Ten Years: Reflections, Review & Prognosis

A boutique secondary market advisor with a singular focus

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April 2024

MELTING POINT
LIQUIDITY SOLUTIONS

Reflections

In marking the ten-year anniversary of Melting Point Solutions' founding, we are filled with appreciation. Our team feels incredibly grateful to have partnered with so many owners and managers of alternative investment fund interests to provide them and their clients with secondary market liquidity solutions. Melting Point's founding mission was to provide an efficient, price-maximizing secondary market solution to holders of illiquid assets of all sizes and types. Through continuous improvement, a conflict-free business model aligned completely with our clients, and a culture of excellence, we have advised on over $8 billion of transactions since inception. While our average transaction size in 2023 was nearly 7x larger than it was in 2014, we do not deviate from our objective of achieving the best outcome for our clients, regardless of size or type.

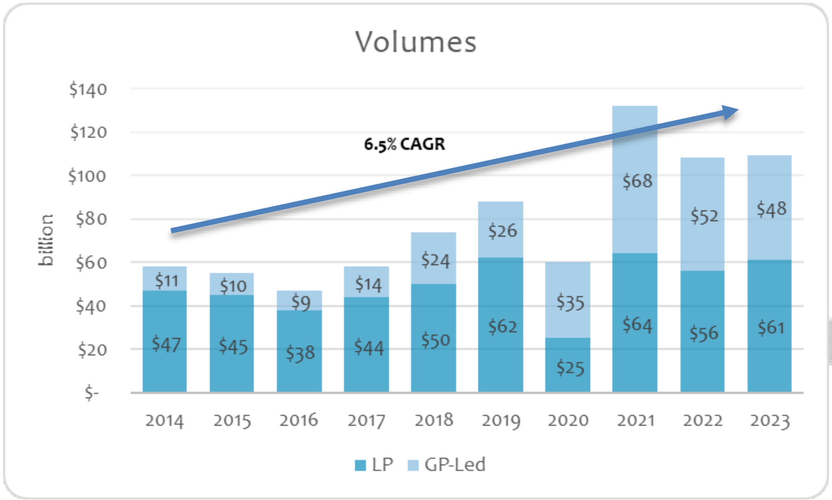
Single family offices, multi-family offices, independent wealth managers, wire houses, O-CIOs, foundations, endowments, pension plans (public and private), fund-of-funds, mutual funds, secondary funds – have all used our services over the past ten years, many on a repeat or serial basis. In addition, we have partnerships in place to provide our services to the clients of 1) Addepar, a premier integrated data aggregation and reporting platform for wealth and asset managers, 2) a large global wealth management firm 3) a large global O-CIO and 4) a leading provider of de-risking consulting services for defined benefit pension plans.

The 'sweet spot' for Melting Point is the lower middle market, as we define it. Our portfolio engagements typically range in size from $25 million to $250 million of NAV for sale, but we have no minimum size constraint and transaction sizes have ranged from under $500,000 to over $1 billion. We employ the same rigorous process regardless of transaction size.

Melting Point covers all the alternative asset classes – private equity, private credit, venture capital, real estate, infrastructure, energy, illiquid hedge funds, litigation finance etc. – and has curated a diverse, multi-dimensional buyer universe of Qualified Institutional Purchasers *(as defined under SEC Rule 501 of Regulation D of the Securities Act of 1933)* stratified by buyer type and asset class, size, vintage and geographic focus. This stratification enables the construction of a robust and competitive auction framework for each sale process, ensuring a market-based price for each fund interest.

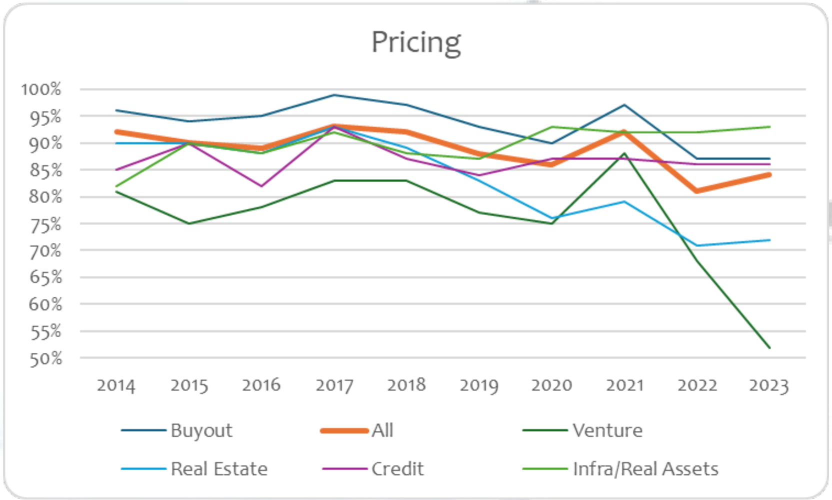
Unlike most of our peers, we have a singular focus – secondary market liquidity solutions for LPs – unburdened by the potential for conflicts of interest introduced by also engaging in primary capital raising or other business lines. At Melting Point, LP secondary sales are not a "loss leader" for a GP restructuring business or designed to curry favor with investors for a primary capital raising business; LP secondaries is our <u>only</u> business, and our client is <u>only</u> ever the seller.

