PRIVATE CAPITAL QUARTERLY

SECOND QUARTER 2021

INSIDE THIS ISSUE

F·E·G®
investment advisors

In 2013, venture capitalist Aileen Lee described venture-backed companies valued at $1 billion as being "rare as a unicorn." When she published that article eight years ago, the venture industry was emerging from a lost decade following the technology bubble bursting in early 2000 and successful and highly valued venture-backed companies were exceedingly rare, occurring less than 0.1% of the time. The unicorn moniker stuck and is now commonly used to refer to private equity companies valued at $1 billion or more. Today, however, unicorns are occurring with greater frequency and at significantly greater values, which has attracted the attention of investors, venture capital firms, and public investors, among others.

Allocations to venture capital—and private equity broadly—have increased and the rise of capital flowing to these strategies has profoundly impacted exit markets, valuations, and potential returns. This *Private Capital Quarterly* highlights notable trends in venture capital through the last decade and offers guidance on how to proceed in this environment.

Venture Capital Trends

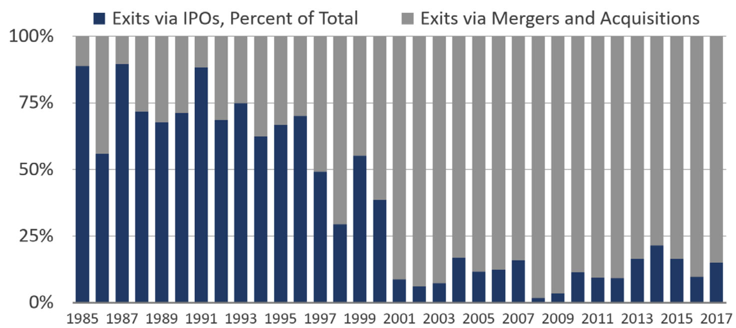
Several trends have influenced the growth and performance of venture-backed companies, one of which began just after the technology bubble burst. Starting in the early 2000s, the number of public offerings dropped significantly as venture-backed companies pursued mergers and acquisitions (M&A) rather than opting to become public companies through the initial public offering (IPO) process. This was due to the rising costs of compliance with regulations and increased public investor expectations for a public company, which dampened the attractiveness of becoming publicly traded.

Investors watching the IPO market are likely already aware of its recent strength; however, M&A still dominates in terms of number of deals. The large dollar exits have been to the public markets, as the aggregate value of venture-backed IPOs has risen dramatically in recent years despite a decrease in the overall number of IPOs from the 1990s.

Despite the recent strength of the IPO market, the trend of more M&A activity and fewer IPOs has contributed to a decline in the number of listed public companies, as companies have opted to stay privately owned for longer periods or be traded on over-the-counter markets.

As a result, public investors are facing a smaller opportunity set while competition—i.e., mutual funds, ETFs, hedge funds—has increased.

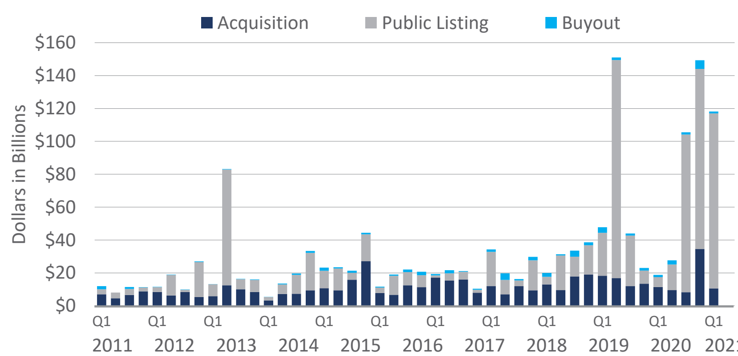
MOST VENTURE CAPITAL EXITS ARE THROUGH MERGERS AND ACQUISITIONS



Data sources: Jay R. Ritter, Warrington College of Business Administration, University of Florida; National Venture Capital Association

Data for 2016 and 2017 are adjusted to match previous years, which exclude unsuccessful deals.

THE BIG DOLLAR EXITS HAVE BEEN TO THE PUBLIC MARKETS



Data source: Pitchbook/NVCA Venture Monitor 2Q 2021

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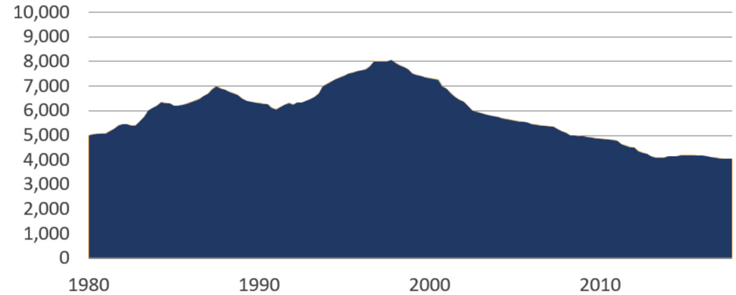
These trends have also contributed to the difficulty in active management beating public indices in recent years. Further, return-seeking investors have not been blind to the success private market investors have experienced.

Consequently, investors have begun turning to private markets to increase returns and gain exposure to fast-growing companies before they become public. Coller Capital's *Summer 2021 Private Equity Barometer* found that the net balance of investors planning to increase their allocations to private equity has increased every year for the last decade. Similarly, FEG's *2021 Community Foundation Survey* offers additional evidence of the trend of increasing allocations to private investments.

