The Private Shares Fund

June 2023

The Investment Case for Late-Stage, Venture Capital-Backed Companies

Should advisors continue to allocate capital to late-stage Venture Capital (VC) backed companies despite recent setbacks at several high-profile companies in the category?

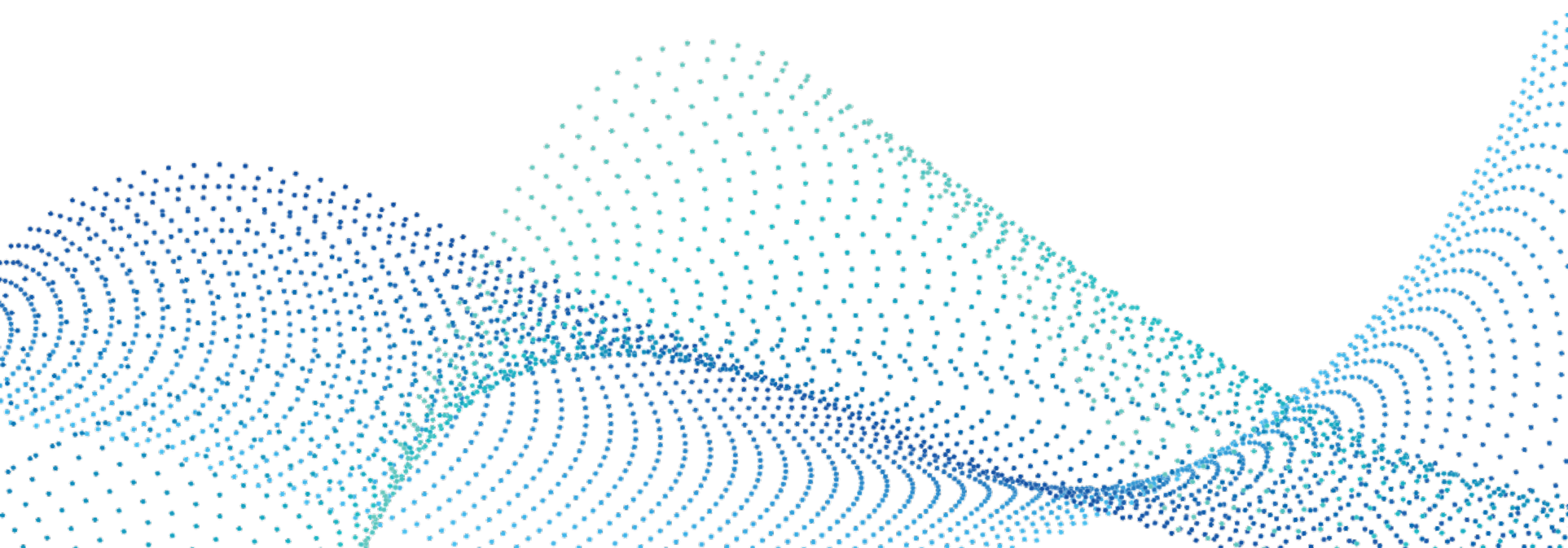
We believe the answer is yes if you have a two-to-four-year investment horizon and the expertise and insight to navigate the asset class.

HISTORICALLY HIGHER RISK, HIGHER REWARD

A key reason why investors may consider an allocation to venture-backed companies is the potential opportunity to generate outsized returns while these companies remain in private ownership. Venture capital is a broad asset class, so it is important to understand how late-stage is defined. Late-Stage VC often refers to companies that have a developed business model, a strong customer base and in many cases are generating hundreds of millions if not billions of dollars of revenue. This differs from early-stage VC which refers to companies that are still developing a business model and go-to-market strategy. When considering an allocation to late-stage VC, historically some of the benefits over earlier-stage investment include:

1. **Market Validation:** Later-stage growth companies often have shown market validation and secured market share in their respective industries. They may be a market leader or dynamic disruptor.
2. **Proven Track Record:** Business models have typically been proven as these companies cleared multiple hurdles, delivered substantial operating metrics, and often raised a series of funding rounds from institutional investors and strategic partners.
3. **Portfolio Diversification:** As innovation is often led by the private sector, an allocation to late-stage growth may provide access to a range of innovative companies and sectors. This becomes increasingly important as companies continue staying private for longer.
4. **Risk Mitigation:** Many consider that investing in later-stage compared to earlier-stage companies can potentially mitigate technology risk, commercialization risk, and scale risk amongst others, while also allowing for attractive upside potential.