Overview of the Secondary Market Since 2014



Except for a pandemic-related blip, overall volumes have increased steadily over the past decade as the institutionalization of the secondary market that began with the Global Financial Crisis in 2007/8/9, continued. Also, the rise of the GP-led market (e.g., continuation vehicles, trophy asset buyouts, stapled-primary transactions, tender offers) over the last four years has primarily been a function of (i) delays in portfolio company exits in a tepid M&A and public exit environment and (ii) a high level of adoption of the GP-led toolkit by both sponsors and buyers – Wall Street's financial engineers to the rescue once again! Capital raising activity remained robust throughout the decade with many new entrants and larger and larger funds raised by the incumbents.

Up until 2020, secondary market pricing was reasonably stable. The low volumes in 2020 negatively affected pricing although there was a brief recovery in 2021 as the overhang from the previous year came to the market. Double digit pricing declines in 2022 resulted from (i) perceived inflated private company valuations, (ii) expected delays in portfolio company exits, (iii) higher underwriting hurdles due to recession fears, and (iv) increased buyer selectivity. Interest rate hikes and tighter lender underwriting standards in 2022 also reduced buyers' use of leverage, changing how aggressively they could bid while still hitting target returns. Except for venture capital and real estate, the pricing reversal experienced in 2022 stabilized in 2023 as bid/offer spreads have narrowed. We expect this narrowing to continue in 2024.



Sources (charts and text): Melting Point Solutions, Jefferies Global Secondary Market Review 2023, Campbell Lutyens 2024 Secondary Market Review, Greenhill Global Secondary Market Review 2021

Evolution of Melting Point Since 2014

These days headlines regarding activity in the secondary market tend to focus on brand name, full-service investment banks either managing a capital raise (usually from one or two secondary fund buyers) for a single or multi-asset continuation vehicle for a well-known GP or brokering the sale of a large ($1 billion plus) LP portfolio to a large secondary fund buyer. We eschew the headlines and focus on what we do best: price maximizing liquidity solutions for our clients.

There has been much focus on and press regarding 'mosaic (multi-buyer) liquidity solutions' over the past 18-months. We were particularly interested to read in a PEI Media story last month that:

> *"The share of multi-buyer mosaic transactions reached 63 percent of all LP portfolio sales advised by Greenhill last year, according to the firm's FY 2023 Global Secondary Market Review. This was an all-time high and up from 50 percent in 2022".*

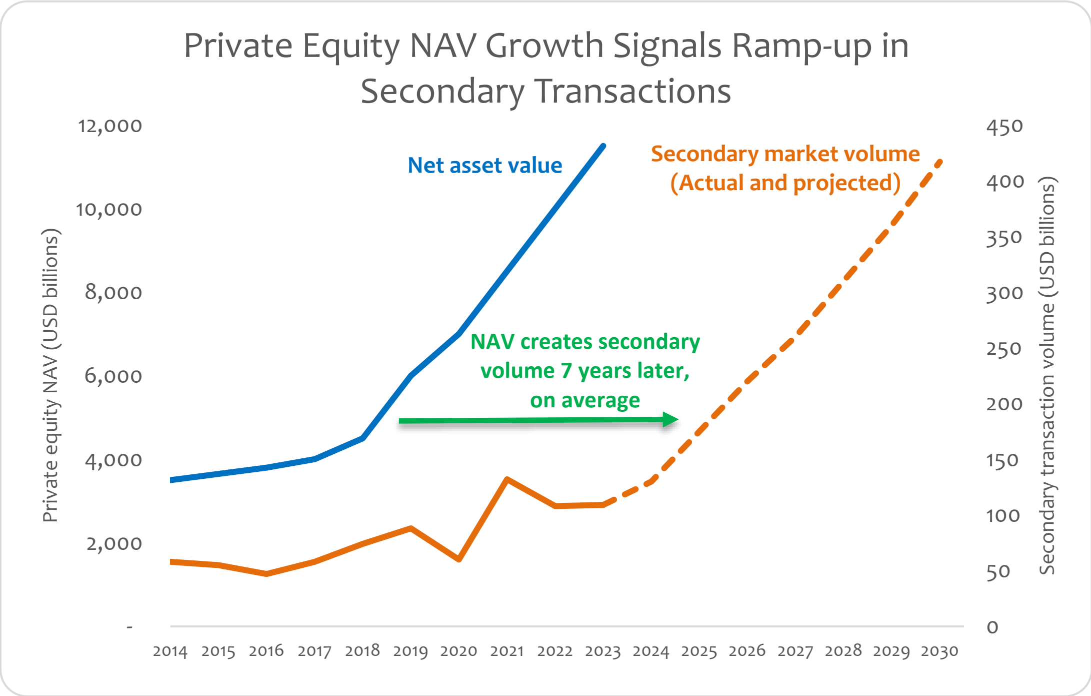
The share of Melting Point's LP portfolio sales that are multi-buyer mosaic transactions has been greater than **90%** every year since our founding. While we always solicit portfolio, sub-portfolio, and line-item bids in our auctions of LP portfolios, in our experience it is exceptionally rare that a portfolio bid is the price maximizing liquidity solution, even after accounting for the increased frictional costs of a multi-buyer solution.