Not only are investors looking to the private markets, but public market asset managers are now investing significantly in privately held businesses. This provides fuel to fund the growth of private companies as they increase in size. Pitchbook estimates that 3,301 venture capital deals have received investment from nontraditional institutions, accounting for $115.9 billion in deal value. These nontraditional institutions include hedge fund and mutual fund managers, corporate venture capital programs (CVC), and private equity firms. This trend has become so entrenched that it might make the term "nontraditional" moot.

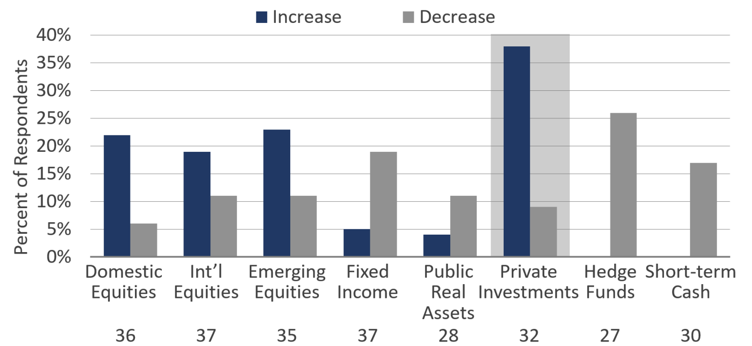
Sunita Patel, chief business development officer for Silicon Valley Bank, commented on several consequences of these trends. First, hedge funds typically move faster and can offer a valuation as much as 50% to 100% more than traditional venture capital competitors, with some valuations at 100x annual recurring revenue (ARR). Term sheets from hedge funds can also be received relatively quickly in comparison to the lengthier diligence and approval process of venture firms. Patel notes that the long-term impact of hedge fund participation will be difficult to predict until a market downturn occurs.

THE NUMBER OF COMPANIES LISTED ON U.S. STOCK EXCHANGES HAS BEEN DECLINING



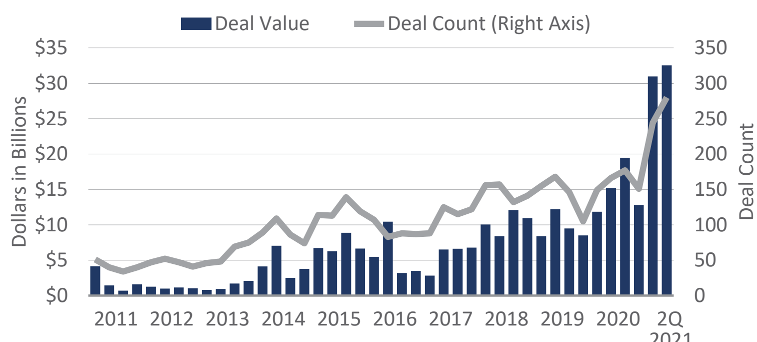
Data sources: Bloomberg L.P. and Jay R. Ritter, Warrington College of Business Administration, University of Florida; University of Chicago for Research in Security Prices. Data as of December 31, 2017

COMMUNITY FOUNDATIONS LARGELY EXPECT TO INCREASE ALLOCATIONS TO PRIVATE INVESTMENTS



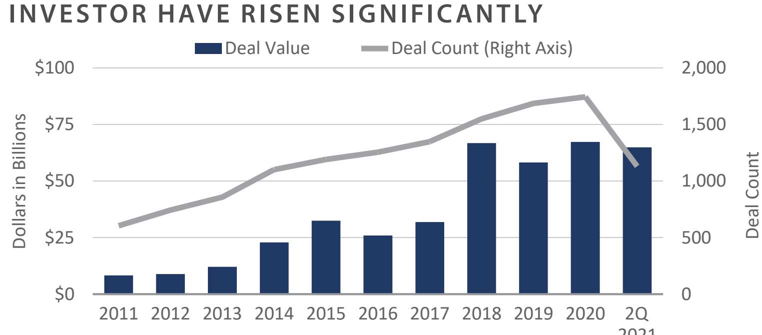
Data source: FEG 2021 Community Foundation Survey; Please see Disclosures for full disclosure. Note: Other responses not shown

CROSSOVER INVESTOR FINANCING VALUATIONS AND ROUND SIZES SOAR



Data source: Pitchbook

DEALS LED BY AT LEAST ONE NON-TRADITIONAL INVESTOR HAVE RISEN SIGNIFICANTLY



Data source: Pitchbook

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The capital inflow has enabled companies to grow while being privately held rather having to wait until after their public listing. In addition to the explosion of unicorns, the last decade saw private financing rounds of a value that was once unheard of. The so-called "mega-deal"—financing rounds of over $100 million—is occurring at an increasing rate. This has enabled companies to reach greater scale and size before they become publicly traded.

Unsurprisingly, valuations of venture-backed companies rose sharply across all stages, in part, due to the influx of capital.

In summary, the number of opportunities in the public market fell while the opportunities in the private market rose. Companies are staying private longer and growing to loftier valuations, and both private and public investors have fueled this growth trend, with mega-deals in the first six months of 2021 setting a new annual record.

