The US Private Equity Lower Middle Market:

An Engine for Job Creation

Investigating the Impact of Private Equity Ownership on Employment in the Lower Middle Market

MARCH 2024

Apogem Capital
A NEW YORK LIFE INVESTMENTS COMPANY

INTRODUCTION

Over the past two decades, private equity has become an increasingly important segment of the investment universe and, as a result, the US economy. Based on a recent report, the US private equity industry, through its ownership of underlying portfolio companies, employs 12 million workers and accounts for 6.5% of US GDP.[1] As the industry's influence on the real economy has grown, concerns about its impact on employment at underlying portfolio companies have also increased.

Private equity ("PE") is often portrayed as an investment strategy predicated on burdening companies with debt and cutting costs while doing little to improve the fundamentals of the underlying business, destroying jobs in the process. This perception has been reinforced by high profile bankruptcies and layoffs by companies owned by large PE firms. While we believe these types of outcomes are far from the norm, very little academic research exists to affirm or refute this perception.

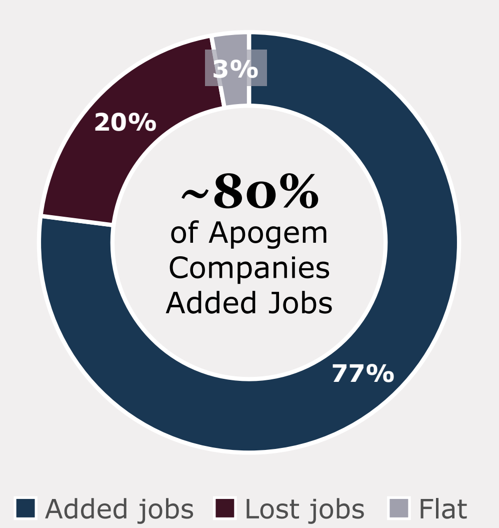
In 2023, Apogem Capital, a leading US Middle and Lower Middle Market specialist, surveyed private equity General Partners ("GPs") to better understand the impact of PE ownership on employment at portfolio companies, particularly the small and mid-sized businesses on which the Firm focuses. Ultimately, the Firm collected data from 48 primarily Lower Middle Market ("LMM")[2] GPs it has invested with over the past 20 years, creating a data set of 530 portfolio companies. This analysis expands on a similar analysis published by PA Capital (a predecessor firm to Apogem Capital) in 2014.

INVESTING FOR GROWTH

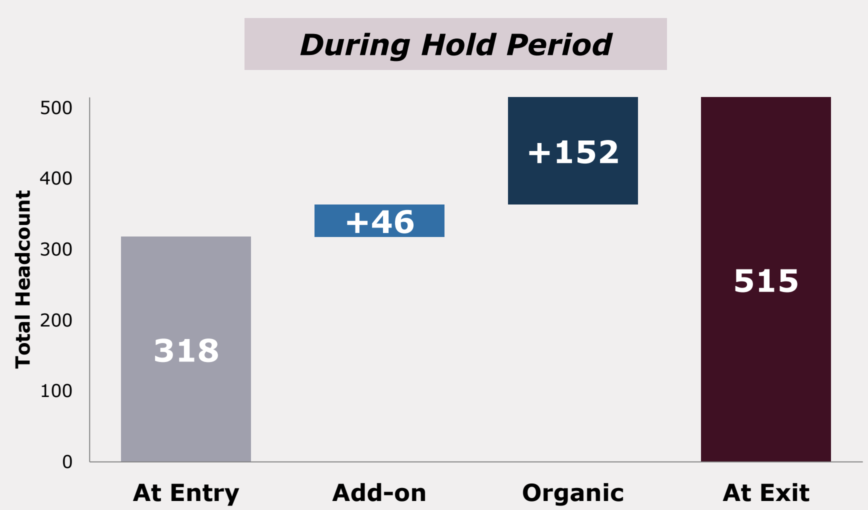
Based on this research, nearly 80% of Apogem's portfolio companies added jobs during their hold period net of any add-on activity, with an average annual organic employment growth rate of 10%. The average Apogem company employs over 300 workers when acquired and over 500 at exit.[3]

The findings of this analysis align with the results Apogem published approximately 10 years ago. We believe this robust employment growth reflects Apogem's emphasis on business building, where GPs seek to generate returns by investing in growing and professionalizing the underlying business. The impact of business building strategies on employment is summarized on the following pages.

