# Overview of the Current Secondary Market

By:

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Upwelling Capital Group

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Securities offered through Bridge Capital Associates, Inc., Member FINRA/SIPC.

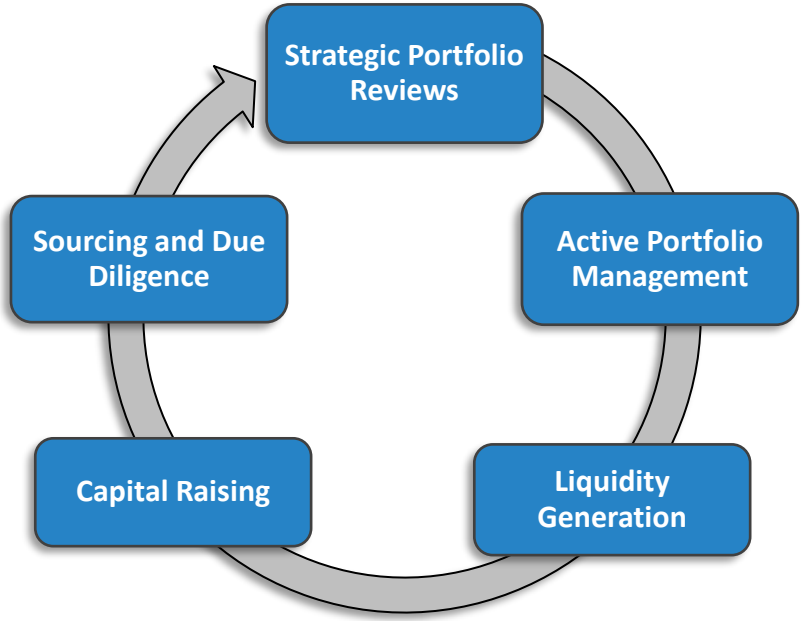
# Agenda

- Introduction
  - Upwelling Capital Group
  - Encuesta del Mercado Secondaries
- General overview of the current secondary market
- Unique structures available to LPs and GPs
- Trends in LATAM and Mexico related to the secondary market
- Case Studies
  - Enfoca
  - Upwelling Transactions

# Upwelling Capital Group

## Bringing Value to the Surface

- Founded in 2011, Upwelling Capital Group LLC provides liquidity and capital solutions to institutional investors and private capital managers
- Upwelling has three decades of experience investing and advising in private equity
- Upwelling has worked with sophisticated secondary buyers with appetite for LATAM funds and have provided advisory services to LATAM-based institutions, managers, and investors




Principals have cumulatively overseen over $50 billion in global private equity commitments and have successfully managed over $5 billion in legacy, tail-end commitments, transfers and workouts for leading institutional investors[1]

[1]Source: CalPERS Annual Report and Alternative Investment Management Portfolio Review

# Upwelling Leadership

## Joncarlo Mark

- Upwelling Capital Group LLC – Founder, 2011 – present
- University of California Davis Foundation – Trustee/Volunteer advisor, 2012 – 2020
- Muzinich & Co. – Senior Advisor, 2016 - 2020
- CalPERS, Alternative Investment Management Program – Senior Portfolio Manager, 1999-2011
- AltExchange Alliance – Board of Directors, 2013 - 2018
- Institutional Limited Partners Association (ILPA) – Chairman, 2007-2010
- Private Capital Research Institute – Advisory Board, 2010 - 2017
- Premier Farnell PLC – Manager, 1992-1998
- University of California Davis Graduate School of Management – MBA
- University of California San Diego – BA
- Registered Representative of Bridge Capital Associates, Inc. (current)

## Accomplishments

- Helped guide growth of largest North American PE program from $10B to $48B of committed and invested capital
- CalPERS AIM Program exceeded comparable public markets returns in 1, 3, 5, & 10-year performance periods
- Point person on the execution of $12 billion of investments in funds and direct investments; sat on multiple LP fund advisory committees
- During tenure as Chairman of ILPA, oversaw drafting of ILPA Principles

# Upwelling Select Engagements

**Sell-side Advisor**

**Muller & Monroe Asset Management**

sold $135 million of funds portfolios to

Multiple Buyers

**Sell-side Advisor**

**Stifel Asset Management**

sold a $30 million VC portfolio to

CONFIDENTIAL

**Sell-side Advisor**

**Single Family Office**

KIDD & COMPANY

received holding company financing from

Northleaf Capital Partners

**Sell-side Advisor**

**Early-stage VC Firm**

CONFIDENTIAL

sold its portfolio of early-stage companies to

CONFIDENTIAL

**Sell-side Advisor**

**Single Family Office**

CONFIDENTIAL

sold $100 million of funds to

Multiple Buyers

**Sell-side Advisor**

**$5 billion middle market PE firm**

CONFIDENTIAL

raised a $25 million co-investment from

EU Family Office

**Investment Advisor**

Advisor to

OPIC

**Overseas Private Investment Corp**

**Investment Advisor**

Advisor To

CalCEF

**California's Clean Energy Foundation**

**Strategic Advice**

$90 million hold/sell portfolio analysis

CONFIDENTIAL

**$1.5 billion US-based Asset Manager**

**Training & Education**

Executive Education for

ilpa

**Institutional Limited Partners Association**

**Valuation Review**

$180 million funds portfolio valuation

TopTier

**Top Tier Capital Partners**

**Investment Advisor**

Advisor To

Energy Foundation

**The Energy Foundation**

## Select Transactions

- Led the dissolution of multiple tail-end fund-of-funds
- Sourced and underwrote multiple lower middle-market direct lending opportunities
- Arranged co-investment for GP buy-and-build transaction
- Managed GP-led secondary sale of early-stage venture capital fund
- Advised on refinancing of holdco capital structure for private investment arm of family office
- Wrote third-party opinion on acquisition and management structure of $6 billion asset manager for prominent family office
- Provided third party valuation assessment of $180 million VC portfolio to be used by board of public entity
- Represented OPIC in structuring of $150M credit facility for small and medium enterprises (SMEs) in Africa

# Encuesta del Mercado Secondario

# Encuesta

**Preguntas**

Number of years your program has invested in PE:

- 0-1
- 2-5
- 5-10
- 11+

Have you sold PE funds in the past (yes or no)?

Do you think you may try to sell PE funds in the next 12 months (yes or no)?

If so, what is the number one factor that has led to your decision to possibly pursue a secondary sale?

- Need for liquidity
- Consolidation of managers/companies in your portfolio
- Portfolio rebalancing out of current strategies into new strategies
- Resolution of underperforming managers

Do you invest with secondary investment managers (yes or no)?

