

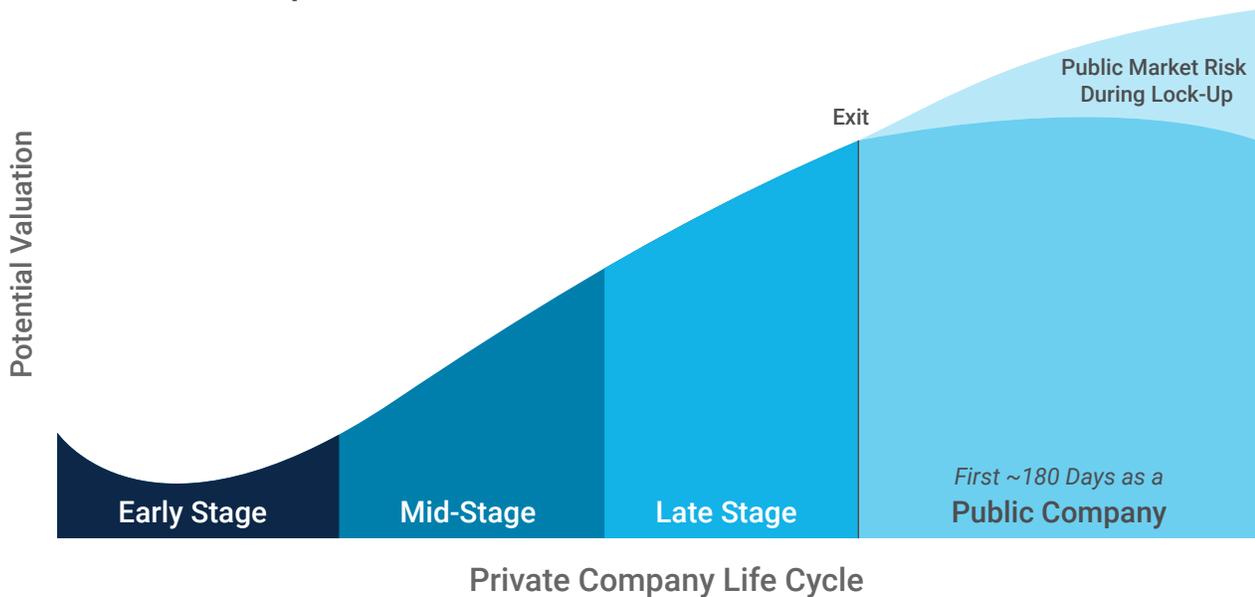
The Life Cycle of Venture-Backed Private Companies

Investing in private companies can offer a number of benefits to investors including access to an asset class that has historically provided a lower degree of correlation to the broader public markets, diversification, and the potential for high growth. As companies stay private longer, a greater portion of their value appreciation is now occurring during the private stage of their lifecycle.

The Venture Capital (VC) J-Curve is generally used by VC funds as a graphic representation showing the typical trend of a basket of private companies' net asset value ("NAV") over time. A VC J-Curve is not a representation of the performance of a specific private company; rather it shows an illustrative trend or pattern often experienced by a portfolio of private companies from inception and initial funding through exit by either mergers and acquisitions (M&A) or initial public offering (IPO). The VC J-Curve can approximate how a private company may progress through its life cycle.

The Venture Capital J-Curve can broadly be broken into four stages: angel/early stage, mid stage, late stage, and exit stage. These stages are designed to define where a company is in its life cycle and suggest common valuations-to-time ratios.

The Venture Capital J-Curve



Source: SharesPost. This chart is for illustrative purposes and does not represent an actual investment. There is no assurance that any private company will achieve the exit stage either through an IPO, M&A, or other means.

EARLY STAGE

The early stage is recognized as the time when a company is in its “start-up” phase, focused on research and development (R&D), proof of concept, product/service creation, and securing early rounds of capital, usually from angel or early-seed investors.

The early stage is known for being “pre/early-product and pre/low-revenue.” Often, early-stage venture capitalists invest in a person or people that have a big and disruptive idea with limited infrastructure around it. During this early stage, companies launch a product or service and build the infrastructure to refine their business model with the goal of generating revenue from early customers and capturing market share.

Investing in early-stage private companies typically carries a much higher degree of risk, but in exchange it offers the greatest degree of return potential, given the investor has committed capital at or near the company’s inception. Many early-stage venture investors take control of a significant percentage of the company’s equity. If the company is successful, the payouts to the fund can be large and can compensate for losses generated from investing in unsuccessful portfolio companies.

In this stage, companies typically show substantial losses and negative net cash flows as they spend heavily on early versions of product, team infrastructure, and market growth.