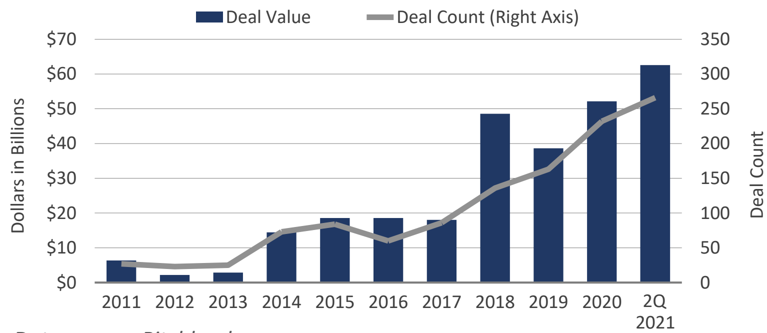
Implications for Investors

With so much market noise and excitement, one can easily lose sight of the big picture. Amid the noise, FEG recommends that investors remain selective, allocate capital to strategies that fit their risk/return profile, and consider whether they have the right long-term allocation to high growth venture-backed companies given the changing market dynamics over the last two decades.

REMAIN SELECTIVE

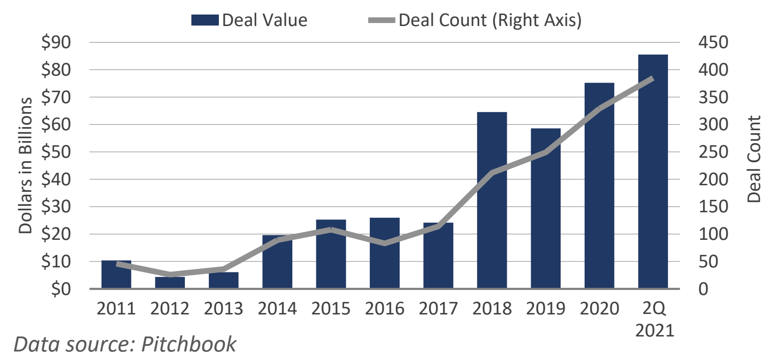
Recent market performance has opened the door for new entrants and for new ways to invest in venture-backed companies. The reality is that venture capital remains as much an access class as an asset class. There is a wide performance dispersion between the top and bottom quartile fund managers.

UNICORNS ARE BEING MADE AT AN UNPRECEDENTED LEVEL AND RATE IN FIRST HALF OF 2021



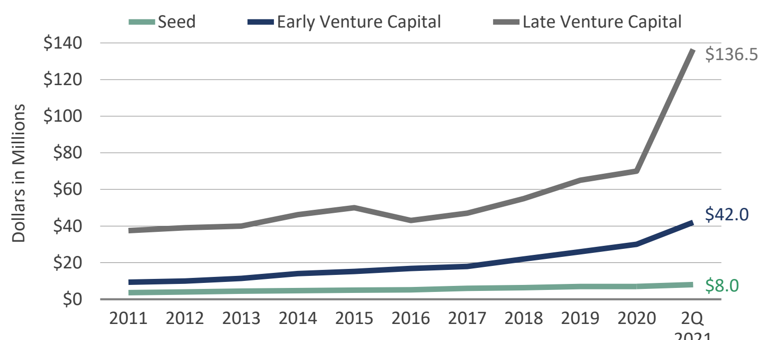
Data source: Pitchbook

MEGA-DEAL ACTIVITY SETS NEW ANNUAL RECORD IN FIRST SIX MONTHS OF 2021



Data source: Pitchbook

MEDIAN VALUATIONS SPIKED ACROSS ALL STAGES IN FIRST HALF OF 2021



Data source: Pitchbook

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RISK/RETURN PROFILE

Venture-backed companies typically receive multiple rounds of financing before their exit (M&A or public listing). These financing rounds often occur at various stages through a company's life—from seed- or early-stage financing when a company is relatively young through large financing rounds that can occur when a company is much larger.

Each stage carries its own unique risk characteristics and opportunity for return. Early-stage companies have less valuation risk due to the lower valuations they carry, although they also have more operational and market risk as products are being developed. Further, management teams can be understaffed, and revenue could be concentrated in a small number of customers.

Later-stage companies benefit from greater maturity with a more robust customer base and better product development. However, these companies also carry more valuation risk as they generally trade at higher valuations, and the volatility of the public markets can influence these valuations.

Investors need to decide if they want to allocate to longer-term-oriented early-stage strategies with less valuation risk and longer holding periods, or later-stage companies with more valuation risk and shorter holding periods.

LONG-TERM TERM STRATEGIC TARGET

As companies accrete more value while privately held, investors should also consider what the right long-term strategic allocation is to high growth technology companies. The small-cap and mid-cap growth companies of the early 2000s are now more likely to be found in the private market than ever before. This begs the question of whether an investor should increase their allocation to privately held companies from their public market holdings given all the associated risks, such as illiquidity, fees, etc.

Conclusion

The sage advice of constraining one's exuberance and investing judiciously applies in the private markets as well as the public. We encourage investors to proceed judiciously as they fund allocations to venture capital. There are numerous long-term tailwinds that could drive this opportunity set in venture capital. COVID-19 has only accelerated the adoption of technology across business enterprises, the consumer sector, and other industries, such as healthcare and education. Capital flows to private equity firms, hedge funds, and other crossover investors have provided a large—and growing—set of buyers and investors for venture-backed companies. The risk is that if the public market valuation multiples pull back, particularly in the technology sector, then venture returns could be compromised even if companies continue to grow revenue.