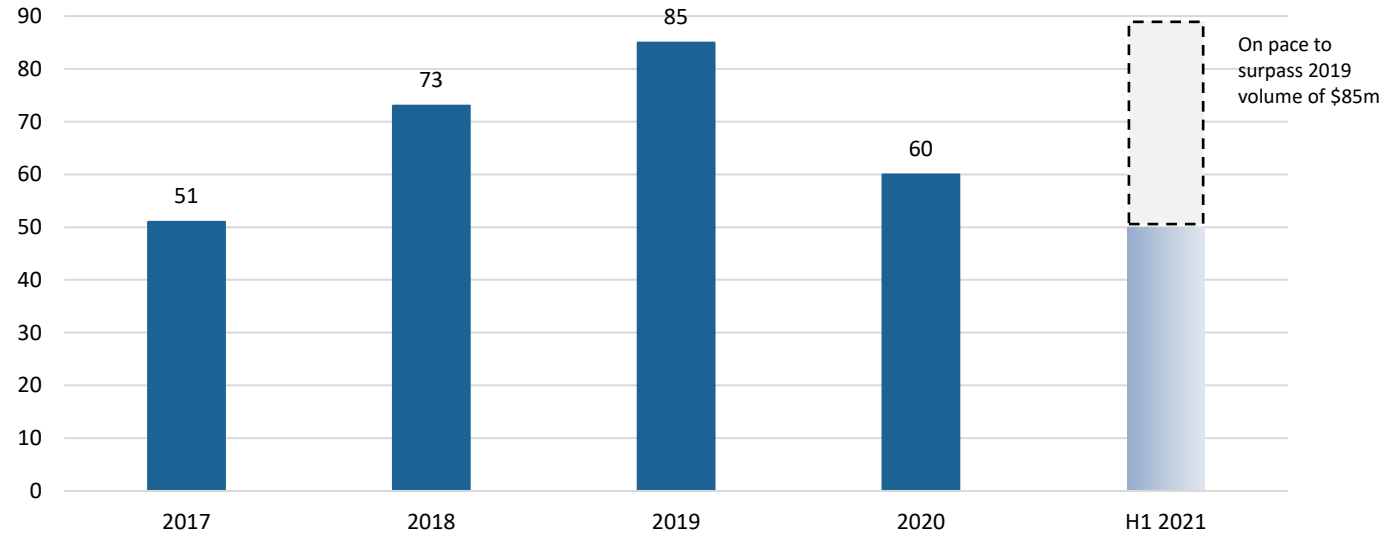
Have you directly acquired PE funds through a secondary in the past (yes or no)?

Would you consider this strategy for your program in the next 12-24 months (yes or no)?

# General overview of the current secondary market

# Secondary Market Overview

## Secondary Market Volume *(as of Q2 2021)*




## Secondary Focused Capital

**Dedicated Secondary Dry Powder:**
$122 billion

**Total Estimated Secondary Capital:**
$152 billion

Source: Campbell Lutyens 2020/H1 2021 Secondaries Market Overview

# Secondary Market Overview

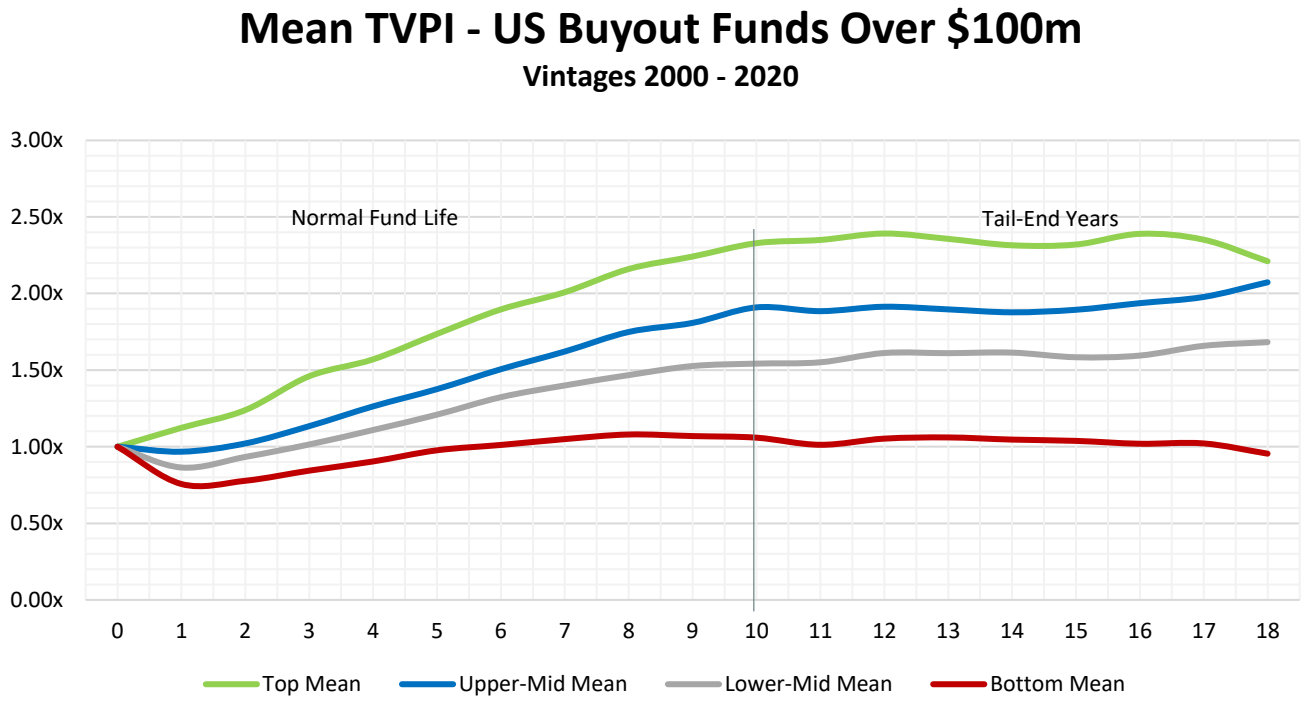
## Secondary Market Breakdown

| Key Secondary Statistics | 2015 | 2019 | 2020 |
|---|---|---|---|
| Total Transaction Volume | $41b | $85b | $60b |
| LPs with allocation to secondaries | 45% | 71% | 71%+ |
| Dedicated secondary investors | 30+ | 70+ | 70+ |
| Annual new capital raised | $24b | $56b | $62b[1] |
| Capital raised to date | $240b | $376b | $438b |

