Verus

PERSPECTIVES THAT DRIVE ENTERPRISE SUCCESS

Period Ending: June 30, 2024

Investment Performance Review

Private Markets

San Mateo County Employees' Retirement Association

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Observations driving Verus outlook

Executive summary

Valuations have rebounded broadly.
As public market valuations have expanded, private markets—having recently bottomed—are following suit. General Partners (GPs), particularly those in the midst of fundraising, are motivated to generate realizations and are bringing their top-performing portfolio assets to market, commanding higher purchase prices. In Venture Capital, AI and AI-adjacent companies have seen significant value expansion.

Deal activity shows early signs of recovery.
Deal activity remains subdued compared to recent years, though it is on track to match or exceed pre-COVID levels. Bid-ask spreads have narrowed as seller expectations normalize from the inflated peaks of 2021, and valuations recover from recent lows. GPs are motivated to deploy capital, seeking to prevent fund return cannibalization due to management fees. On the buy side, value opportunities may increase, providing a counterbalance to higher debt costs in a rebounding valuation environment. In Venture, GPs are positioning themselves to capitalize on the next wave of technological innovation, driving deal flow.

Exit activity remains weak.
Aversion to higher-risk assets has constrained exit activity as public market investors haven't reliably rewarded freshly minted IPOs. Sellers who delayed exits in anticipation of more favorable exit conditions may reconsider should pressure to realize gains grow and their valuation expectations normalize. Exit prospects for larger deals will continue to face headwind should Merger and Acquisition (M&A) remain scrutinized by governing bodies.

Untraditional methods of generating capital are proliferating.
To address the lack of exits and extended hold periods, managers are increasing their usage of untraditional mechanisms that enable liquidity (e.g., Continuation Vehicles, deferral of purchase and debt payments, and NAV loans). These solutions have the potential to be executed in a manner unfavorable to LPs, necessitating critical LP judgement and diplomacy.

Fundraising remains depressed broadly.
Aside from Europe, fundraising remains depressed due to record amounts of dry powder and the inability to free up existing LP capital via distributions. A difficult fundraising environment may inhibit AUM growth, core competency shifts, blind pool risk, and access constraints. To the benefit of existing GP-LP relationships and portfolio incumbents, some LPs have preferred to allocate to established managers rather than emerging ones.

Rising cost of debt may reduce return on equity.
GPs are shifting towards a higher proportion of equity to debt when executing leveraged buyouts, resulting in diminished upside from leverage. Somewhat caused by elevated interest rates, the observed extension of J-curves, diminishing of exit options, decline in earnings growth, and decreased interest coverage may reduce investment return prospects across Private Markets.

Summary of findings

Outlook		
Unattractive	Neutral	Attractive
○	◑	●

Strategy		Stage	'23	'24	Commentary
Buyout	U.S.	*Small Mkt*	●	◑	Small market buyouts often present easy-to-grasp revenue growth opportunities. Purchasing is also relatively cheaper and less leverage dependent. Smaller companies offer investors the potential to mitigate headwinds resultant from higher interest rates, though at higher risk as companies at this size are more subject to idiosyncratic and cyclical risks. The potential for prolonged macro-related headwinds prompted our shift from last year.
Buyout	U.S.	*Mid Mkt*	●	●	The middle market offers potential value on the buy, being at a size where take-privates, bankruptcies, carve-outs, and macro-driven motivating selling are prominent. Often, companies at this scale are not operating at their full potential, allowing for margin expansion opportunities. They also benefit from large and mega caps opting to grow their companies through acquisitions as they bide time for more rewarding exit markets. Growth equity offers a reprieve from headwinds pervading private markets. Growth equity investments typically require little to no debt to finance and allow asset owners to maintain control.
Buyout	U.S.	*Large Cap*	◑	◑	Operating improvement opportunities are relatively limited in large cap companies. Companies at this scale typically possess strong market positions and were owned by multiple sponsors, who presumably professionalized and optimized their investments. Large cap buyout returns are typically driven by leverage and multiple expansion, both of which are hindered in an elevated rate environment.
Buyout	*Europe*		◑	◑	Despite geopolitical conflict and fragmented capital markets, the region demonstrated resilience in investment activity. We remain positive on opportunistically partnering with pan-European and region-specific managers who have proven track records that are likely to persist.
Venture Capital	*Early-Stage*		◑	◑	Strong early-stage managers may provide for an outsized value-appreciating component within a private markets portfolio. The expansion of purchase prices are offset by the opportunity to invest early in a start-up with the potential to gain significant market leadership in frontier markets. Early-stage investments are relatively insulated from macro environments as valuation step-ups are tied to the perception of operating milestones.
Venture Capital	*Late-Stage*		○	○	Entry valuations rebounded to a level above historical normal. Value step-ups upon exit are limited. Until IPO markets provide meaningful upside to later stage funding rounds and M&A becomes less contentious with regulatory bodies, we find the later stage to be limited in its risk-return prospects.

Outlook		
Unattractive	Neutral	Attractive
○	◐	●

Summary of findings (cont.)