Change in Employment
Realized Portfolio Companies[3]



Average Change in Employment
Realized Portfolio Companies at Entry vs. Exit[3]



BUSINESS BUILDING STRATEGIES

Apogem typically targets companies where the Firm's investment, alongside a private equity GP, represents the first or early institutional capital. The businesses are often established, family- or founder-owned companies with secular growth potential through "business building" strategies.

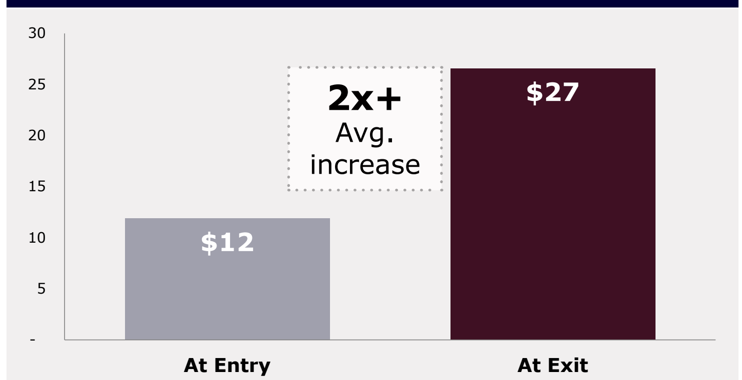
Typical Business Building Strategies

- Product and / or geographic expansion
- Professionalizing firm management and sales teams
- Cost management
- Instituting Key Performance Indicators ("KPIs") and tech-enabled processes
- M&A

GROWING PROFITS WITH EMPLOYMENT

The goal of these strategies is to grow revenue and EBITDA and prepare the company to be sold up market, generally to larger private equity funds or strategic acquirers. If implemented successfully, these strategies often require significant investments in the business.

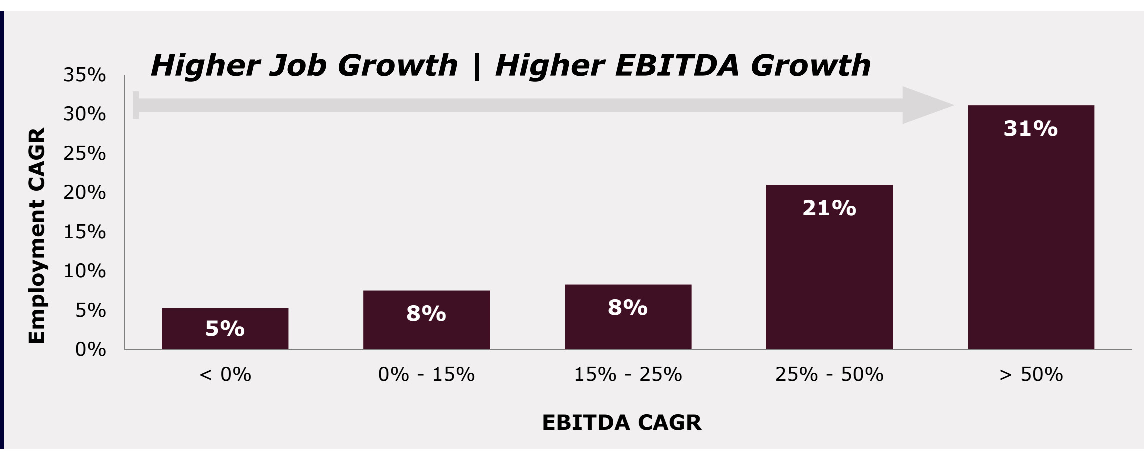
Average EBITDA: At Entry vs. Exit
Realized Portfolio Companies | $ in millions[3]



While growing headcount can impact a company's profitability in the short-term, Apogem's analysis reveals a strong correlation between investing in employment and higher EBITDA growth during Apogem's hold period — the companies with the strongest EBITDA growth also added to headcount at a high rate.