Common characteristics include:

- Initial product and market development (R&D)
- Proof of concept established
- Infrastructure development for go-to-market
- Early customer traction
- High “cash burn” rate
- High failure rates of 40%–60%

MID STAGE

Mid stage is recognized as the time when private companies work to refine their business model, capture market share, and start to generate revenues. These companies have revenue streams of \$10 million to \$50 million with significant annual growth rates. Mid-stage companies are focused on maturing their product offering, making it more robust, or adding additional features. Significant capital investments fuel market growth, which tends to result in substantial losses. At this stage, companies represent a lower risk investment than in the early stage, but still face many material risks. Risks in this stage are generally centered on execution, competition, regulation, market size, and scalability of technology.

Common characteristics include:

- Revenue levels of \$10 million to \$50 million or more with growth rates in excess of 100% per annum
- Increased product development and concept stabilization
- Execution risk
- Lower failure rates than early stage
- Significant and growing losses

Valuations of mid-stage companies are estimated based on scalability and total addressable market combined with a proven ability to execute. Investing in mid-stage companies can potentially generate high returns, albeit lower than what can be expected from a successful early-stage investment. While investments in mid-stage companies have inherently lower risk than early-stage companies due to the lower failure rate, companies in this stage still present a high risk due to the substantial cash burn needed to achieve their high levels of growth and the level of inherent execution risk.

LATE STAGE

Late-stage companies are focused on scaling their business through marketing and sales and may begin to focus on cash flows as growth rates begin to mature. With annual revenue in excess of \$50 million, capital investments are made to foster further growth and development through new products and technologies and by penetrating new markets. Venture capital investors still invest in late-stage companies, but the profile of these VC investors is often different than early-stage venture investors. The likelihood of a late-stage company failing falls as the customer base, product line, and revenues grow.

Valuations of late-stage companies are more connected to fundamentals than earlier stage companies as they continue to grow and the company executes against its annual revenue goals. Investing in late-stage companies can generate solid return multiples, though not at the same levels as early-stage investing. Given the significantly reduced failure rates, however, investing in late-stage companies may be more attractive for investors on a risk-adjusted basis.

Common characteristics include:

- Revenue levels in excess of \$50 million with growth rates of 25%–50% or more per annum
- Incremental product improvements
- Strong focus on maintaining market share if total market growth is slowing
- Reduction of failure rates
- Moving closer to an exit

EXIT STAGE

At the exit stage, the value of a private company is monetized through a liquidity event with either an IPO or an acquisition by another company. Annual company revenue has typically hit \$200 million or more with average annual growth rates of 10%–25% per year. If the company's exit strategy is to go public, it faces substantial legal, filing, and administrative fees, which can significantly impact a company's earnings in the year incurred. Approximately 80% of all exits are done through mergers and acquisitions versus IPOs.¹

Common characteristics include:

- Revenue levels of \$200 million or more with average annual growth rates of 10%–25%
- Focus on extending market share
- Exit expenses and legal complexities
- Lock-up risks resulting from the combination of illiquidity and general market volatility

After a liquidity event, the pre-IPO or pre-transaction stockholders are typically subject to restrictions on their ability to monetize the value of their securities, which may take the form of a "lock-up" on public sales of securities, a hold-back of transaction proceeds, or other contractual limitations. The IPO lock-up commonly lasts for 180 days following the offering. After a merger or an acquisition, hold-backs are negotiated, often tied to milestones, and can last a year or longer. Lock-ups and hold-backs create risk for the stockholder, driven predominantly by the volatility associated with public exchanges.

After going public, the company quickly assumes a different investment profile and is focused on growing market share and meeting street expectation of revenue and profits.

Understanding the life cycle of private companies is critical to taking advantage of attractive risk-adjusted return potential in private markets. We believe that investors should diversify their portfolios into both public and private strategies in order to access the growth and value previously available in public markets.

DEFINITIONS

A **lock-up** is defined as a period of time following the IPO or acquisition of a company in which stockholders, who owned the stock prior to the liquidity event, are prohibited from selling their shares. The length of time varies based on the circumstances of the liquidity event.

SOURCE

1. PitchBook, NVCA Venture Monitor, as of 06/30/19.

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The Fund is not suitable for investors who cannot bear the risk of loss of all or part of their investment, or who require a liquid investment. There are significant potential risks to investing in securities of private, late-stage, venture-backed growth companies, including risks relating to the fair valuation of securities, a significant portion of the Fund's assets being allocated to technology companies, and the potential for the Fund's quarterly repurchase program to require the liquidation of portfolio holdings earlier than the Investment Adviser would otherwise do so. This is not a complete enumeration of the Fund's risks. Please read the Fund prospectus for other risk factors related to the Fund, its investment strategy, and your investment in the Fund, and other additional details.

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