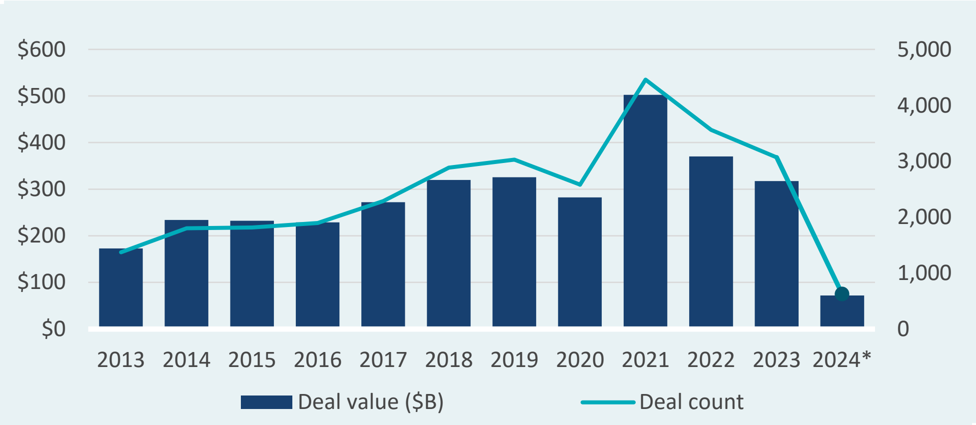
Strategy	Stage	'23	'24	Commentary
Private Credit	*Senior Debt*	●	◐	The revitalization of the Broadly Syndicated Loan ("BSL") market and increase in private lender competition has led to meaningful spread compression and looser documentation. Despite overcrowding, Direct Lending still offers decent current income to private portfolios, a merit that can be further appreciated in a realization-constraint private equities environment. Though spreads are compressed, base rates remain elevated. Managers who focus on market segments with lower levels of traffic may not have to make excessive sacrifices on pricing and documentation
	Subordinated Capital	◐	◐	Subordinated Capital's increasing equity participation and higher spreads offer higher returns to senior secured structures, though with higher risk. Borrowers have increased their interest in financing acquisitions and growth capital solutions using subordinated debt where unitranche financings have been commonplace. Pricing for this investment type has improved and structures often included cash pay interest versus paid in kind interest (which some sponsors are taking advantage of to defer debt burdens). Related to the deferral or avoidance of higher interest payments, "Structured Equity" / "Capital Solutions" type of financings have increased in popularity for borrowers who'd prefer not to take equity dilution.
	Credit Opportunities	●	●	The enactment of Basel III Endgame, a US Federal Reserve FDIC rule forcing banks to increase capital requirements / reduce risk, may catalyze an already widening funding gap and decrease competition within Credit Opportunities. Some may find these strategies and loan types appealing as they offer higher returns and lower correlation relative to larger sized corporate cash flow lending funds. Asset-based lending may offer additional downside protection in less benign environments and diversification in a collateral base.
	Control Oriented Distressed	◐	◐	Though distressed marks remain slightly above levels observed in 2022, they are trending downwards from 2023. Although meaningful distressed opportunities are not yet present, we remain positive on managers who can execute on distressed during dislocation and provide flexible capital solutions during more benign environments. Liquid strategies, such as buying discounted bonds, may appeal to investors looking for shorter durations and faster returns on their investments.
Secondaries		◐	◐	Secondaries remain a solution for budding private equity portfolios optimizing for J-curve mitigation and ramping of private equity exposure. Increased use of continuation vehicles may bring more upside to portfolios targeting secondaries. Discounts have come down, shifting our sentiment to one of opportunistic inclusion upon portfolio need.

U.S. buyout – Small/middle market

Rebound in activity from recent lulls

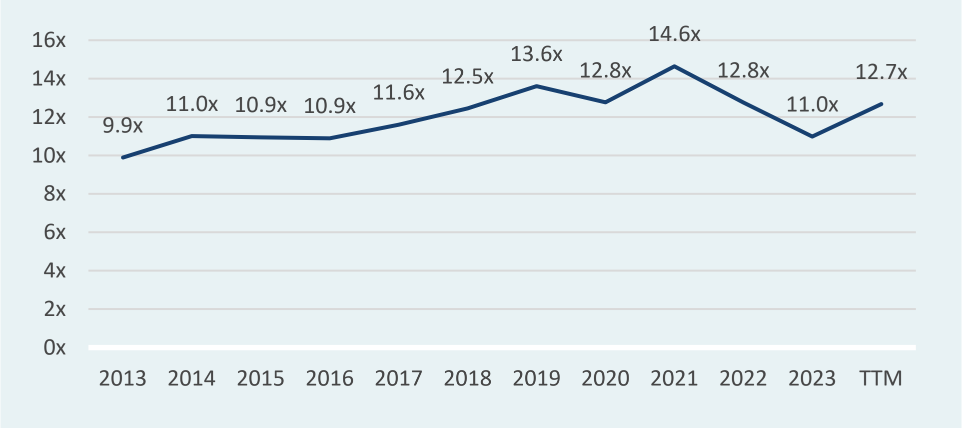
- Although deal activity has declined compared to recent years, especially from the highs of 2021, it is on track to return to pre-COVID levels, with $72 million in aggregate deal value across 622 companies for the quarter.
- U.S. middle market buyout multiples have rebounded from their gradual decline between 2021 and 2023 (from 14.6x to 11.0x, now at 12.7x), likely driven by a combination of public market expansion and pressures to deploy capital and generate liquidity. Anecdotally, some sponsors have brought top-performing portfolio assets to market, contributing to increased aggregate valuations and a narrowing of bid-ask spreads.
- Despite rising debt costs, purchase price multiples have not adjusted accordingly, increasing the need to find value during acquisitions. The middle market may present more opportunities where complexity risks lead to perceived discounts, such as in carve-outs, take-private transactions, bankruptcies, and founder-led or fundless-sponsor-owned companies facing financial distress.
- The current environment may inhibit value creation through valuation expansion and leverage, prompting GPs to focus more on improving operating metrics to generate returns. Opportunities to drive revenue growth or optimize costs are more prevalent in small-cap and middle-market companies, which tend to be less professionalized compared to their larger-cap counterparts.