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PRIVATE EQUITY

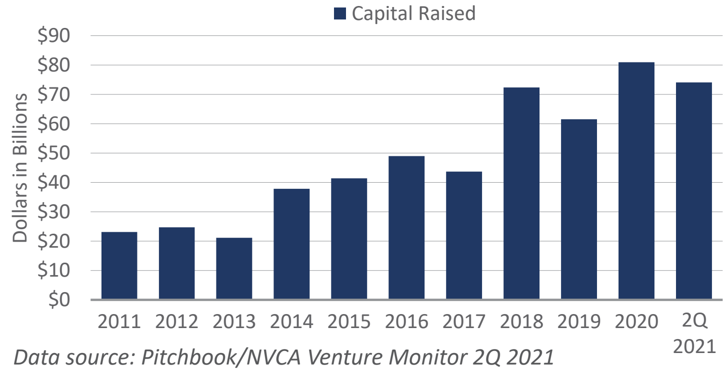
Venture Capital

- Venture capital activity remained robust in the second quarter of 2021, setting the stage for a potentially record-breaking year.
- U.S. venture funds raised $74.1 billion in the first half of 2021, compared to $81.0 billion in all of 2020. Expectations are for venture funds to raise over $100 billion for the first time in history following last year's record levels. Funds with $1 billion or more accounted for almost half of all capital raised in the first half of the year.
- Venture-backed companies received $150 billion of capital in the first half of the year, just short of last year's annual total. Similar to the fundraising environment, investment activity is expected to exceed previous highs.
- Mega-deals—financing rounds of $100 million or more—drove investment activity in 2021, with 167 deals closing with $41.7 billion of capital in the first quarter. The total for all of 2020 was $76.6 billion.
- Crossover investors—i.e., hedge funds, public asset managers—are participating at previously unseen levels, coinciding with the size of the financing rounds and high valuations.
- Pre-money valuations continued to rise for venture-backed companies across all stages, particularly for later-stage financings (Series C and Series D).
- IPO activity surged in the second half of 2020 and accelerated further in early 2021. Public listings have accounted for a significant portion of the overall exit value of venture-backed companies.
- Venture fund performance remains strong, with top quartile IRRs (internal rates of return) landing near or above 25% for each vintage of the last decade.

INVESTOR IMPLICATIONS

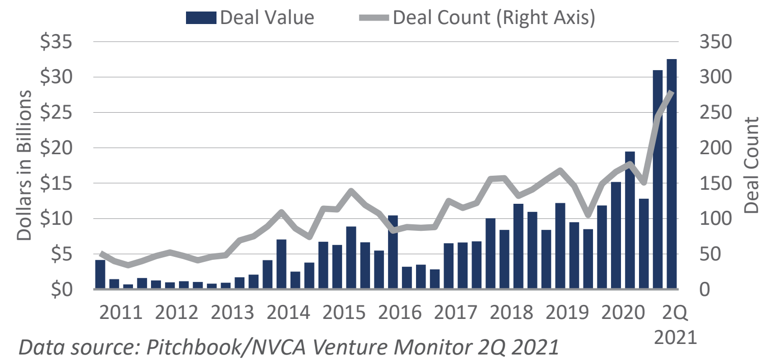
Investors should be prepared for volatility due to the high valuations and capital flows.

FIRST-HALF U.S. VENTURE CAPITAL FUNDRAISING NEARLY EQUALS LAST YEAR'S TOTAL



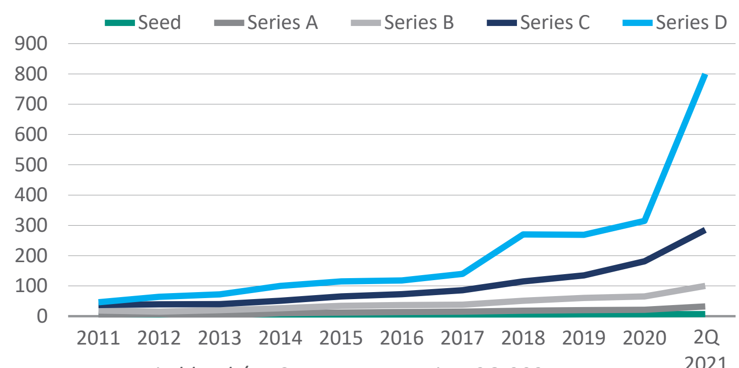
Data source: Pitchbook/NVCA Venture Monitor 2Q 2021

CROSSOVER INVESTOR FINANCING VALUATIONS AND ROUND SIZES SOAR



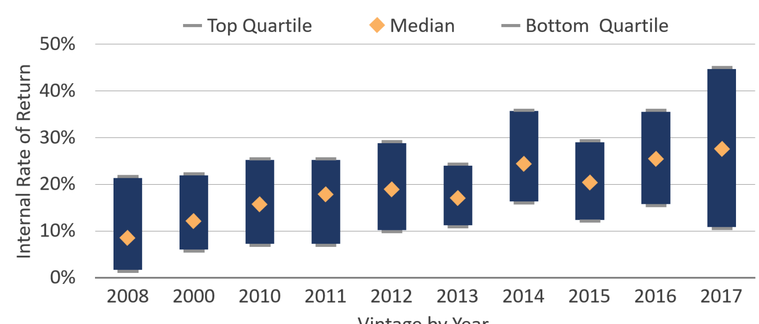
Data source: Pitchbook/NVCA Venture Monitor 2Q 2021