Source: Campbell Lutyens 2020 Secondaries Market Overview

[1]Estimate based on large expected closings at the end of 2020

# Secondary Market Overview – Why Beneficial to LPs?

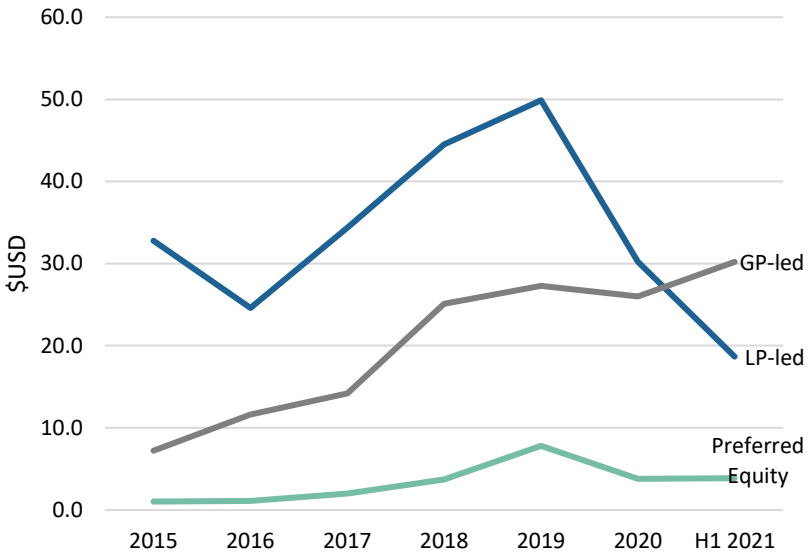



- Private equity funds, on average, lose value when held beyond 10 years, **regardless of historic performance or quartile ranking**
- There is more downside risk than upside potential by holding funds beyond 10 years relative to the initial 10 years of their life

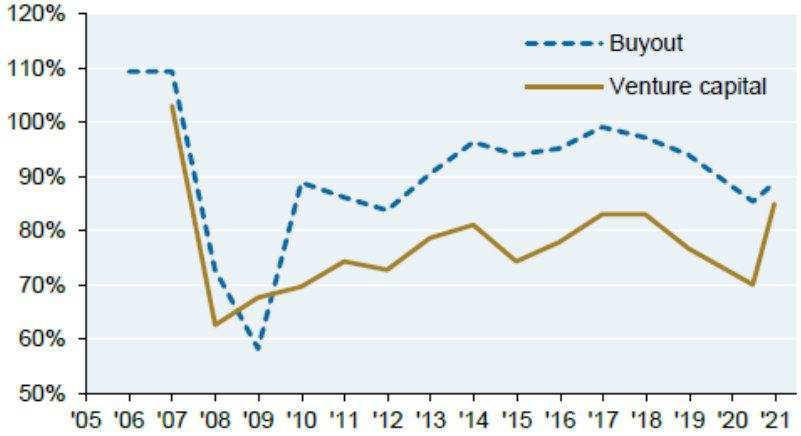
Source: Upwelling Research based on Pitchbook information

# Secondary Market Overview

## Secondary Market Volume Breakdown[1]




## Average Secondary Market Pricing[2]

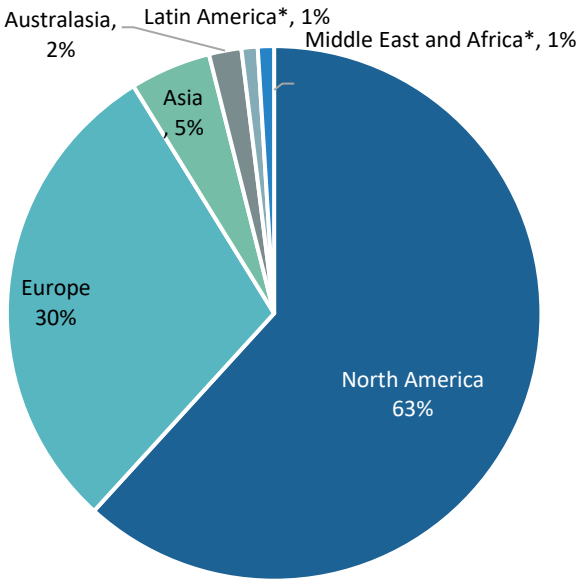



While LP-led deals have historically made up a larger percentage of secondary activity, GP-led transactions surpassed them for the first time in the first half of 2021

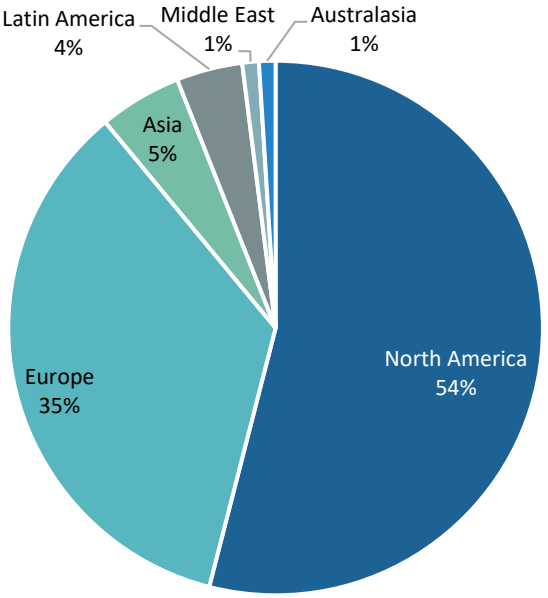
[1]Source: Campbell Lutyens 2020/2021 Secondaries Market Overview
[2]Source: Coller Capital 2021 Secondary Pricing Report

# Secondary Market Overview – Geography of Funds Sold

## LP-Led Deals




## GP-led deals

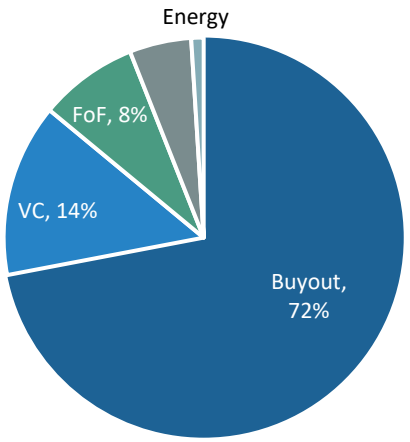



- Secondary market is largely dominated by North America and Europe
- Latin America has less than 1% of LP-led deals; however, makes up a larger share (4%) of GP-led