DEAL ACTIVITY BY COUNT AND VALUE



Source: Pitchbook Q1 2024

MEDIAN EV/EBITDA MULTIPLES



Source: Pitchbook Q1 2024

U.S. buyout – Small/middle market (cont.)

Increased activity relative to other Buyout segments

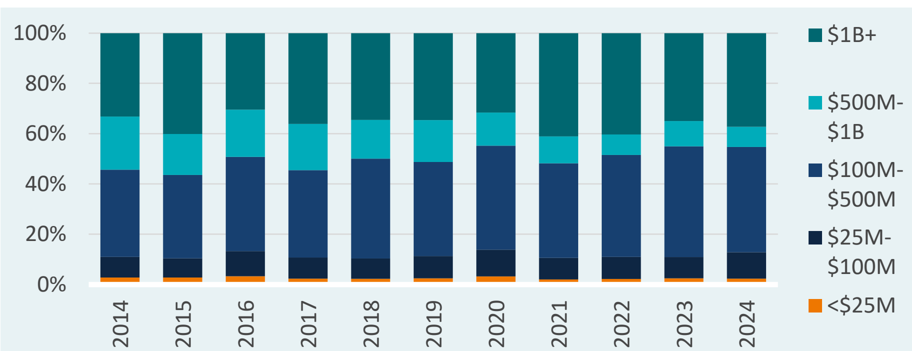
— Fundraising in the middle market increased as a portion of all Buyout dollars fundraised (10-year record of 55%), somewhat substantiating the relative attractiveness of the market segment. As a share of all PE Buyouts, middle market deal value has reached a record high of 74%, inferring the capital deployment headwinds of larger cap managers and the perceived risks of small cap.

— With exits being constrained for large caps, which typically rely on IPOs, and expensive debt impeding new investments, GPs are shifting their focus to growing existing portfolio companies while waiting for more favorable exit conditions. As a result, large cap firms may target their smaller counterparts for acquisitions.

— Less resilience couples the perceived higher return potential of these sub-asset classes, highlighting the importance of experienced management teams and company board members, particularly folks who've managed through recessionary environments.

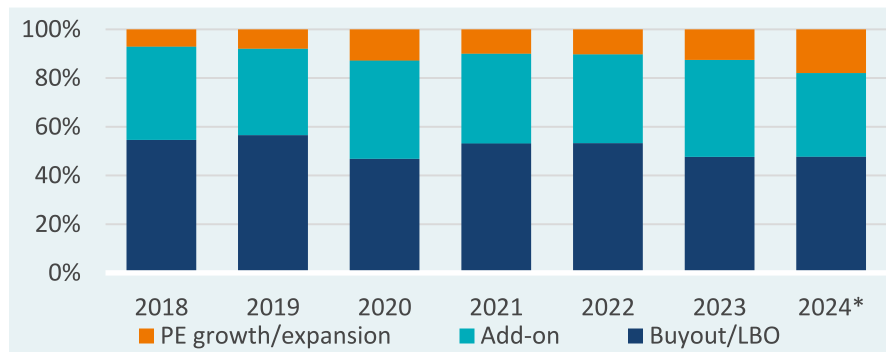
— Growth Equity deals continue to see increased deal activity as they are primarily financed via equity. Owners who desire to maintain control will prefer a minority sale, especially to a counterparty who is able and willing to provide operational value-add. Growth deals by deal value increased to 23%, up from the 5-year average of 18.5%. By count, Growth Equity increased to 18.0% from the 5-year average of 10.7%.