An analysis of results from January 2010 to March 2023 indicates that investing in high-quality, late-stage VC-backed companies before they leave the private marketplace has produced significantly better returns overall than waiting for the initial public offering, as the data in the chart below illustrates. Of course, past results do not indicate future performance.



We examined all 746 Initial Public Offerings (IPOs) of U.S. VC-backed private companies that executed an IPO between January 2010 and March 2023. We then charted the change in price at both six months and 12 months after the IPO. As per the chart below, investors who bought into VC-backed companies as late as their last private financing rounds saw average price increases of 254%/243% and median price increases of 97%/71% over the six and 12-month periods following their IPO date, respectively.

By comparison, those who invested in the IPO, or after the start of public trading, experienced much lower price changes or even losses.

Note: Factors that are unusual outliers have greater influence on Average results than they do on Median results.

U.S. VC-BACKED IPO ANALYSIS

PERFORMANCE OF U.S. VC-BACKED COMPANIES WITH AN IPO EXIT

(01/01/2010) - 03/31/2023)

6-Month Post-IPO From:

	Last Private Financing	IPO Price	First Trade
AVERAGE:	254%	17%	-4%
MEDIAN:	97%	2%	-14%

12-Month Post-IPO From:

	Last Private Financing	IPO Price	First Trade
AVERAGE:	243%	17%	-4%
MEDIAN:	71%	-8%	-22%

Gains and losses have been factored into the calculation of these overall results.
Source: Liberty Street Advisors, Inc. , Pitchbook, Y-Charts, Nasdaq, SEC Edgar. Total 746 U.S. Venture-Capital-Back Private Companies that executed an IPO from January 01, 2010 through March 31, 2023. Last private financing prices adjusted for subsequent stock splits to allow for appropriate comparisons. Only includes formerly VC-backed, U.S. companies listing on the NYSE or NASDAQ. Analysis tracks the change in price for an individual share at last private financing, and therefore does not factor in potential tax implications or management and performance fees that may be associated with investments in private markets. Past Performance is no guarantee of future results.

THE VC RISK/REWARD EQUATION

Over the last decade, nearly $1.5 trillion in capital has flowed into U.S. VC deal activity[1], of which nearly $1.0 trillion involved late-stage VC and growth investments.[2] In recent years, non-traditional sources of capital including hedge funds, cross-over funds, and sovereign wealth funds, made sizeable allocations to this asset class primarily due to the following factors:

- Sustained low-interest rate environment
- Increased excitement around innovation
- Capital deployment pressure
- Desire for pre-IPO access to establish positioning
- “Fear of missing out” (FOMO)

Overall, this has culminated in growing demand which led to increased valuations, in some cases at frothy levels.

Venture capital offers a different risk/reward profile compared to other private market segments, meaning that there is potentially greater risk associated with these assets that may generate higher returns. There is also remarkable variance within the asset class. For example, early-stage VC-backed investments often involve emerging businesses still in the conceptual phase of their development. With this higher risk comes the potential for significantly higher returns, often in the 5x+ range (five times or more on the original investment) as seen in the past.

1 Pitchbook, NVCA. (2023). Venture monitor. Q1’ 2023.
2 Pitchbook, (2023).

Venture capital is perhaps the smallest segment of the private market compared to other segments such as buyout stage assets, real estate, and infrastructure. Also, VC-backed companies rarely have meaningful levels of debt, if any, in their capital structure, which can help mitigate risk of default. That said, in 2022 there was over $246 billion in VC-related deal activity[3], of which more than $152 billion involved late-stage VC and growth investments.[4] While the pace of venture and growth-oriented deal activity has slowed over the last several quarters due primarily to a more challenging macroeconomic environment, there continues to be significant dry powder available to support the ecosystem.

In parallel, there is a growing supply of venture-backed opportunities as companies continue experiencing protracted life cycles. For example, approximately 75% of all U.S. companies with revenues over $100 million are currently private companies[5], whereas this percentage would have been more heavily allocated to public companies in prior decades.

Protracted life cycles often create both a need for more capital (primary investments) and creative liquidity options (secondary investments) as not all shareholders have the same investment horizon. In other words, staying private for longer can create different levels of friction within the ownership structure of these companies, which is further compounded by the illiquid nature of private markets. Sophisticated investors can often take advantage of these dynamics to negotiate favorable terms in normal market conditions, and these terms may become even more pronounced during periods of increased macro uncertainty and dislocation.

