2022 has seen new funds raised and closed at the **fastest rate since 2007**. However, Q3 reports began to show signs of a **thinning of the herd**, with more mega funds and fewer closings. Analyst now expect that 2/3rds of funds in the market will postpone closings until next year



…and Funds are getting larger with each turn

2022 has also seen Private Equity groups launch larger funds, with **83% of funds raised in 2022 seeing a step-up in size** from prior vintage

The median step-up size is at 53% YTD, its highest in the past 10 years, however, that is down from 62% in 1H 2022



Source(s): Pitchbook

**Data as of 9/30/2022*

Private Equity - Year of The Add-On[1]

~80% of total investments were add-on acquisitions to existing platforms...

With overall exits down, Financial Sponsors are **shifting focus to building out their existing platforms** and furthering growth initiatives; opposed to new large platform investments

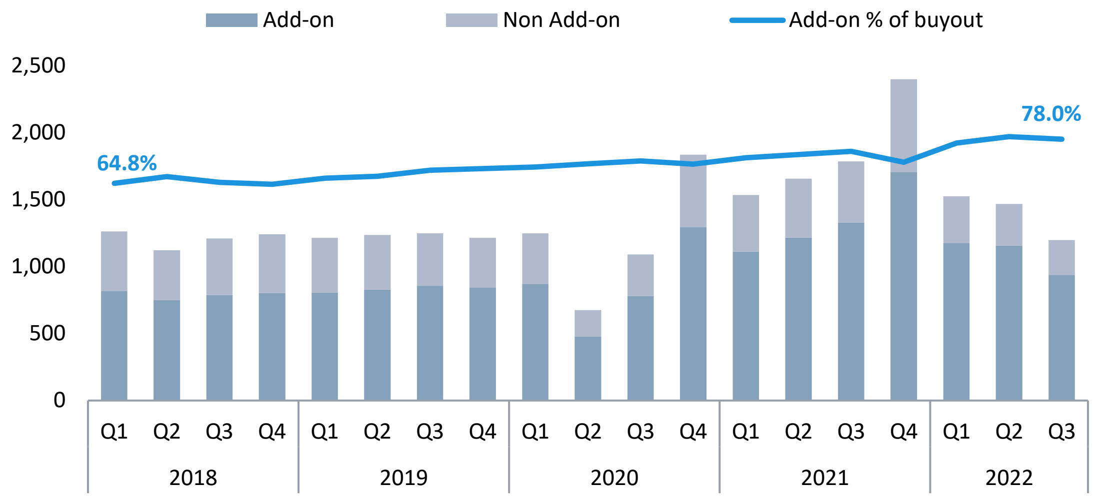
These deals **are easier to finance and integrate**, and better received by investment committees and lenders

...presenting an interesting opportunity for middle market companies

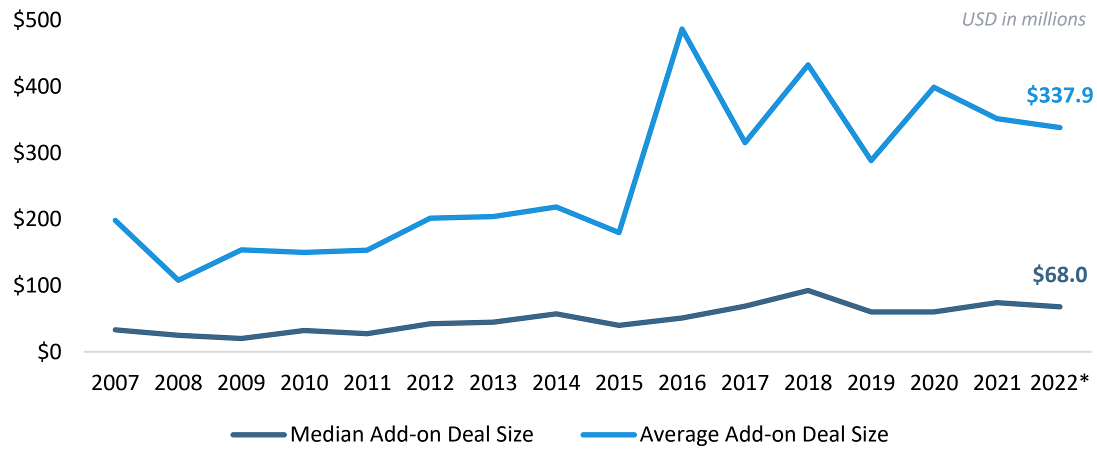
Middle Market (MM) companies are predominantly targeted for add-ons, and with PE exits down, **scarcity value for investable MM targets are poised to drive/maintain higher values**