BUYOUT DEAL FLOW BY SIZE



Source: Pitchbook Q2 2024

DEAL VALUE BY INVESTMENT TYPE



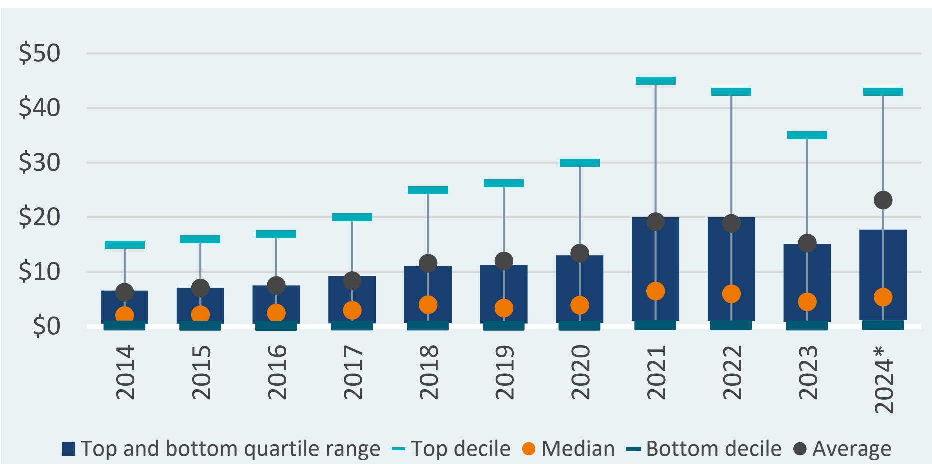
Source: Pitchbook Q2 2024

Venture capital – Early stage

Limited exits and rising valuations

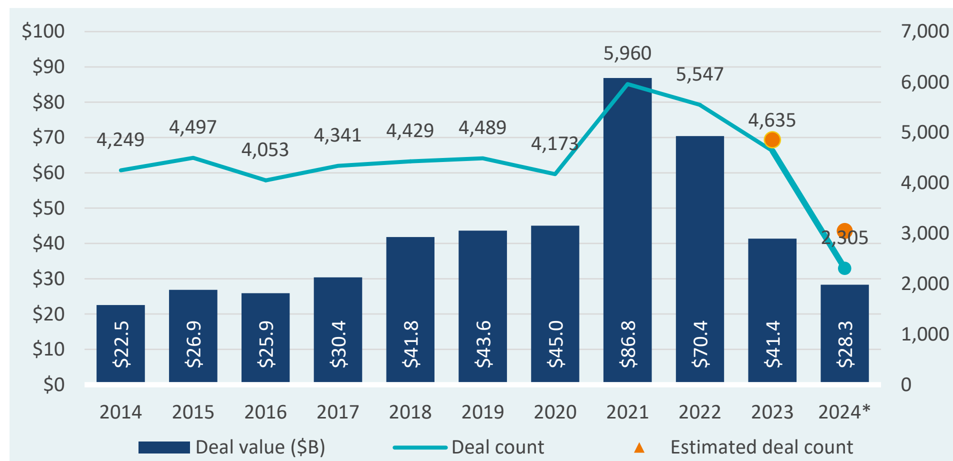
- Valuations rebounded, mitigating the downward pressures from elevated interest rates. Average deal sizes reached record highs, surpassing even those of 2021 ($23M compared to $19M). The 10-year average stands at $13M.
- While the year over year increase in valuations is most significant in AI, other sectors also saw substantial gains. For example, AI valuations rose from $48M to $65M, Fintech from $45M to $53M, and SaaS from $35M to $53M.
- Early-stage investors poured in $28B, aiming not to miss out on the next wave of technological innovation. This pace exceeds the $41B invested in 2023 and the 7-year pre-2021 average of $34B. Notably, Q2 2024 marked the highest early-stage deal count since Q1 2022.
- Despite broad valuation increases, early-stage investors may benefit from the reduced frothiness of purchase prices seen in previous years. The step-up from Seed to Series A decreased to 1.6x, representing a 31% drop compared to 2022.

U.S. EARLY-STAGE VC DEAL VALUE DISPERSION



Source: Pitchbook Q2 2024 U.S. VC Valuations Report

EARLY-STAGE VC DEAL VALUE DISPERSION



Source: Pitchbook Q2 2024 U.S. VC Valuations Report

Venture capital – Late stage

Limited exits and rising valuations

— Valuations increased in 2024, with median values surpassing those of 2021 ($68.6M vs $67.0M). The rise in valuations raises curiosity around the significance of future step-ups upon subsequent funding and exits.

— Late-stage returns are closely tied to exits. While exits remain limited, they are on pace to exceed 2022-2023 levels as companies adjust to new valuation expectations in exchange for growth financing opportunities.

— Post-IPO market capitalization trends were mixed. Reddit and ARM saw gains following their debuts, while other newly minted public companies saw contractions.

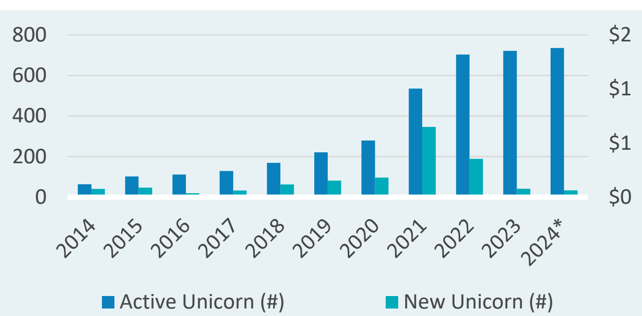
- Instacart's public market performance, in particular, has been challenging for later-stage investors. Having raised $265M on a $39B valuation in a late-stage round in 2021, the company's market capitalization dropped to $8.4B as of August 16, 2024.

