

Buyouts

Emerging Manager Report

In partnership with Gen II Fund Services • September 2021 • buyoutsinsider.com



**Standing out in a
crowded market**

How new managers are
making their mark

In partnership with

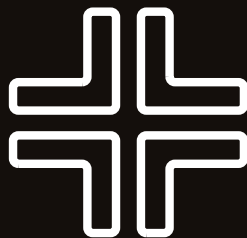
GenII

Sponsored by

withum⁺

FEEL VALUED

You deserve the proper time, knowledge and attention to detail. Whether you are an emerging manager or an established fund, personalized attention and expertise is never negotiable.



Partner with Withum

How to contact us

Private Equity Editor

Chris Witkowski

cwitkowski@buyoutsinsider.com, 646 356 4511

West Coast Bureau Chief

Lawrence Aragon

laragon@buyoutsinsider.com, 415 469 1183

Commissioning Editor, Buyouts

Karl Shmavonian

karl.s@peimedia.com, 646 356 4527

Senior Special Projects Editor

Graeme Kerr

graeme.k@peimedia.com, +44 20 3862 7491

Special Projects Editor

Chase Collum

chase.c@peimedia.com, 212 796 8336

Editor, PE Hub

Sarah Pringle

springle@buyoutsinsider.com, 646 356 4508

Reporters

Iris Dorian

idorbian@buyoutsinsider.com, 646 249 3890

Kirk Falconer

kfalconer@buyoutsinsider.com, 613 883 7149

Karishma Vanjani

karishma.v@peimedia.com, 646 970 3796

Aaron Weitzman

aaron.w@peimedia.com, 646 356 4532

Contributors

Amy Carroll, Bobby Drysdale, Vicky Meek

Managing Editor, Production: Mike Simlett

Production Manager: David Sharman

Production Editors: Daniel Blackburn,

Adam Koppeser, Nicholas Manderson, Jeff Perlah

Copy Editor: Eric Fish

Art Director: Mike Scorer

Head of Design: Miriam Vysna

Art Director - Americas: Allison Brown

Senior Designer: Lee Southey

Designers: Denise Berjak, Pio Blanco

Head of Marketing Solutions: Private Equity Group

Alistair Robinson

alistair.r@peimedia.com, +44 20 7566 5454

Subscriptions and Reprints

subscriptions@peimedia.com

Customer Services

customerservices@peimedia.com

Editorial Director, US: Rich Melville

Editorial Director: Philip Borel

Director, Product: Amanda Janis

Director of Research and Analytics: Dan Gunner

Operations Director: Colm Gilmore

Managing Director, Asia: Chris Petersen

Chief Commercial Officer: Paul McLean

Chief Executive Officer: Tim McLoughlin

For subscription information visit
buyoutsinsider.com



Buyouts

Emerging Manager Report 2021

ISSN 0883-2773 • SEPTEMBER 2021

Insight

2

Seven charts that matter

Key findings from this year's survey

EDITOR'S LETTER

5

The Gen II View Experienced partners make a difference

6

Analysis

9

Enduring appeal The pandemic raised the bar for emerging managers, but the appetite remains strong for those with compelling propositions

Finding a niche

Emerging managers must offer something compellingly different if they are going to attract investors' attention

14

Fundraising in a pandemic

Ongoing travel restrictions combined

with a wave of early re-ups mean emerging manager fundraising is as challenging as ever

18

Walking a fine line

LPs in emerging manager funds tend to push hard on terms but conceding too much can ultimately spell disaster

23

A differentiated strategy

Q&A with Arctos Sports Partners' Robin Slutsky

31

Opening up

As LPs become more receptive to new relationships, strong networks and track records are helping emerging managers stand out

34

Improving diversification

Q&A with Argand Partners' Kay Blackwell

37

Respondent profile

A look at who participated in this year's survey

38

Methodology

How we conducted the survey

40



Insight

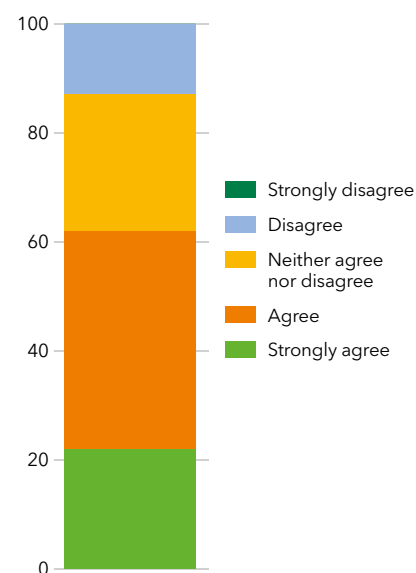
Buyouts Emerging Manager Survey 2021 **Launching a new private equity firm is no easy task in any environment, and even more so in a pandemic. Here are seven findings every emerging manager should know**

The fundraising environment for emerging managers is tough – no doubt about it. In addition to ongoing restrictions on face-to-face meetings, which makes building new investor relationships difficult, LPs are being inundated with early requests for re-ups from established firms, according to the fifth annual *Buyouts Emerging Manager Survey* conducted in partnership with Gen II

New managers remain attractive

Despite some inevitable risk aversion in the face of a global pandemic, a significant majority of respondents – 62 percent – believe that the risk/return profile for emerging managers is attractive relative to established firms. The rationale is simple. New managers are hungry, and they can't afford to get this wrong. It is vital that early deals impress because a firm's very survival depends on it. In addition, funds tend to be smaller, leading to an increased chance of producing outsized returns. "There is a very interesting dynamic at play," says Scott Reed, co-head of private equity in the US at Aberdeen Standard Investments.

The risk/return profile for emerging managers is attractive at the moment versus established managers (%)



Fund Services, LLC. They simply don't have the bandwidth to plough the necessary resource into the deep dive due diligence that emerging managers require, **writes Amy Carroll.**

Nonetheless, the fundamental appeal of the emerging manager category remains untainted. These firms are often led by some of the most talented and experienced investors in the market, now unencumbered by the bureaucracy

and tarnished alignment mechanisms of their former houses. But not all emerging managers will succeed. The bar has been raised and only the very best will survive to shake off their emerging manager label.

So, what are LPs looking for from new GP relationships and what do they expect in return?

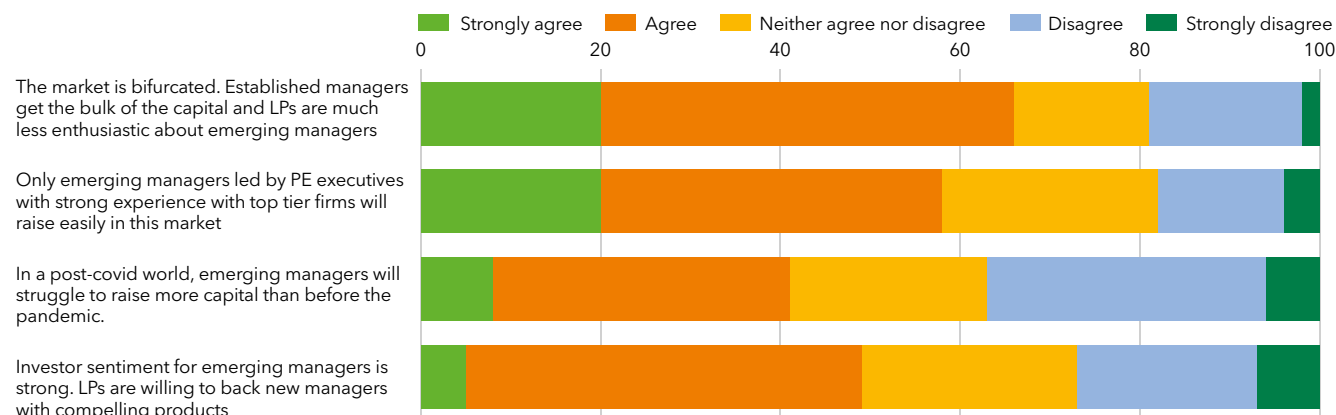
The fifth annual *Buyouts Emerging Manager Survey* explores the latest evolutions in this complex and challenging part of the market. ■

Pragmatism is a watchword

Despite a history of compelling returns in the emerging manager segment, emerging managers themselves are realistic about the challenges they face. More than 40 percent believe that, in a post-covid world, young firms will struggle to raise more capital than before the pandemic.

Meanwhile, they acknowledge that only firms led by executives with strong experience with top-tier houses and compelling, differentiated products will succeed. Indeed, two-thirds of respondents describe the market as bifurcated, with established managers getting the bulk of the capital, and emerging managers missing out.

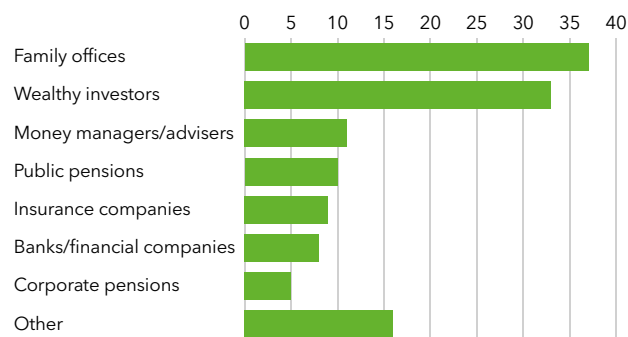
How do you perceive market sentiment around emerging managers right now? (%)



New managers attract non-institutionals

Some investors are more willing than others to invest in an emerging manager starting with family offices and high-net-worth individuals. These non-institutional investors tend to have a less rigid, box-ticking approach to making commitments. But they are not an emerging managers' only option. A growing number of endowments and foundations now have emerging manager programs, as they seek to reset their GP relationships. Some alpha-oriented insurance companies also have allocations, as do some private and public pension funds, which tend to use emerging managers as an incubator for future additions to their core program.

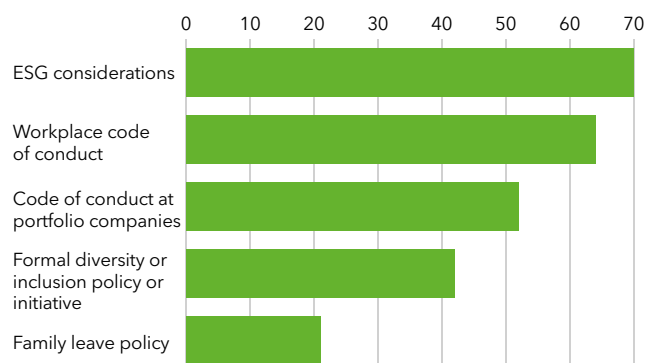
On average, what share of capital came from the following sources? (%)



ESG and DE&I programs are essential

ESG considerations are also becoming increasingly important when investors are screening new potential relationships and indeed, LPs see the ability to ensure ESG is baked in from the outset, as being one of the advantages of an emerging manager. While 70 percent of investors look for ESG considerations, however, only 42 percent look for formal diversity and inclusion policies or initiatives. Nonetheless, emerging managers with a DE&I angle are currently hot property. Indeed, an emerging manager allocation is one of the most effective ways in which investors can meet their nascent diversity and wider impact objectives.

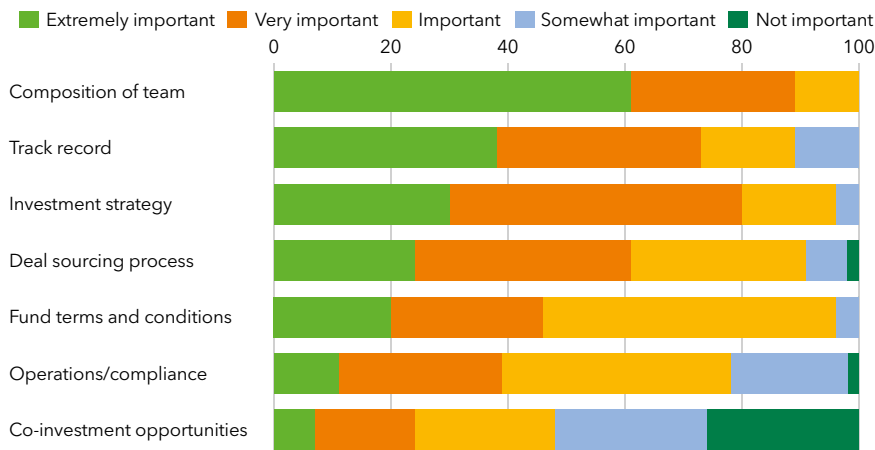
Do you look for any of the following in an emerging manager? (%)



Fundamentals are front of mind

Whoever the investor, they are sure to scrutinize every aspect of an emerging manager proposition before they are prepared to hand over a check. Track record is inevitably critical, cited by 89 percent of survey respondents as either important, very important or extremely important. But this is surpassed by deal-sourcing processes, fund terms and conditions, and team composition. LPs are likely to require multiple meetings and, in particular, will reference widely with both former portfolio company executives and LPs in previous funds. "The bar is much higher due to the greater counterparty risk," said one LP surveyed.

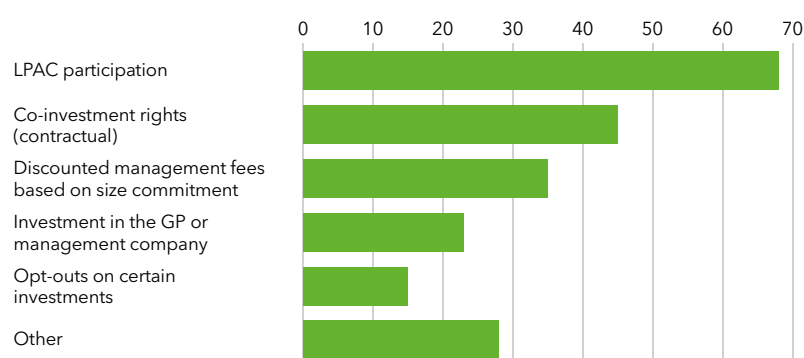
How important are the following factors when evaluating an emerging manager fund? (%)



LPs want a seat at the table

As well as conducting rigorous due diligence before investing with an emerging manager, LPs are also negotiating hard on terms. Top of the priority list is LPAC participation, but contracted co-investment rights are becoming increasingly important to potential investors, as well. Many LPs see the ability to establish preferential co-investment status before a manager becomes highly sought-after as one of the most compelling reasons for having an emerging manager program. GPs, meanwhile, covet their co-investment and are using it effectively as a powerful fundraising tool. Other terms on the table include opt-outs on certain investments, a stake in the GP or management company and discounted management fees.

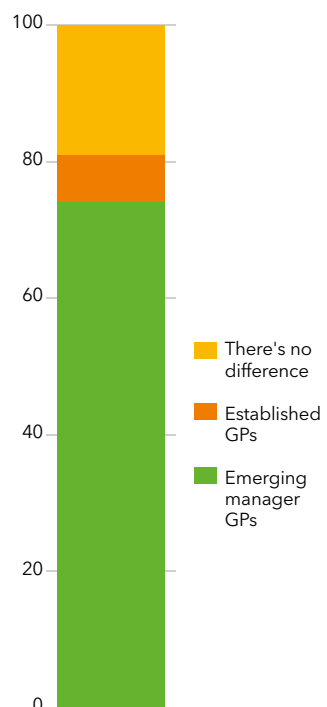
What kind of terms do you try to negotiate with emerging managers? (%)



LPs push new managers harder on fees

Almost three-quarters of emerging managers surveyed said they believe LPs negotiate harder on fees with new firms than they would with established GPs. Some of the survey's investor respondents, meanwhile, said they would even expect fees to be waived altogether if they deemed that they were adding value. Pushing too hard on economics can be counterproductive for investors, however, if the GP is left unable to hire the right talent and build out the organization effectively. "You might feel good about having negotiated preferential terms in the short term," says Reed. "But in the long run, if the GP can't be the kind of firm that you want to be invested in, then that makes you a fool."

When negotiating fees, who do you believe LPs generally negotiate harder with? (%)





New York
130 West 42nd Street
Suite 450
New York
NY 10036
T: +1 212 633 1919

London
100 Wood Street
London
EC2V 7AN
T: +44 20 7566 5444

Hong Kong
19F On Hing Building
1 On Hing Terrace Central
Hong Kong
T: +852 2153 3240

Buyouts

Published 12 times a year by
PEI Media. To find out more about PEI
Media visit thisisPEI.com

© PEI Media 2021

No statement in this magazine is to be construed as a recommendation to buy or sell securities. Neither this publication nor any part of it may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording, or by any information storage or retrieval system, without the prior permission of the publisher. Whilst every effort has been made to ensure its accuracy, the publisher and contributors accept no responsibility for the accuracy of the content in this magazine. Readers should also be aware that external contributors may represent firms that may have an interest in companies and/or their securities mentioned in their contributions herein.

Cancellation policy You can cancel your subscription at any time during the first three months of subscribing and you will receive a refund of 70 percent of the total annual subscription fee. Thereafter, no refund is available. Any cancellation request needs to be sent in writing to the subscriptions departments (subscriptionenquiries@peimedia.com) in either our London or New York offices.

Printed by Pureprint Group
pureprint.com



Editor's letter

Emerging managers are still worth the risk



Chase Collum

chase.c@peimedia.com

When the world went into lockdown at the end of Q1 2020, more than a few new managers were fearful investors would shun the risk of allocating to new GPs, but in this year's *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services, LLC, we found those fears have largely subsided. Nearly half of this year's GP participants said investor sentiment for emerging managers is strong, and that LPs are willing to back new managers with compelling products. Some 66 percent of GPs said they see the market as bifurcated, with established managers receiving the bulk of new investment capital, and that LPs are much less enthusiastic about emerging managers.

LPs seem less aware of this alleged bifurcation and more bullish about the prospect of investing with new managers. Sixty-two percent of LP respondents agreed or strongly agreed that the risk/return profile for emerging managers is attractive at the moment versus established managers, and only 13 percent disagreed. LPs firmly rejected the idea that the pandemic has made their organizations more cautious of investing in emerging managers, with only 17 percent agreeing or strongly agreeing and 51 percent in disagreement or strong disagreement on that point.

Over the past five years that we've conducted this survey, new managers have consistently reported that they believe LPs will be most impressed by their track record. LPs, on the other hand, are less worried about track record than they are team composition. This year, all respondents rated team composition as an important factor, with 89 percent rating it as either very important or extremely important.