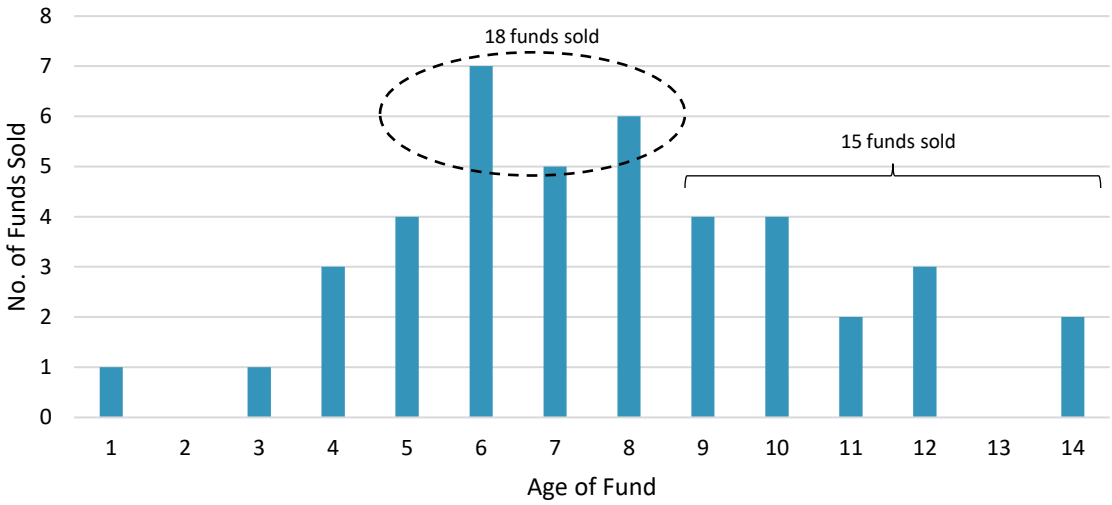
Source: Campbell Lutyens 2020 Secondaries Market Overview

# Current Secondary Market Volume

## PE Funds Purchased (H1 2021)[1]




## Example: Q2 Portfolio Sold[2]




- Buyout Funds made up a far majority of PE Funds acquired at 72%; Venture Funds followed with 14% of deals
- Average age of funds sold was 7.7 years

[1]Source: Setter Volume Report H1 2021
[2]Source: European & North American Intermediary

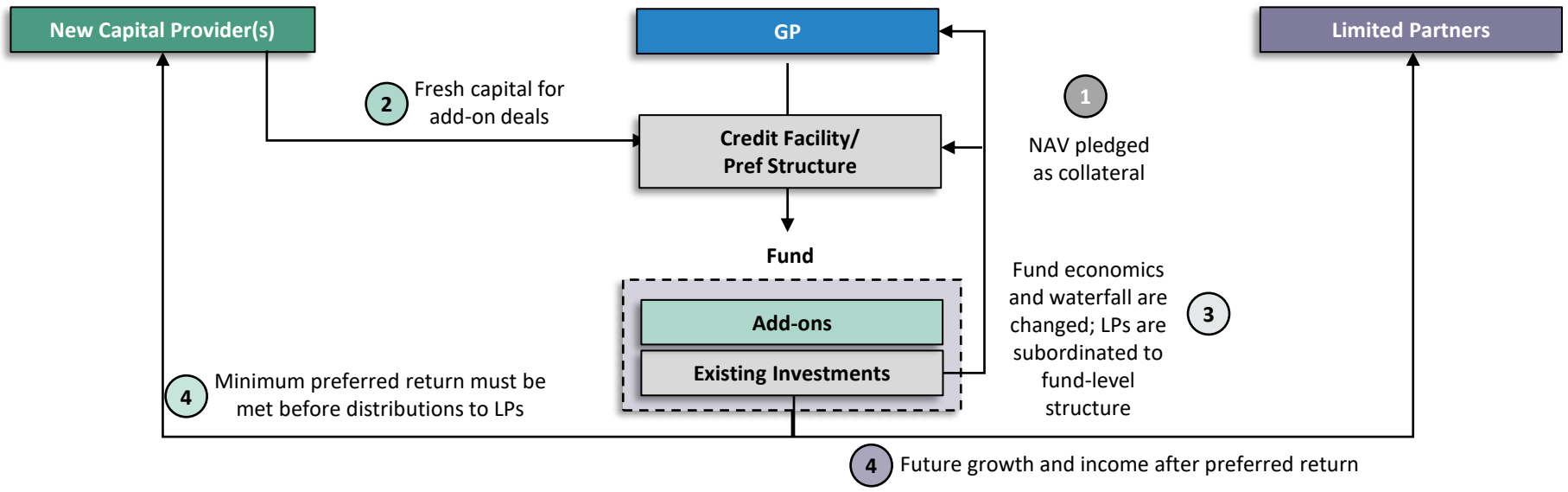
# Unique structures available to LPs and GPs

# GP-led Solutions

## Summary of GP-led Secondary Options

| | |
|---|---|
| Structured Secondaries | ▪ Provides liquidity to LPs and GPs without selling the underlying assets<br>▪ Gives GPs the ability to put new capital to work in portfolio companies without cross-fund investing and at a lower cost that straight equity<br>▪ Allows LPs to prudently leverage diversified fund portfolios and redeploy capital<br>▪ Debt or preferred equity solutions, often without burden payment schedules (i.e. capital provider(s) gets paid when companies or funds are exited or distributions occur) |
| Acquisition / continuation funds | Continuum of capital for investment funds that allows a manager to:<br>▪ Provide liquidity to LPs without selling portfolio companies outright<br>▪ Raise capital to support existing companies<br>▪ Catalyze a new fund with existing assets versus raising a pure, blind pool committed vehicle |
| Single asset transactions | ▪ A variation of an acquisition fund or continuation fund<br>▪ Provides a GP the opportunity to continue to own and manager an asset for an extended period<br>▪ LPs provided the option to exit or remain in the company alongside the manager at newly established and aligned economics |
| Strip sales | ▪ Another variation of a continuation fund<br>▪ A slice of assets –whether funds owned by an LP or companies owned by a GP - are sold to a new capital provider<br>▪ Assets can be pulled from multiple funds in whole or in part<br>▪ For GPs, they maintain the management of such assets |

