PitchBook

Raising the GP Stakes

How the strategy has developed and what comes next

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Key takeaways

- GP stakes fundraising continues to balloon, with the three largest investors in the space seeking a combined $17.0 billion—more than has been raised for the strategy in the past decade.

- As the pool of top-tier managers seeking an investment shrinks, GP stakes investors are changing tactics. Some managers will seek to deploy additional capital on current investments rather than pursue new partners, while others are looking to smaller and younger GPs or expanding beyond PE entirely.

- Firms that have received a GP stakes investment have delivered above-average fund returns, with over 60% of target GPs' funds landing in the top two quartiles. Additionally, these GPs achieved outsized fund size step-ups and/or expanded into new fund strategies.

- Based on data from firms that have already received investment, we compiled "buyer's lists" of GPs that are prime targets for GP stakes, including Genstar Capital and Roark Capital.

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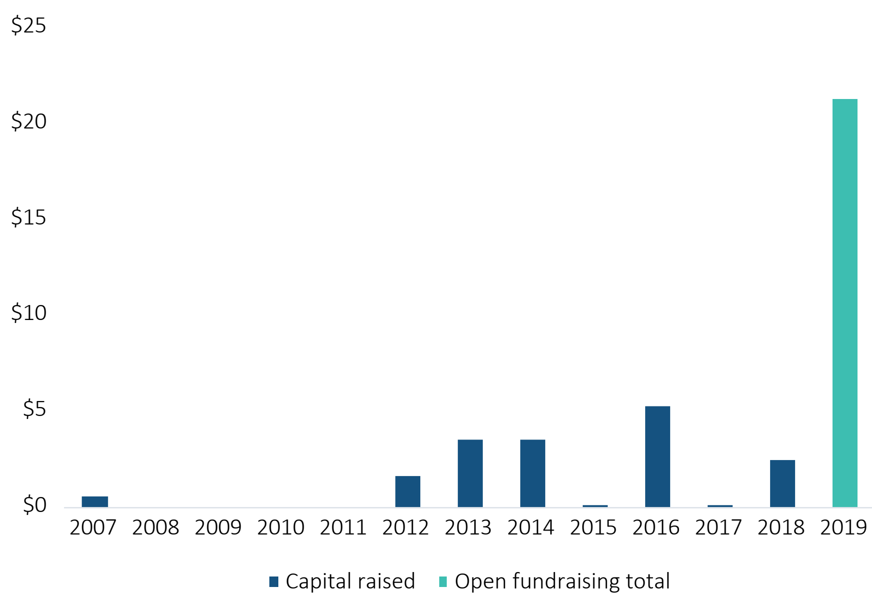
Introduction

GP stakes investments and fundraising continue to proliferate as the strategy develops a track record of high cash-on-cash yields, helping to tap into the swelling demand from LPs for PE investments beyond the vanilla buyout fund. A flood of capital is entering the space, and several new GP stakes investors are vying to make their mark. Notably, all three of the largest players are raising follow-on funds. Blackstone's Strategic Capital Holdings is raising its second GP stakes fund and recently lifted the target size from $3.3 billion to $6.0 billion after market appetite proved higher than expected; Dyal is expecting to close on its $7.0 billion vehicle, which would be the largest GP stakes fund ever raised, in 2Q 2019; and Goldman Sachs' Alternative Investments and Manager Selection (AIMS) Group is seeking $4.0 billion for another Petershill fund. As an unprecedented tidal wave of cash pours into the strategy, these investors are looking for a place to deploy capital, targeting smaller GPs and expanding to other private market strategies.

GP stakes fundraising value ($B) including open funds



Source: PitchBook | **Geography:** Global
*As of May 24, 2019

Strategy evolution

What do we mean by open-ended and closed-ended? This is different than the way mutual funds are structured. We are focused on the GP's fund structure. Hedge funds are subject to redemptions and the whim of investors, although there may be lock up periods. PE, VC, and other private markets strategies raise funds where capital cannot be redeemed until the end of the fund's life except through the secondary market.