Seeing this misalignment, we decided to dive deeper into the nuance of which attributes of emerging managers LPs find most attractive. It is clear that LPs see a great deal of value in new managers with a strong sense of purpose and a well-defined niche.

Per our results, LPs want to see a coherent strategy driven by a strong, diverse team. And they still want the outsized risk-adjusted returns emerging managers are known for.

“ LPs are willing to back new managers with compelling products ”

Chase Collum

The Gen II view A re-emergence for emerging managers is under way



Expert analysis by **Jeff Gendel**, principal

As we finished last year's emerging manager survey, the market for emerging managers ground to a virtual – and literal – halt. The pandemic meant pencils down for LPs as they performed triage on their existing commitments and attempted to assess the near- and long-term business impact from covid. Even the best-intentioned, most-dedicated LPs were delaying commitments to emerging managers, and many in the market couldn't see any light at the end of the tunnel.

Fortunately, the ground stop for new commitments didn't last too long. As we moved through the fourth quarter and into 2021, LPs figured out how to make commitments over Zoom, how to overcome the lack of a traditional

“Over 80 percent of respondents cited ‘proven expertise and experience with funds like mine’ as an ‘extremely important’ or ‘very important’ factor in choosing service providers”

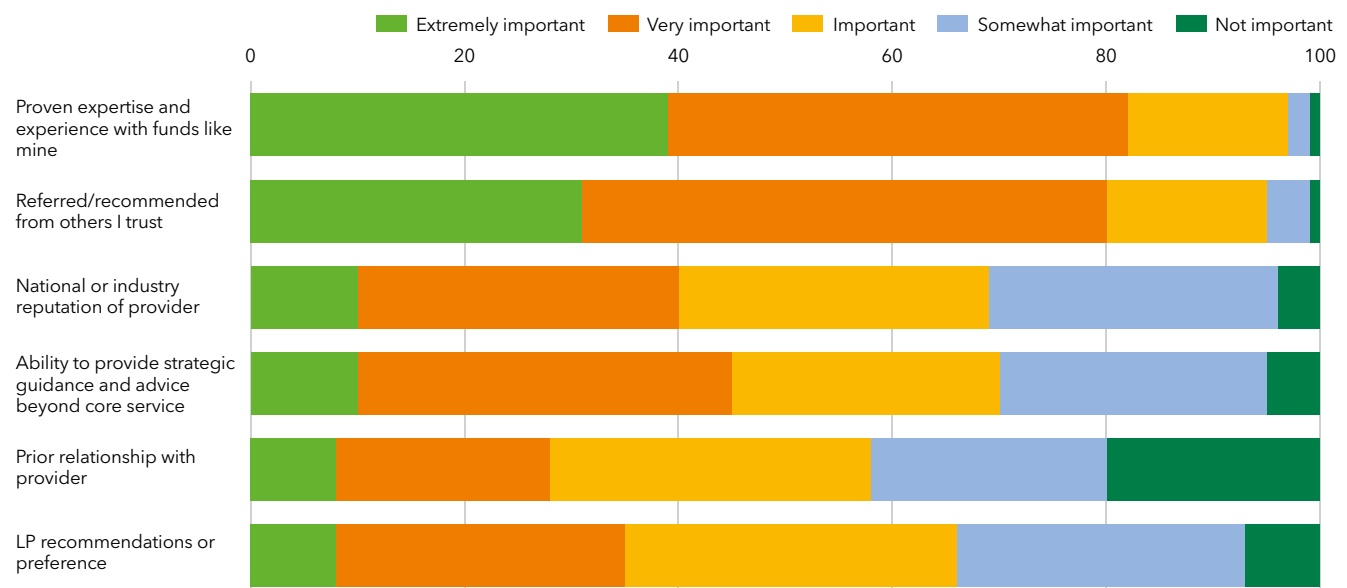
in-person meeting and assessment of face-to-face team chemistry. GPs became better at telling their stories, and of course, the bounce back in valuations confirmed that most sectors of the economy would not be as adversely impacted by the pandemic as once thought.

As we look toward the balance of 2021 and into 2022, the emerging manager market is poised to eclipse its pre-pandemic levels of new firm creation. Indeed, at Gen II, we have seen more emerging manager opportunities this year than at any time since we began to track this segment, including a record number of first-time funds seeking more than \$1 billion in capital.

Operations deep dive

What has been in sharper focus for our emerging manager prospects is the depth of due diligence they perform on fund administrators and service providers across the spectrum. Many of these due diligence questions reflect a far deeper understanding of the drivers of success from an operational perspective, and a broader set of imperatives from the GP and LP view. And as the 2021 Emerging Manager

How important are the following factors in choosing service providers? (%)





Survey shows, over 80 percent of respondents cited “proven expertise and experience with funds like mine” as an “extremely important” or “very important” factor in choosing service providers. By comparison, less than a third of respondents cited “a prior relationship with the provider” as a crucial factor in that decision.

The questions posed by emerging managers and their LPs across many disciplines of the sponsor/administrator relationship include: Can the administrator demonstrate scalable solutions as sponsors raise more capital? Are they regularly investing in technology to meet the enhanced reporting needs of investors and internal stakeholders? Have they instilled a corporate culture that ensures long-term stability across the service team and firm? Do they provide specifics on the team that services the engagement – is it a dedicated team, or will the sponsor need to call separate departments for separate tasks? What access to fund information can the sponsor have in an on-demand fashion? And how is the fund administrator ensuring data protection and defense against cyber threats?

GPs want a service partner with a long-term view, where the

“GPs want a service partner with a long-term view, where the administrator’s investment back into their organization yields tangible results for their clients”

administrator’s investment back into their organization yields tangible results for their clients. Or, simply stated: can my fund administrator be my partner for the lifetime of our firm?

Demonstrating the value proposition

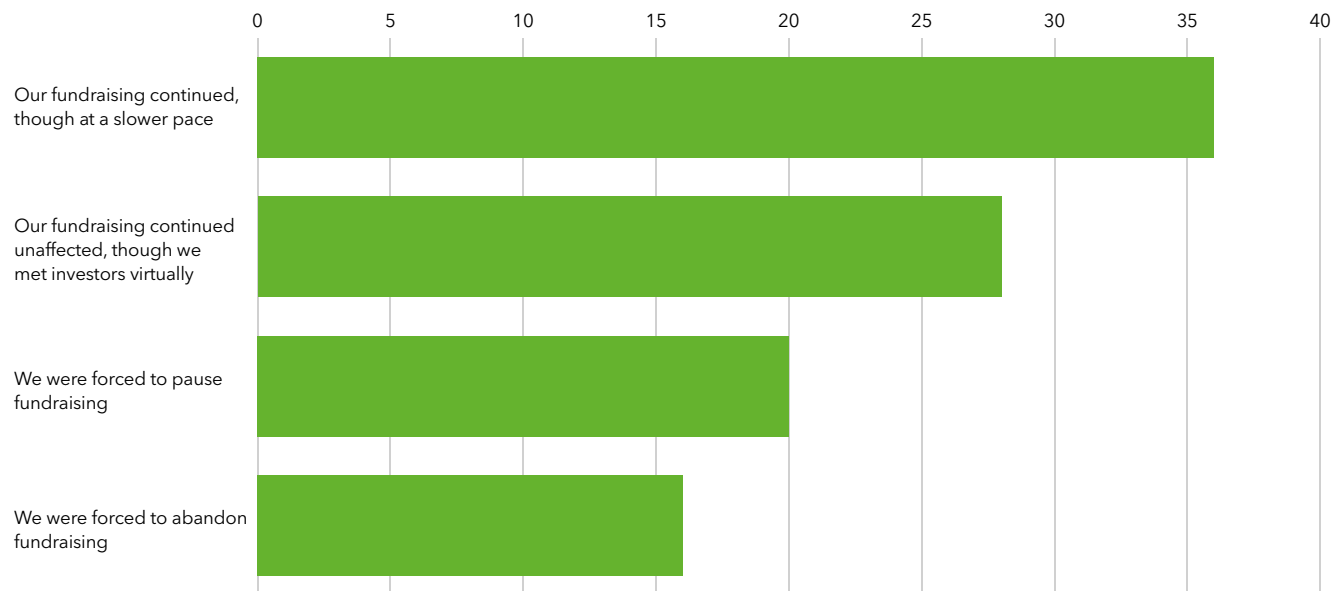
At Gen II, we offer our value proposition to emerging managers through a keen understanding of these drivers, and through our unmatched experience and unparalleled track record. Working with more than 85 sponsors as they have embarked upon their first fund –

more than any other administrator – the industry’s leading emerging managers and their investors rely on us to provide world-class service and performance.

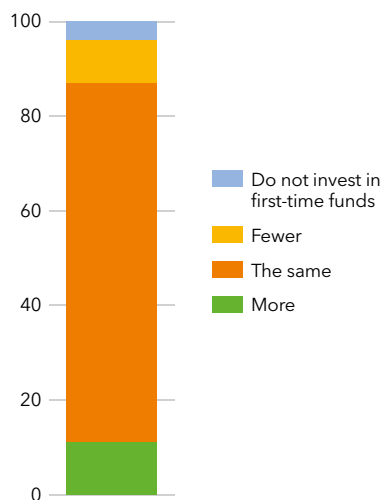
Expert people lie at the core of any service relationship – Gen II’s team of more than 750 professionals is the most experienced team in private equity fund administration. Our investment in people through the Gen II Learning Academy ensures that we continue to develop world-class fund administration professionals to service our clients as they grow.

Next-generation technology plays an increasingly important role in the fund administration process for emerging managers. Today’s first-time fund sponsors strive to offer the same access to investment and performance information as they likely had in their predecessor firms. Whether that data request comes from the IR team, deal team or corner office, emerging managers need confidence that satisfying information requests is only a few clicks away. For our part, we have developed cutting-edge technology to enable IR teams and CFOs to break the traditional one fund to one investor reporting protocol and enhance the IR dialogue by providing bespoke

What impact has the pandemic had on fundraising? (%)



Do you plan to make more or fewer commitments to first-time funds compared with the previous 12 months? (%)



performance information across fund entities, investment types and LP relationships. Investors are also seeking greater transparency on portfolio company activity. Gen II's technology investments enable sponsors to access integrated portfolio company, ESG and performance reporting data that today's investors seek.

“The emerging manager market is poised to eclipse its pre-pandemic levels of new firm creation”

Scalability, performance and experience truly matter

Given the increased complexity of fund structures, escalating stakeholder expectations and complex regulatory requirements, it is vital that emerging managers team up with a provider that can demonstrate relevant and specialized experience, a commitment to technology investment, team continuity and growth, and the ability to scale with clients. And, of course, seamless, proven performance in today's hybrid work environment is crucial.

Gen II has helped launch more than 85 emerging managers. We have worked with them to build a strong foundation for success, with proven ability to help them scale as they add

new funds, investments and investors. The private equity entrepreneurs we work with value the confidence our experience imparts, and they can trust their funds will be well run. Our clients know they can rely on us as a true partner able to offer independent and valuable guidance over and above the fund administration services we provide. Our partnership approach to business relationships is an essential differentiator that resonates for the emerging managers on Gen II's platform.

For the end of 2021 and beyond, marketplace data reflects that the emerging manager market appears poised to continue its blazing path – with record investor interest, larger dedicated pools of investor capital for emerging managers, more family offices, and professional investors seeding first-time funds. A highly qualified set of professional service firms – fund administrators, auditors, compliance consultants and attorneys – with deep experience supporting first-time funds will continue to be a vital component of the emerging manager's journey. ■

Emerging Manager Survey

The enduring appeal of emerging managers

Page 10

Finding a niche

Page 14

Fundraising in a pandemic

Page 18

Walking a fine line: What LPs want

Page 23

Respondent profile

Page 38

Methodology

Page 40

**Source for all data: Buyouts Emerging Manager Survey,
conducted in partnership with Gen II Fund Services, LLC**

Appetite for risk-taking automatically diminishes in a crisis. Add in ongoing restrictions for international travel and in-person meetings, and it is unsurprising, then, that the fundraising market for emerging managers appears markedly more challenging than for established firms.

Indeed, almost two-thirds of emerging manager GPs surveyed in the fifth annual *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, either agree or strongly agree that the market is bifurcated, with established managers getting the bulk of the capital, while LPs display far less enthusiasm for younger houses.

“Large, institutional LPs have little appetite for emerging managers with challenges of scale, risk appetite, staff bandwidth and process challenges,” says Lindel Eakman, partner at Foundry Group. “Many LPs may have one or two emerging managers in their portfolios, where they had an existing relationship with the GP in their previous firm, but few have dedicated programs. Covid has reduced the risk profile even further, pointing investors toward their existing relationships. LPs do now seem ready to engage, and travel, but the Delta variant means, once again, they are having to press pause.”

Despite this risk aversion, emerging managers remain an important component of many investors’ private equity strategies. More than 60 percent of LPs surveyed agree or strongly agree that the risk/return profile for emerging managers is attractive compared with that for established firms.

“Emerging managers may be hungrier and work harder than more established managers that have raised multiple funds and garnered years’ worth of management fees and carry,” says Molly LeStage, managing principal and private market consultant at Meketa Investment Group.

“The advantage of having an emerging manager program is that you can tap into what has historically been a category that

generates extremely compelling returns,” adds Scott Reed, co-head of private equity in the US at Aberdeen Standard Investments. “There is a very interesting dynamic at play when you have experienced and talented investors stepping out on their own. That first handful of deals has to be good, or the firm’s very existence will be called into question. Their feet are

“There is a very interesting dynamic at play when you have experienced and talented investors stepping out on their own”

SCOTT REED
Aberdeen Standard Investments

The enduring appeal of emerging managers

The pandemic raised the bar for emerging managers, but the potential to generate outsized returns means appetite remains strong for those with compelling propositions

held to the fire. That leads to arguably the best alignment of interest you can get.”

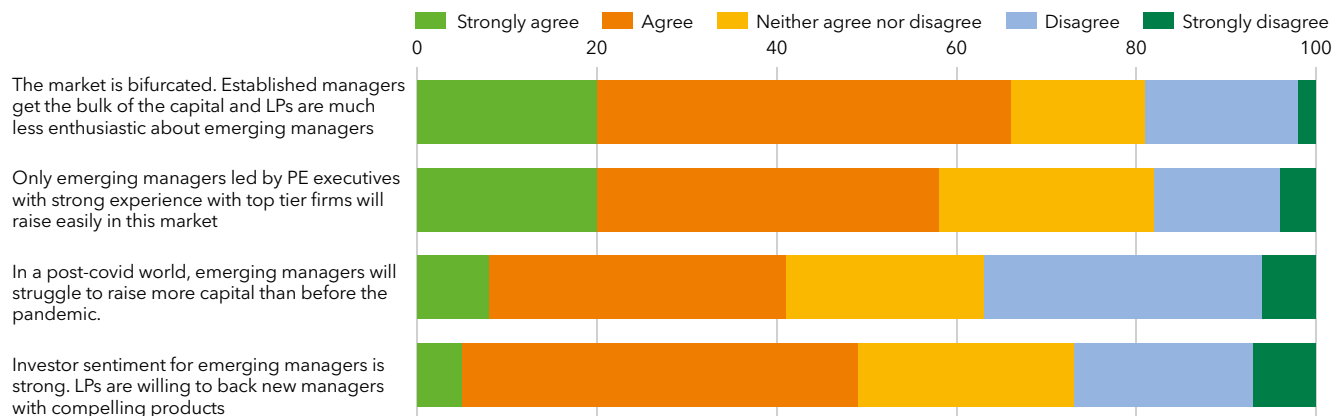
Enhanced due diligence

Nonetheless, LP due diligence on emerging managers is extensive, and has historically relied heavily on in-person contact. That is why the covid crisis has proved so challenging. Investors need to dig deep into every aspect of a new relationship in order to mitigate the inherent risk.

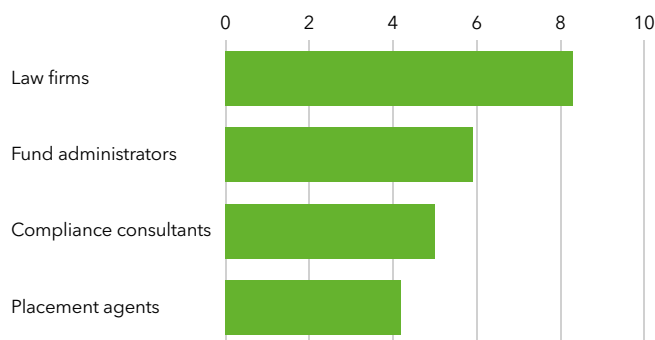
“The bar is much higher due to the greater counterparty risk,” said one of the LPs surveyed. Another cited more robust walk-throughs of case studies and processes around sourcing and value creation as some of the key differences between emerging manager due diligence and that of more established firms. Other examples included analysis of the interpersonal history of the founders, and detailed track record attribution. Emphasis on extensive referencing was clear.