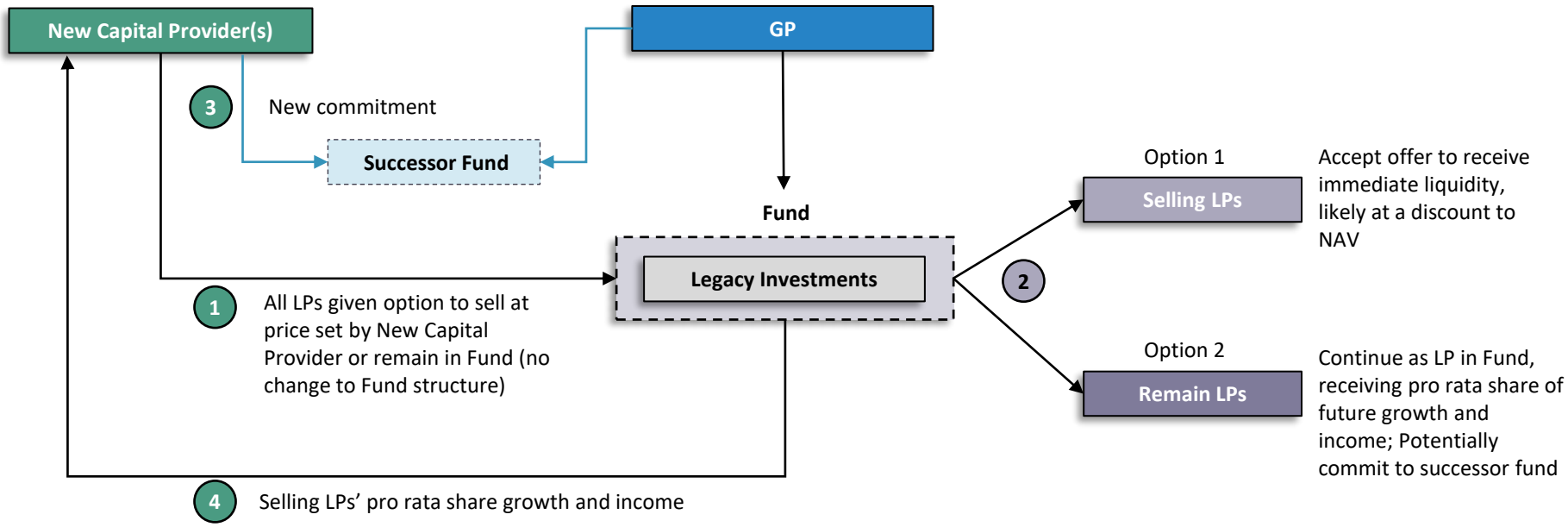
# Fund Loan / Preferred Equity Financing




## Mechanics

- Fund NAV plus unfunded capital is used as collateral to credit or preferred equity structure
- Accrued GP carry can also be contributed to collateral pool
- New Capital Provider(s) offers capital to the GP to be used for predetermined purposes (i.e. add-ons, debt paydown, GP working capital)
- Future distributions split according to negotiated cash flow waterfall based on future return thresholds (MOIC or IRR)
- LTV/ Advance ratios a product of size of capital needed, quality and diversification of portfolio; range from 20-50% of NAV
- Preferred equity structures less restrictive than senior debt (PIK only, limited restrictions) and can be customized to meet specific needs
- Fund interest is typically not diluted, although it is subordinated to preferred return or fund-level financing structure

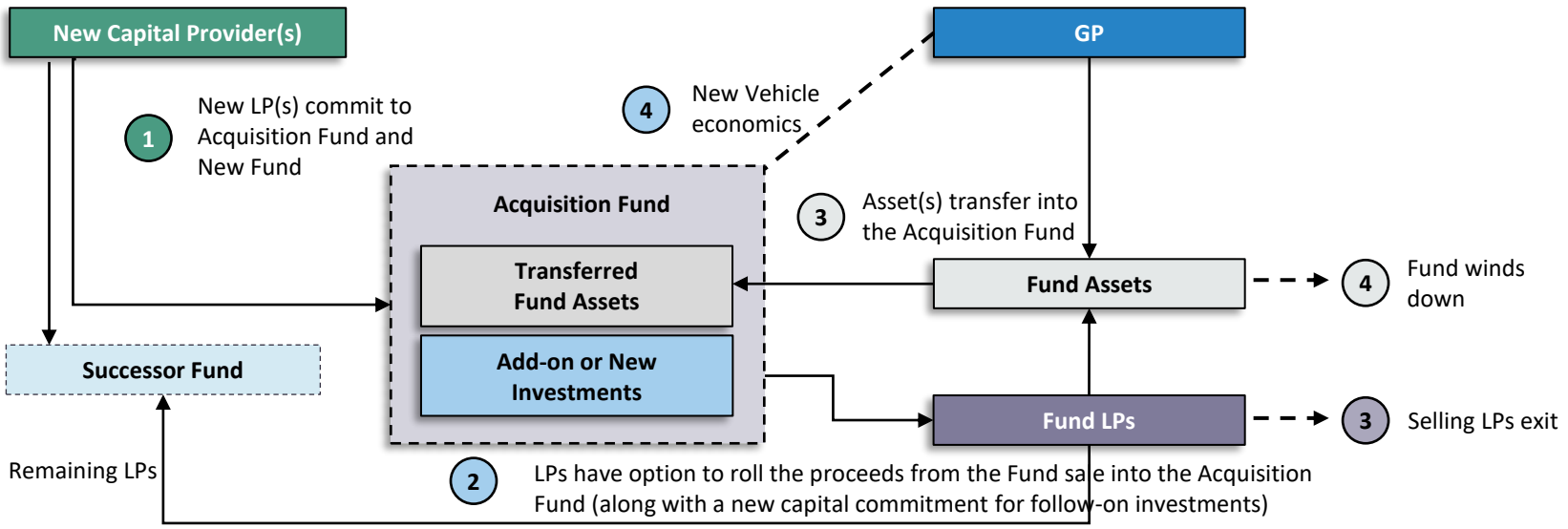
# LP Tender with Stapled Commitment to New Fund




## Mechanics

- Limited Partners have option to sell existing LP interests to a New Capital Provider(s)
- Selling LPs receive liquidity and New Capital Provider(s) assumes their LP interest
- New and Remaining LPs may work with GP to augment existing LP Agreement subject to voting thresholds (i.e. recycling rights, fund term, hurdle, management fees, etc.)
- Does not require creating new fund documents for new vehicle as would be the case with an acquisition/continuation fund
- Provides path to raise capital for successor fund with New Capital Provider(s)