MEDIAN PRE-MONEY VALUATION BY FINANCING ROUND



Data source: Pitchbook/NVCA Venture Monitor 2Q 2021

VENTURE CAPITAL PERFORMANCE



Data source: Thomson One

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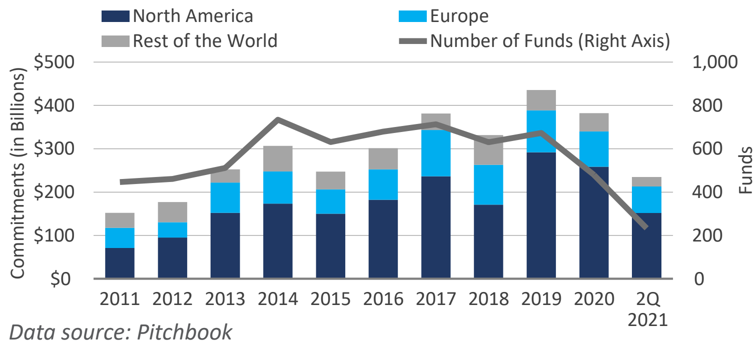
Leveraged Buyouts

- Private equity fundraising continued to soar in the second quarter. As of June 30, 2021, global leveraged buyout funds raised roughly $234 billion of aggregate capital commitments, nearly double the amount raised from the same period in the prior year.[1] More than 65% of the commitments were to U.S.-based private equity funds.[2]
- In the U.S., deal activity remained strong. As of June 30, 2021, both deal value and volume were up more than 20% from the same period in the prior year.[3] Private equity firms continued to prioritize add-ons, which accounted for roughly 75% of annual transaction volume.[4]
- As of June 30, 2021, the median U.S. private equity buyout purchase price multiple was 13.1x earnings before interest, taxes, depreciation, and amortization (EBITDA). The median Debt/EBITDA ratio climbed to 7.5x EBITDA.[5]
- Overall, U.S. private exit value and volume were up 128% and 27%, respectively, during the first half of 2021.[6] Trade sales to strategic or financial acquirers represented most of the global private equity-backed exits.[7] At this pace, 2021 is expected to be a record year for exits.
- Private equity performance was strong through the first quarter of 2021. The spread between top quartile and bottom quartile remained above 1,000 basis points.[8]

INVESTOR IMPLICATIONS

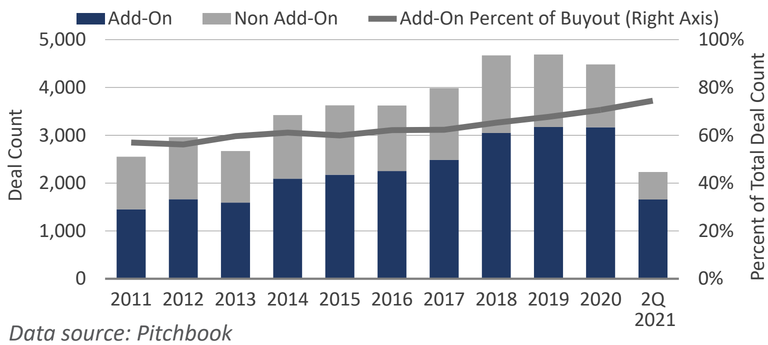
Private equity markets continue to be valued. Investors are encouraged to remain cautious and partner with managers focused on creating value via operational improvements as opposed to financial engineering.

PRIVATE EQUITY FUNDRAISING REBOUNDS



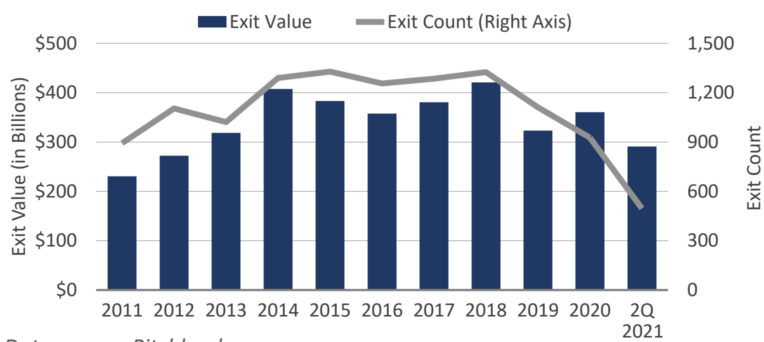
Data source: Pitchbook

MANAGERS PRIORITIZE ADD-ON TRANSACTIONS



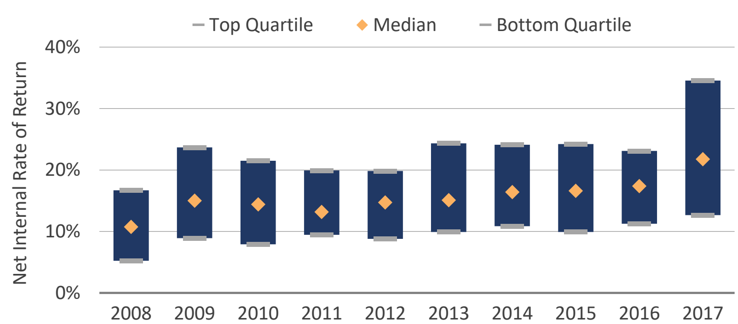
Data source: Pitchbook

EXIT ACTIVITY ON PACE FOR RECORD LEVELS



Data source: Pitchbook

PERFORMANCE REMAINS STRONG



Data source: Thomson One

[1-8] Pitchbook; Data as of June 30, 2021

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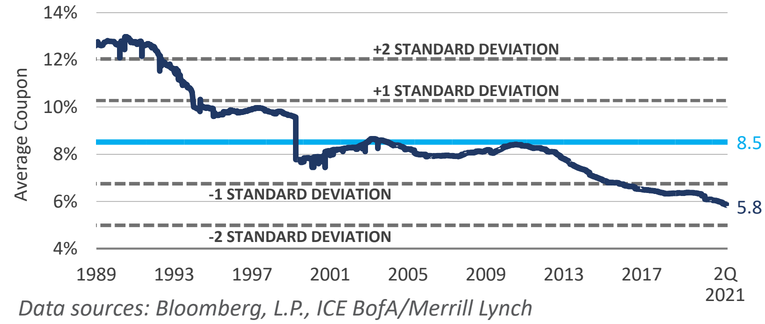
PRIVATE DEBT

