What an economic downturn means for VC, PE and M&A

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AXIOS PRO

Introduction

Welcome to the latest Axios Pro: Deals Report.

The global dealmaking environment was experiencing a downturn before Silicon Valley Bank failed in March. That much was obvious, and while we don't yet know all the ripple effects from SVB, we're here to discuss what we do know this all means for the public and private markets.

> Should you remain calm? Is it time to take action? That might depend on your company, job function and myriad other factors. Our goal is to put this downturn into context, so you can make the most informed decisions possible.

> **Why it matters:** Axios Pro: Deals helps dealmakers navigate the fast-paced world of VC, PE and M&A every single day. In this report, the Pro newsroom analyzes their respective industries to surface the stats, trends and opportunities that matter most right now.

> **The bottom line:** If you care about what the current economic climate means for dealmaking, then this report is for you.

Learn more about Axios Pro by visiting AxiosPro.com.

Overview

High inflation, rising interest rates, and worries about an economic cool-down knocked dealmaking activity off its stride in 2022, even though M&A remained strong by historical standards.

What's going on?

Valuations declined, causing companies to think twice about completing deals with cut-rate price tags.

> Worldwide, the total value of M&A deals fell by 38% and volume declined by 18%; in the U.S., deal value fell by 39% and volume fell by 15%.

> The most difficulty came late in 2022, with deals more likely to be abandoned (24% in October versus 15% in January) and more likely to be paused (28% versus 17%), according to Datasite, a software provider for dealmaking due diligence.

> In the venture capital space, there was also a steady slowdown in startup funding through 2022. Deal count slowed roughly 14% from the record highs of 2021, according to data from PitchBook as of Dec. 31, 2022.

Yes, but...

VC fundraising didn't falter. VCs raised $162.6 billion, breaking the previous year's record of $154.1 billion, per PitchBook. Big, well-established funds were the prime beneficiaries of those investments; newer funds faced a more challenging fundraising environment.

What's happening?

A cloudy forecast leaves dealmakers struggling with uncertainty while they also ponder industry-specific forces that may create risks—and opportunities—in the months to come.

> There's no consensus among economists and other forecasters about the direction of the U.S. economy.

> Companies selling discretionary items like furnishings or fashions may face a tougher road than businesses focused on consumer staples.

What's next?

Dealmaking might regain some of its mojo in 2023, with mounds of capital patiently waiting on the sidelines and investors tempted by lower valuations on companies with great technologies.

> Strong companies are likely to acquire weaker competitors as laggards struggle financially, default on loans, and beat paths to the exit.

> Layoffs, market turmoil, and other disruptions are likely to roil sectors like fintech and media, challenging investors but also creating opportunities as new enterprises and upstart technologies take root.

Read on for more in-depth takes into dealmaking in the retail, fintech, media, health tech, and climate sectors.

Thought bubble

The massive, years-long growth spurt in VC and M&A dealmaking culminated in 2021, and the slowdown in 2022 led to recalibration of expectations across the dealmaking community. 2023 will force companies to set expectations lower as dealmakers seek to find a new level for valuations in VC and PE deals.

George Moriarty
Senior Editor, Axios Pro Deals

Fintech

The big picture

Fintech dealmaking slowed way down in 2022.

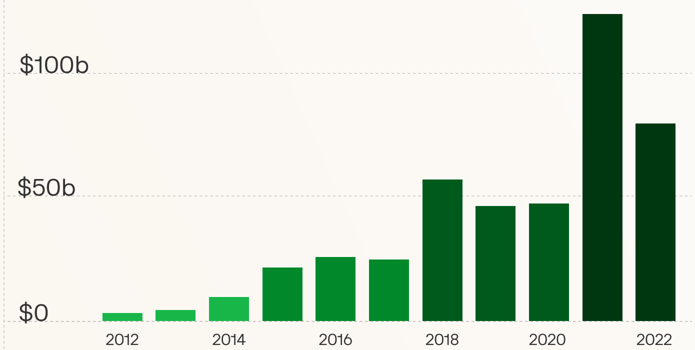
> VC investors pulled back aggressively, with $79.5 billion in deals representing a 35% decline from 2021.

> While M&A was strong by historical standards, it was down from 2021—and very quiet in Q4, which historically sees a frenzy of deals.

Global fintech venture capital activity

Source: PitchBook

Annually; 2012 to Dec. 20, 2022



What's happening?

A volatile economic environment contributed to the slowdown in fintech dealmaking.