This trend (among others) will likely further **decouple private MM valuations** from public market comps

Add-On as % of Total PE Deals (2012 - 2022)



Median/Average Size of Add-Ons (2012 - 2022)



Source(s): Pitchbook

**Data as of 9/30/2022*

*1) **Add-On Acquisition**: When a private equity firm acquires a company to add onto an existing portfolio company. In add-on deals, the existing portfolio company is called the platform and the private equity firm is called the sponsor.*

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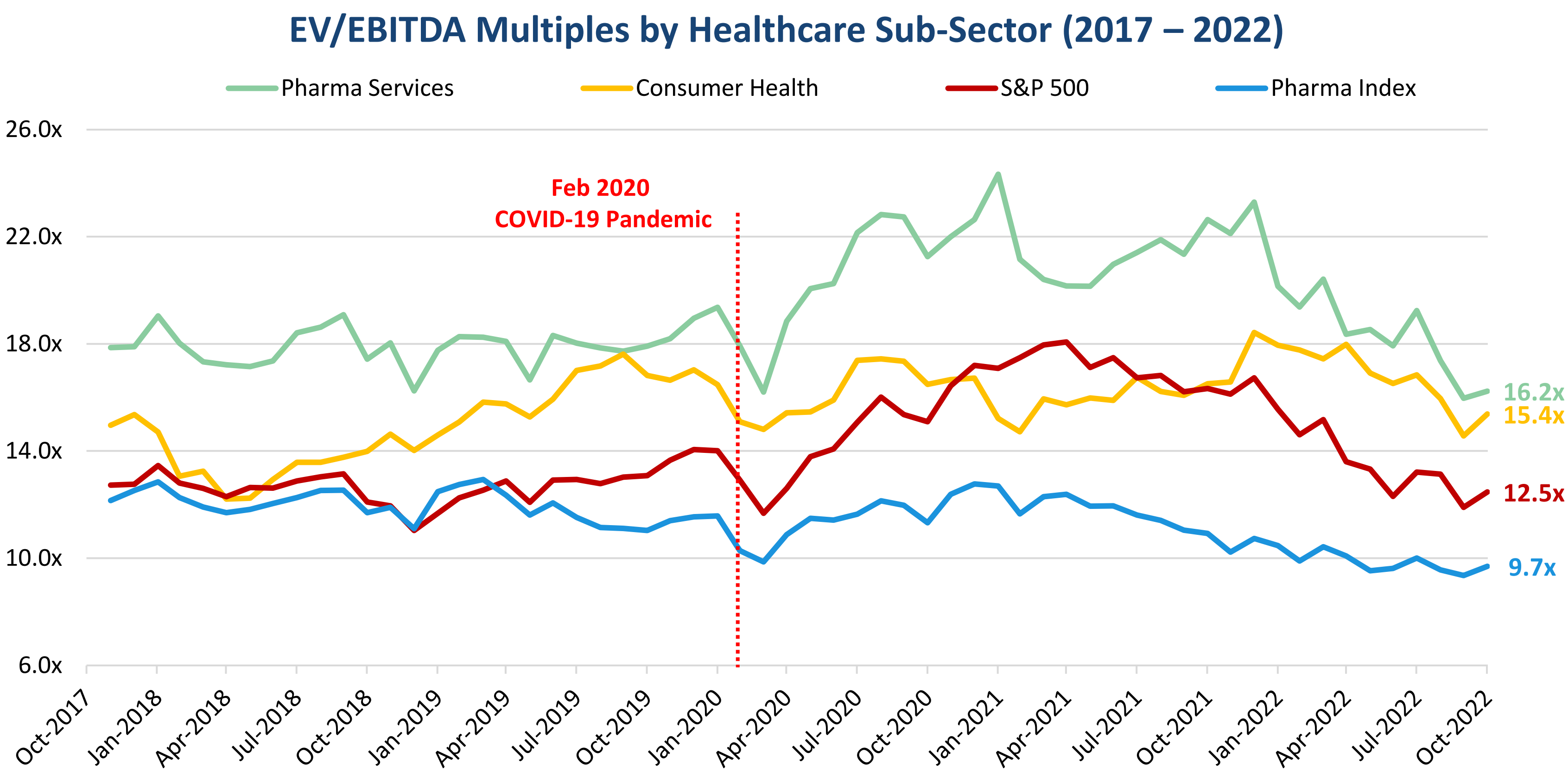
Healthcare Well Positioned