- The second quarter saw continued strength in the public credit markets. As of June 30, 2021, high yield bonds returned 2.8% for the quarter and 3.7% year-to-date.[1] With coupons of less than 6% and high yield bonds trading through par, an extension of this rally appears to be limited.
- According to Preqin, private debt fundraising through the second quarter of 2021 is ahead of 2020's full year pace. As of June 30, 2021, 112 funds had raised roughly $94.4 billion of capital. If this pace continues, private debt fundraising will reach an all-time high.
- Fundraising for distressed debt and special situations funds has slowed from 2020's torrid pace, in line with the strength in the public markets—which reduces distressed opportunities. Only $24.6 billion was raised through the second quarter of 2021, roughly 33% of 2020's calendar year total.
- Calendar years 2018-2020 each saw approximately $90 billion raised for direct lending and mezzanine debt, which FEG refers to as private lending. Fundraising in the first half of 2021 is running well ahead of that pace, suggesting a potential all-time high for private lending fundraising by year-end, assuming additional funds come to market in the second half of the year.

INVESTOR IMPLICATIONS

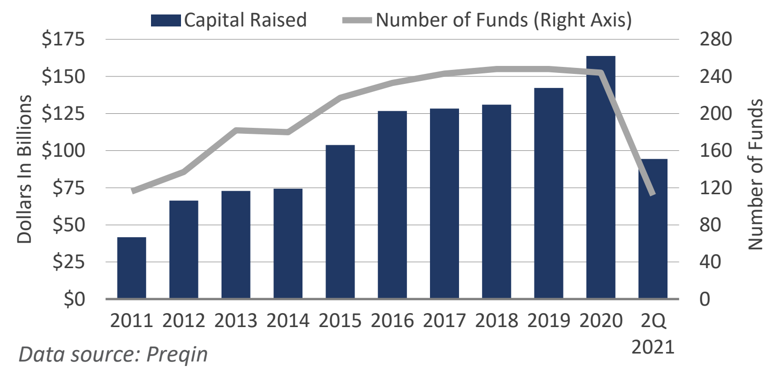
The resurgence in private lending is in line with the reduction in distressed and special situations funds. This is due primarily to the recovery in the credit markets and the overall economy.

HIGH YIELD BOND COUPONS FALL BELOW SIX PERCENT



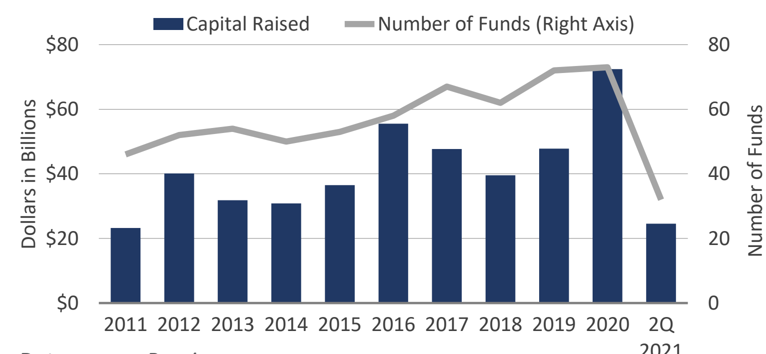
Data sources: Bloomberg, L.P., ICE BofA/Merrill Lynch

PRIVATE DEBT FUNDRAISING ON TRACK FOR ALL-TIME HIGHS



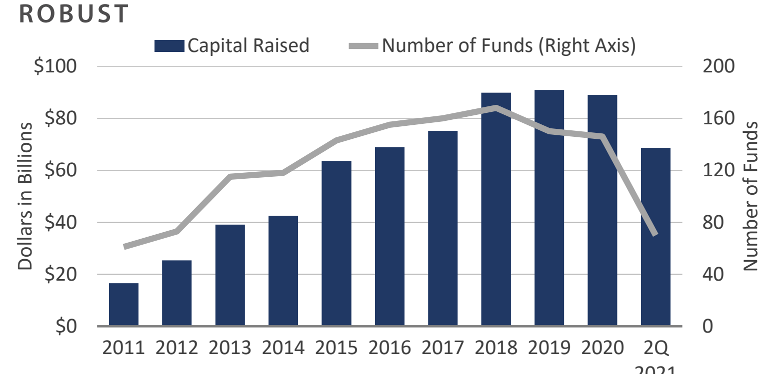
Data source: Preqin

DISTRESSED DEBT AND SPECIAL SITUATIONS FUNDRAISING SLOWS



Data source: Preqin

FUNDRAISING FOR PRIVATE LENDING REMAINS ROBUST



Data source: Preqin

[1] Ice BofA US High Yield Master II Index

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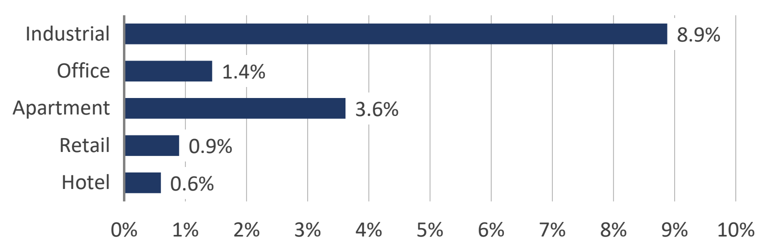
PRIVATE REAL ESTATE