> Repeated Fed rate hikes hit lending fintechs hard, while the once-hot crypto space was pummeled by a receding tide of funding and the collapse of FTX in late 2022.

Of note

Fintech giant Stripe has dropped about 40% from its peak valuation of around $103 billion since last summer.

> Stripe's internal valuation now stands at $24.71 per share, which implies a valuation of $63 billion.

> It was initially marked down last June from $40 to around $29 per share.

What's next?

The downturn will continue to impact fintech dealmaking in 2023 — but there are opportunities to be had.

> Consolidation is likely, providing opportunity for the strongest firms to secure their positions at reasonable prices.

> Seed and Series A dealmaking is expected to remain relatively strong, but investors eyeing more-established companies will want to see clear paths to profitability.

What they're saying

Insiders offered these looks ahead for 2023:

> "Generative AI meets fintech. I expect robo investors to roll out new AI-assisted robo advisors," said Brian Dixon, managing partner of Kapor Capital.

> "Dealmaking tends to pick up toward the end of bear markets, and I expect we'll see the same situation this time around ... Consolidation is normal in a maturing industry, and crises can accelerate that process," said Lule Demmissie, CEO of eToro US.

Thought bubble

Uncertainty reigns in 2023, pushing venture investors to focus on repeatable, low-capital businesses in subscription and software businesses over lending and proptech.

Still, many investors seem to agree on one prediction: Expect a great awakening in the second half of the year, when the wave of companies that raised at sky-high valuations in 2021 run out of capital and are forced to consider M&A or a downround in a much more skeptical market.

Lucinda Shen

Fintech Deals reporter

Climate

The big picture

Climate dealmaking remained healthy in 2022, bucking the downward trend seen in most other sectors as investors demonstrated their enthusiasm for the sector.

> VC investment in climate technology companies maintained the robust fundraising level of 2021, even as sectors like fintech and retail saw major declines in dealmaking.

> Company valuations remained high, with some insiders questioning whether a rebalance might be required to keep the sector healthy.

What's happening?

More capital is available than there are projects, and the corporate focus on ESG means opportunity for sustainability-focused firms. The upshot: high expectations for 2023.

> Infrastructure investors are pumping capital into the sector, but are more cautious around projects with uncertain timelines and less-predictable revenue targets.

> Carbon trading marketplaces are thriving, with a ten-fold increase in investment compared to 2020—surpassing $1 billion in 2022—as corporate goals around reduced carbon footprints drive interest.

What's next?

Electric vehicle sales are expected to make a big jump in 2023 and continue to transform the car industry, providing investors and companies with opportunity for dealmaking.

> Auto makers are showcasing an array of new models at affordable prices and EV charging stations are proliferating across the country as states begin to tap $5 billion in federal funding.

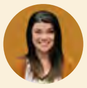
> Billions of dollars in tax credits are flowing to EV buyers, fleet owners, and car manufacturers.

What they're saying

"While we still think there's a massive economic opportunity — and food is inevitably a big part of the climate story — valuations got so inflated in 2020 and 2021 that there's going to be a reckoning, or a repricing, there — some of which is healthy," said Collaborative Fund's Sophie Bakalar.

Thought bubble

After a year of record-breaking deal activity, investors anticipate a "return to normal" for the sector that includes continued private funding and healthy M&A activity at lowered levels compared to previous years.



Megan Hernbroth
Climate Deals reporter

Global investments in carbon trading markets

Annually; 2017-2022

Data: PitchBook
Chart: Axios Visuals

Media ▷

The big picture

After a banner 2021, media dealmaking dropped sharply as companies turned to cost cutting amid falling ad revenue, inflation, and fear of an economic downturn.

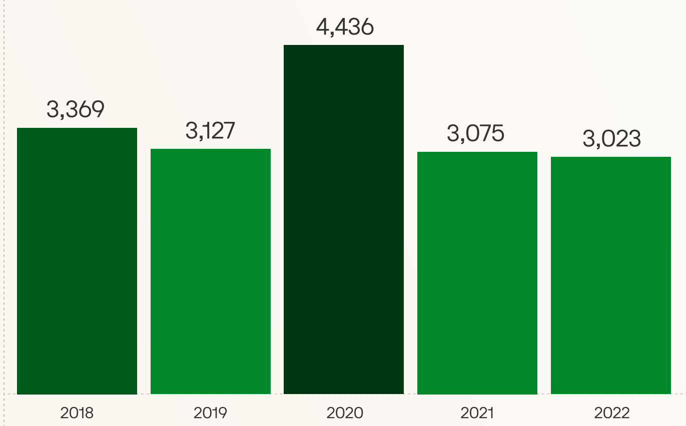
> Total deal value took a major hit, dropping 61% to $142.7 billion.