Healthcare's Resiliency and Safe Harbor

Healthcare's nondiscretionary nature has proven to be non-cyclical and recession resilient, resulting in YTD outperformance over the S&P 500. Public markets have been rocked by the seemingly unending stream of negative headlines, but investors are more confident in Healthcare's ability to weather the volatility and impending recession.

Pharma Services and Consumer Health companies have withheld their premiums throughout 2022, both currently sitting ~34% above the S&P 500, while CROs and Tech Enabled companies bore the brunt of the sector's losses



Source(s): S&P Capital IQ

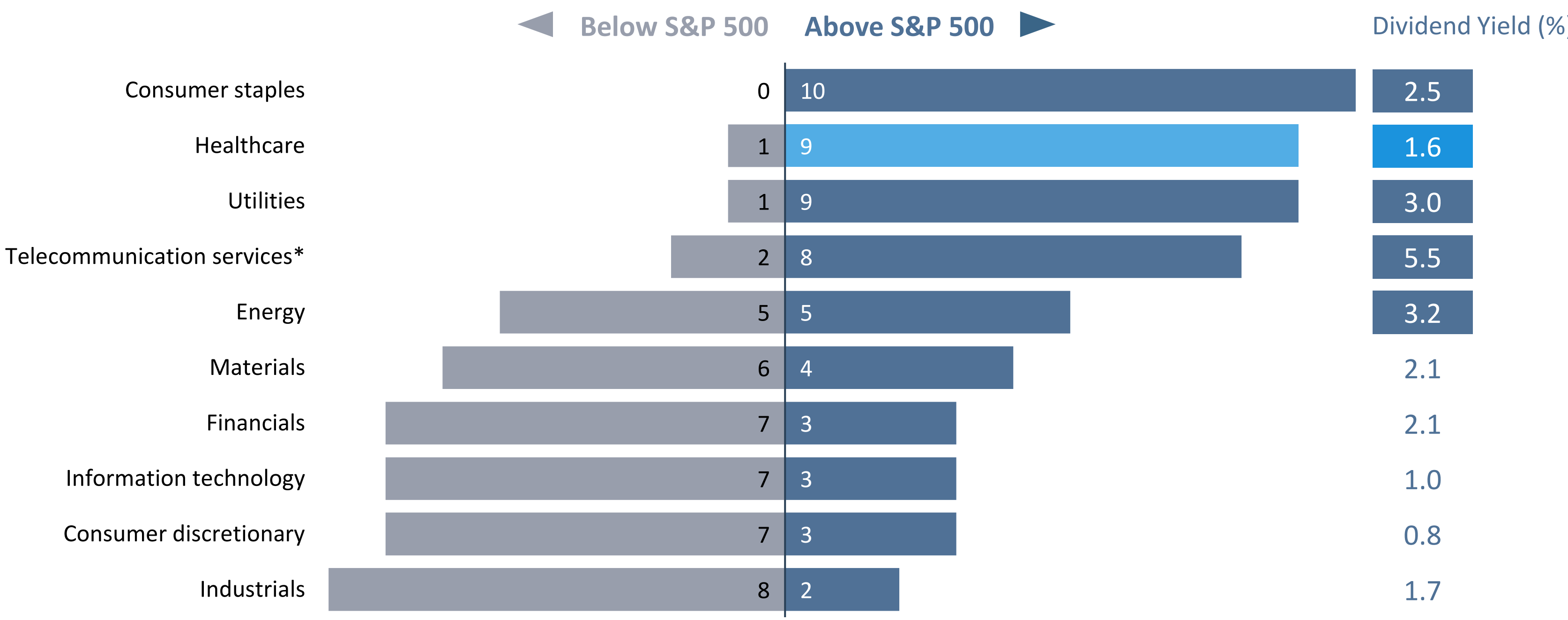
**Date as of 10/30/22*

Healthcare's Resiliency and Safe Harbor

Healthcare's resiliency is proven by a strong track-record, finishing above the S&P 500 benchmark in 9 of the past 10 downturns[1] - tied for the second-best record.