— Merger and acquisition (M&A) activity has been hindered by anti-trust scrutiny, with challenges from regulators peaking in recent years. Some speculate that the FTC's tough stance may have had some influence on Wiz's decision to decline Google's $20B acquisition offer.

— The number of active unicorns has reached all-time highs in 2024 (735 unicorns valued compared to 535 unicorns). This trend points to a burgeoning IPO pipeline in the near to intermediate term. However, unicorns with weakening demand and shrinking financial runways may face increased flat or down rounds, leading to potential valuation discounts.

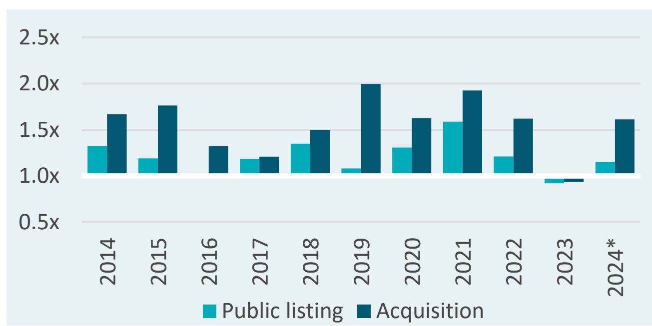
— Amid a backdrop of limited distributions and increasing unrealized values, alternative exit strategies such as direct secondaries, continuation vehicles, and intra-GP fund transactions may gain traction.

UNICORN COUNT AND VALUE



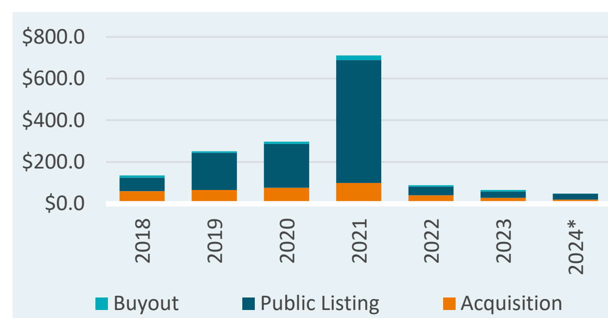
Source: Pitchbook NVCA Venture Monitor as of June 2024

VALUE STEP UP UPON EXIT



Source: Pitchbook NVCA Venture Monitor as of June 2024

EXITS BY TYPE



Source: Pitchbook Q2 2024 U.S. VC Valuations Report

Private credit

Spread compression; record repricing

— With the re-emergence of the Broadly Syndicated Loan market, new issue spreads compressed significantly, diminishing the attractiveness of Direct Lending, which had initially benefited when interest rates began to rise.

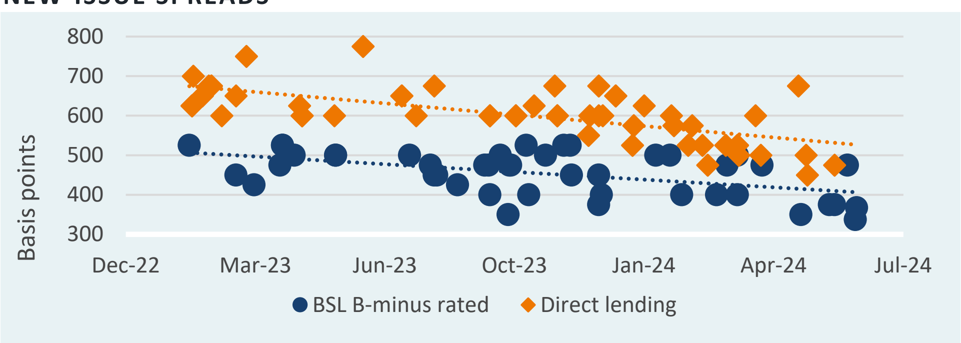
— Larger lenders are relaxing documentation requirements and pricing standards in a bid to deploy capital, reducing the availability of deal flow for covenant-heavy and alpha-seeking lenders. In Q1 2024, a notable number of private loans were refinanced by BSL's. This trend reversed in Q2 2024, signaling Direct Lending's capitulation on borrower-friendly terms.

— As borrowers seek to reduce debt burdens, repricing and overall U.S. loan activity hit record highs in the first half of 2024. New debt issuance remained muted, constrained by elevated interest rates and wider bid-ask spreads.

— Banking regulations and recent disruptions, such as Basel III Endgame and the collapse of Silicon Valley Bank, may widen funding gaps and create new credit opportunities. Lenders targeting less competitive segments are likely to outperform traditional corporate lending strategies due to wider spreads and equity-like components.