> Just about every major media company cut headcount in 2022 and took other steps to curb costs, with big streaming investments still in the red and ad buyers trimming their sails.

Media deal activity

Annually; 2018-2022

Data: PitchBook
Chart: Axios Visuals



What's happening?

New industry players and delivery platforms are roiling the traditional media ecosystem, creating a more fragmented landscape and less certainty about the sector's direction.

> Independent channels, including Substack newsletters and podcasts, are benefitting from public distrust of mainstream media to increase alternative media's share of voice.

> Elon Musk is shaking up Twitter – and creating uncertainty about where the microblogging powerhouse is headed.

> New, deep-pocketed players are acquiring established franchises, planting their flags as major sports content providers. Two prime examples: Google's agreement to offer NFL Sunday Ticket through YouTube TV and Apple's deals with Major League Baseball and Major League Soccer.

What's next?

Media businesses are flirting with new ways to measure user engagement – and upending the traditional metrics that drive all-important ad spending. That's driving big changes at Nielsen, the measurement-industry leader, as it works to maintain its dominance.

> Nielsen enters 2023 as a newly private business working to transform its media measurement practices to capture digital audiences. But the firm's market share is threatened by upstarts promising better ways of measuring today's media audiences.

What we're watching

> **Microsoft-Activision's FTC fight:** The tech giant had expected to complete its $69 billion purchase of the gaming company by June 30, 2022. But it now has to battle regulators in the EU, U.K. and U.S.

> **Tegna's deal:** The $5.4 billion sale to Standard General, backed by Apollo Global Management, is awaiting regulatory approval.

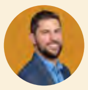
> **Vice Media's sale:** The digital media startup has been in talks with Greek broadcaster Antenna Group as it struggles to get its finances in order. The Wall Street Journal reported a $100 million miss on its 2022 revenue goal, an all too familiar story for Vice.

> **Reddit's IPO:** The social media company filed its IPO prospectus with the SEC in December 2021 with hope for a $15 billion valuation. But a year later, it has yet to announce a date.

> **Disney:** Now that Bob Iger is back in charge, does one of Hollywood's biggest dealmakers have another ace up his sleeve to bring Magic back to the Kingdom?

Thought bubble

The NBA, NASCAR and major college conferences like the PAC-12 and Big 12 will attempt to get hefty price increases on their next round of rights deals. That will be challenged by media companies' more discerning spending plans. But big tech is ready to pounce.



Tim Baysinger
Media Deals reporter

Retail

The big picture

Retail dealmaking cratered in 2022 as interest rates rose, lending tightened, and customers emerging from pandemic changed their shopping priorities.

> Deal value dropped by 48% to $121.6 billion compared to the previous year.

> One bright spot: Discount and department store deal value surged 158% as investors bet that consumers would embrace bargain shopping amid economic uncertainty.

What's happening?

More retailers may struggle to keep their heads above water as consumers continue to worry about inflation and the possibility of recession.

> The number of retailers on rating agencies' distressed-company watch lists have risen sharply, suggesting more defaults in 2023.

Where it's going

Sectors that line up with consumer trends are poised for growth, and technological innovation will continue to make noise across retail.

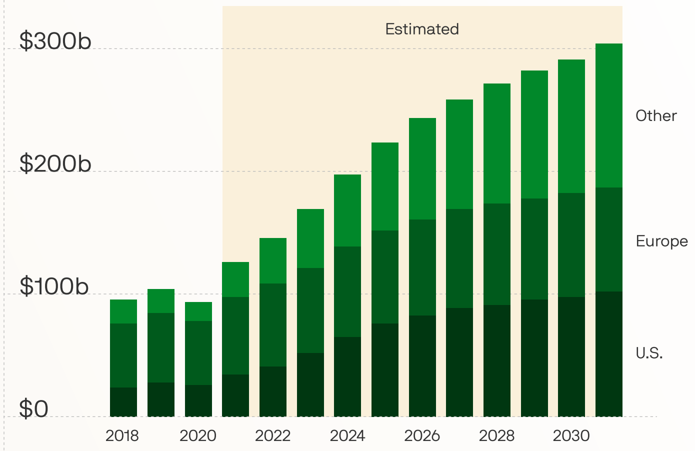
> Tech that makes omnichannel retail more efficient, cuts shrink, and elevates the customer experience is key as retailers focus on cutting costs and holding market share.