“In the vast majority of cases, emerging managers don’t have attributed track records from prior firms, so you need to piece it all together,” Reed explains. “That means talking to CEOs, CFOs and

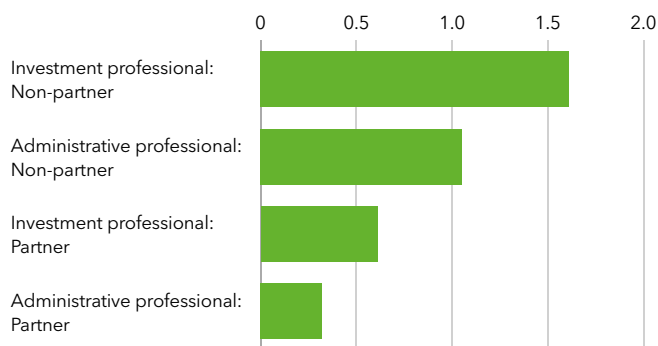
How do you perceive market sentiment around emerging managers right now? (%)



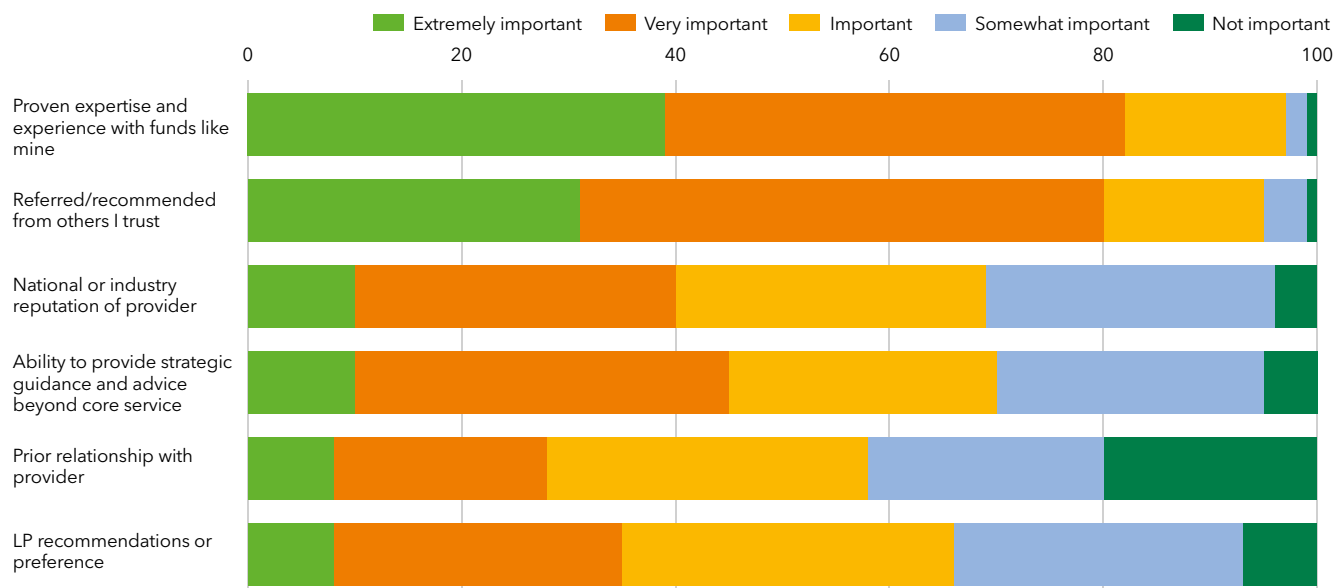
On average, how many months in advance of the first closing did you engage with (or do you anticipate engaging with) the following professional services firms (%):



How many staff do you plan to add at the following levels and roles? (%)

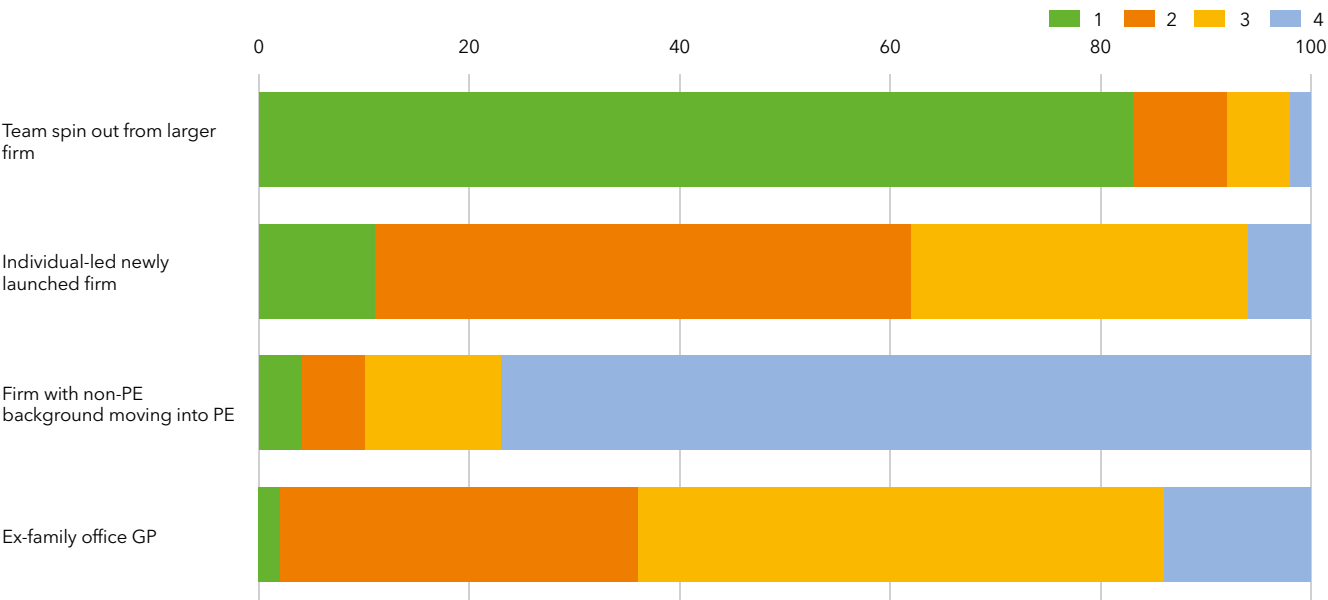


How important are the following factors in choosing service providers? (%)

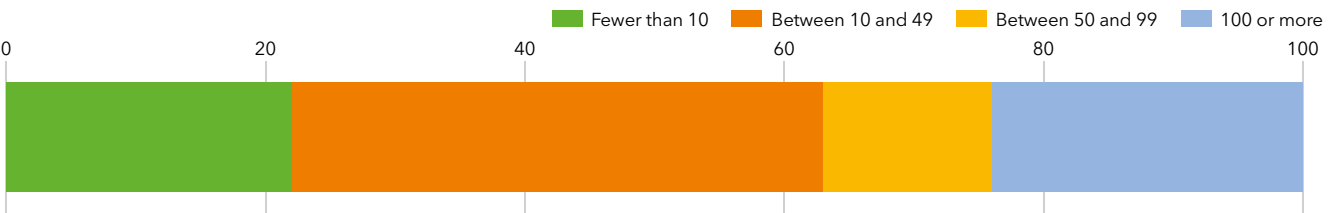


LPs weigh in

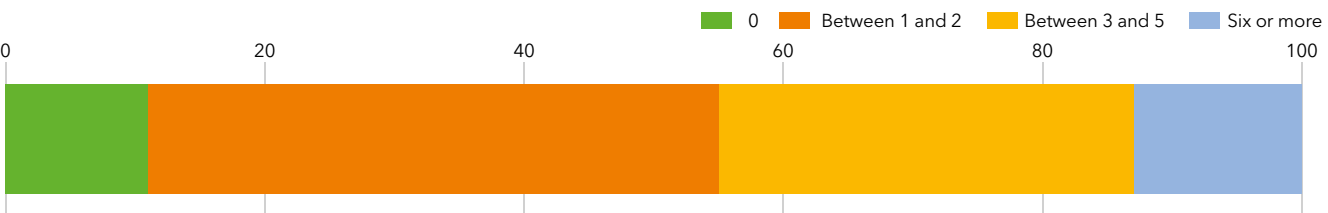
How likely you are to invest in the following types of emerging managers? (1 most likely, 4 least likely, %)



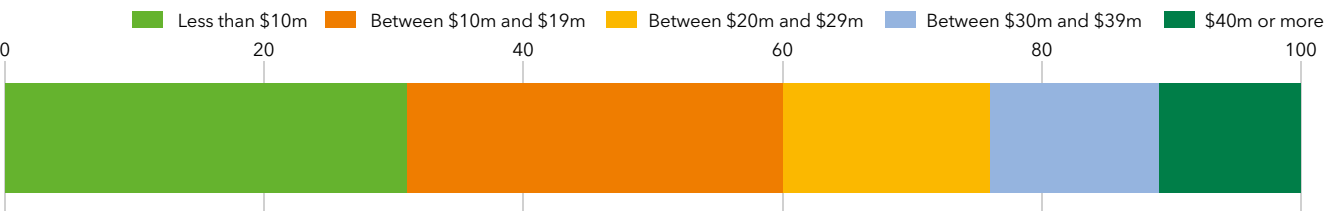
How many emerging managers do you meet with per year? (%)



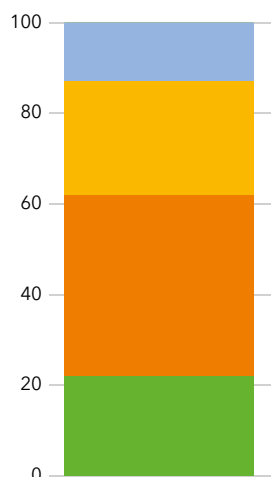
How many emerging manager funds do you anticipate backing over the next year? (%)



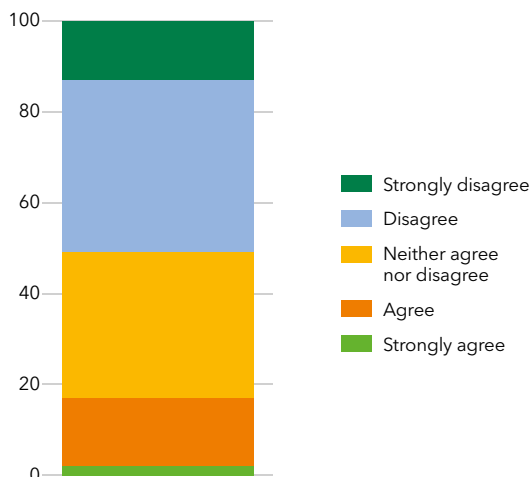
What is a typical commitment size you will make to an emerging manager fund? (%)



"The risk/return profile for emerging managers is attractive at the moment versus established managers" (%)



"The pandemic has made my organization more cautious of investing in emerging managers" (%)



"Emerging managers may be hungrier and work harder than more established managers"

MOLLY LESTAGE
Meketa Investment Group

lenders, LPs in previous funds – anyone who can validate what they are telling you. There is a lot of heavy lifting involved."

Power of differentiation

Given the extra resources required for an LP to get comfortable with an emerging manager, the new manager must offer something differentiated and persuasive. Almost half of GP respondents believe LPs are willing to back new managers as long as they have a compelling product. Track record also remains key. Nearly 60

percent of GP respondents say they agree or strongly agree that only new managers with strong experience with top-tier firms will raise easily in this market.

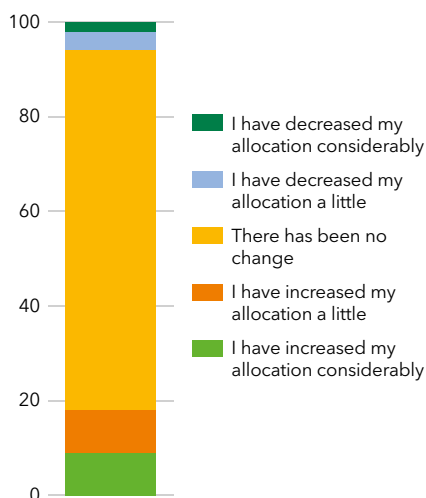
Team spinouts from established firms remain the most popular form of emerging manager among LPs. In fact, 83 percent of LP respondents cited this as their favored option. Individually-led new firms were also considered appealing; less so, those launched by former family office professionals. Firms entering PE from other backgrounds were widely dismissed and deemed unattractive by more than three-quarters of LPs surveyed.

"Each category has its own positives," says Rick Spencer, co-head of Barings' funds and co-investment platform. "Spin-outs are associated with full engagement and total alignment with LPs but [there are also] potential resource limitations, questions around fundraising success, more significant key person risks and an operational buildout that requires significant conviction around the investment team, its future and the strategy. The value to LPs, however, is pronounced. It allows for a more influential voice with the GP, longer term partnership possibilities, economic advantages in the fee structure and strategic value through co-investment.

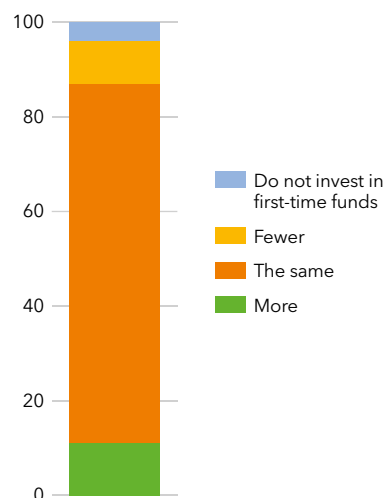
"Development within a platform, meanwhile, can mitigate the operational issues. The GP can focus on its investment activity without the distraction of the operational requirements. The downside, however, is shared economics with the existing platform, potential conflicts in investment allocations and control questions around the personnel, investment committees and strategy."

"Every LP has its own biases and preferences," adds Reed. "We certainly look at new spin-outs favorably. Where a team with a documented history of working together has separated from a prior institution, those stories tend to be easier to digest. We have also backed individuals stepping away from firms. However, we are less interested in those with no principal investing experience who are just hanging out a shingle." ■

How have recent market gyrations (to multiples, valuations) caused a change in your allocation to emerging managers? (%)



Do you plan to make more or fewer commitments to first-time funds compared with the previous 12 months? (%)



Finding a niche

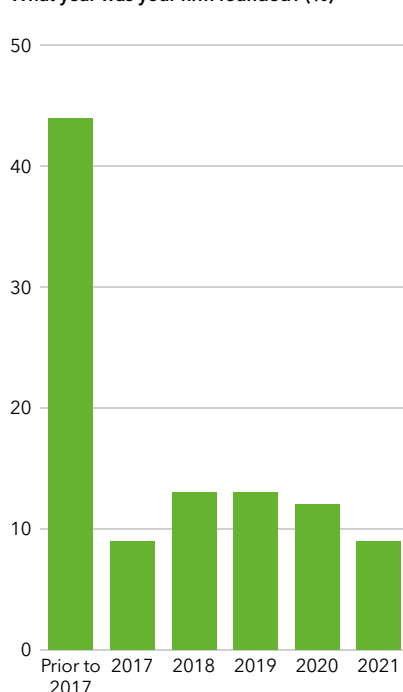
Emerging managers must offer something compellingly different if they are going to attract investors' attention and stand out from the crowd

The term 'emerging manager' is nebulous, and interpretations of what it means differ depending on the LP. Firms are typically deemed to be on their first or second fund. They will typically be five years old or younger. There are also connotations around size and a degree of specialization. But beyond that, the parameters are wide.

At Neuberger Berman's emerging manager platform, Northbound Equity Partners, the term spans everything from newer and smaller funds to diverse teams, as well as independent organizations and new strategies within larger houses, according to Patricia Miller Zollar, a managing director at the firm. How a new manager positions itself with LPs in a crowded space is therefore critical.

So, what is it that LPs are looking for? Sector specialization is flavor of the day and indeed, 71 percent of emerging

What year was your firm founded? (%)



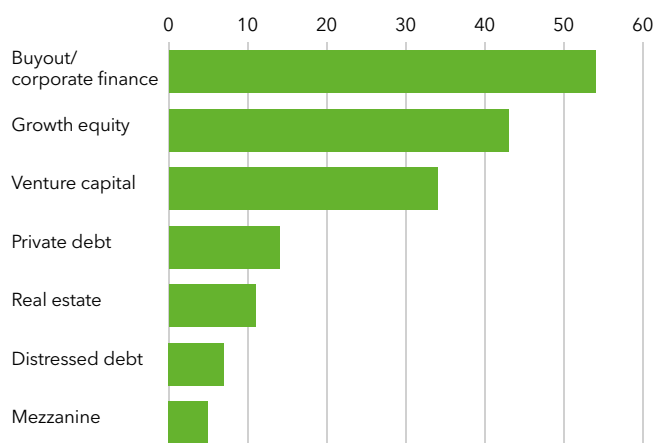
managers canvassed in the fifth annual *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, described themselves as specialists, with 35 percent targeting a single sector.

"A lot of newer firms are sector orientated," says Scott Reed, co-head of private equity in the US at Aberdeen Standard. "In particular, there has been no shortage of technology and healthcare funds in recent years."

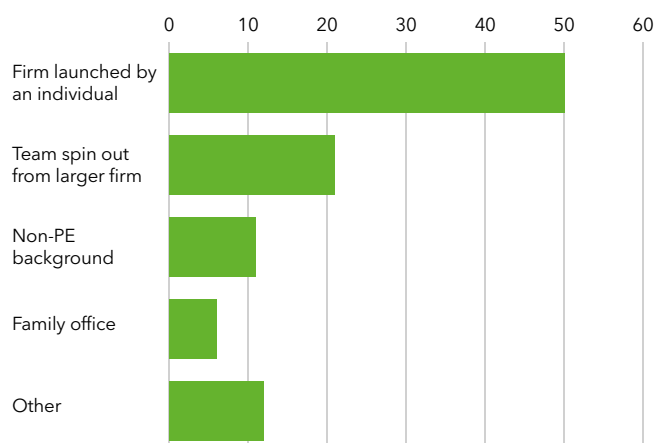
The degree of specialization is only increasing. Recent success stories include Arctos Sports Partners, a platform dedicated to the professional sports industry and sports franchise owners.

Funds with impact – and especially those with diversity, equity and inclusion angles – are also in high demand. "The events of the past year have caused diversity and inclusion to be at the forefront of a lot of investors' minds," Miller Zollar

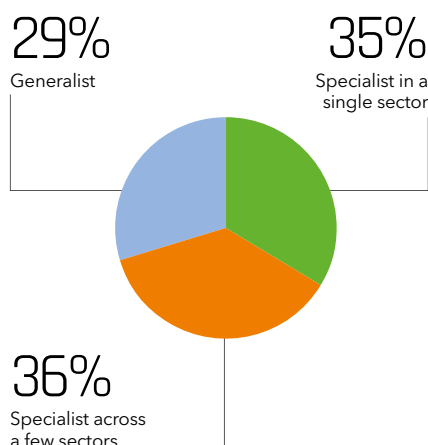
What kind of investment strategy does your firm pursue? (Multiple responses allowed, %)



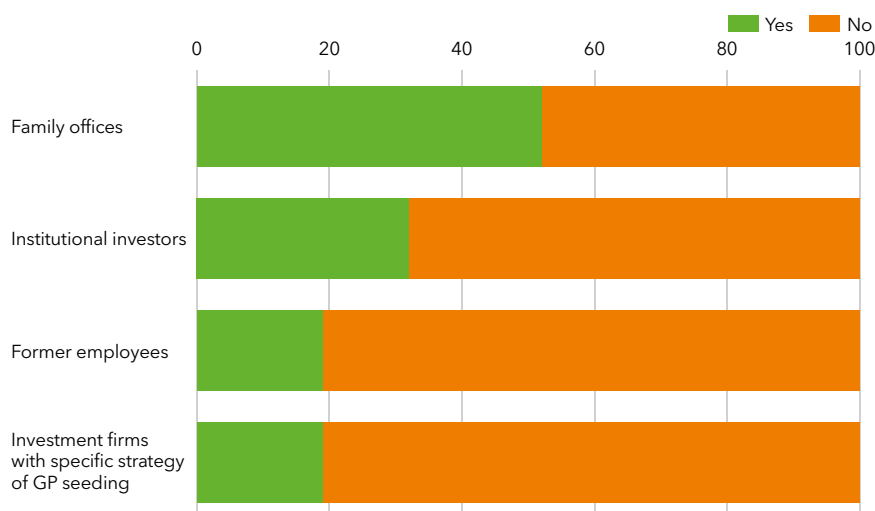
What is your firm's heritage? (%)



Would you consider your firm to be a...