Sellers should be wary of direct approaches from dedicated secondary funds to buy their assets; they will 'sell' you on ease and speed of execution, but it is very unlikely to be price maximizing. Working with Melting Point enables the same single point of contact but opens a vast network of potential purchasers. As you can see from the chart opposite, the average auction spread (high to second place) we have achieved for our clients more than justifies hiring Melting Point as an advisor.

[1] 92% of clients have elected to sell at least one interest post auction.
[2] NAV points per line-item

Prognosis For the Future

According to the CAIA Association, alternative investments currently sit at $22 trillion in assets under management or 15% of global assets under management. At $110 billion in estimated total volumes in 2023, the secondary market currently provides only 0.5% in annual liquidity. Furthermore, the growth in alternative investments over the last 10 years, (c.12% CAGR, according to Preqin) was almost double that of the growth in the secondary market.



According to PineBridge Investments, the average time between the initial (primary) investment in private equity and secondary sales is seven years. In other words, portfolios completed a few years ago when the investment pace was speeding up, are just starting to come to the secondary market now. If this trend continues, the volume of secondary transactions will grow at a faster pace over the next few years.

The chart to the left highlights how projected secondary market volume neatly matches NAV growth, offset by seven years. The implication is that the value of secondary transactions may triple over the next seven years.

The O-CIO and investment consulting channel has been Melting Point's largest client segment (by aggregate NAV sold) and with the projected accelerating adoption of alternative investment products, we expect increased demand for Melting Point's services in the coming years. Also, with regard to the wealth management segment (Melting Point's second largest client segment, by aggregate NAV sold), a recent survey of financial advisors conducted jointly by CAIS and Mercer found that more than half (62%) of financial advisors currently allocate between 6% and 25% of their clients' portfolios to alternative asset classes, with 85% of them expecting to increase allocations to one or more alternative asset classes further within the next two years.

We do not expect this increased supply to generate a market imbalance. According to PEI Media publication *Secondaries Investor*, secondaries fund raising hit an annual record of $117.9 billion in 2023, more than double the 2022 count of $58.3 billion. Further, Bain & Company estimates total dry power to be over $200 billion currently. We believe that the market estimates for dry powder significantly underestimate the amount of available capital for secondary market purchases because it fails to account for secondary market investments made by "non-traditional" buyers such as insurance companies, pension funds, sovereign wealth funds, etc. Since inception, nearly 25% of Melting Point-advised sales have been made to "non-traditional" buyers.

We expect the next decade to be one of exceptional growth and evolution. The end of "free money" may (finally) hasten the creative destruction necessary in the venture community and force the sale and re-valuation of many other assets, namely real estate. However, we have called for "the denominator effect" twice in the last decade to no avail. The democratization of private fund investing will likely lead to portions of the secondary market becoming more efficient, from a process standpoint, but we, as a secondary market advisory firm, will continue to help investors of all size and type, navigate the opacity of this market, with the same focus and alignment of interests that have served us well for the past decade.

Client Testimonials

"For nearly a decade, Melting Point has been an invaluable partner to us in navigating the secondary market and achieving efficient execution across virtually every asset class." **Eric Alt – Managing Partner and Co-CIO, Hall Capital Partners.**

"With larger and more complex defined benefit plan terminations on the rise and continued growth in terminations in the pension risk transfer market anticipated over the next decade, Melting Point has been an exceptional partner to our clients that need to liquidate their allocation to alternatives." **Steve Keating – Managing Director, BCG Pension Risk Consultants.**

"With other advisors, we have questioned who their "real" client is. With Melting Point, we never question their alignment." **Anonymous – Managing Director, multi-billion-dollar single family office.**

"Our client was very happy with the pricing and the execution was flawless. The trades got done because of Melting Point's knowledge of the market and its strong relationships." **Anonymous – Vice President, global investment consulting firm.**