# Acquisition Vehicle with Stapled Fund Commitment



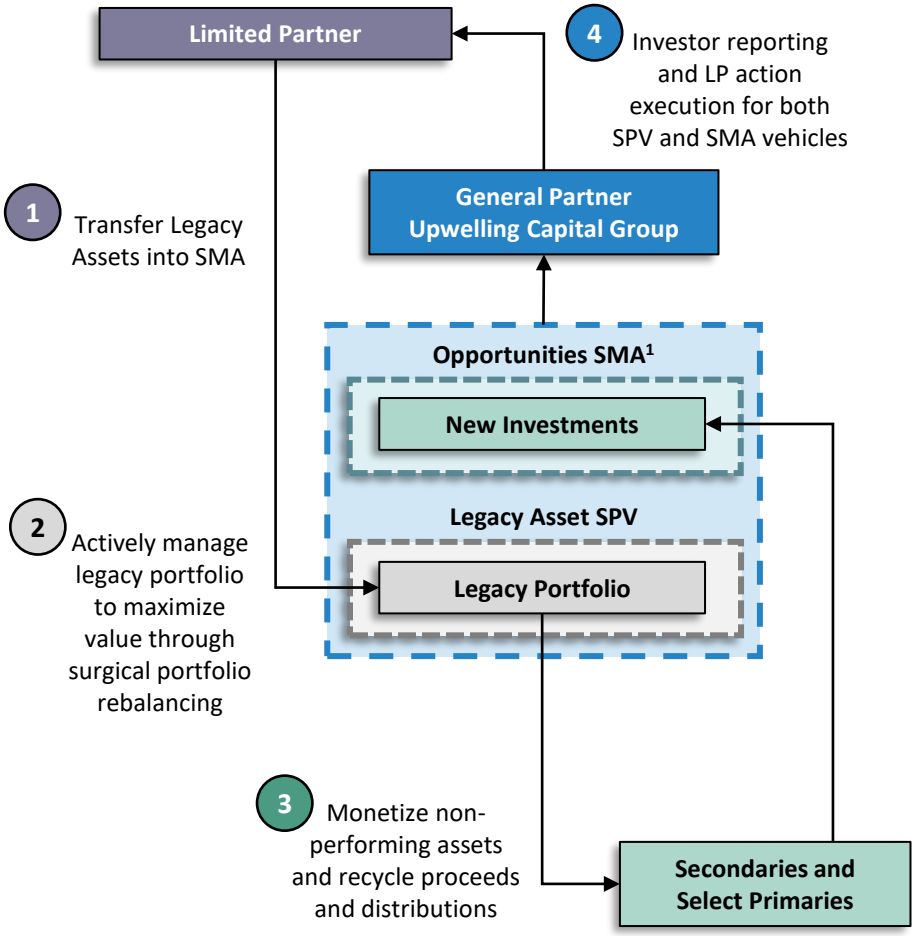

## Mechanics

- Acquisition Fund is established to acquire assets from one or more funds managed by the sponsor, or as a part of a new team spin out
- New Capital Provider(s) make commitments to new vehicle, which would purchase the Fund assets and be used to make follow-on or new platform investments
- Terms of Acquisition Fund often include the following provisions:
  - New Investment Period with extended follow-on investment rights
  - New management fee structure
  - Scaling carried interest based on MOIC hurdle
- Existing LPs have option to roll equity/unfunded commitments into new structure or take liquidity on sale
- Note possibility of only acquiring select assets from funds and establishing legacy vehicle for non-core assets, which will be exited over time
- New Capital Provider(s) agree to make new commitment to New Fund

# Legacy Asset SPV

## Mechanics

- Investor transfers legacy funds and direct holdings to a SPV
- Transferred assets are fully managed by a well-resourced group focused on maximizing value
- Manager surgically rebalances the portfolio selling select assets based on deep analysis of portfolio companies and future upside
- Reduces unfunded capital commitments and fees as appropriate
- Additional GP oversight encourages timely, prudent exits of remaining assets
- Sales proceeds and distributions from Legacy Portfolio are recycled and reinvested into SMA, pursuing secondaries, select primaries and direct investment opportunities
- Investment pacing aligns with liquidity generated from Legacy Portfolio, so no cash commitment is required
- Additional investment capital can be contributed to new structure

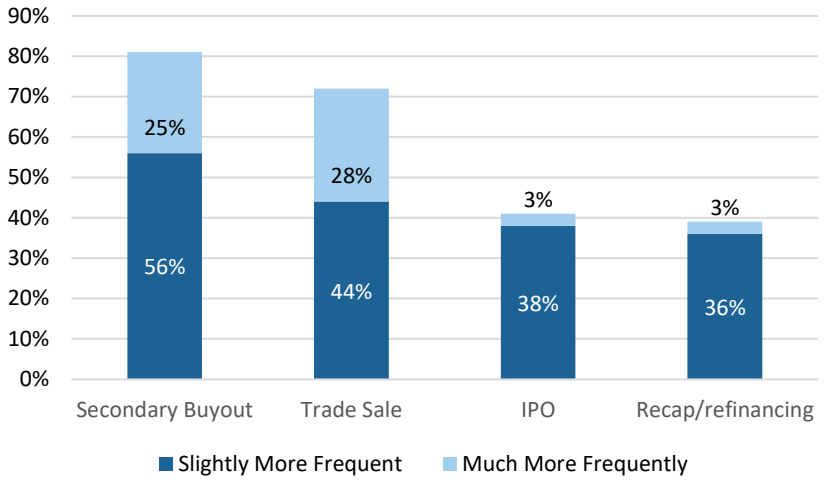



[1] Option to have cash generated by Opportunities SMA returned to LP or recycled in an evergreen structure.

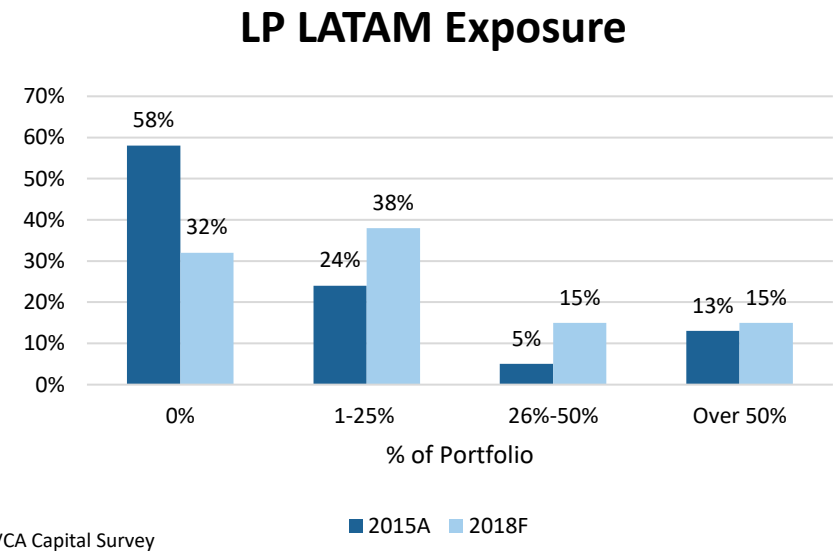
# Trends in LATAM and Mexico related to the secondary market

# LP Expectations for LATAM

81% of LPs expected secondary buyouts to be a more frequent exit for LATAM PE by 2017




68% of LPs surveyed expected to have exposure to LATAM PE by 2018; just 42% had exposure in 2015