Has your firm utilized seed funding from the following sources? (%)



explains. “An increasing number of LPs are asking how they can support DE&I efforts through their investments – which is, in turn, driving increased interest in the emerging manager space.”

“LPs are looking to emerging managers to fulfil their mission- and impact-driven allocations,” adds John McCormick, partner at Monument Group. “In particular, the diversity and inclusion movement is giving minority-owned managers a lot of due attention, so long as they have the requisite investment capabilities, of course.”

Corlex Capital, for example, is a minority-owned PE firm that provides

“The events of the past year have caused diversity and inclusion to be at the forefront of a lot of investors’ minds”

PATRICIA MILLER ZOLLAR
Neuberger Berman

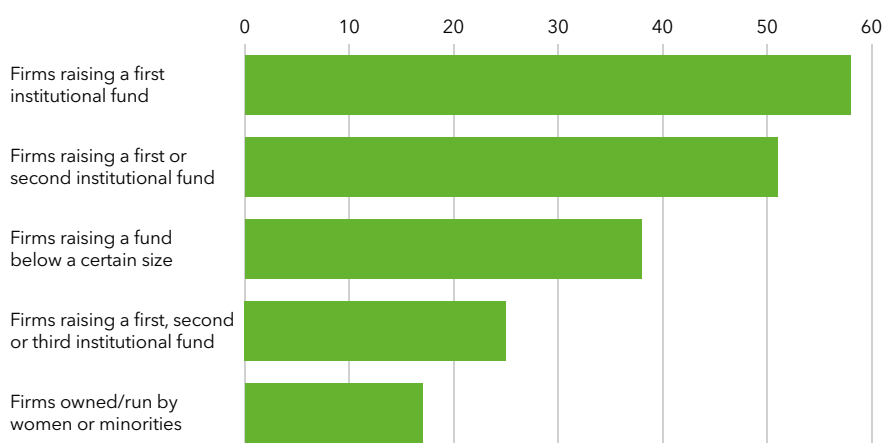
growth capital in the franchising industry.

Molly LeStage, managing principal and private markets consultant at Meketa Investment Group, agrees that a DE&I angle is helpful. “Key differentiators for emerging managers that are proving to be successful include ownership structure and, specifically, diverse ownership,” she says. “If a manager is focused on under-represented groups, is a sector specialist or is led by individuals with unique backgrounds, that also plays well.”

In a congested marketplace, what matters is that a new manager has something compelling to set it apart. That could mean proprietary access to micro or lower mid-market businesses, according to Rick Spencer, co-head of Barings’ funds and co-investments platform. Or it could be an exceptional operating partner network like that of Argand Partners, which has set out its stall as the go-to globalization partner for mid-market industrial companies.

“We see emerging managers stand out for their differentiated networks and niche investment strategies,” Miller Zollar says. “Emerging managers will often focus on less competitive and attractively priced transactions. The use of leverage may be conservative and there may be strong alignment of interest. We see emerging and diverse managers going where others are not.” ■

How do you define the term ‘emerging manager’ when it comes to PE/VC?
(Multiple responses allowed, %)





Gen II

HEADQUARTERS

805 Third Avenue
24th Floor
New York, NY 10022
212-408-0550
www.gen2fund.com

YEAR FOUNDED

2009

KEY PERSONNEL

Steven Millner

*Co-founder &
Managing Principal*

Norman Leben

*Co-founder &
Managing Principal*

Steven Alecia

*Co-founder &
Chief Client Officer*

Jeff Gendel

*Principal, Business
Development*
jgendel@gen2fund.com

COMPANY OVERVIEW

Gen II Fund Services, LLC is the largest independent, U.S. based, private equity fund administrator, administering over \$600B+ of private capital. The Gen II team is the longest-tenured, most experienced team in the fund administration industry. Our senior management team has more than 25 years of experience and are recognized as leaders in private equity fund administration. Our dedicated client service teams, led by a Principal with an average of 15 years of fund administration experience, provide our clients with world class service and expert guidance.

GenII | Well-run funds.

Administering
600B+
Private Fund Capital

99%
Client Retention

25+YRS
Fund Administration
Experience

Reporting to
50,000+
Investors for Our Clients

Helped launch
90+
Emerging Managers &
Spin-out Groups

Servicing
6,000+
Fund Entities

More emerging managers choose Gen II than any other administrator.

source: @preqin

Gen II is the 2nd largest private equity fund administrator in the United States.

source:  CONVERGENCE
OPTIMAL PERFORMANCE

Boston | Dallas | Denver | New York

San Francisco | Stamford | Luxembourg



Getting a new private equity firm off the ground is no mean feat. Fundraising can be protracted, and is invariably hard work.

An international pandemic has not helped.

“Covid has made fundraising for emerging managers – never an easy assignment – even more difficult,” says Rick Spencer, co-head of Barings’ funds and co-investment platform. “The statistics around the number [of firms raising funds] and amount of capital raised by emerging managers in 2020 was significantly lower than in years past, as investors have been inclined to continue investing with managers they know.

“Meanwhile, the inability to meet managers in person, the needs of the existing portfolio and the general acceleration of the fundraising cycle have made it difficult to get time and attention from investors.”

That is because, traditionally, an emerging manager fundraising would involve some serious clocking up of airmiles. And although the pandemic has lessened the travel burden, LPs still crave as much interaction with new managers as possible.

Close to 40 percent of the respondents in the fifth annual *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, met with upward of 150 limited partners prior to closing. For the investors that did ultimately make commitments, multiple meetings and – due to the pandemic – conference calls were required.

More than three-quarters of respondents experienced in excess of three separate interrogations with individual LPs. For more than a quarter of respondents, this figure rose to over five.

Time pressure

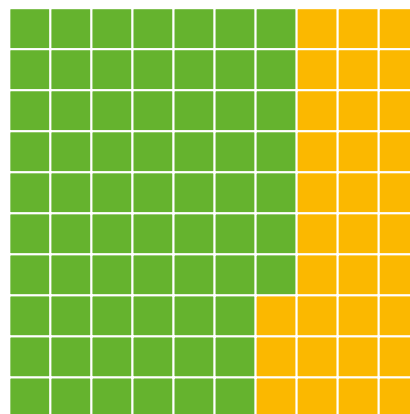
Fundraising is time-consuming and, even in a virtual environment, time pressure was cited as one of the most significant factors that emerging managers face. “Time was undoubtedly one of the biggest challenges,” one respondent claimed.

Fundraising in a pandemic

Ongoing travel restrictions combined with a wave of early re-ups mean emerging manager fundraising is as challenging as ever

Are you currently fundraising?

Yes
67%



No
33%

“Data request fulfilment, time demands and managing internal expectations were the biggest headaches,” said another. A third noted that “juggling LP meetings with running and investing a fund was particularly hard.”

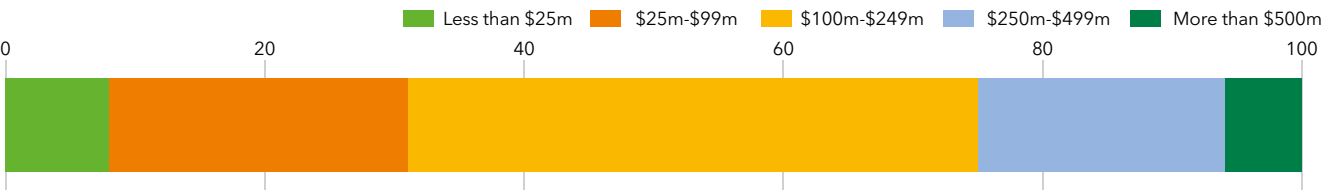
And time constraints appear to go both ways. Overstretched LPs also lack the bandwidth to take on the additional work that emerging manager investment entails.

“LPs are currently overwhelmed by a backlog of funds coming to market,

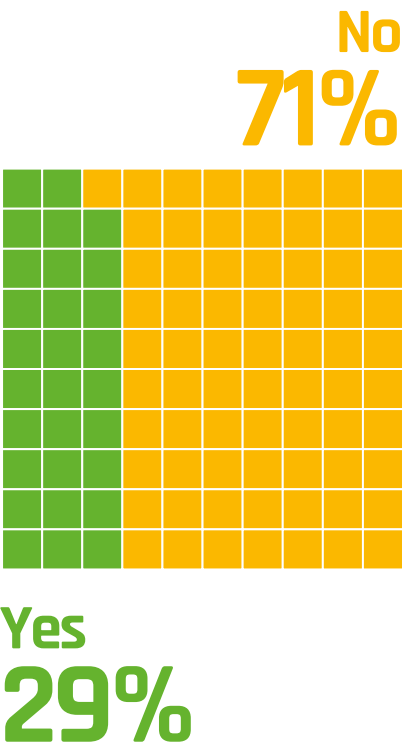
including those high-quality VCs that have generated outstanding returns and are taking priority with investors, given their tight timelines,” says Monument Group partner John McCormick. “It takes time to diligence emerging managers and time is something that is currently in short supply.”

Other challenges cited by emerging managers include getting investors comfortable with partial track records and the ability to properly identify and interact with potential LPs during a pandemic.

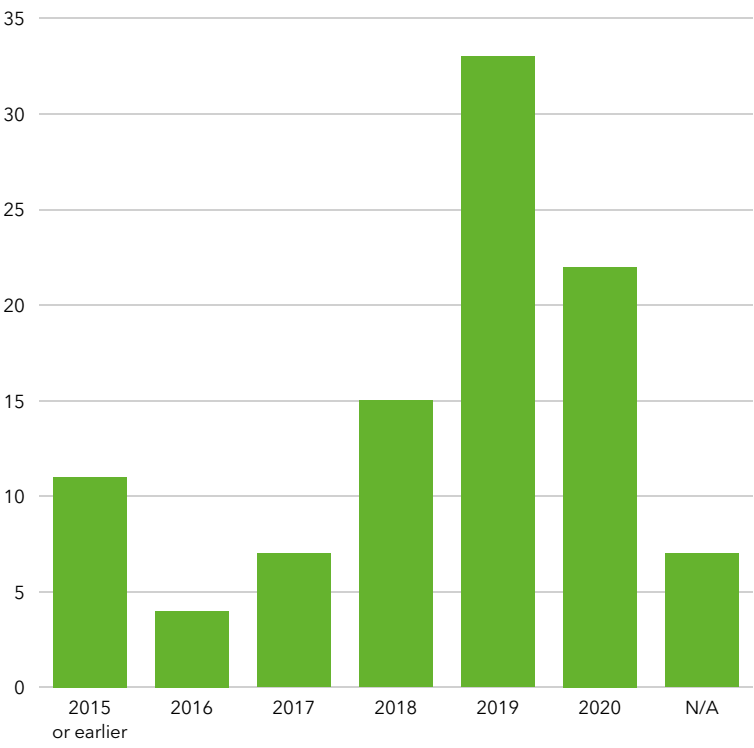
What is the target of the fund you're currently raising? (%)



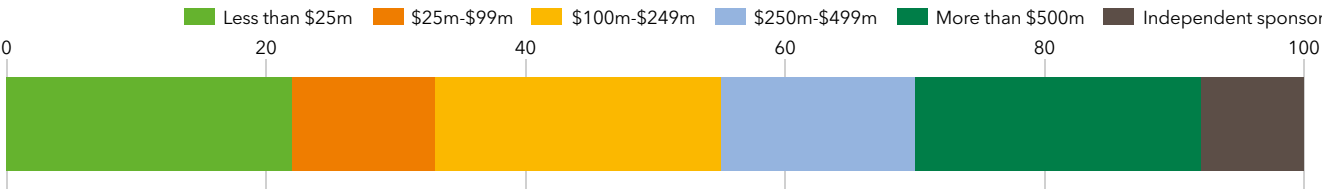
Are you using a placement agent?



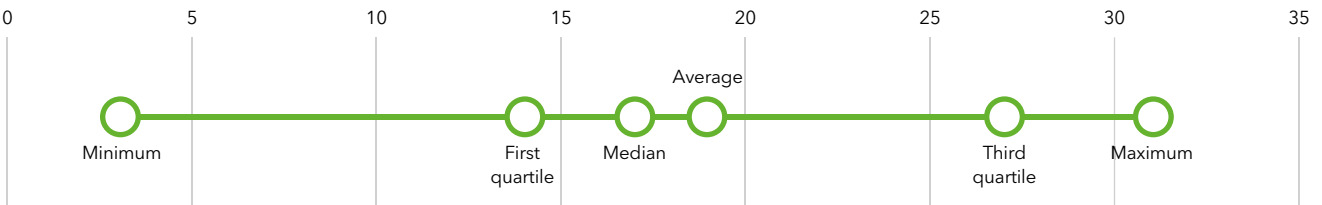
What year did you launch marketing for the fund? (%)



What is the size of your most recently closed fund? (%)



Time taken to raise the most recent fund (months)



Elsewhere, GP respondents simply cited an engrained bias against emerging managers as the most profound challenge in this segment of the market. “LPs will take a meeting but overcoming the inertia and the predisposition to say no can be hard,” one GP respondent noted.

“Fundraising for emerging managers remains challenging,” agrees Derek Schmidt, director of private equity at Marquette Associates. “There are already so many high-quality funds raising capital, as well as new strategies, that getting in front of institutional investors is difficult. Very few strategies are truly differentiated at this point. It takes an investor to believe in a team, which often requires a personal connection. And that often only comes from an in-person meeting.”

“During covid, some investors were more inclined to support existing relationships versus forming new ones,” adds Alli Wallace Stone, managing principal and consultant at Meketa Investment Group. “Zoom may have increased the number of introductory meetings for some emerging managers, but it is unclear how many of those converted to full diligence and commitments.”

“Fundraising timelines elongated for less established managers and some investors were not comfortable conducting virtual due diligence with managers they had not supported previously. Given the long-term nature of private equity funds of 10-15 years, investors want to make sure that they are comfortable with all aspects of the opportunity.”

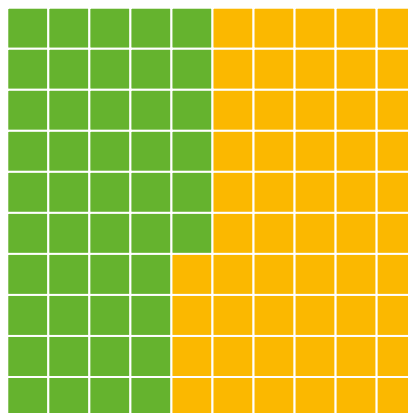
Abandoned fundraising

Indeed, 16 percent of respondents said they had been forced to abandon fundraising as a result of the covid crisis, while another 20 percent said they had been forced to press pause. Only 28 percent claimed that fundraising had been unaffected, bar the need to meet virtually. The largest contingent, at 36 percent, said fundraising had continued, albeit at a slower pace.

Meanwhile, non-institutional investors, such as family offices and wealthy

Did you use a placement agent for your most recent fund close?