The ability to grow headcount and profitability together indicates that workers are operating more productively. We believe this dynamic is a result of the broader business professionalization efforts being implemented by the GP and company management team as part of the value creation plan for the company.

Change in Employment by EBITDA CAGR[3]



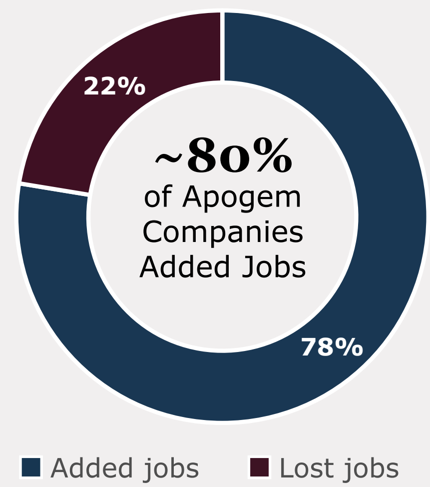
INCREASING EMPLOYMENT THROUGH RECESSIONS

In addition to analyzing long-term trends, we focused on the impact of recessions on employment growth at portfolio companies. Apogem's dataset includes nearly 60 companies where US employment contracted during their hold period. Despite this challenge, our analysis reveals that a significant proportion of portfolio companies realized during recessions increased their workforce.

Specifically, nearly 80% of the companies realized during periods when US employment shrank added jobs during Apogem's hold period, net of any add-on activity. Further, these companies delivered an average annual organic employment growth rate of 8%, even as the overall US economy lost jobs.[3,4] These figures are substantially similar to the overall data set, where nearly 80% of companies also added jobs during their hold period and grew employment at an average annual rate of 10%.

We believe the ability to grow employment, even through recessions, reflects the potential benefits of Apogem's investment approach and focus on the Lower Middle Market.

Change in Employment[3,4]
Companies Realized during Recessions



Job Creation During Recessions: Potential Benefits of Lower MM PE

- **Benefits of professional ownership:** GPs can tap into their capital reserves, experience navigating prior cycles, and institutional resources to guide a company through a recession, potentially enabling the company to preserve or continue growing employment.
- **Conservative use of leverage:** Lower Middle Market PE companies tend to use debt more conservatively than their larger counterparts, requiring less cash flow to be allocated to interest payments. This may enable a company to continue to execute on its value creation plan and grow employment, even during a recession.
- **Target companies with secular growth potential:** The focus on business building strategies outlined on the previous page can enable companies to grow independently of macroeconomic cycles. For example, companies can continue to create new value by professionalizing sales teams or instituting tech-enabled processes during a downturn.

CONCLUSION

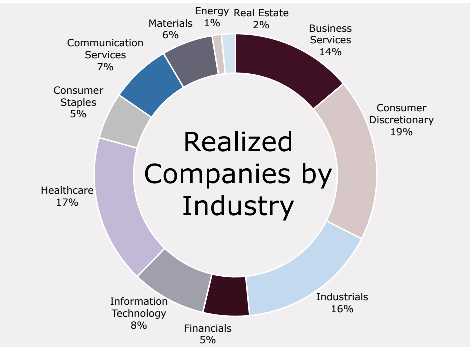
The results of Apogem's analysis demonstrate that segments of the private equity industry can be meaningful contributors to job creation. By targeting Lower Middle Market businesses and business building strategies, we believe it is possible to both deliver attractive financial results and employment growth. In fact, we believe the success of business building strategies in this segment often necessitates investment in a company's workforce.