2015 Coller-LAVCA Capital Survey

# LATAM Secondary Market

**Growth of LATAM PE / Secondaries Market**

- Private Equity in Mexico grew form 32 GPs in 2006 to 155 in 2016
- 2019 total transactions estimate to approximately $1.6 billion[1]

**LATAM Secondary Market – Recent Growth**

- Brazilian pensions received board approval for secondary process
  - PE market picked up steam in 2005-06 so early vintages are in tail-end years (~$1 billion opportunity)
- Although rare, some LATAM institutions are exploring fund secondary sales
- AFOREs AUM has grown from $1.2T in 2010 to $4.4T in 2020[2]
- Focus may not be on selling funds, but instead on secondary directs

**Pricing**

- Deals brokered by international firms: 10-40% discount to NAV
- Discounts vary based on fund and complexity

**Challenges**

- Size: Firms with global mandates seek larger transactions ($100m+)
- Educational: Local parties have yet to complete many secondary transactions
- Regulations, fees, tax implications

**Opportunities**

- Room for creative structures
- Signs of Change: Multiple Venture Capital deals and successful Mexican PE deals (i.e. Cholula)
- Public Markets: Momentum in exits via public markets

Source: Spectra Investments on Secondaries Investor - June 2018
[1]Source: Campbell Lutyens 2020 Secondaries Report
[2]Source: bnamericas report August 2020

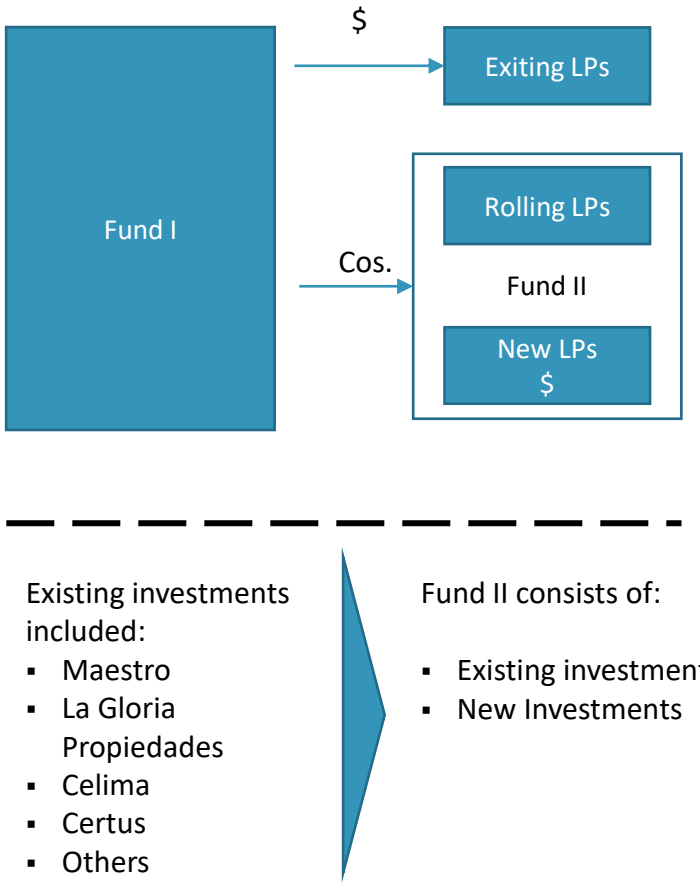
# Enfoca: GP-led Secondary

## Situation

- Enfoca was founded in 2006 in Lima, Peru
- The firm was Peru-focused and invested in market leading companies
- First fund raised $57 million (67% committed from local pensions)
- Value drivers included Maestro, a hardware store that the grew from USD $129m to $543m in sales and from USD $9m to $50m in EBITDA between 2007 and 2013
- Limited exit opportunities due to illiquidity of public markets and rarity of strategic investors targeting Peru
- Enfoca sought a secondary opportunity to raise capital around existing Fund I companies

## Result

- GP-led secondary in the form of an **acquisition fund** which received addition capital for new investments
- Existing LPs had the option to sell the stakes or roll over into new fund
- New LPs included the Canada Pension Plan Investment Board (CPPIB) and Goldman Sachs Asset Management (GSAM)
- Total size of the deal was over USD $950 million



# Relevant Upwelling Transactions

| | Fund of Funds Dissolution | GP-led VC Sale | Aged Primary |
|---|---|---|---|
| **Description** | Manager of two SMA fund-of-funds was looking to sell underlying funds to wind down vehicles | Manager of a healthcare venture portfolio needed to provide liquidity to LPs (mostly family offices), which would allow them to recycle capital into new fund | US Endowment seeking to implement direct commitment model; hired Upwelling to sell young fund-of-funds with direction to work closely with fund-of-fund manager |
| **Size** | $90 million | $30 million | $25 million |
| **Characteristics** | ▪ 2006-2011 vintages<br>▪ Assets mainly venture and buyout<br>▪ US Funds | 25 early-stage portfolio companies with several having accelerated revenue growth | ▪ 2016 vintage FoF<br>▪ US venture with secondary, primary and direct exposure<br>▪ Only 25% called at time of sale |
| **Approach** | ▪ Broad market outreach to find best buyer for each fund.<br>▪ Worked closely with manager on LP communication<br>▪ Mitigated sensitivity with managers who had limited experience with secondaries | ▪ Given the specific industry, Upwelling focused on finding investors with expertise in healthcare<br>▪ Worked closely with manager to collect and package portfolio information for process, much of which was poorly organized | ▪ Narrowed target buyer group that would provide ideal LP for FoF manager.<br>▪ Worked closely with seller and potential buyer to support process. |
| **Outcome** | ▪ Rolling closes with final close 3/31/21<br>▪ Pricing exceeded our high-end sale value forecast<br>▪ Five separate buyers for 12 funds | With consent from all LPs, the buyer acquired the entire portfolio, which created a liquidity event for both the LPs and GP | ▪ Secured US pension to buy position at NAV<br>▪ Helped buyer, who was new to secondary transactions, throughout process |