Yes
46%

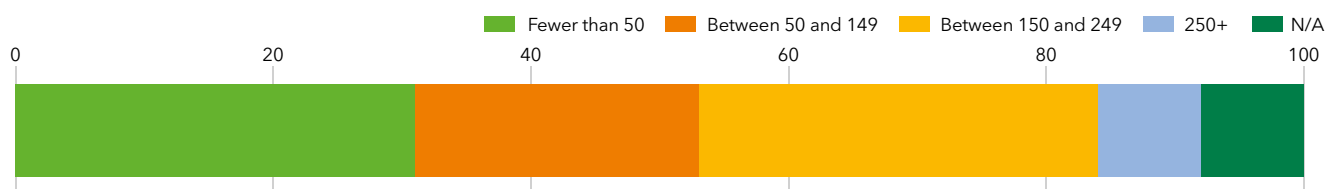


No
54%

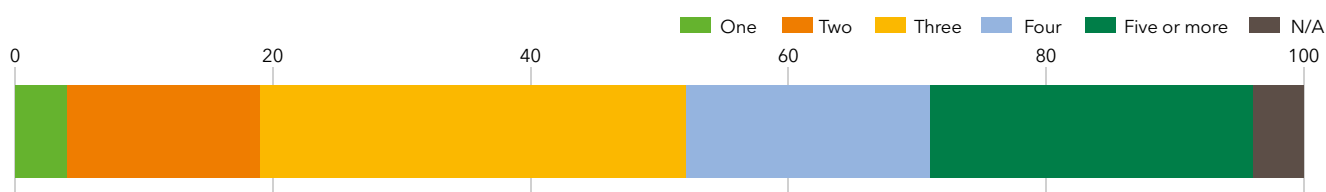
*“Covid has made fundraising
for emerging managers
— never an easy assignment —
even more difficult”*

RICK SPENCER
Barings

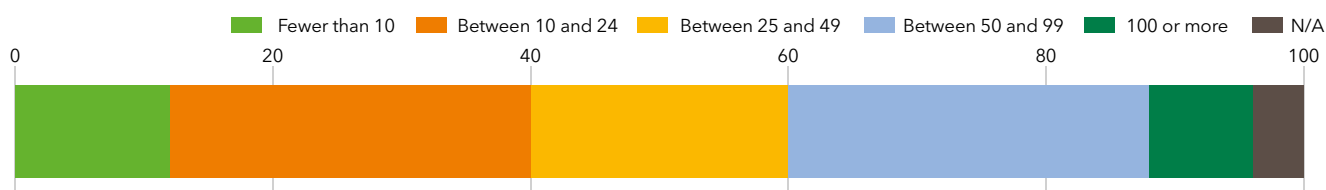
How many prospective investors did you meet with? (%)



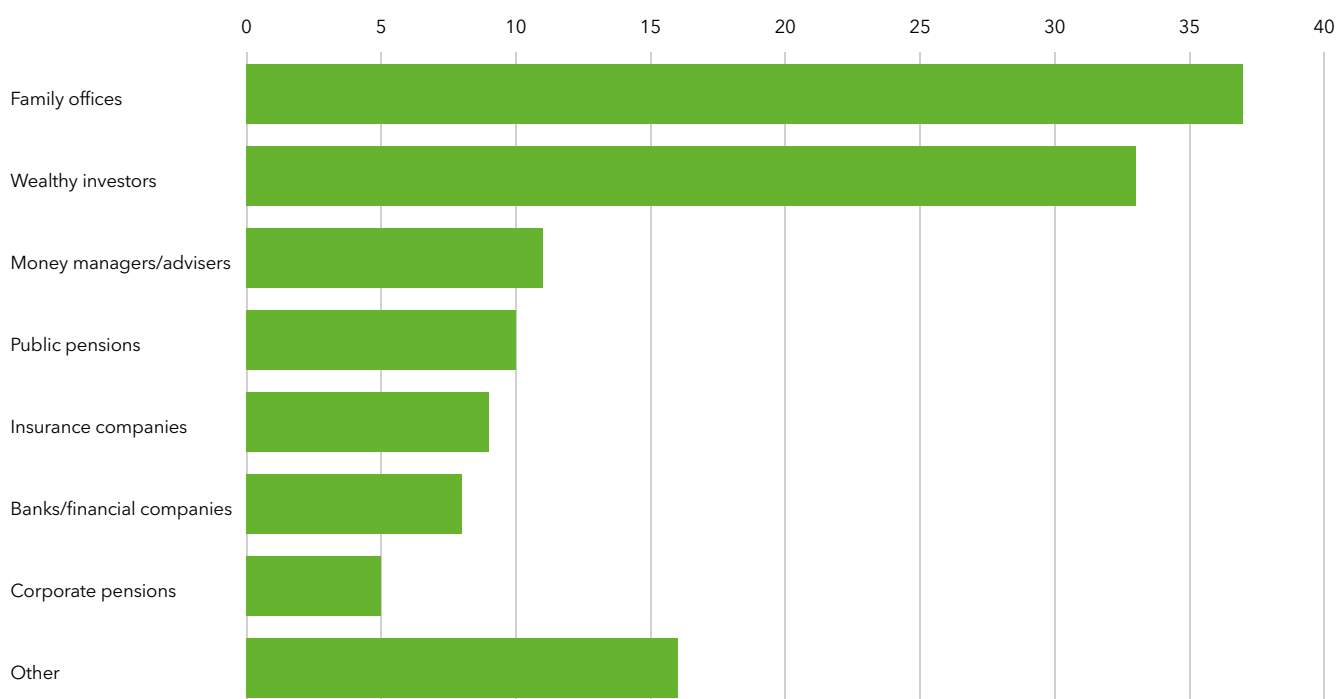
For investors who committed, how many meetings (including conference calls) did you have with them on average? (%)



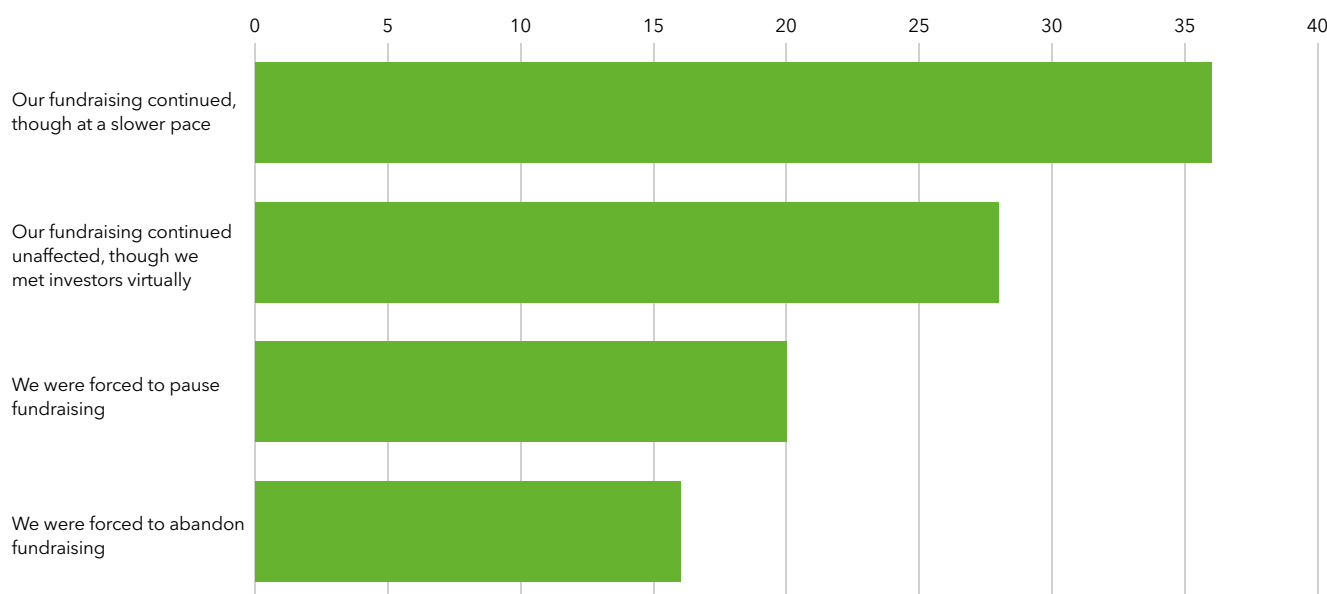
How many limited partners do you have in your most recent fund? (%)



On average, what proportion of capital came from the following sources? (%)



What impact has the pandemic had on fundraising? (%)



individuals, continue to be the most fruitful for emerging managers raising funds, and by some distance. “Family offices have a willingness and ability to get their heads around managers that don’t necessarily check every single box,” says McCormick. “Many may have been doing direct deals for some time already, so they tend to be more comfortable with newer managers than more rigid programs.”

However, McCormick adds that there are a growing number of endowments and foundations with active emerging manager strategies.

“Selectively, we see these foundations and endowments revamping their programs,” he says.

“There are a number of them out there that are willing to spend time on emerging managers as they seek to re-set their portfolio of relationships.”

“We typically find that our public fund and endowment and foundation client base has the greatest appetite for emerging managers,” adds Wallace Stone. “Many of them have explicit goals with respect to supporting emerging and diverse-owned asset managers. In addition, many of them have staff dedicated to these initiatives.”

“Fundraising timelines elongated for less established managers”

ALLI WALLACE STONE
Meketa Investment Group

Meanwhile, Spencer believes the potential pool for investors is wider still.

“Family offices, high-net-worth individuals and insurance companies with an alpha orientation are the most likely to back an emerging manager,” he says. “Private and public pensions also use emerging manager programs as an incubator for future manager additions to their core programs.”

There is no doubt that emerging managers continue to play a key role in the private equity strategies of a range of different investors. And with good reasons.

“The emerging manager space is less penetrated, which offers greater potential for attractive returns,” says Patricia Miller Zollar, head of Northbound Equity Partners, Neuberger Berman’s specialist emerging manager business.

“They can act as feeder relationships for future core positions and may serve as a complement and diversified source of return to a traditional private equity program. Emerging managers are also more likely to have a niche and specialized investment focus and there can be additional benefits in the form of access to smaller companies, often with more attractive valuations and with less leverage.” ■

Walking a fine line

LPs in emerging manager funds tend to push hard on terms but conceding too much can ultimately spell disaster

An overwhelming 93 percent of limited partners surveyed in the fifth annual *Buyouts Emerging Manager Survey* conducted in partnership with Gen II Fund Services, LLC, said they would be prepared to back a first-time fund, up slightly from 89 percent last year. Meanwhile, close to a third have a formal emerging manager allocation.

Anecdotally, one of the primary reasons why investors decide to get serious about emerging managers is that it allows them to achieve preferential status with the stars of tomorrow, particularly when it comes to accessing co-investment.

Indeed, almost half of investors

surveyed said co-investment opportunities were an important factor when evaluating such a proposition and 61 percent described themselves as being active co-investors with emerging managers. In fact, almost 40 percent expect to complete three or more of these co-investments over the course of the next year.

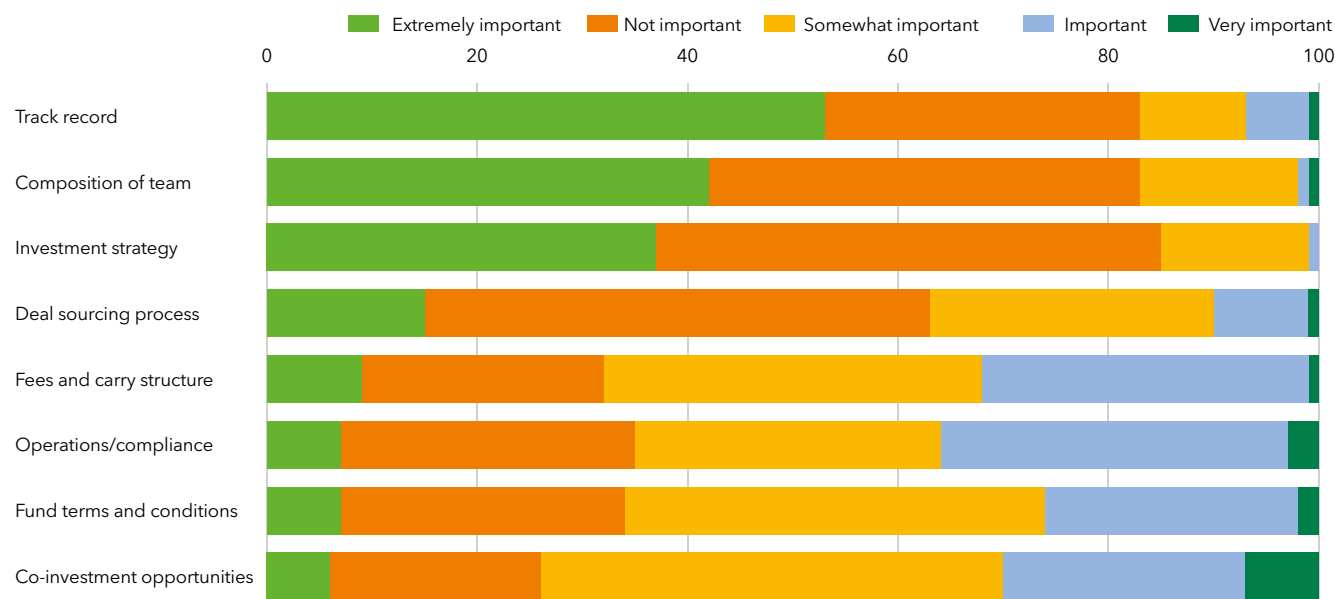
“LPs in emerging managers are highly focused on co-invest at the moment,” says Monument Group partner John McCormick. “The thesis is that these emerging managers are going to be sought after once they are established, and if you don’t get in early, you may miss the opportunity to become one of the preferred co-investment partners – to establish that pole position. GPs can be very protective

of their co-invest. They will use it as a way to hook investors and can be very successful in doing so.”

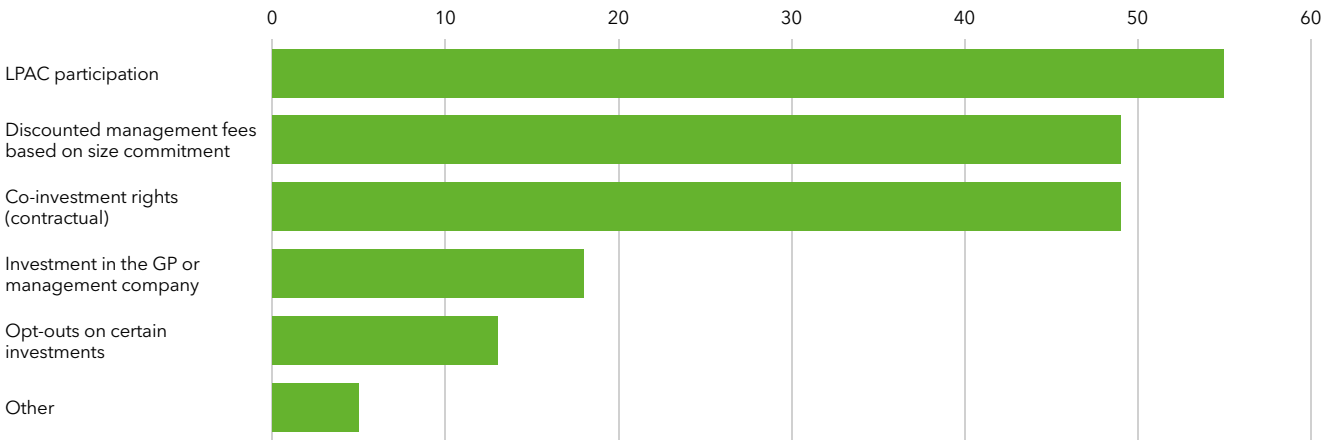
Other critical factors, of course, include track record, cited as important, very important or extremely important by 89 percent of LPs surveyed. This figure increases to 91 percent when it comes to deal-sourcing processes, to 96 percent for investment strategy and fund terms and conditions, and 100 percent for team composition.

“LPs are going to look first and foremost at past experience,” says Alli Wallace Stone, managing principal and consultant at Meketa Investment Group. “They are going to want the GP to demonstrate past experience managing

How important do you believe the following factors are for LPs evaluating your fund (%)

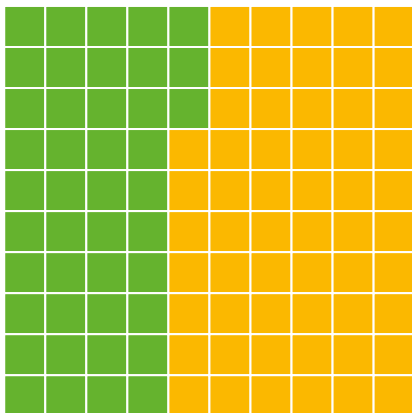


Which of the following terms did you offer/provide to investors (Multiple responses allowed, %)



Did you have an anchor investor with more favorable economic terms?

Yes
43%

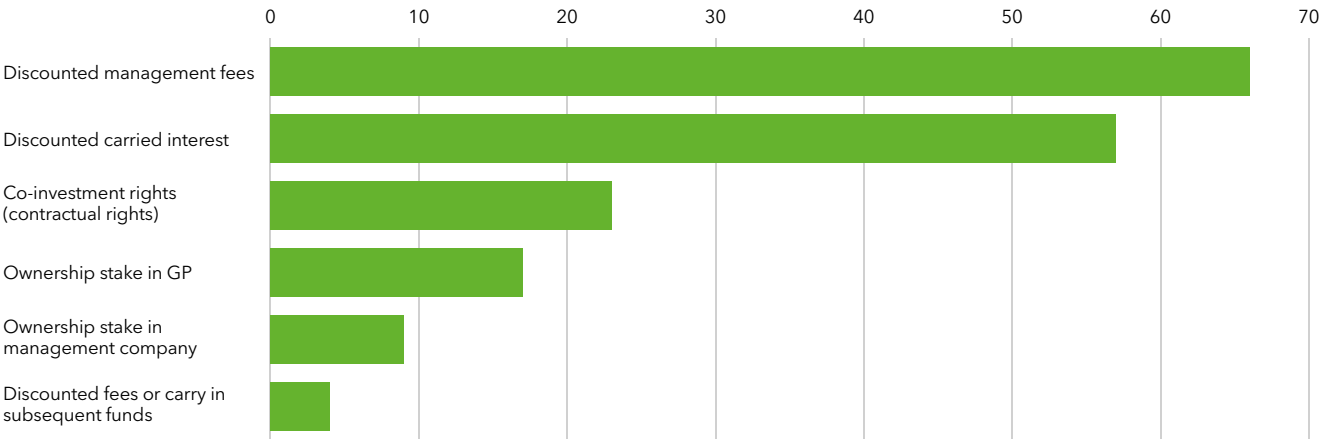


No
57%

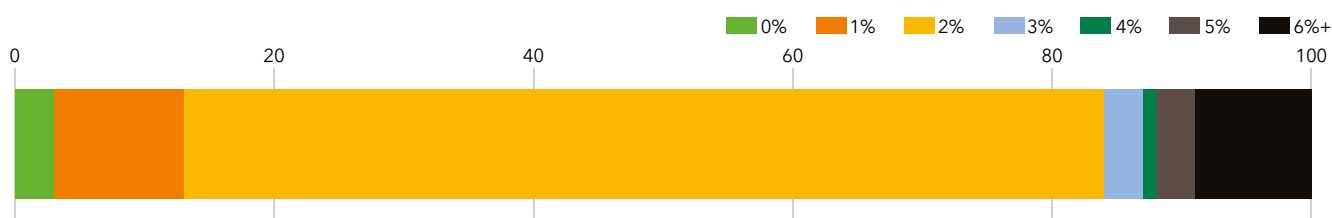
similar types of investments. They are going to want to be able to attribute past investments at prior firms to the lead investors at the emerging firm and understand their approach to investing, lessons learned and how they are going to source dealflow and make enhancements to new companies going forward.

“Team composition is also very important. Do these individuals have a history of having worked together before? Have they invested together over multiple cycles? Have they had to make decisions together at a prior firm and how well do they know one another? During challenging times, will they be able to stick together over multiple funds? Do they have the skills necessary for the strategy and how

If so, what terms did the anchor investor receive? (Multiple responses allowed, %)



What management fee as a percentage have you asked for in your fund? (%)

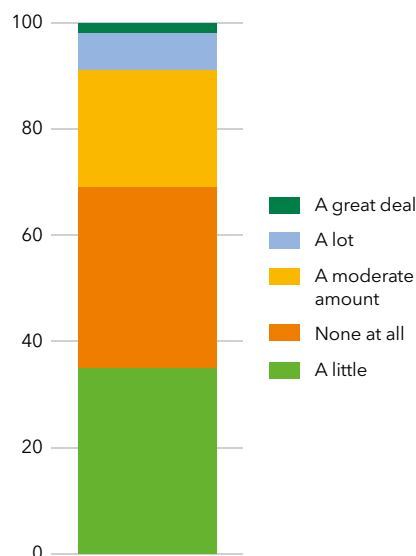


will they divide up responsibilities and economics?”