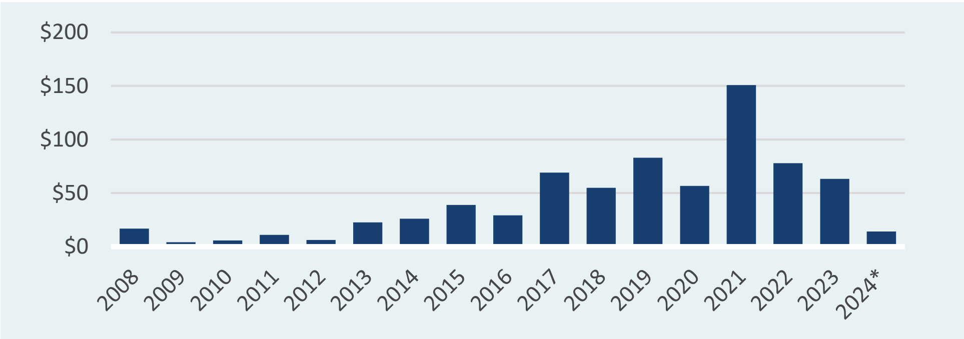
— While distress indicators remain slightly elevated compared to 2022, they have shown improvement since 2023 (default rates dropped from 1.75% in July 2023 to 0.92% in July 2024, and distressed ratios based on outstanding amounts fell from 5.47% to 4.42%). Although a significant distressed investing environment remains to be seen, we maintain confidence in managers adept at navigating dislocation and offering flexible capital solutions during more stable market conditions.

NEW-ISSUE SPREADS



Source: Pitchbook / LCD Q2 24

DIRECT LENDING CAPITAL RAISED



Source: Pitchbook / LCD Q1 24

Investment Type	Policy Target	Policy Range	Market Value %	Market Value $(000)	Unfunded Commitment $(000)	Market Value + Unfunded $(000)
SamCERA - Total Plan			**100.0%**	**6,486,126**		
Buyout (70% +/- 30%)	4.9%	2.8%-7.0%	4.1%	266,977	147,789	414,766
Venture Capital (30%, 0%-40%)	2.1%	0.0%-2.8%	1.4%	92,511	42,182	134,693
Debt-Related/Special Situations (0%, 0%-30%)	0.0%	0.0%-2.1%	1.4%	91,575	80,173	171,748
Total Private Equity*	**7.0%**	**5%-9%**	**6.9%**	**451,062**	**270,144**	**721,208**

Portfolio Summary

- As of June 30, 2024, the portfolio's exposure to Private Equity was $451,062,351 with $266,977,081 in Buyout, $92,510,769 in Venture Capital, and $91,574,502 in Debt-Related/Special Situations. Total market value is the current reported value of investments, excluding the remaining unfunded commitments.
- Since initial allocation to Private Equity, SamCERA has contributed $597,454,622 towards its Private Equity commitments, with $338,981,720 to Buyouts, $78,334,600 to Venture Capital, and $147,032,991 to Debt Related. Unfunded commitments total $326,144,244.
- The total portfolio exposure at 6.9% of plan is below the 7.0% target, effective July 1st 2022. Compared to December 31, 2023, portfolio exposure is up 0.2%. Buyout, Venture Capital, and Debt Related / Special Situations exposures remain within policy range.

Portfolio Activity

- In 2024, SamCERA committed $28,000,000 to Kinderhook Fund VIII, $28,000,000 to Peak Rock Capital Fund IV.

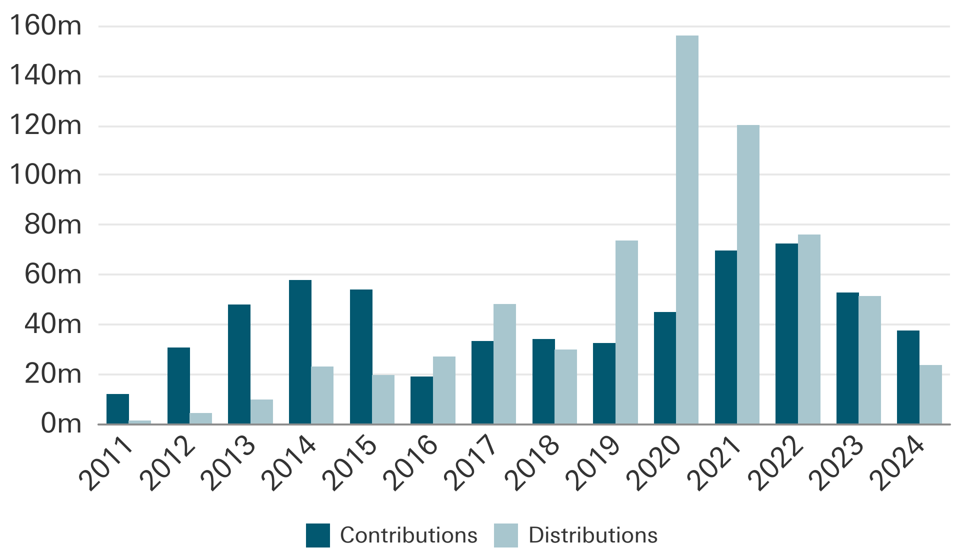
Performance

- The Total Private Equity portfolio's performance, as measured by net IRR, is 18.64% 521 bps above the same cash flow invested in Russell 3000 Total Return Index 13.73% Capital weighted average investment age of the portfolio is 5.34 years.
- The portfolio is currently valued at $451,062,351. Together with $661,238,628 in realized distributions, the Total Value at $1,112,300,979 is $516,669,481 above $595,631,498 in total capital contributions, resulting in a total value multiple of 1.87x and a distribution multiple of 1.11x.
- Thus far in 2024, contributions marginally outpaced distributions at a ratio of 1.68:1.