Whether accessed through primary or secondary investments, investors in late-stage VC and growth stage investments typically expect a shorter holding period as they may have a clearer path to liquidity via Merger & Acquisition (M&A) or IPO. That being said, we believe that this asset class still requires a longer-term view of at least two-to-four-years to generate attractive levels of capital appreciation. Investors with a shorter time horizon would be wise to limit their exposure.

SECONDARY MARKET LIQUIDITY

For those with a higher risk tolerance, VC investing can be rewarding, but a key question all investors should ask is: "What about liquidity?"

Over the past two decades, the secondary market for private asset transactions has grown significantly, providing increased liquidity to various participants across the ecosystem. Again, a major driver for the liquidity needs is the protracted life cycles noted above, which can create friction within the ownership structure of private market funds and the underlying companies themselves.

The secondary market helps to provide much of the needed liquidity for the general partners (GPs) of funds, the limited partners (LPs) who invest in these funds, and the shareholders in the funds' underlying portfolio companies. Secondary investors are often able to take advantage of dislocations and information asymmetry, which may allow them to purchase private assets at significant discounts to their fair market or intrinsic values. Purchasing at a discount does not guarantee the ability to sell at a gain.

A subset of this secondary transaction volume includes the buying and selling of securities in late-stage VC-backed companies. Global secondary volume in 2022 declined from 2021, but still exceeded pre-2021 levels, illustrating investor confidence in venture capital.[6] It's important to note that while the secondary market for venture capital has experienced growth, it still represents a relatively small portion of the overall venture capital ecosystem.

The development of a deep secondary market is desirable for investors allocating to a mature asset class such as late-stage venture capital. As the number of primary commitments to venture capital have spurred the growth of the asset class over the past decade, a healthy secondary market has followed as the inventory is often passed through multiple hands between funding rounds.

3 Pitchbook, NVCA. (2023). Venture monitor. Q1' 2023.
4 Pitchbook, (2023).
5 Pitchbook, (June 1, 2023).
6 Jefferies, (January 2023). Global Secondary Market Review.

This leads to more investors in the market and growing the viability of the market. We see the growth of the secondary market driven by some core changes to the asset class:

1. Increased demand for access to different stages of venture capital
2. Companies are staying private for longer leading to a desire or need for partial or full-liquidity
3. Growth of company-led tender offers

The risk/reward profile for secondary transactions also varies depending on the underlying asset stage and transaction types. As the supply-demand imbalance is likely to persist, those investors that have a long-term horizon can potentially take advantage of the secondary markets by allocating to what they believe are attractively priced companies.

MARKET OUTLOOK

As the market corrects during periods of increased volatility and uncertainty, it can create an attractive buying opportunity for experienced investors to either enter or increase their exposure to the late-stage VC asset class. Similar to public market behavior, private market investors may exhibit a desire for increased liquidity during these periods, perhaps even more so, which can lead to a supply/demand imbalance. However, the ability to achieve such liquidity is more challenging when the underlying assets held are illiquid, which can result in transactions being consummated at higher discounts. Similarly, new private financings completed during these periods may come with lower valuations and more investor-friendly terms, as noted above.

Given the current state of the market, the clear implication of a tougher exit environment is that some private companies will continue to delay exit events and remain private until the market presents the ability to optimize valuation and liquidity. During periods such as this, we often see a clear bifurcation in which high-performing companies that are well-managed will continue to raise capital without much issue, while low performing companies that are capital-constrained are likely to experience significant hardship.

To this extent, in addition to active company selection, we are also seeing the importance of sector selection and avoiding allocation to private market companies in areas without fundamental demand. We are seeing tailwinds behind certain sectors continue to be supportive. For example, cybersecurity and artificial intelligence are both sectors with positive tailwinds. Security will continue to benefit from a catch-up in spending from government and enterprises. Artificial intelligence has been a net beneficiary in 2023 with a number of private names performing well amidst the challenging growth backdrop.

We continue to believe that companies with differentiated business models, strong operating metrics, healthy balance sheets, experienced management teams, and seasoned boards will ultimately reward their investors, even if it takes a bit longer than expected.

The big implication may be that private companies will continue to delay exit events and thus decide to stay private for longer until the opportune time arises to optimize valuation and liquidity. Historically, we've seen that periods of increased volatility and macroeconomic uncertainty are often good catalysts for increasing the supply of attractively priced opportunities in the private markets, which can lead to strong performance in subsequent years.

While various macro headwinds have caused public and private valuations to retrace, the venture asset class has historically performed well during recessionary periods.