“We tend to look for sponsors that are investing in their businesses to build a firm and not just raise a fund,” says Patricia Miller Zollar, head of Northbound Equity Partners, Neuberger Berman’s specialist emerging manager business. “We also look for a verifiable track record; a strong committed and stable team; strong alignment of interest through the GP commitment; appropriate fund sizes and terms; a differentiated investment strategy and appropriate infrastructure and processes.”

ESG has also become an increasingly important consideration, coming under scrutiny from 70 percent of investors. Focus on formal diversity and inclusion policies and initiatives is growing, but still lags, at 41 percent.

Do you receive pressure from investors regarding fees? (%)



“We would always encourage anchor investors to think about the fund’s targeted strategy and scalability”

DEREK SCHMIDT
Marquette Associates

Points of negotiation

Many investors will also try and use their willingness to back an emerging manager to negotiate on terms. Indeed, almost three-quarters of respondents said they would negotiate harder on fees with them than with an established firm, while two-thirds of manager respondents said they had received pressure from investors regarding fees.

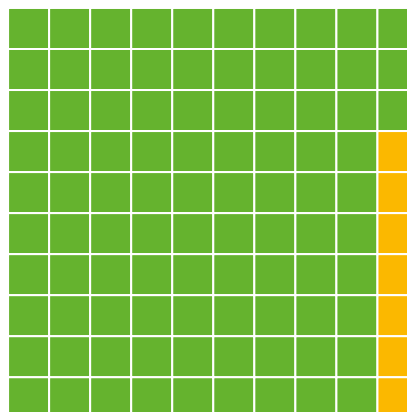
Nonetheless, the 2 percent management fee remains the norm, having been employed by 72 percent of emerging managers surveyed. A further 13 percent are charging a lower level of fee, while the remaining 16 percent are charging more, including 9 percent charging fees of 6 percent upwards.

At the top of LPs’ lists of priorities, however, is LPAC participation, which 55 percent of emerging managers surveyed said they had offered. This was followed

LPs have their say

Will you back a debut PE/VC fund?

Yes
93%



No
7%

by contractual co-investment rights, offered by 49 percent. Other points of negotiation include discounted management fees based on the size of commitment, also offered by 49 percent; opt-outs on certain investments, offered by 13 percent, or even a stake in the general partnership or management company.

And the list goes on. Other points of contention include details around the key-person clause, no-fault divorces, information rights and distribution waterfalls. Some investors surveyed even said they would seek to pay no carry, or indeed no fees at all, if they believed they could add value. “We seed as a strategic and so no fees are paid,” said one.

Others take a more pragmatic view, keen to avoid harming future performance by pushing too hard on economics. “We like to be early in the case of founder’s share class or first close if we become comfortable quickly but will not rush our diligence for the sake of a discount,” said one. “We will also not engage in fee compression as we want such managers to survive and therefore look to support their business.”

“You have to be careful about asking for material fee discounts which then compromise the GPs’ ability to hire the right talent and build out the organization,” says Scott Reed, co-head of private equity in the US at Aberdeen Standard Investments. “You might feel good about having negotiated preferential terms in the short term, but in the long run, if the GP can’t be the kind of firm that you want to be invested in, then that makes you a fool.”

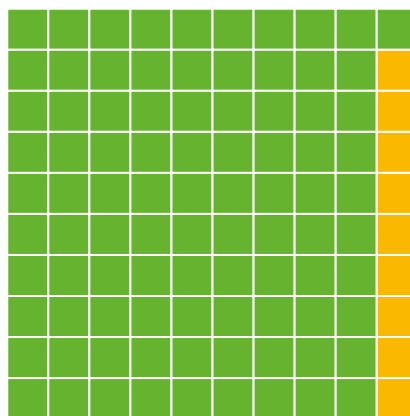
Firmly anchored

Of course, investors are especially likely to expect preferential terms if they come in as an anchor investor, which is something close to two-thirds of LP respondents said that they were willing to do.

There are risks, particularly the risk that a fund will not reach its stated target, leaving the LP over-represented and the manager under-resourced. “We would always encourage anchor investors to think about the fund’s targeted strategy and scalability,” says Derek Schmidt, director

Will you back a manager raising its second fund?

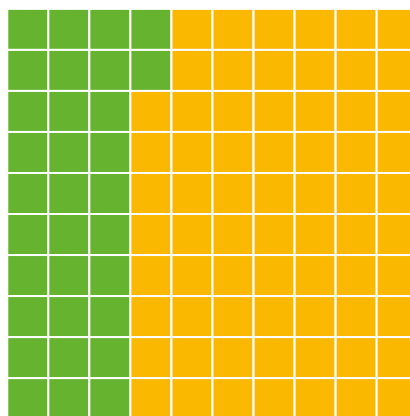
Yes
91%



No
9%

Do you have a formal allocation to PE/VC emerging managers?

Yes
32%



No
68%

66.9%

If you have a formal allocation to PE/VC emerging managers, what is the allocation target as a percentage of your total PE/VC portfolio?

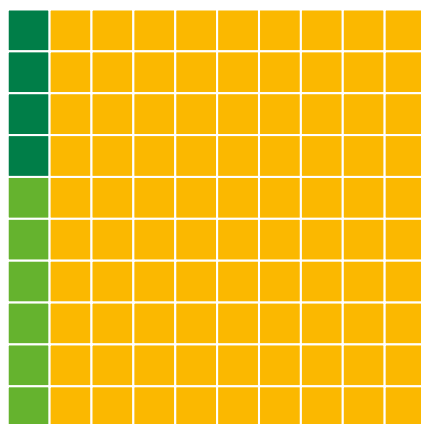
of private equity at Marquette Associates. “While a large early commitment is immensely helpful to an emerging manager, that capital should come with limits, including a minimum first close requirement and a hard-cap to ensure that strategy is deployable.”

But, of course, there are also advantages. Indeed, 63 percent of investors surveyed said they would expect discounted carried interest as an anchor investor; 59 percent said they would expect discounted management fees and 53 percent co-in-

Do you outsource at least a portion of your emerging manager program to a third-party adviser?

Yes,
all of it
4%

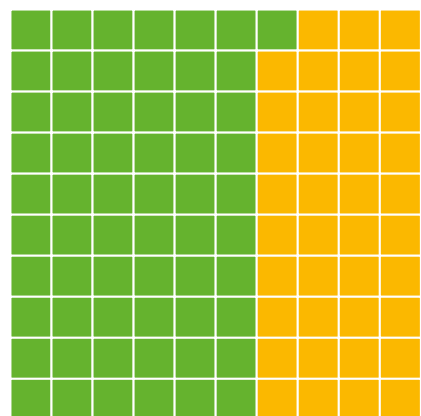
Yes,
part of it
6%



No
90%

Do you make co-investments with emerging managers?

Yes
61%



No
39%

“LPs are going to look first and foremost at past experience”

ALLI WALLACE STONE
Meketa Investment Group

vestment rights. Less common, but still cited by almost 40 percent of respondents, was the more controversial discounted fees on subsequent funds, while 31 percent expressed interest in owning a stake in the GP and 28 percent in the management company.

“Reduced fees or preferred economies are typically expected for LPs that are anchoring the fund or investing sizable capital,” says Molly LeStage, managing principal and private markets consultant at Meketa Investment Group. “We also

infrequently see stakes in management companies being negotiated.”

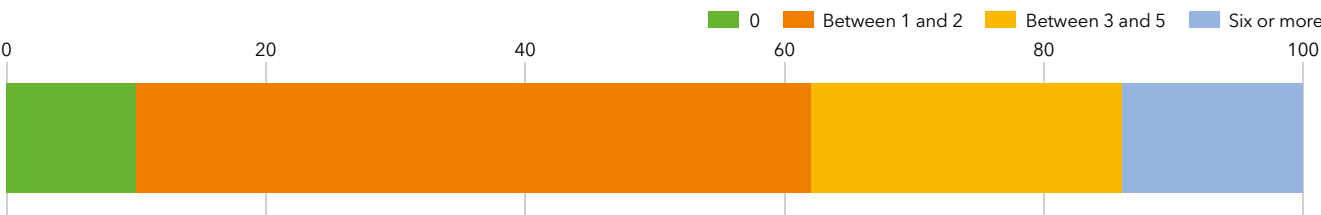
Indeed, there are a number of big-ticket investors that have made this their strategy. Groups like Capital Constellation, backed by the Alaska Permanent Fund Corporation, will write sizable checks but expect that ownership stake in return.

“For the most part, investors will get a preferred economic stake but won’t look to take any kind of governance role,” McCormick explains. “That plays better with other LPs coming in.”

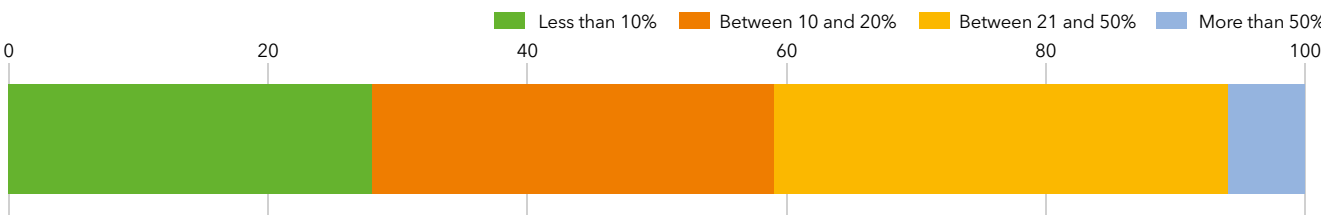
Meanwhile, 43 percent of emerging managers surveyed said they had had an anchor in their latest fund. But securing an anchor is not a fundraising panacea. “Having a cornerstone can help accelerate the process,” says McCormick. “But it isn’t a guarantee. Having a referenceable LP on board can help, but it depends who that LP is. LPs can also be turned off by the anchor investor, particularly if that anchor has negotiated highly preferential terms.”

Indeed, anchor investors can be seen

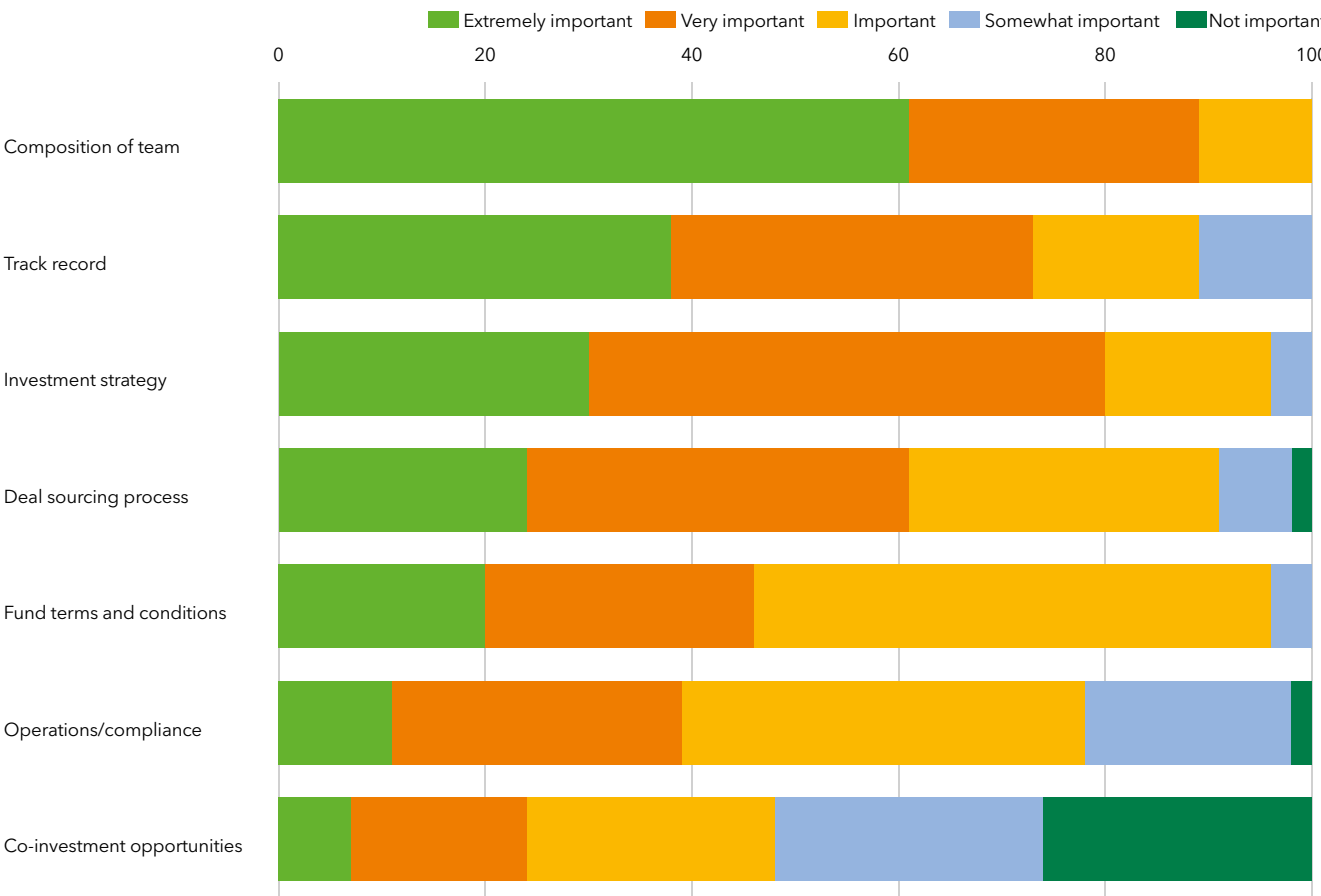
If yes, how many co-investments do you anticipate making alongside emerging manager funds over the next year? (%)



What is your target allocation as a percentage of your total PE/VC portfolio regarding co-investment opportunities?



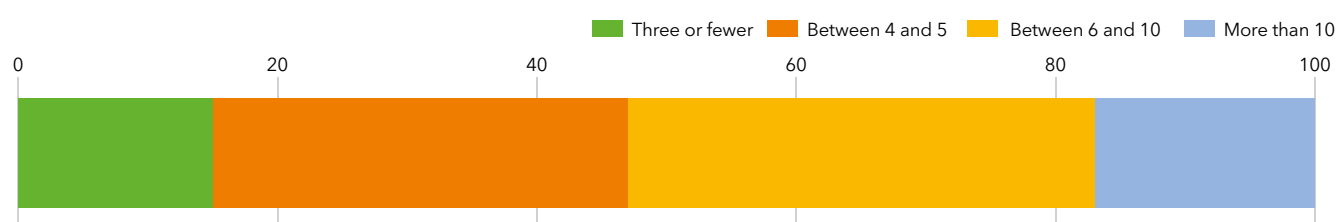
How important are the following factors when evaluating an emerging manager fund? (%)



How long does it typically take from first introduction to a signed commitment? (%)



How many meetings, including conference calls, would you expect to have with an emerging manager before making a commitment? (%)



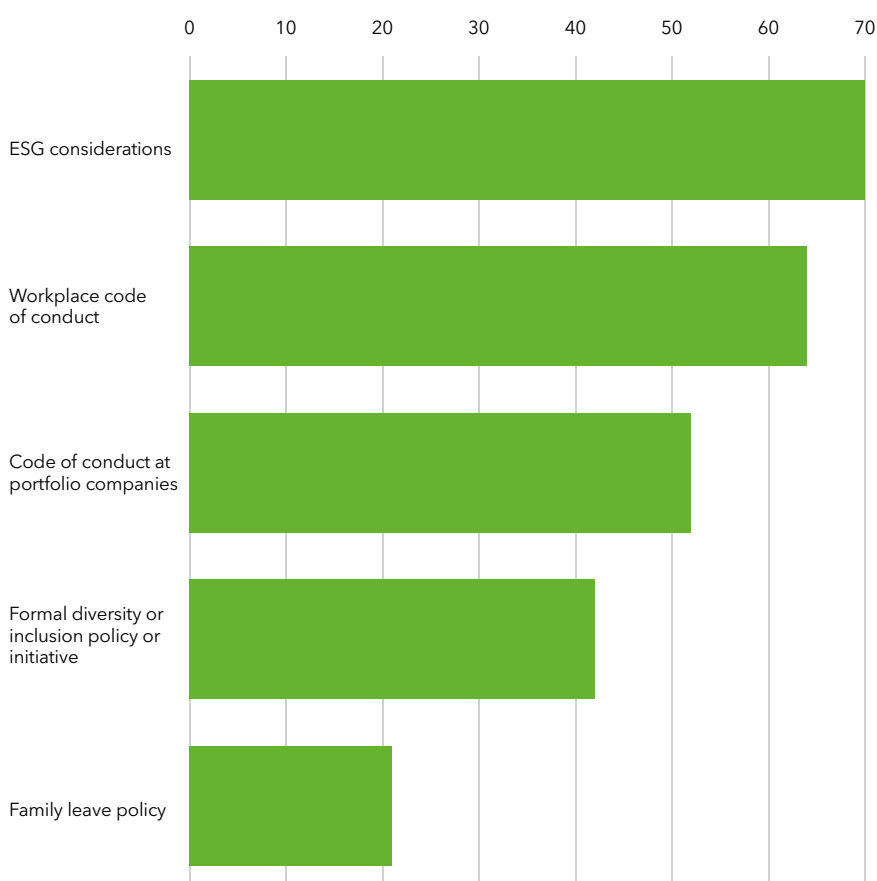
as both a positive and negative by the LPs that follow. “An anchor investor adds credibility to an emerging manager’s fundraising effort. It can act as a catalyst to the development of the GP,” says Rick Spencer, co-head of Barings’ funds and co-investment platform. “Having an anchor in place means the spade work has been done for the structural and operational requirements of being a manager and that there will be working capital support for team retention and build, as well as capital availability to allow the manager to pursue opportunities.

“The disadvantages, however, are the potential for diluted alignment,” Spencer adds, citing an anchor’s potential influence around governance and investment activity, as well as preferential co-invest access.

There are also pros and cons for the GP itself. “Emerging managers can’t always be picky but should give strong consideration to how they build their LP base,” says Schmidt.