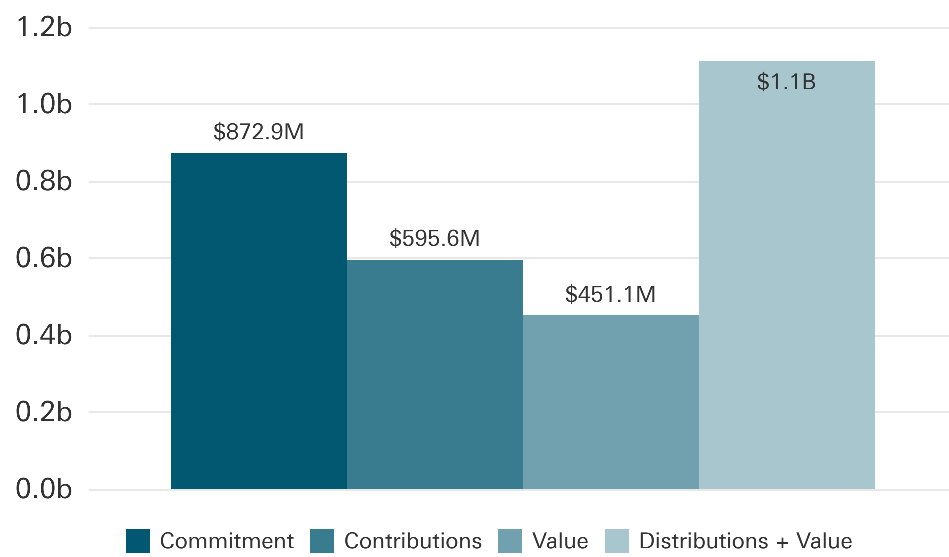
Attribution of returns:

- Buyouts up $244,427,955 / 1.68x (Great Hill V and VI, and Sycamore leading), with 0.94x of called capital realized and distributed.
- Venture Capital is up $240,021,048 / 3.73x cost (Emergence III, NEA 14, and General Catalyst VI leading), with 2.68x of called capital realized and distributed.
- Debt-related, up $32,176,254 / 1.22x cost (Abry Senior Equity V, Abry Adv Sec II, and Abry Adv Sec IV leading), with 0.60x of called capital realized and distributed.
- Within Private Equity, the current allocation of market value exposure is 59.2% to Buyout, 20.5% to Venture Capital, and 20.3% to Debt-Related/Special Situations.

Cash Flows on Annual Basis as of 6/30/2024

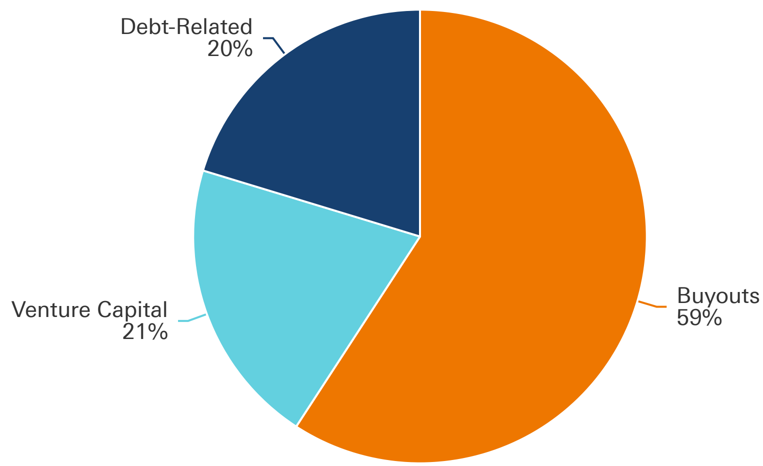


Cumulative Cash Flow and Valuation as of 6/30/2024



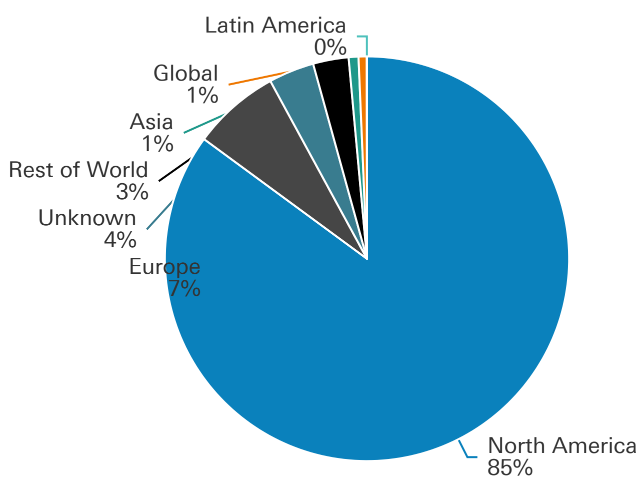
Investment Type	Commitment	Reported Value
Buyouts	$527,935,000	$266,977,081
Debt-Related	$214,500,000	$91,574,502
Venture Capital	$130,500,000	$92,510,769
Total	**$872,935,000**	**$451,062,351**