THE BOTTOM LINE

There is no question that the late-stage VC asset class comes with a higher risk/higher return profile when compared to conventional public equity and fixed-income strategies, as well as certain private market strategies. However, solid data and analysis indicate that investors with longer-term time horizons would be well served to explore how this asset class may complement their current portfolio allocation models.

Christian Munafo, Chief Investment Officer of Liberty Street Advisors, Inc.

DISCLOSURES

As of December 9, 2020, Liberty Street Advisors, Inc. became the adviser to the Fund. The Fund's portfolio managers did not change. Effective April 30, 2021, the Fund changed its name from the "SharesPost 100 Fund" to "The Private Shares Fund." Effective July 7, 2021, the Fund made changes to its investment strategy. In addition to directly investing in private companies, the Fund may also invest in private investments in public equity ("PIPEs") where the issuer is a special purpose acquisition company ("SPAC"), and profit sharing agreements.

Investors should consider the investment objectives, risks, charges and expenses carefully before investing. For a prospectus with this and other information about The Private Shares Fund (the "Fund"), please download here***, visit the Fund's website at*** PrivateSharesFund.com ***or call 1-855-551-5510. Read the prospectus carefully before investing.***

The investment minimums are $2,500 for the Class A Share and Class L Share, and $1,000,000 for the Institutional Share.

Investment in the Fund involves substantial risk. The Fund is not suitable for investors who cannot bear the risk of loss of all or part of their investment. The Fund is appropriate only for investors who can tolerate a high degree of risk and do not require a liquid investment. The Fund has no history of public trading and investors should not expect to sell shares other than through the Fund's repurchase policy regardless of how the Fund performs. The Fund does not intend to list its shares on any exchange and does not expect a secondary market to develop.

All investing involves risk including the possible loss of principal. Shares in the Fund are highly illiquid, and can be sold by shareholders only in the quarterly repurchase program of the Fund which allows for up to 5% of the Fund's outstanding shares at NAV to be redeemed each quarter. Due to transfer restrictions and the illiquid nature of the Fund's investments, you may not be able to sell your shares when, or in the amount that, you desire. The Fund intends to primarily invest in securities of private, late-stage, venture-backed growth companies. There are significant potential risks relating to investing in such securities. Because most of the securities in which the Fund invests are not publicly traded, the Fund's investments will be valued by Liberty Street Advisors, Inc. (the "Investment Adviser") pursuant to fair valuation procedures and methodologies adopted by the Board of Trustees. While the Fund and the Investment Adviser will use good faith efforts to determine the fair value of the Fund's securities, value will be based on the parameters set forth by the prospectus. As a consequence, the value of the securities, and therefore the Fund's Net Asset Value (NAV), may vary.There are significant potential risks associated with investing in venture capital and private equity¬ backed companies with complex capital structures. The Fund focuses its investments in a limited number of securities, which could subject it to greater risk than that of a larger, more varied portfolio. There is a greater focus in technology securities that could adversely affect the Fund's performance. The Fund's quarterly repurchase policy may require the Fund to liquidate portfolio holdings earlier than the Investment Adviser would otherwise do so and may also result in an increase in the Fund's expense ratio. Portfolio holdings of private companies that become publicly traded likely will be subject to more volatile market fluctuations than when private, and the Fund may not be able to sell shares at favorable prices, such companies frequently impose lock-ups that would prohibit the Fund from selling shares for a period of time after an initial public offering (IPO). Market prices of public securities held by the Fund may decline substantially before the Investment Adviser is able to sell the securities.

The Fund may invest in private securities utilizing special purpose vehicles ("SPV"s), private investment funds ("Private Funds"), private investments in public equity ("PIPE") transactions where the issuer is a special purpose acquisition company ("SPAC"), and profit sharing agreements. The Fund will bear its pro-rata portion of expenses on investments in SPVs, Private Funds, or similar investment structures and will have no direct claim against underlying portfolio companies. PIPE transactions involve price risk, market risk, expense risk, and the Fund may not be able to sell the securities due to lock-ups or restrictions. Profit sharing agreements may expose the Fund to certain risks, including that the agreements could reduce the gain the Fund otherwise would have achieved on its investment, may be difficult to value and may result in contractual disputes. Certain conflicts of interest involving the Fund and its affiliates could impact the Fund's investment returns and limit the flexibility of its investment policies. This is not a complete enumeration of the Fund's risks. Please read the Fund prospectus for other risk factors related to the Fund.The Fund may not be suitable for all investors. Investors are encouraged to consult with appropriate financial professionals before considering an investment in the Fund.

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