“Some anchor investors will ask a lot and emerging managers need to consider if an anchor’s capital is worth it, as this can often limit the ability to attract future investors. Building a too concentrated,

Do you look for any of the following in an emerging manager? (%)



Analysis

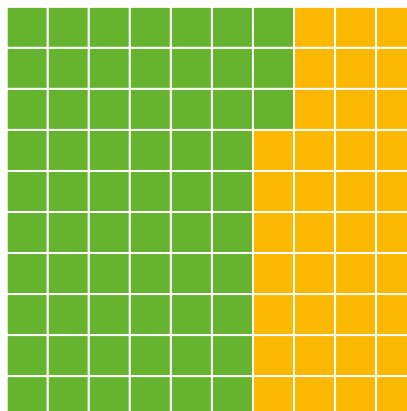
or friends and family, LP base can create challenges for Fund II or Fund III as a manager looks to scale.”

Two-thirds of those anchors did receive discounted management fees and 57 percent received discounted carry. Close to a quarter received contractual co-investment rights, 17 percent a stake in the GP and 9 percent a stake in the management company. The sale of ownership stakes, however, can be particularly counterproductive.

“We vigorously object to the habit that many LPs now seem to have of taking a part of the business,” said one investor respondent. “We actually walk away from GPs that have sold their dream.” ■

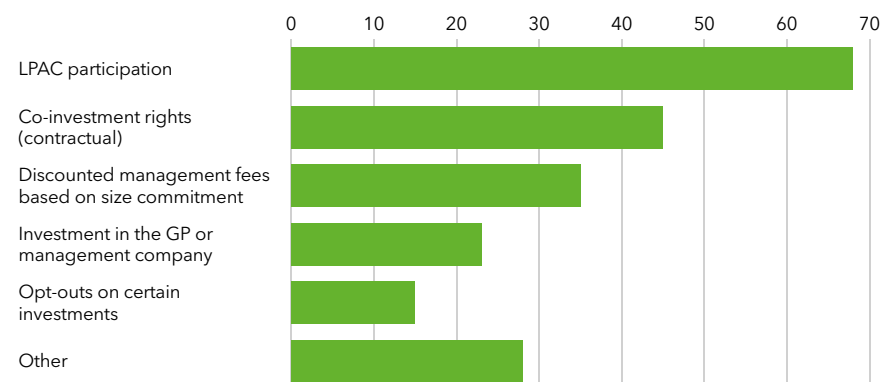
Would you make an anchor commitment to an emerging manager?

Yes
63%

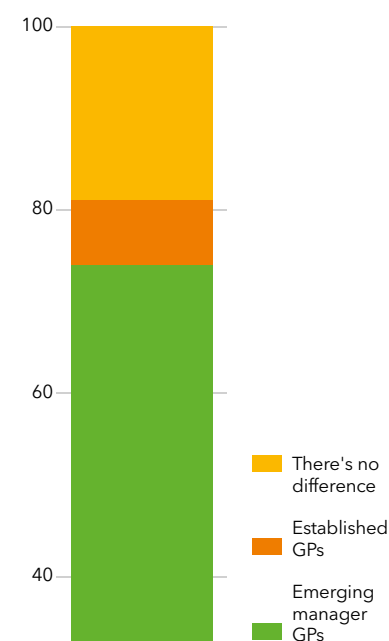


No
37%

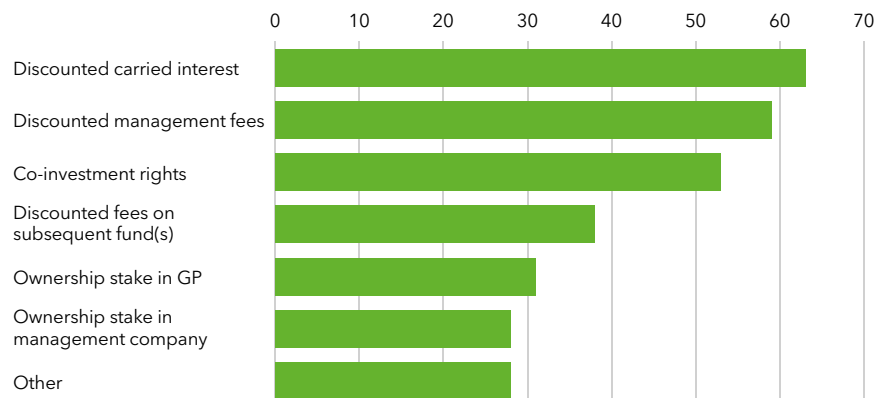
What kind of terms do you try to negotiate with emerging managers?
(Multiple responses allowed, %)



When negotiating fees, do you believe LPs generally negotiate harder with... (%)



If you were to make an anchor commitment, what special terms would you seek?
(Multiple responses allowed, %)



Q&A

A differentiated strategy is critical to the success of a first-time fund, says partner at Arctos Sports Partners **Robin Slutsky**

Q You have just closed on one of the largest first-time funds in history. To what do you attribute your success?

A rctos has a differentiated strategy predicated on a compelling investment thesis in an exciting and growing sector. Given how many private equity funds are seeking to raise capital at any given point in time, having a clear and unique strategy is critical.

In addition, most of our team has had a history of working together prior to forming Arctos. Ian Charles spent most of his career at Landmark Partners where Joe Nasr previously worked. Doc O'Connor and Jordan Solomon both worked together at Madison Square Garden Group before Arctos. So, while we were a first-time fund, we are not a first-time team.

Q Can you tell us more about Arctos' strategy and how the members of your team complement one another?

A rctos Sports Partners is the first private equity firm focused exclusively on the professional sports industry. We invest in teams in multiple ways, including growth capital on a team's balance sheet, financing to help a new buyer acquire a team and liquidity solutions for owners looking to sell out or down their stake in a franchise.

Our team has a deep and complementary skill set across sports and entertainment operations and private equity investing and is uniquely positioned to act as a collaborative partner for sports ownership groups and leagues.



Q What makes the sports industry an attractive area to invest?

The sports ecosystem sits at the center of a series of compelling secular trends, including live events, digitization, data analytics, legalized sports betting and international growth with strong tailwinds that have accelerated post-covid.

"The sports ecosystem sits at the center of a series of compelling secular trends"

Historically, sports returns have been uncorrelated to other asset classes. They have high levels of recurring revenues at between 70 and 80 percent plus, and benefit from consumer preferences for live entertainment and appointment viewing content. Franchises enjoy strong customer loyalties that span generations. Teams are currently seeing the benefits of this loyalty in the form of pent-up demand as cities have reopened to live events.

Finally, the business of sports is evolving quickly in exciting ways, with the advent of digital technology and growing financial sophistication in the space. Team properties are becoming anchor assets within broader content platforms that incorporate everything from physical real estate to mobile sports betting and gaming, with exciting potential for growth.

Q How can private equity impact the sports industry?

This industry has historically had to fund growth organically. We think private capital will allow for high ROI investing and growth acceleration whether it be in real estate and new stadium development projects, technology, gaming, the fan experience or the acquisition of another franchise. We also believe institutional capital will help to simplify ownership structures of teams where there may be dozens of limited partners. The industry, with access to private capital and alongside increasingly sophisticated ownership groups and management teams, will generate stronger revenue growth and profitability, and, as a result, higher valuations going forward. ■

withum⁺



Financial Services Market Leader



Up-to-Date On Financial Matters

40+

YEARS OF EXPERIENCE

With over 40 years of experience, Withum brings clients the benefits of a larger organization without sacrificing the attention and personal service that one expects from a local firm. Our team of professionals can help you meet the challenges of starting or managing your fund.



REGISTERED FIRM WITH THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Our professionals are up-to-the-minute on matters affecting the PCAOB, SEC, FINRA, NFA, CFTC and other regulatory organizations.



WE ARE AN INDEPENDENT MEMBER OF
THE GLOBAL ADVISORY
AND ACCOUNTING NETWORK

INTERNATIONAL NETWORK

In connection with HLB, we have specific individuals identified to assist member firms in coordinating international services to our clients. We ensure that all aspects of a client's financial affairs are addressed in the same high quality, professional manner, whether in the United States or at your international locations.

Withum serves all aspects, size and investment types of the alternative investment global community. Our professionals provide the expert advice and innovative solutions you need to in today's fast-paced, tech-driven world.

15

OFFICES



A national CPA and advisory firm with office locations in major cities and financial centers across the country, including New York, Massachusetts and California.



Global Reach Through HLB



Industry Thought Leaders



INDUSTRY RESOURCE

Withum has created an emerging manager desk reference for startup advisers that addresses the key areas around structuring funds and the investment advisory business.

Withum also provides a comprehensive illustrative pro-forma financial statement manual as a guide that the alternative investment industry, including funds and administrators, use as a resource to help with financial statement preparation.

Our expertise within the alternative investment space make fielding questions of tax impact, infrastructure, jurisdictional distinctions, fee structures, and fund launches smooth and easy to navigate. In order to keep pace with market trends and ensure we are appropriately positioned to respond to the needs of this dynamic marketplace, Withum has determined alternative investments to be one of the top strategic priorities for the Firm — making significant investments in technology, people and service innovation focused on private equity funds, venture capital, hedge funds, fund of funds, mutual funds, SPACs, exchange traded funds and other types of alternative investments products.

KEY TEAM MEMBERS



Tom Angell, CPA
Partner, Practice Leader
Financial Services Group
T (212) 829 3239
tangell@withum.com



Michael Oates, CPA
Partner, Tax Leader
Financial Services Group
T (212) 808 0238
moates@withum.com



Steve Yardumian, CPA
Partner
Financial Services Group
T (617) 849 6168
syardumian@withum.com



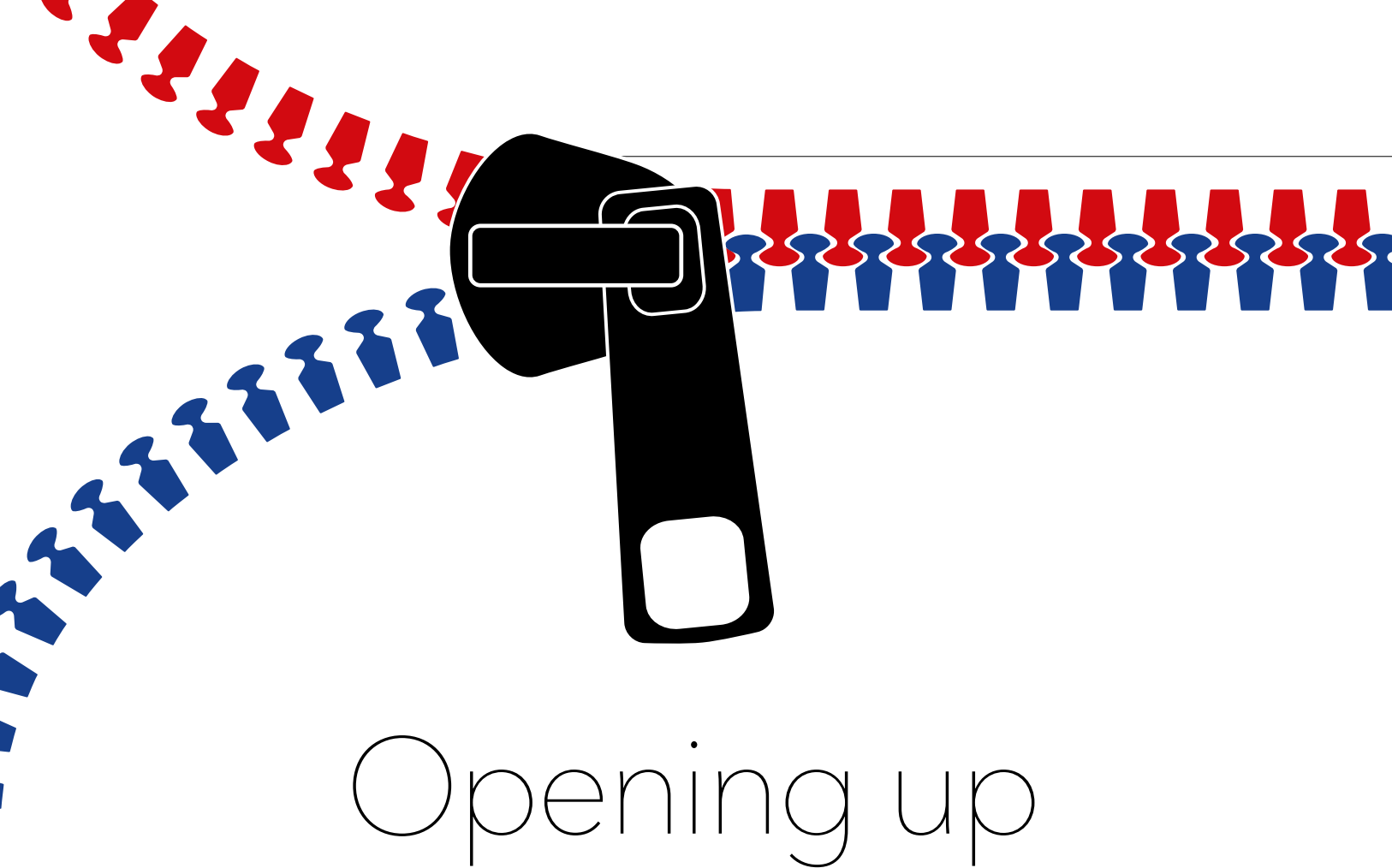
Peter Lubcker, CPA,
Partner
T (646) 604 4199
plubcker@withum.com



Carl Scheuten, CPA,
Partner
T (973) 532 8883
cscheuten@withum.com



Fatema Raza, CPA
Partner
Financial Services Group
T (732) 743 4565
frazar@withum.com



As LPs become more receptive to new relationships, strong networks and track records are helping emerging managers stand out in a crowded mid-market. Vicky Meek reports

LP appetite for private equity – and in particular North American private equity – appears insatiable. In a development few would have predicted at the start of the pandemic, fundraising has not just continued relatively uninterrupted; it has smashed records.

In the first six months of 2021, North American GPs raised an aggregate \$297 billion, the highest amount in any first half period since the global financial crisis, according to data from affiliate title *Private Equity International*.

Yet, in a continuation of a trend seen for many years now, that capital is increasingly concentrated among larger players – the average fund size increased by 26 percent on H1 2020 figures to \$740 million, far higher than first-half

averages in other recent years. It is clear that LPs are seeking out larger funds in a bid to deploy capital and keep a lid on the number of GP relationships they need to manage. So where does that leave today's emerging managers – particularly in spaces such as the US mid-market, where competition is hardly scarce?

Emerging managers certainly had a more difficult time in the early phases of the pandemic – after all, most LPs were trying to understand their existing

exposures and were getting to grips with virtual meetings as opposed to scoping the market for new relationships.

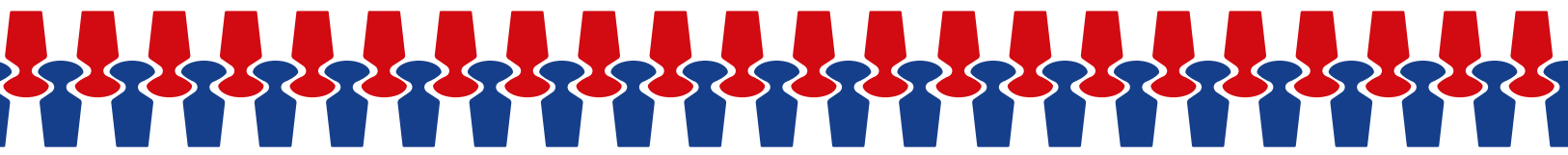
“We did see a flight to familiarity to begin with as LPs focused on re-ups with existing managers,” says Eric Deyle, managing director at Eaton Partners. “And it’s true that the lack of in-person due diligence and opportunity to build relationships put first-time funds at a disadvantage.”

“Things came to a grinding halt when the pandemic struck,” says Sanjiv Shah, managing director at HarbourVest. “That meant that some groups who were thinking about launching had to revisit their timings, while others raising successors to their debut funds had to rethink when they were going to come to market. The situation caused a lot of uncertainty for emerging managers.”

14%

LPs that plan to allocate more to emerging managers in 2021

Source: Eaton Partners



However, activity following the initial shock suggests that some of the early reticence to commit to newer managers dissipated reasonably quickly. In July 2020, Gallant Capital Partners reached a final close on its inaugural fund at \$378 million. According to the firm, the fund hit its hard-cap and was substantially oversubscribed.

In early 2021, Seaside Equity Partners, led by former Wafra executive Andrew Thompson, reached a final close on \$160 million, and March this year saw the close of Denali Growth Partners' debut fund at \$203 million. In July came the news that Avesi Partners had reached a final close at \$875 million on its first fund – well over its \$650 million target. And that is to name just a few recent US emerging success stories.

“There was a bit of a pause in interest in emerging managers at the beginning of the pandemic as LPs focused on existing relationships,” says Natalie Walker, partner at StepStone. “But we’ve seen things really pick up over the past year and we’d expect that to continue.”

Backing this up are the results of an Eaton Partners survey published in April, which found that 71 percent of LPs were planning to make no change to their emerging manager allocations, while 14 percent were expecting to allocate more to funds raised by newer firms.

Fierce competition

That does not mean the market is necessarily welcoming all emerging manager funds with open arms. Despite LPs' strong appetite for private equity, the fundraising market is highly competitive. “Existing GPs are coming back on a more frequent basis than previously,” says Chris Webber, senior vice-president at Monument Group. “That means newer managers are competing against re-ups much

“We’re seeing the creation of dedicated funding platforms and a broadening of the type of investor targeting newer managers”

ERIC DEYLE
Eaton Partners

more than they were a few years ago and LP bandwidth is also stretched.”

This is potentially why we are seeing a bifurcated market today for emerging managers. “The market is split between the haves and the have-nots,” says Walker. “Emerging managers with relationships with LPs and strong track records are raising more quickly than usual because of the virtual due diligence process, while those without are taking much longer to raise.”

\$1.3bn

Capital raised by first-time US mid-market funds in Q1 2021

Source: PitchBook

And possibly today more than ever, given travel restrictions, those emerging managers able to draw on existing relationships with LPs fall firmly within the ‘haves’ camp.