# Summary - Mitigate Risk of Execution for Successful Outcome

**Understand the various stakeholders involved in a secondary sale**

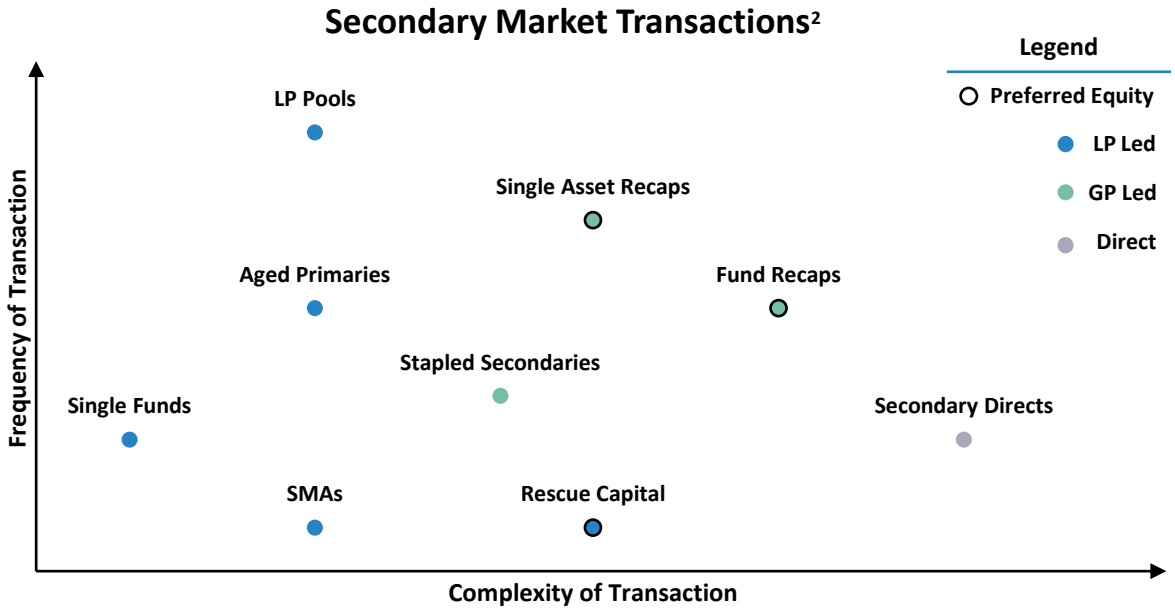
- LP side – PE staff, CIO, trustees, outside counsel, advisors, buyers
- GP side – GP, portfolio companies, co-investors, advisors, buyers, LPs

| Limited Partners | General Partners |
|---|---|
| ▪ Socialize potential transaction with CIO and Trustees well in advance of sale<br>▪ Conduct internal or external analysis to determine intrinsic value of portfolio<br>▪ Have a transaction price in mind before going to market<br>▪ Understand transfer rights of each fund<br>▪ Ensure you have capable, dedicated advisors (legal, transactional) supporting the process<br>▪ Have necessary legal and financial documents organized in advance of going to market<br>▪ Establish internal person as point person to interact between the GPs, legal counsel and internal finance team<br>▪ Communicate regularly with your constituents to avoid surprises<br>▪ Be open to a wide range of options, including structured deals and deferred pricing to maximize value | ▪ Have a clear set of objective for a GP-led transaction<br>▪ Be aware that a robust market process will be require to satisfy your LPs<br>▪ Get LP buy-in but do your homework in advance of soliciting their approval<br>▪ Do not discount assets in advance of a trade<br>▪ Provide optionality to your existing investors<br>▪ Be prepared to subordinate economics in a secondary sale (i.e. new capital will want to make sure most of your carried interest will be earned when they get liquidity)<br>▪ Ensure you have capable, dedicated advisors (legal, transactional) supporting the process<br>▪ In LATAM, you must address regulatory, FX, and tax implications in advance of deal<br>▪ Be open to a wide range of options to create a win-win outcome |

# Appendix

# Secondary Market Landscape

## The "secondary market" has evolved to encompass a variety of transactions




**Secondary Market Transaction Definitions[3]**

| | |
|---|---|
| LP Pools | Multiple LP fund interests sold in a single transaction. |
| Single Funds | Single LP fund interest sold in a transaction. |
| Secondary Directs | Investor to investor sale of majority ownership in a company, as opposed to a company being sold to a competitor. |
| Rescue Capital | LP can't make capital calls and needs to sell a fund commitment (typically occurs only in times of distress). |
| SMAs | Separately managed accounts are rarely sold in a secondary transaction. Relationship typically dissolved. |
| Aged Primaries | Secondary transaction of young funds, typically with more uncalled capital than called capital. |
| Stapled Secondaries | Committing to a manager's upcoming fund as part of another transaction (typically a fund recap). |
| Fund Recaps | Offering terms to buyout current LPs, continuation of current fund structure for LPs that don't sell, and terms for LPs that put additional capital into the deal. |
| Single Asset Recap | Recapitalizing a fund's portfolio company directly, taking a minority stake and allowing the fund manager to continue managing asset |

[3]Definitions are Upwelling's categorization of transaction subsets that may not always be distinctly differentiated.

# Upwelling Market Activity (Recent & Current Transactions)

- LP Portfolios and GP-led transactions
- Raised co-investment capital for multiple single assets
- Currently leading secondaries in US, LATAM and Asia (pending)

## $1.75 billion of recent secondary opportunities

| Project Name | Category | Description | Region | Size ($M)[1] |
|---|---|---|---|---|
| Buffalo | GP-Led Secondary | Continuation fund for two middle market companies in need of capital for M&A and recapitalization | US | 650 |
| Pronto | GP-Led Secondary | LP Tender for global venture capital fund | LATAM | 100 |
| Mako | GP-Led Secondary | Aged primary + LP Tender for growth equity manager | US | 75 |
| Bolt | GP-Led Secondary | GP-led sale of sole LP interest in SMA | US | 150 |
| Clover | GP-Led Secondary | Recapitalization of a lower middle market fund with four portfolio companies | US | 150 |
| Carnitas | GP-Led Secondary | Continuation fund for growth equity manager | LATAM | 40 |
| Axe | LP Secondary | LP secondary sale of a single funds interest | US | 20 |
| Tower | LP Secondary | LP portfolio of high-quality lower middle market partnerships | US | 130 |
| Maritime | LP Secondary | LP portfolio of credit, buyout and infrastructure funds | US | 50 |
| Nile | LP Secondary | LP portfolio of diverse top-performing Fund of Funds positions | US | 15 |
| Pollen | LP Secondary | Sale of funds & direct positions held by US-based family office | US | 49 |
| Rockets | LP Secondary | Secondary sale of a LP interest in a top performing PE fund managed by a premier US-based GP | US | 13 |
| Tungsten | LP Secondary | Secondary sale of a co-investment vehicle's underlying investments in middle market companies | US | 150 |
| Zinc | FoF Dissolution | LP portfolio of buyout, venture, and mezzanine | US | 90 |
| Dandy | FoF Dissolution | Secondary venture capital fund-of-funds dissolution on behalf of a publicly traded financial institution | US | 30 |
| Sweetness | FoF Dissolution | Fund-of-funds dissolution on behalf of GP, included three SBICs | US | 45 |
| **Total** | | | | **1,747** |

Upwelling
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