> An expected upswinging in eco-friendly shoppers and bargain hunters make resale companies attractive for M&A.

Estimated resale growth by aggregate sales in each market

As of May 16, 2022

Data: Morningstar
Chart: Simran Parwani/Axios



What they're saying

"Going into 2023 those retailers who will win will do so through better execution and improving margins of e-commerce transactions that are fulfilled through local stores. And that involves investments in technology," says Greg Buzek, president of IHL Group.

Thought bubble

This year is likely to yield bad news for the retail segment, with the default rate for both high-yield bonds and leveraged loans expected to increase by year's end according to rating agencies such as Fitch. The pain could be more keenly felt by small- and mid-sized retailers who are dependent on short-term credit, and therefore vulnerable to continued interest rate hikes.

Richard Collings
Retail Deals reporter

Health Tech

The big picture

Health tech dealmaking fell off significantly in 2022, with a substantial number of planned M&A agreements being pushed into the new year amid falling valuations.

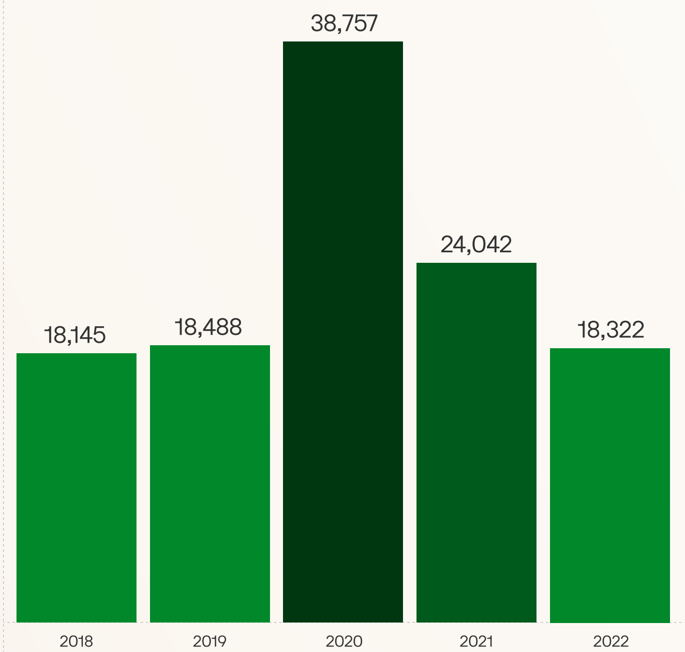
> The value of health tech M&A deals fell 35% in 2022 to $328.8 million, and the number of health tech deals declined 25% to 4,523.

> Just 27 of the 46 auctions that Axios covered across health tech M&A markets in 2022 led to deals by year's end. Some auctions expected to be relaunched in 2023 while others have simply been scrapped.

Health tech deal activity

Annually; 2018-2022

Data: PitchBook
Chart: Axios Visuals



What's happening?

Health tech investors are looking more closely than ever at profitability, while also focusing on companies whose products can thrive in stormy economic conditions.

> With values resetting, company owners and investors alike are shifting their frame of reference away from revenue exit multiples and toward profit margins and earnings growth.

> Companies that improve their customers' workflows are in favor—especially those that can increase a client's revenue or provide efficiencies in today's tight labor market.

By the numbers

Health tech claimed 9.2% of the worldwide M&A market in 2022, compared with 8.9% in 2021.

> **Yes, but:** That small percentage increase is one bright spot in an otherwise muted portrait.

> Health tech deal value in 2022 was $328.8 million, down nearly 35% from $504.9 million in 2021.

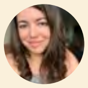
> Last year there were 4,523 health tech deals, down about 25% from 6,070 deals in 2021.

What they're saying

"The 'rule of 40' should continue to be a guide for when SaaS revenue multiples will apply," says Mark Tomaino, operating partner at Welsh Carson Anderson & Stowe.

Thought bubble

As constraints on debt markets begin to ease, private equity investors will join strategic investors like CVS, Walgreens and Amazon in the value-based care land grab in 2023.



Claire Rychlewski
Health Tech Deals editor

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