Further analysis shows that a large contributor of outperformance is due to higher dividend yields. If this consideration is removed, analysis shows that the Healthcare sector not only holds its value, but historically deliverers growth above other defensive sectors during recessionary environments, further outperforming

Number of Periods Sector Finished Above S&P 500



Source(s): Capital Group – Guide to Recessions 2022 Edition

1) Includes the last 10 periods that the S&P 500 declined by more than 15% on a total return basis.

Institutional Investors' Healthcare Allocations

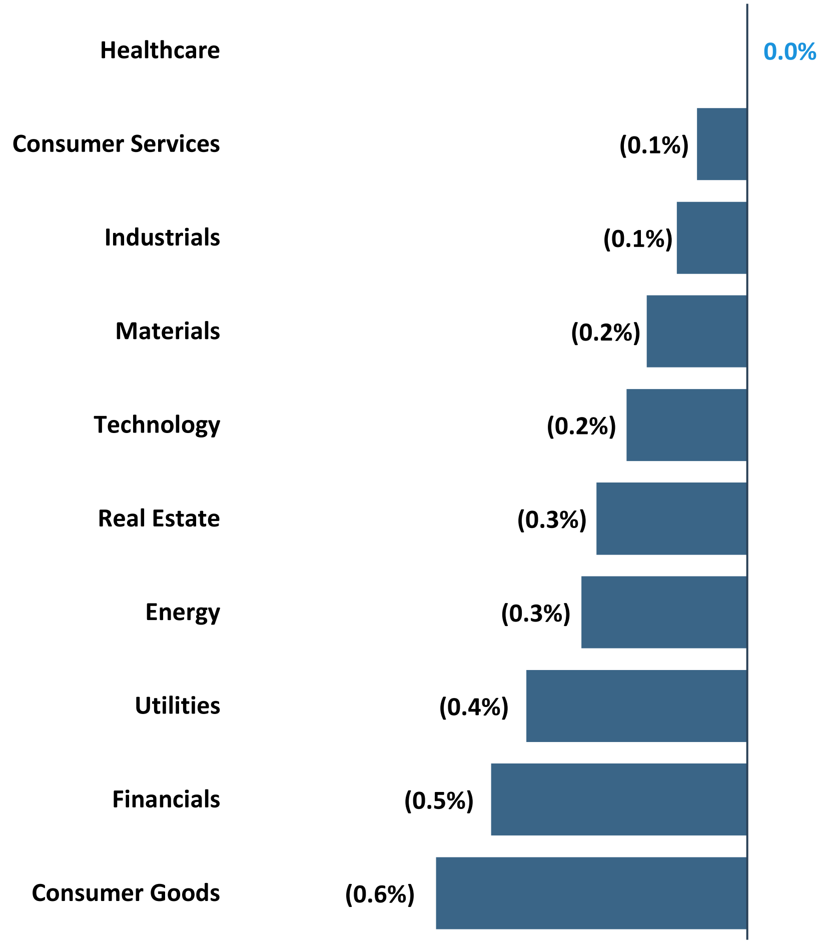
As of October 5, 2022, net cumulative capital flows from Institutions were down ~$303B YTD

Institutions continued to sell equities aggressively in Q3, while hedge funds were overall buyers, posting net inflows of $22B in Q3

Notably, the selling pressure was experienced by all sectors except Healthcare

Healthcare's proven track record in past economic downturns comforted investors, providing a needed tailwind for public sector valuations

Institutional Capital Flows per Sector (8/31/22 – 9/28/22)



