

STATE OF THE MARKET

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Funds Group



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It does what it says on the can: Investing in an era of innovation

BY MIKE ZELENIUCH, MANAGING DIRECTOR AT APOGEM CAPITAL

The private equity secondary industry has innovated at an astonishing pace. Over the last decade, new investment techniques have transformed the industry, bringing novel transaction structures and strategies to the private equity ecosystem that had not changed much in decades prior. The secondary industry has learned to thrive in new ways and offers innovative financing solutions to the private capital market that has redefined the concepts of primary and secondary.

We expect to see more growth and innovation in the future and the primary and secondary markets continue to converge. We celebrate this innovation: we are proud of how key players within the secondary market have introduced new ideas and tools to enhance investor experiences. Apogem has monitored these opportunities closely and has carefully selected where and how to participate. We have maintained our commitment to our disciplined approach to investing in small to mid-size companies where we bring to bear the full breadth of Apogem's focused investment platform.

Over the last few years, Apogem's secondary strategy has selectively introduced certain transactional innovations that have improved how we partner with financial sponsors and limited partners. However, we have kept our approach focused on what we have consistently pursued over time: talented investors in the small company space with whom we can partner on liquidity solutions in customised ways.

As our senior team embarks on its 23rd year of secondary investing, we are eager to see what comes next for the secondary industry but remain focused on investing in market segments we know well and where we have had success. We believe this focused approach offers financial sponsors a market-committed liquidity partner and our limited partners an opportunity to invest in an access-constrained segment of the secondary market.

Innovation: New and improved ingredients

Most private markets' investors aren't aware of the sheer volume and complexity of innovations created by secondary fund managers over the last decade. Apogem's secondary team executed its first secondary transaction in 2002; at that time, the transactions, though beneficial, were typically infrequent and mostly conventional in style. In that era, a few managers, ourselves included, executed financings alongside financial sponsors, participating in what has since developed into the GP-led secondary market as we know today.

Apogem employs a hybrid strategy focusing on both LP and GP secondaries. While we score ourselves on the more conventional side of the secondary investment spectrum, we have invested using several innovative techniques in our market:

- **Deferred purchases on limited partner stakes:** we have executed LP-led transactions where seller financing is offered by limited partners exiting their fund stakes, which helps to bridge the gap between bid-ask spreads; a few hundred basis points of pricing premium has the potential to lead to multiples of that, if you make the right investment;
- **Mid-life GP-led secondaries to finance growth:** we have invested in various opportunities where our capital goes higher up in the capital structure, building alignment and capitalising on near-term, high-quality growth opportunities. Moving into a day-one 'in the money' return can improve sponsor alignment and help compensate for complexity and risk. We lean heavily on our secondary team's direct investment and underwriting experience to execute these investments; and
- **Multi-component packaged transactions:** we have a history of structuring bespoke transactions that combine secondary with elements of primary and co-investment. We believe

this approach helps develop sponsor relationships and creates a broader transaction that is diversified across multiple categories at the close. In these transactions, we seek to interweave day-one embedded discounts with more concentrated, alpha-oriented opportunities.

We have chosen our segments carefully, but the secondary industry has produced an even wider range of investment opportunities than those described above. We will offer credit to groups 1) executing preferred structures as an alternative to exits that provide sellers with proceeds at close and upside on their NAV performance, 2) skillfully using capital-market facilities and 3) supplying various forms of clever fund financing. For several reasons, these aforementioned transaction types are not a fit for Apogem's investment strategy. We commend those groups that have demonstrated the ability to create these specialised transactions.

Deferrals, mid-life secondaries and packaged transactions have been additive to our own portfolio construction goals, but no secondary innovation has changed the market structure of modern private equity like the GP-led secondary and, more specifically, the continuation vehicle. Likewise, GP-led secondaries have meaningfully changed our own portfolio construction approach. After a period of "ex-credit investor" scrutiny of this marketplace, we have evolved our model with the goal of being the leading investor of choice on small company, GP-led secondaries.

Choosing quality ingredients: GP-led secondaries

No secondary innovation has provided the media with more to write about than the continuation vehicle. We have watched this market carefully from its pre-Global Financial Crisis beginnings, debated its merits and risk-reward profiles, before deciding to invest our time and effort in this space more intentionally. We don't need to re-hash the debate that has been and continues to occur around these transactions, but we

have taken the stance that they are occurring to the benefit of stakeholders when structured properly with the stakeholders' interests in mind. Our active multi-manager programme gives us the benefit of putting our "LP hat" on and, when we invest in GP-led secondaries, we do so in ways we believe are fair to all stakeholders.

The target company attributes of a GP-led secondary are not particularly different from what we seek in LP secondaries: we look to partner with the same type of financial sponsors as we do across the Apogem platform. Our transition into this marketplace has thus been relatively efficient from a pipeline and access standpoint. We have adjusted our concentration tolerances slightly on single-company exposures, but we continue to focus on identifying investment opportunities that present the following characteristics, within both GP and LP secondaries:

- Market-leading businesses in sectors that are resilient across economic environments and trophy assets with proven value creation plans and logical exit scenarios;
- Ownerships by sponsors we feel are exceptionally well-aligned with management teams;
- Reasonable capital structures conducive to future growth; and
- Sponsors with whom we typically have strong, pre-existing relationships and mutual desires to find paths to working together.