- The National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index (NPI) posted a gain of 3.6% during the second quarter and returned 7.4% on a trailing 1-year basis. Industrial properties continued to outperform, with a total return of 8.9% in the second quarter and 23% on a trailing 1-year basis.[1]
- During the quarter, private real estate transaction volume increased 60% compared to second quarter 2020 to 1,785 deals; total deal value also doubled to $68 billion compared to the same period in 2020.[2] One of the largest transactions announced during the quarter was Blackstone's proposed acquisition of QTS Data Centers in June for $6.7 billion, which represented the first privatization of a public data center REIT.[3] The deal was indicative of managers targeting the public real estate market in order to deploy significant capital raised by private estate funds over the past several years.
- Residential real estate continues to post record gains, with median existing-home sales prices up 23.4% year-over-year to $363,300 as of June.[4] This trend is being driven by low interest rates and limited supply due to under-building over the past decade. As a result, some potential buyers are being forced to rent longer, leading to a 10% rise in median apartments rents over the past year, with some markets seeing significantly higher rent growth.[5] Migration of individuals and companies away from large coastal markets to more affordable "sunbelt" markets also remains an ongoing trend.
- Property types most impacted by the pandemic, including retail and hotels, have recovered year-to-date and are attracting capital from investors seeking distressed opportunities. Retail transactions more than doubled in the second quarter of 2021 compared with 2020. Similarly, hotel transactions have rebounded significantly from the lows of 2020, with deal numbers up over 250% according to Preqin. Investors are targeting the sector in anticipation of a recovery in tourism and have often been willing to pay record prices for higher quality assets.[6]
- In the second quarter, both the number of private real estate funds closed and the total aggregate capital raised dropped below long-term averages. A total of 59 private real estate funds closed in the second quarter, raising an aggregate $19 billion. By comparison, the average number of funds closed from 2016 through first quarter 2021 was 123 per quarter, and aggregate capital raised each quarter over the same period averaged $38 billion. One contributing factor to weaker fundraising could be the increased number of funds in the market, which reached an all-time record of 1,240 as of mid-year.[7]

INVESTOR IMPLICATIONS

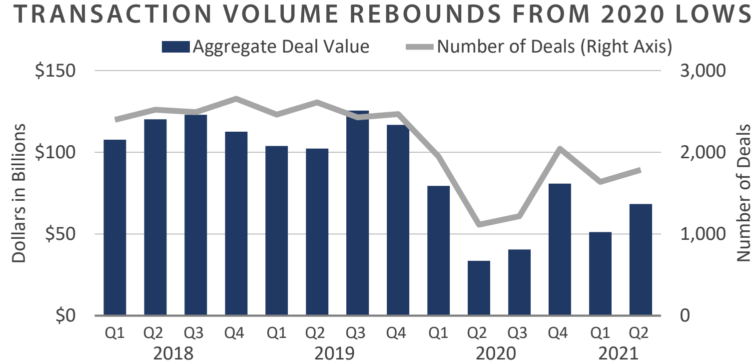
Real estate continues to be characterized by strong competition for deals due to record capital flows, low interest rates, and attractive relative yields. An example of this is Blackstone's "BREIT," a private REIT with approximately $50 billion in capital available. While some property types such as retail, hotels, and office continue to face uncertainty due to the ongoing impact of the pandemic, nearly all sectors are attracting capital. These factors should be supportive of property values, with the key risks in the current market being higher materials and labor costs, rising interest rates, and competition for deals, all of which could result in lower future returns.

INDUSTRIAL CONTINUES TO OUTPERFORM ALL PROPERTY TYPES



Data source: NCREIF

TRANSACTION VOLUME REBOUNDS FROM 2020 LOWS



Data source: Preqin Pro

[1, 6] NCREIF; Data as of June 30, 2021

[2] NAREIT; Data as of June 30, 2021

[3] Miriam Gottfried, Blackstone to Buy Data-Center Operator QTS Realty Trust for $6.7 Billion, The Wall Street Journal, June 7, 2021

[4, 7] Preqin; Data as of June 30, 2021

[5] Will Parker, Apartment Rents Increase as Young Workers Head Back to Cities, The Wall Street Journal, August 3, 2021

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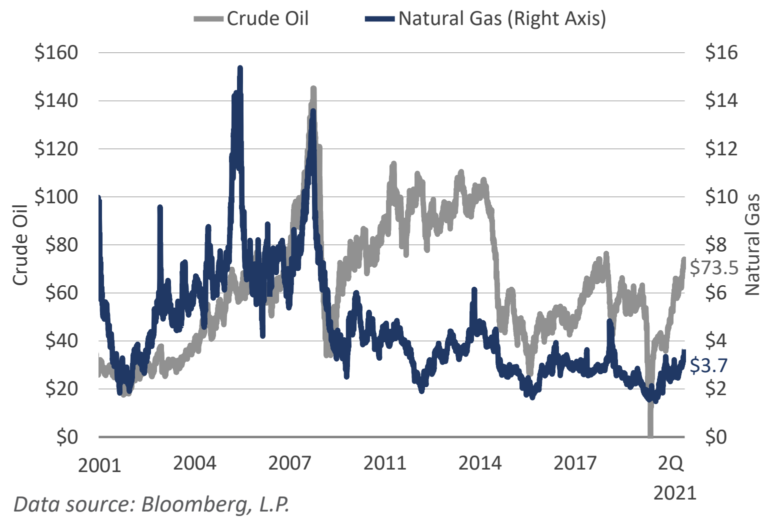
NATURAL RESOURCES