Current Exposure by Fund Type



Geography	Reported Value
Global	$2,957,634
North America	$385,300,013
Europe	$31,678,063
Asia	$3,544,779
Latin America	$77,754
Rest of World	$12,871,751
Unknown	$14,632,357
Total	**$451,062,351**

Reported Value by Geography



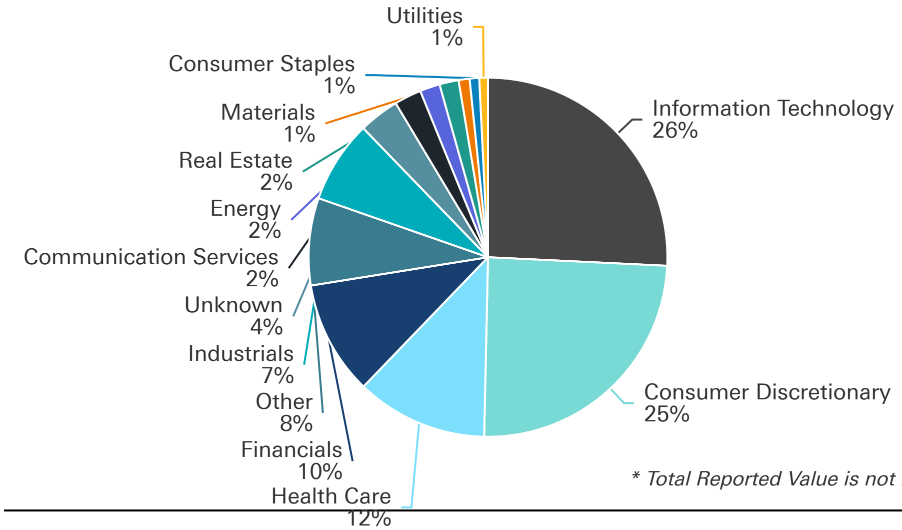
Based on the value of portfolio companies and fund reported exposures as of June 30, 2024. Differences between reported value and the total portfolio valuation is due to temporary cash funds, fees, other expenses, and holdings with undisclosed geography breakdown.

** Total Reported Value is not inclusive of Sixth Street TAO*

Global Industry Classification Standard	Reported Value
Communication Services	$11,035,212
Consumer Discretionary	$111,345,002
Consumer Staples	$3,897,177
Energy	$8,190,106
Financials	$46,523,295
Health Care	$53,728,309
Industrials	$33,662,635
Information Technology	$116,663,598
Materials	$4,482,763
Real Estate	$7,819,442
Utilities	$3,517,819
Other	$35,564,636
Unknown	$14,632,357
Total	**$451,062,351**

Based on the value of portfolio companies and fund reported exposures as of June 30, 2024. Differences between reported value and the total portfolio valuation is due to temporary cash funds, fees, other expenses, and holdings with undisclosed GICS breakdown.

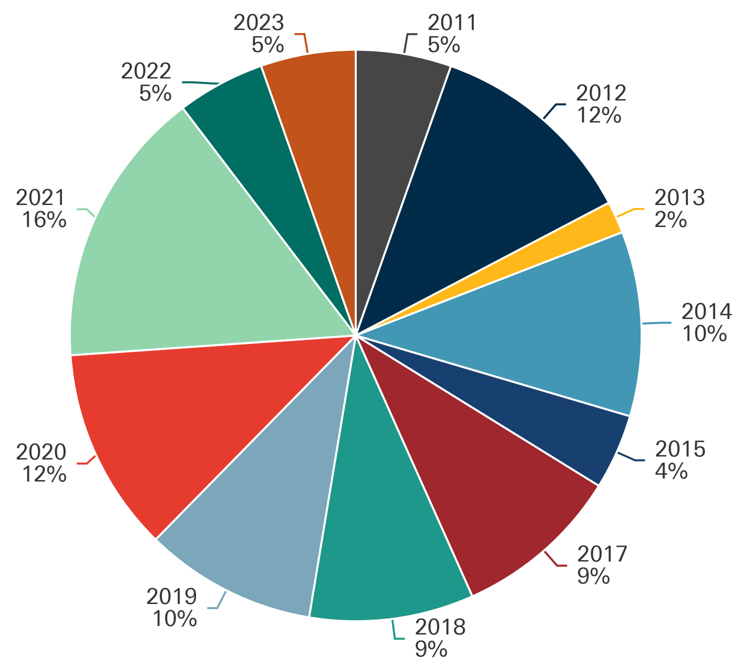
Reported Value by Industry



** Total Reported Value is not inclusive of Sixth Street TAO*

Vintage Year	Commitments	Reported Value
2011	$66,000,000	$24,385,222
2012	$68,000,000	$53,683,794
2013	$35,000,000	$8,140,228
2014	$72,500,000	$47,137,704
2015	$53,000,000	$19,206,659
2016	$10,000,000	$0
2017	$37,000,000	$42,806,219
2018	$35,000,000	$41,944,202
2019	$50,000,000	$43,899,741
2020	$66,435,000	$52,125,662
2021	$114,000,000	$71,078,377
2022	$75,000,000	$22,438,310
2023	$135,000,000	$24,216,235
Total	**$816,935,000**	**$451,062,351**

Current Exposure by Vintage Year



- **No Material exceptions to Policy**