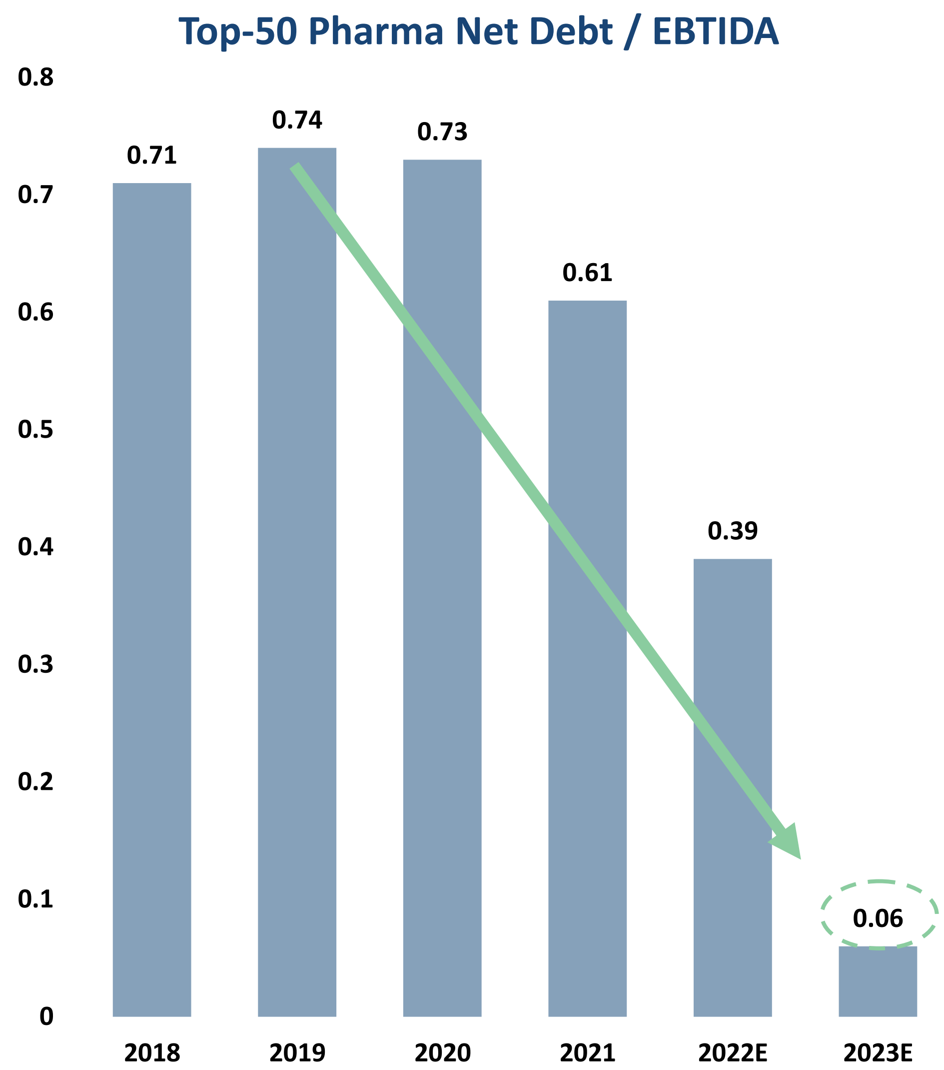
Source(s): S&P Global Market Intelligence

Strategics' Dry Powder and Debt Capacity

Top-50 Pharma companies' Net Debt / EBTIDA ratio is near all-time lows, providing additional tailwinds

Healthy Pharma balance sheets will further prop up existing industry tailwinds as companies are prepared to **weather any potential economic downturn and pursue opportunistic M&A**

In addition to Private Market Funds' $1.2T in dry powder, **Pharma companies have an estimated $300B of firepower earmarked for dealmaking over the next 18 months**