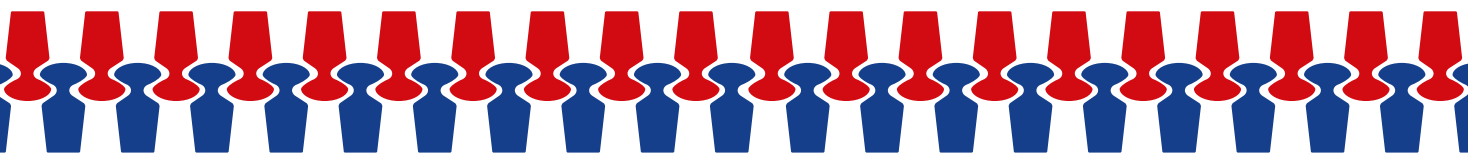
“There has been a flight to familiarity,” says Shah. “But the fact that we spend a lot of time relationship-building means that it doesn’t necessarily follow that we invest in the same groups over and over. When we invest in a new team, we may only have two degrees of separation from them rather than six. We often have connections with individuals even if the name on the business card has changed.”

Spinning out of a major firm can help attract LP attention. Ex-KKR executives Jim Momtazee, Karr Narula and Neel Varshney, for example, teamed up with ex-Ares partner Alex Albert last year to establish Patient Square Capital to target healthcare investments. Yet the firm also illustrates another trend in emerging manager fundraising: larger fund targets.

“A wave of emerging managers raising upwards of \$1 billion has come out over recent times,” says Walker. “Historically, we’d have viewed emerging managers as sub-\$1 billion, but the funds are getting larger. That’s because we’re seeing quite a few GPs spin out of large firms, their track records are in the mid-to-large space and their reputations justify the larger fund size.”

With its debut fund launched on the market in February, Patient Square is believed to be seeking \$3 billion, which would make it among the largest ever inaugural funds.

Helping these newer firms navigate first-time fundraising are new pools of capital dedicated at least partly to emerging managers. “The amount of capital available for emerging managers has never been greater,” says Deyle. “We’re seeing the creation of dedicated funding



platforms and a broadening of the type of investor targeting newer managers. Foundations, family offices and endowments have long been supporters of new firms, but now we are seeing pension funds and insurance companies step in, too.”

Many LPs – in the US especially – have established emerging manager programmes dedicated to finding new talent in the industry, and some have further formalised such programmes. Capital Constellation, for example, is a joint venture between several institutional investors, including Wafra, Alaska Permanent Fund Corporation, RPMI Railpen, Kuwait Investment Authority and AP3, that was established to support the development of next-generation managers.

In addition, firms such as Gatewood Capital Partners and Grafine Partners have raised or are raising capital with the specific aim of seeding emerging managers and helping them reach first close.

On good terms

Part of the attraction for LPs is the prospect for higher returns than with established managers – several studies have suggested the hunger felt by emerging managers has the potential to deliver out-performance, although they also find that dispersion is higher than for existing firms.

Yet some LPs are also looking for better terms and access to co-investment opportunities. “Emerging managers can be a good way for LPs to access better economics or co-investment opportunities, particularly if they are a cornerstone investor,” says Walker.

The expectation of a long-term relationship is also top of mind for investors. “Some LPs are using emerging manager programs to back teams early in their development with the intention of growing with them,” says Deyle. “Once a firm is raising fund III or IV, it’s really difficult

“The market is split between the haves and the have-nots”

NATALIE WALKER
StepStone

to establish a key role with a sponsor or become a strategic investor. The trend for co-investments is playing into this – LPs need to come in at the right inflection point if they are to establish themselves as a first-look co-investor.”

At the same time, some emerging managers are being highly strategic about which LPs they are targeting. “There is a lot of capital being directed towards private markets and private equity in particular,” says Shah. “That is creating

more opportunities for spin-outs and other emerging managers. It’s clear some are oversubscribed and doing one-and-done closes. Yet there is also a cadre of GPs that are being more thoughtful and intentional about how they build their LP network. They are looking to build a diversified LP base that will stay with them as they develop and grow.”

Deyle agrees. “Relationship building has really gathered momentum post-pandemic,” he says. “It’s a crowded market and so there needs to be a disciplined go-to-market strategy. Emerging managers are increasingly looking at who they should build relationships with who will be there for fund III.”

Overall, the fundraising outlook for emerging managers looks promising, in particular as many LPs are now actively seeking out new relationships. Even if the early stages were tough, the pandemic may ultimately turn out to have helped their cause. “Emerging managers have the benefit of starting with a blank page,” says Walker. “They don’t have portfolios that have just gone through the pandemic and may be impaired – that’s quite a differentiating factor today.”

And it may even be that covid-19 leads to more emerging managers coming to market.

“Post-pandemic, we will see several GPs with performance that will come through more slowly as a result of the disruption caused in the portfolio,” says Deyle. “That may well mean that the prospect of carry diminishes – and when that happens, you see people leave to set up new firms.”

The result may be that we see a whole raft of new players, with capital ready to support them. And if that happens, the US mid-market private equity landscape may look quite different in the years to come. ■

12.5%

First-time funds closed as a proportion of the total number of US mid-market funds closed in Q1 2021

Source: PitchBook

Q&A

*Emerging managers often provide investors with access to niche strategies that improve diversification, says Argand Partners director of investor relations, **Kay Blackwell***

Q How would you describe investor appetite for emerging managers?

Investors view emerging managers as a compelling opportunity set and are keen to identify and track new talent. However, it is often challenging to translate this interest into hard commitments due to mature portfolios, stable existing relationships and the comfort that long track records provide. We have recently seen increased traction when an emerging manager has a diverse team. A growing focus on DE&I has increased interest in backing diverse teams, another significantly underinvested part of the market.

Q Why are emerging managers an attractive addition to a private equity portfolio for investors?

We are energized, focused and have strong alignment with our investors. We invest behind differentiated strategies and develop differentiated ways to create value. We must source, invest and manage our portfolio better than the established market to stand out. We are also able to build and structure our firms in an innovative and nimble way that fosters highly effective investment management processes and attracts ambitious and dedicated talent. We prioritize talent management and retention, diversity and inclusion, innovation and long-term alignment. Finally, emerging managers often provide investors with access to niche strategies at the lower end of the market, increasing diversification and the potential for alpha generation.



Q What do LPs look for in an emerging manager? What matters most (ie, track record, differentiation, team composition, terms and conditions)?

Team is probably the most significant diligence factor for investors when reviewing emerging managers – skill set and experience, breadth of bench, history working together, mix of personalities. Along with the investment strategy, this is part of a manager's differentiation – does the investor believe that this team is special? Can it execute successfully on a well-defined strategy?

Q What were the biggest challenges you faced in your most recent fundraising?

We found that it was crucial to have a pipeline of on-strategy investments and to execute deals during our fundraising. This meant securing anchor capital early on to allow us to activate our strategy. We

also spent a lot of time with our investors discussing how we create value during the investment process and demonstrating impact.

Q Why do you think you were successful?

We invest in the global middle market in advanced manufacturing and business services companies, and we have a team that has invested together executing the same strategy over market cycles. In our experience, there aren't many private equity firms that approach the mid-market with a global mindset. In addition, we had a robust pipeline of deals sourced by our investment team because of a long history working and investing globally. Sigma Electric, which was sourced by our partner, Joyce Schnoedl, was a deal that we completed during the fundraising. Being able to diligence a deal live and co-invest with us helped investors get to know our team and understand our underwriting and investment approach first-hand.

Q How does LP due diligence differ for an emerging vs established manager?

The process is similar, but formal and informal references generally take on more importance as part of the diligence process for an emerging manager, along with reaching deeper into the team to assess talent. Unfortunately, the pandemic has presented additional logistical hurdles for emerging managers, particularly first-time funds. For many investors, it's hard to invest behind a team you've only met virtually. ■

Respondent profile

A look at the participants in our fifth annual Emerging Manager Survey

The fifth annual *Buyouts Emerging Manager Survey* conducted in partnership with Gen II Fund Services, LLC, attracted a wide spectrum of LPs and GPs.

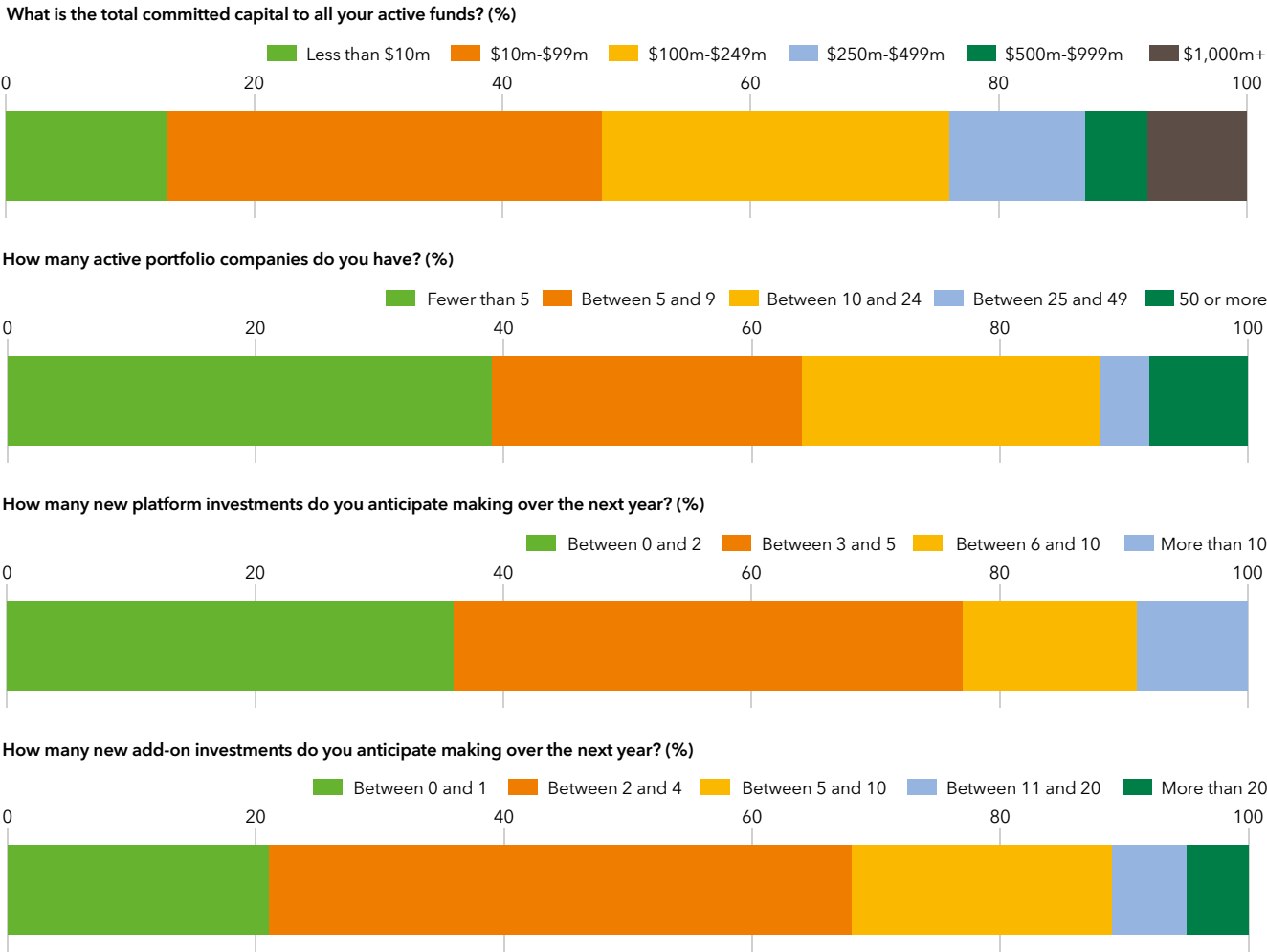
GP participants were, for the most part, firmly situated in the mid-market, with 63 percent having between \$10 mil-

lion and \$249 million of committed capital. Even still, nearly one-quarter reported commitments above that mark.

Just shy of 40 percent of participating GPs had fewer than five portfolio companies in their fold, with 49 percent reporting between five and 24 portfolio companies. A full 77 percent said they plan to

add between zero and five portfolio companies in the coming year, with nearly half of those planning to add two or less new companies to their portfolios.

Meanwhile, 88 percent of GP participants reported that their firm comprises 10 or fewer investment professionals, and only 27 percent of GP participants said



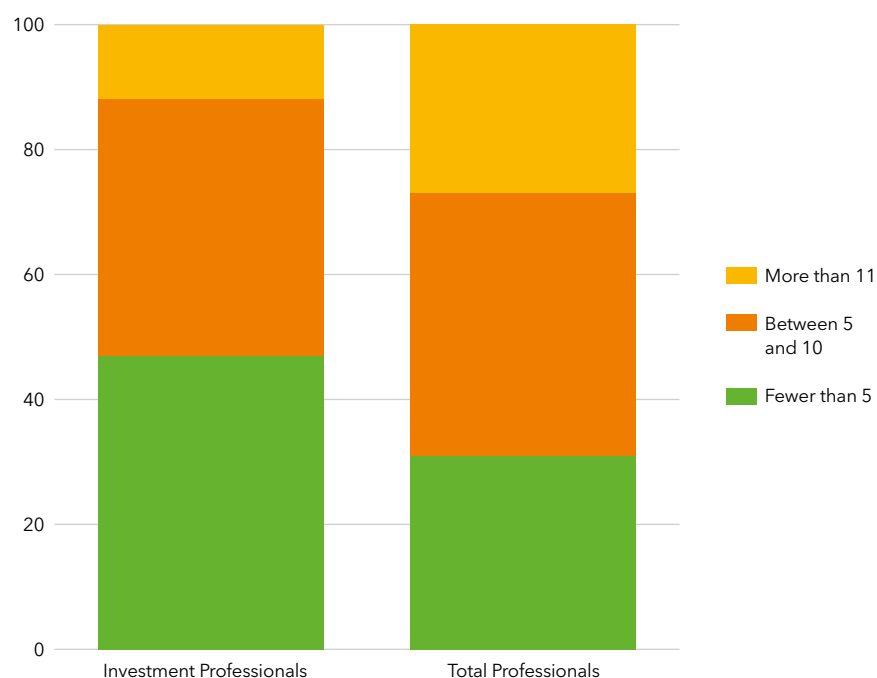
their firms comprise more than 11 total professionals.

The LPs who participated in the fifth annual *Buyouts Emerging Manager Survey* included a cohort of heavily private equity-focused investors. Thirty-four percent of LP participants said that they allocate 90 percent or more of their total portfolio to private equity, and only 19 percent reported allocations of less than 15 percent.

At the same time, nearly one-third of LP participants said the total value of their private equity and venture capital portfolios amounted to less than \$250 million, while 37 percent valued their PE/VC portfolios at between \$1.5 billion and \$10 billion.

Nearly half of this year's LP participants said they allocate between \$25 million and \$250 million in additional capital to PE and VC funds per year on average. ■

How many investment professionals work for your firm? (%)

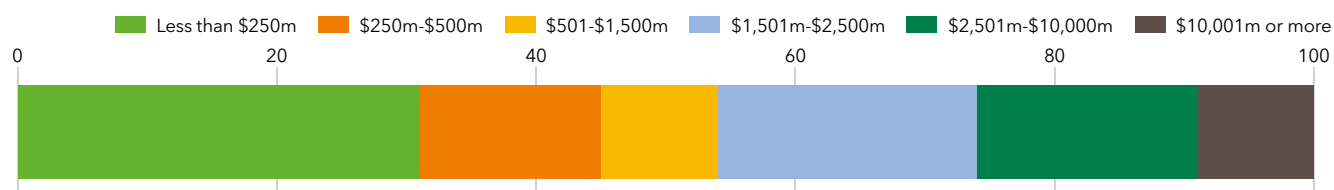


LPs have their say

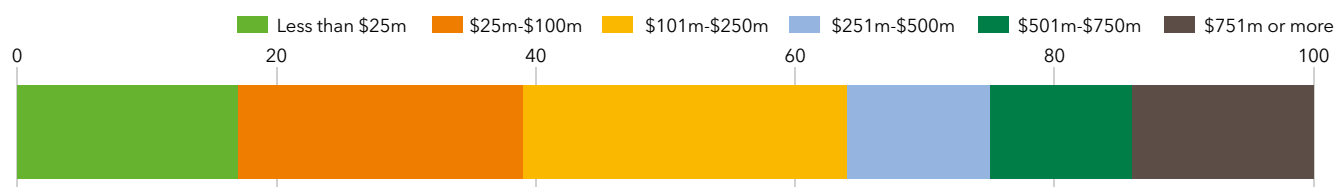
What is your target allocation to PE/VC as a percentage of your overall portfolio? (%)



What is the value of your overall PE/VC portfolio? (%)



How much capital do you commit to PE/VC funds of all types per year on average? (%)



Methodology

More than 140 fund managers and 50 institutional investors contributed to the 2021 Buyouts Emerging Manager Report produced in partnership with Gen II Fund Services, LLC

Field work for the fifth annual *Buyouts Emerging Manager Survey* conducted in partnership with Gen II Fund Services, LLC was carried out between May 28 and July 2, 2021. A total of 145 managers self-selected as “emerging managers” were surveyed.

The initial list was narrowed down to managers that have fundraised or are in the process of fundraising their third fund or fewer. A total of 56 institutional investors with a self-identified appetite for emerging managers were surveyed. Incomplete fund manager and investor surveys were reviewed for inclusion in the sample on a respondent-by-respondent basis.





Guide to Family Offices

Sixth Edition

Access the world's leading family offices

Guide to Family Offices is an essential resource for in-depth and proprietary information about the world's leading family offices that invest in alternative assets.

The newly expanded 6th Edition includes:

- Over **400** family office profiles
- Key personnel with contact information
- Description and investment objectives
- Assets under management
- Fund opportunities sought by strategy, size, geography, T&C requirements
- Direct and co-investment opportunities sought by strategy, size, industry

This guide is the key to locating new investors quick and easy!

Included with the family office guide is an exclusive database of more than **2,800** family office and wealth manager executives (with **2,200+** hard-to-find e-mail addresses).

Subscribers receive **10% off** the guide online at privateequityinternational.com/gfo6/

Enter promo code **FOSUBS10** at checkout to redeem.

Partnering
with emerging
managers
to ensure that
their funds are
well-run funds.

GenII

We support emerging managers with
best practices in private equity fund
administration, client service, and
cloud-based technologies.

Visit gen2fund.com for more information.

GenII