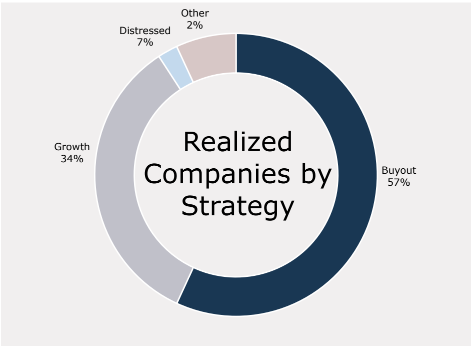
While many investment strategies rely on cost cutting to improve profitability, serving as early institutional capital in Lower Middle Market businesses creates the opportunity to grow profits by improving and professionalizing the underlying business while growing employment.

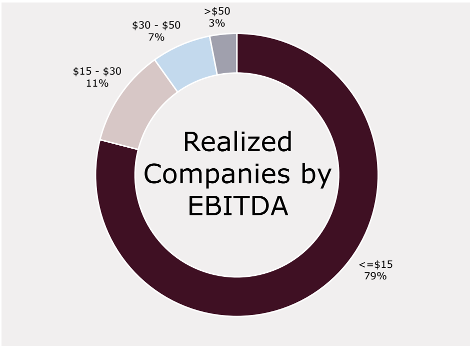
METHODOLOGY

In 2023, Apogem collected data from 48 private equity general partners ("GPs"). The GPs represented a broad range of Lower Middle Market GPs with which Apogem has committed capital. Across the 48 GPs, Apogem aggregated employment, performance, and other financial information relating to 530 portfolio companies, representing over 20 years of portfolio company information. The data represents the most recently available data at the time of the survey. For the majority of unrealized companies, figures are as of December 31, 2022.

Of the 530 companies, approximately 200 companies were realized at the time of this survey and the data provided by the GP represents the full hold period. This report focuses on the realized companies in the data set in order to provide information consistently for a full hold period. Realized companies are summarized below by industry, strategy, and EBITDA at entry.







About Apogem Capital

Apogem Capital was formed in April 2022 through the combination of PA Capital, Madison Capital Funding, and GoldPoint Partners to create a singular and unified private markets alternative investment firm.

With approximately $41 billion in assets under management as of December 31, 2023[5], Apogem has the deep relationships, data, and history in the middle market to deliver innovative solutions to both clients and sponsors. Apogem Capital offers investors access to the middle market's growth engine through investments in what we believe to be leading private companies and funds. The Firm manages a streamlined suite of capital solutions, including direct lending, junior debt, primary fund investments, secondary investments, equity-co-investments, GP stakes, and private real assets.

Apogem Capital is a wholly owned subsidiary of New York Life Insurance Company ("NYLIC"), through New York Life Investment Management Holdings, LLC ("NYLIM").

For more information visit: apogemcapital.com

ENDNOTES & DISCLOSURES

1. “Economic Contribution of the US Private Equity Sector in 2022.” American Investment Council, EY, 21 Apr. 2023, www.investmentcouncil.org/new-ey-report-private-equity-fuels-job-growth-high-wages-and-small-businesses/.

2. Lower Middle Market is broadly defined as portfolio companies with less than $250 million in enterprise value.

3. Company information has been provided by the underlying managers, which is subject to change and has not been independently verified or audited. Excludes companies for which data is unavailable. In many cases, limited information was available. While we believe the data set is broadly representative of the trends in Apogem’s investment portfolio, the data set does not represent all portfolio companies Apogem has invested in or all GPs Apogem has committed capital to. Figures as of December 31, 2022.

4. Includes companies where the US economy lost jobs during the company’s hold period. That is, if the US economy lost jobs between the month the company was acquired and the month the company was realized, that portfolio company would be included in this data set. US employment data as provided by the St. Louis Federal Reserve: U.S. Bureau of Labor Statistics, All Employees, Total Nonfarm [PAYEMS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PAYEMS, October 19, 2023.

5. AUM is estimated and unaudited as of December 31, 2023. AUM includes non-discretionary and co-advised assets, as well as assets managed for New York Life and certain of its subsidiaries.

Disclosures