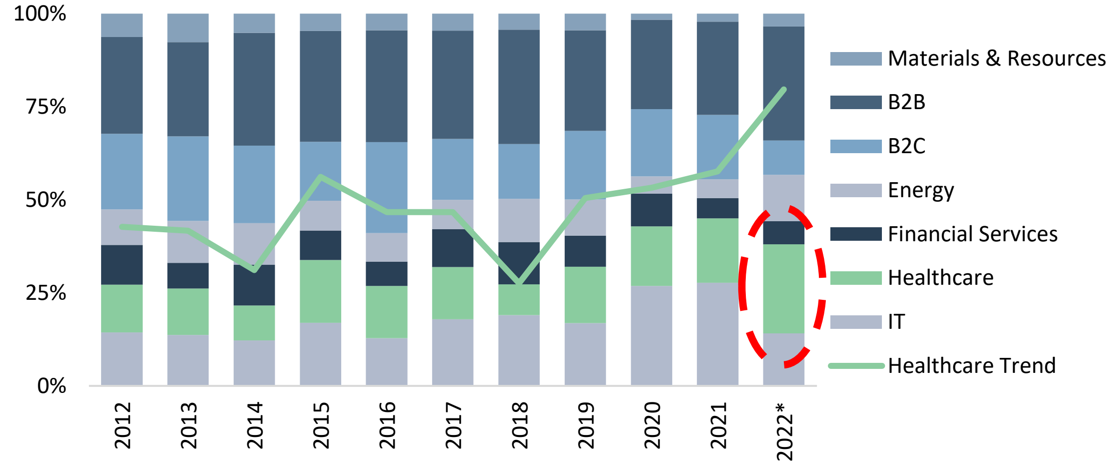


Source(s): Pitchbook; RBC Capital Markets

Private Equity Healthcare Exits

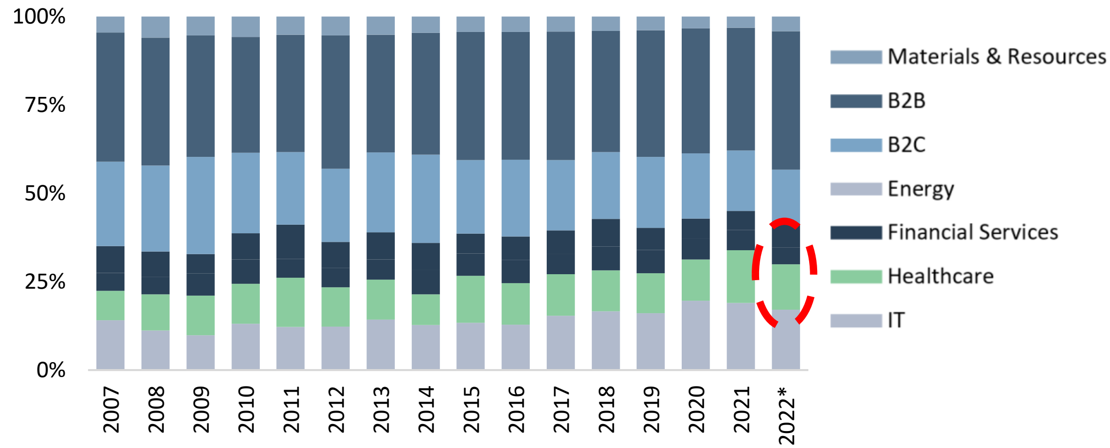
For the first time since 2007, **Healthcare transactions have made up the largest percentage of total deal value**, totaling $56B through Q3 2022

PE Exits by Sector as % of total deal ($)value



While accounting for ~30% of the overall deal value, Healthcare only accounts for 13% of the number of deals – more **evidence that the industry is holding on to its high valuations**

PE Exits by Sector as % of total deal (#)volume



Source(s): Pitchbook

**Data as of 9/30/2022*

Select 3Q Healthcare Deals

October	AVEO ONCOLOGY has been acquired by LG Chem	AKOUOS has been acquired by Lilly	MYOVANT SCIENCES has been acquired by Sumitovant BIOPHARMA	carecentrix has been acquired by Walgreens Boots Alliance	MedAlliance has been acquired by Cordis	Osmotica Pharmaceuticals has been acquired by Alora PHARMACEUTICALS	LogicBio THERAPEUTICS has been acquired by ALEXION
September	rxss Rx Savings Solutions has been acquired by MCKESSON	EYESOUTH PARTNERS has been acquired by OLYMPUS PARTNERS	PHARMALEX CONFIDENCE BEYOND COMPLIANCE has been acquired by AmerisourceBergen	PARADIGM ORAL HEALTH has been acquired by BlackRock	forma THERAPEUTICS has been acquired by novo nordisk	signifyhealth has been acquired by CVS Health	SHIELDS HEALTH SOLUTIONS has been acquired by Walgreens Boots Alliance
August	TAPEMARK has been acquired by LTS TRANSDERMAL. MARKETLEADER.	aerie has been acquired by Alcon SEE BRILLIANTLY	metrics contract services has been acquired by Catalent	MERIDIAN BioGroup has been acquired by Pace PEOPLE ADVANCING SCIENCE	CHEMOCENTRYX has been acquired by AMGEN	GBT has been acquired by Pfizer	OLYMPUS EVIDENT has been acquired by BainCapital

Source(s): PitchBook, CapIQ

**Data as of 10/31/2022*

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