- Oil prices rose 24% in the second quarter to close at $73.47/barrel. As of mid-year, oil prices were up 56% year-to-date. Oil prices reached their highest levels in more than two years, surpassing pre-pandemic highs as investors anticipated increased demand due to the summer travel season, the continued rollout of vaccines, and the ongoing reopening of economies. Cuts in capital spending by upstream energy companies led to concerns about potential supply gaps as demand recovers.
- Natural gas prices also reached multi-year highs, gaining 40% in the second quarter to close at $3.65/MMBtu.[1] Natural gas prices benefited from record heat in much of the U.S. as well as continued demand for U.S. liquid natural gas (LNG) exports.
- Despite improving oil and natural gas prices, fundraising for upstream energy funds remains extremely challenging. Eight of the 10 largest private energy funds closed in the second quarter had renewable energy as part of their investment mandate, demonstrating the strong appetite for clean energy. Among the largest funds to close in the second quarter was EnCap's Energy Transition Fund at $1.2 billion, indicating a clear shift away from its longstanding presence as one of the largest firms in the upstream private energy sector.[2]
- During the second quarter, the total U.S. rig count, as measured by Baker Hughes, increased 12.7% from the first quarter to 470 rigs, representing a 77% increase compared to 2020. The U.S. natural gas rig count finished the quarter at 98, up from 92 rigs at the end of first quarter. Year-over-year, the U.S. total natural gas rig count increased by 31%. The U.S. total oil rig count increased 14.8% in the second quarter, moving from 324 rigs at the beginning of the quarter to 372 at quarter-end. Year-over-year, the U.S. total oil rig count is up 98%, or 184 rigs.[3]

INVESTOR IMPLICATIONS

The focus on "energy transition" has taken center stage in 2021, with widespread moves by investors to divest of fossil fuels in favor of renewable energy. Even large cap public energy companies have announced commitments to clean energy initiatives. The upstream energy sector stands out as one of the few areas of the market characterized by limited capital availability. Meanwhile, the industry continues to rightsize by paying down debt and emphasizing free cash flow generation. Beyond energy, the outlook for natural resource prices—i.e., base metals, agricultural commodities—broadly is characterized by favorable supply/demand fundamentals, with inflationary pressures emerging in the first half of 2021. We believe these trends should ultimately have a positive impact on private equity energy and resources funds, which have underperformed over the past decade.

OIL AND GAS PRICES REACH MULTI-YEAR HIGHS



Data source: Bloomberg, L.P.

[1] Energy Information Administration www.eia.gov; June 30, 2021
[2] Preqin, Data as of June 30, 2021
[3] Baker Hughes; Data as of July 2021

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INDICES

Bloomberg Barclays US Corporate High Yield Index represents the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets are excluded but, Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. The index includes the corporate sectors: Industrials, Utilities, and Finance, encompassing both US and non-US Corporations. See www.bloomberg.com for more information

The Russell Indices are constructed by Russell Investment. There are a wide range of indices created by Russell covering companies with different market capitalizations, fundamental characteristics, and style tilts. See www.russellinvestments.com for more information.

The FTSE NAREIT Composite Index (NAREIT) includes only those companies that meet minimum size, liquidity and free float criteria as set forth by FTSE and is meant as a broad representation of publicly traded REIT securities in the U.S. Relevant real estate activities are defined as the ownership, disposure, and development of income-producing real estate. See www.ftse.com/Indices for more information.

The S&P 500 Index is capitalization-weighted index of 500 stocks. The S&P 500 Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The NCREIF Property Index is a quarterly time series composite total rate of return measure of investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only.

HFRI ED: Distressed/Restructuring Index — Distressed/Restructuring strategies which employ an investment process focused on corporate fixed income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance or obliged (par value) at maturity as a result of either formal bankruptcy proceeding or financial market perception of near term proceedings. Managers are typically actively involved with the management of these companies, frequently involved on creditors' committees in negotiating the exchange of securities for alternative obligations, either swaps of debt, equity or hybrid securities. Managers employ fundamental credit processes focused on valuation and asset coverage of securities of distressed firms; in most cases portfolio exposures are concentrated in instruments which are publicly traded, in some cases actively and in others under reduced liquidity but in general for which a reasonable public market exists. In contrast to Special Situations, Distressed Strategies employ primarily debt (greater than 60%) but also may maintain related equity exposure.
Information on any indices mentioned can be obtained either through your consultant or by written request to information@feg.com.

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The Community Foundations data is obtained from the proprietary FEG 2021 Community Foundation Survey. The study includes a survey of 110 U.S. Community Foundations. The survey was open for responses online from February 22 - March 26, 2021. Participants also had the option to complete as a word document and email the results back to FEG. The data from this survey was grouped into between five and seven categories based on assets of the community foundation with assets ranging from less than $25 million to greater than $1 billion. The information in this study is based on the responses provided by the participants and is meant for illustration and educational purposes only.

All data is as of June 30, 2021 unless otherwise noted.

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