The GP stakes strategy originally developed around open-ended strategies (i.e. hedge funds) but has evolved to be primarily focused on PE and other closed-end strategies. As investment in the top tier of North American PE managers has become saturated, Europe appears to offer fertile ground. Eurazeo, a Paris-based GP managing several PE strategies, has secured numerous GP stakes deals across Europe in recent years, which may signal investments to come from the big US-based firms. In addition to expanding to Europe, GP stakes investors have sought smaller and younger firms that are more likely to be seeking growth capital than providing founder liquidity. In recent quarters, half a dozen managers have popped up seeking to invest in smaller firms. Though we highlighted several in our 2019 Private Equity Outlook, those firms have been mostly quiet to date. There are other firms seeking to get in on the action, too. Goodhart Partners formed Volunteer Park Capital, which is seeking $200.0 million to invest in middle-market managers, and newcomer Stonyrock Partners has partnered with Leucadia Asset Management to raise a $1 billion permanent capital vehicle targeting GP stakes investments in middle-market GPs.

In addition to seeking out smaller GPs that may need development capital, GP stakes investors are expanding beyond traditional buyout managers and are increasingly targeting other closed-end private market managers, including debt, secondaries, and VC. The risk/return profile and fee structures for these fund strategies may differ slightly, though the GPs often have similar economics, growth rates, and requirements for capital as their PE peers. There have been half a dozen investments in debt managers but few deals involving secondaries GPs. While the balance of carry and management fees for secondaries GPs closely resembles those of PE GPs, the stability of the yield component for debt and real estate means the carry tends to be less volatile, and funds often earn more from management fees. Going forward, we believe these closed-end fund structures bode well for future GP stakes investments. As these private capital managers pursue outsized step-ups and expand strategy offerings, the capital needs are outstripping the ability of partners to fund GP commitments and keep ample cash on the balance sheet.

Whereas debt and real estate funds earn proportionally more of their revenue through management fees, carry tends to be disproportionately important to the VC strategy due to its reliance on outlier investments. VC funds also tend to be smaller than other private market strategy funds, which means less in management fees and has traditionally resulted in muted appetite from GP stakes investors. Late-stage firms, though, tend to gather a larger and steadier sum of AUM on which they can charge management fees. To that end, AIMS recently inked a VC investment in General Catalyst. With a greater emphasis placed on carry, these firms may require an adjustment to the valuation calculation, but we believe there will be more VC deals going forward, particularly as late-stage venture and growth equity strategies continue to proliferate.

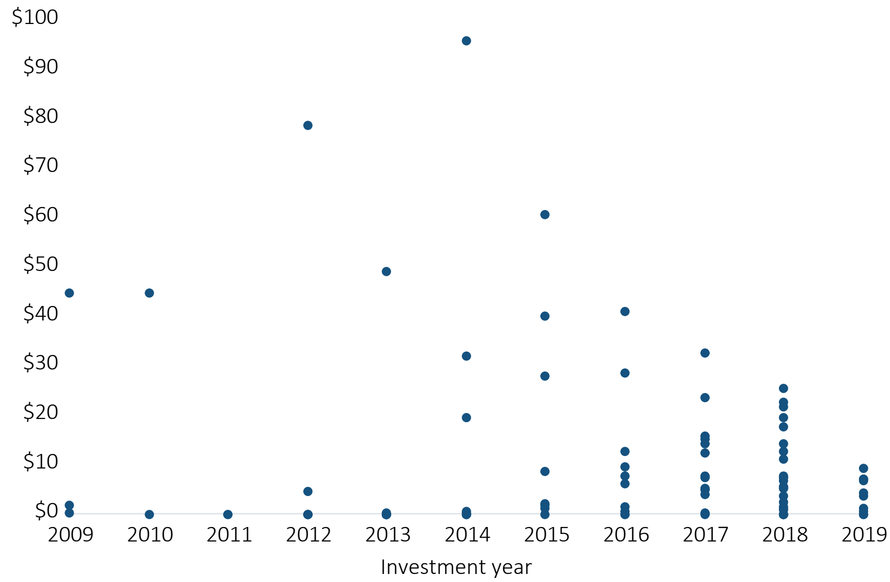
This strategy evolution has led some LPs to fear that premier opportunities have dried up and that a supply and demand imbalance may cause GP stakes investors to pay up for deals or resort to lower-quality firms, having a negative impact on performance.[1] As the pond shrinks, a trifurcation of strategy appears to be occurring between Goldman, Blackstone, and Dyal. Whereas both Goldman and Blackstone are pursuing middle-market GPs, only Goldman appears to be expanding to VC. Dyal has no plans to change tactics, however. Dyal's managing director Michael Rees reportedly told investors he has only 10 to 15 more firms he wants to add to his stable.[2] In a PitchBook webinar, Rees said the firm intends to slow the pace of new partnerships and begin focusing on deploying capital in new ways with existing partners.