Over the past five years, we have observed a bewildering level of choice in GP-led secondaries: estimates suggest GP-led secondaries volumes have grown from ~\$14 billion in 2017¹ to \$50 billion+ forecasted in 2024.² Over this timeframe, we've remained focused on taking a leadership position in smaller cap opportunities. We believe it is in these situations that our capital is more valuable to financial sponsors and where we can generate asymmetric access that we'd struggle to get in larger transactions. Since 2021, we have acted as lead investors (where we were the primary term sheet and legal negotiator) in about a dozen investments with a mean transaction size of approximately \$140 million.³ While we recognise how "conventional" these transactions have become, in many of our investments, it was the sponsor's first time executing a GP-led secondary. Just ten years ago this innovation was rare in our small-company market. At least in small-company terms, it's as if a new exit option dropped from the sky.

Small companies, big market: How we do it

The Apogem platform is purpose-built to service financial sponsors that own small-cap companies, which has served as a significant aid in our pipeline development. Across Apogem, we call on ~300 financial sponsors and have built up a database of over 22,000 mostly small cap companies that we've interacted with in some way over the last two and a half decades. We offer a variety of financial solutions to the industry and break down our business into two main categories: direct lending (managing \$19 billion AUM with over 150+ sponsors) and private equity (managing \$21 billion across primary commitments where we have over 200 LPAC seats, secondaries and co-investments).⁴ Our platform is a tremendous source of deal flow, especially in the small-company space, where relationships matter and sponsors prefer to work with institutional groups committed to their market.

We use our 120+ investment professionals across Apogem strategies, institutional processes and technology to drive efficiency in sourcing and due diligence. The speed with which we gain insights helps us to efficiently identify and focus on opportunities that are attractive to our strategy. While we are actively invested with ~300 financial sponsors, we generate leads across ~1,000 active sponsors from within Apogem's core market.

Significant white space remains in our market, especially for GP-led secondary transactions. Based on our analysis of data from Pitchbook, approximately 100 private equity managers globally have done at least one continuation vehicle.⁵ That is just over 2% of the total 4,500 private equity managers just in the US,⁶ with the utilisation of CVs likely skewing toward the larger end of the middle-market and above. We estimate continuation vehicles for companies under \$20 million in EBITDA only represent 6% of the total volume.⁷ We believe our strategy has room to grow but, as always, we are taking a cautious approach to each incremental investment with a bias towards careful evaluation of the ability to seek long-term return opportunities.

The future of secondaries

The private equity secondary market has been a fertile market for innovation and we are eager to see what comes next. Apogem's approach to secondary investing has been and remains focused on the core fundamentals that we believe have driven our success — seeking to identify good businesses, with talented managers, in healthy industries and with the right structures. We will seek to innovate where appropriate in ways that we feel can improve overall risk-adjusted return opportunities, but we will stay focused on the smaller company market where we have invested for two decades.

As we enter 2025, we do so humbly, ready and excited for what the new year may bring to our industry. We are still a mostly "first-name-basis" industry and look forward to learning about the next new tool or strategy over a cocktail or nice glass of wine. To our limited partners and sponsor partners, we commit to doing what we said we would do, consistent with our two-decade history in this market.

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Apogem (f.k.a. New York Life Investments Alternatives LLC), integrated and combined its three relying advisers PA Capital, LLC, GoldPoint Partners, LLC, and Madison Capital Funding, (collectively, the "Former Relying Advisers"), to create a singular and unified alternative investment firm in early 2022. This article contains information related to the historical advisory businesses of the Former Relying Advisers, including assets under management, number of GP relationships, employee tenure, and other metrics.

1. FY 2023 Evercore Secondary Market Survey Results (February 2024)
2. Jefferies H1 2024 Secondary Market Review (July 2024)
3. Apogem proprietary database
4. Estimated and unaudited as of 30 September 2024
5. Pitchbook, Deal Data Search, as of June 2024, including both Secondary Transaction and Secondary Buyout deal types
6. Ernst & Young, May 2021. Economic contribution of the US private equity sector in 2020
7. Morgan Stanley, February 2024. FY 2023 Morgan Stanley Secondary Market Update



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Mike focuses on opportunistic secondary market investments with an emphasis on mid-market transactions. Mike was previously with Cuyahoga Capital Partners. In 2012, PA Capital (now Apogem Capital) acquired the investment advisory business of Cuyahoga Capital Partners. Prior to Cuyahoga, he was with Victory Park Capital where he analysed and executed special situations debt investments. Prior to Victory Park Capital, Mike worked at Merrill Lynch Capital. Mike began his career in investment banking at KeyBanc Capital Markets. Mike received a B.B.A. from Loyola University Chicago and an M.B.A. from the University of Chicago.