While some LPs fear pivoting to smaller GPs, these petite and more niche players could prove worthwhile. A niche area of expertise increases the likelihood of being able to charge above-average management fees while others in the industry feel the brunt of fee compression. An example of this is GP stakes. Per publicly available sources, Dyal charges a 2.0% management fee on its $5.3 billion 2016 vintage fund and still levies a 20% carry whereas most PE funds above $5 billion charge 1.5% management fees. Additionally, these investments in more nascent GPs are likely closer to the beginning of a firm's growth curve, increasing the risk profile, but potentially offering a greater return.

To visualize the GP stakes strategy evolution, we looked at the target GP's fundraising total before each investment. We see VC, debt, and secondaries as wide-open opportunities, but they will likely follow the same trajectory as PE as top targets are picked off over time.

1: "Global Private Equity Report 2019," Bain & Company, 2019
2: "Buying Stakes in Private-Equity Firms, Not Just Their Funds, Pays Big," The Wall Street Journal, Miriam Gottfried, November 18, 2018

Target GP's fundraising total ($B) when investment was received

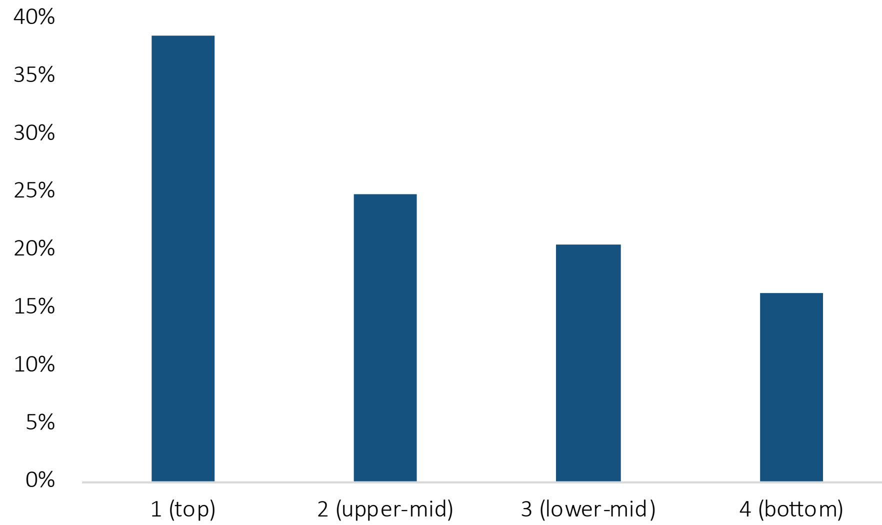


Source: PitchBook | **Geography:** Global
*As of June 6, 2019

What makes you different?

GP stakes investors want to invest in firms that will steadily grow AUM and the associated fee revenue. Performance is one of the key indicators of firms likely to grow assets consistently. Our research shows that private market performance tends to be sticky, meaning the top performers tend to stay on top over longer periods of time. LPs often choose to allocate more to top performers, and GPs stakes investors want managers that are garnering vast sums of capital and able to seek aggressive step-ups between funds. Top performers are also allowed to falter every so often and are given the benefit of the doubt when they have a poorly performing fund, raising the chance of LPs recommitting to subsequent funds. This has the benefit of stabilizing a firm's asset base and lowering investment risk. Additionally, elevated performance levels afford managers the freedom to pursue more offerings in terms of strategy and geography. These established managers can act as a platform used to attract and retain talent, keeping strategy expansion in-house while pitching to an established LP base. Of the firms that have received a GP stakes investment, over 60% of their previous funds were in the top two quartiles, on average.

Proportion of funds by IRR quartile for GP stakes targets[3]



Source: PitchBook | **Geography:** Global
*As of May 30, 2019

While performance is paramount in understanding which firms are in the best position to target healthy step-ups and expand offerings, not all firms with top-quartile performance are seeking to expand. Although IRRs and TVPIs are important, GP stakes investors want to see AUM growth and, concurrently, fee growth. In conjunction with performance, we looked at step-ups for managers' most recent funds prior to receiving GP stakes investments. We noticed these firms tend to achieve larger step-ups than their peers, likely one of the triggering events for investors trying to find targets. Firms that have received a GP stakes investment in the past three years have seen step-ups of nearly twice the industry average. Though we were only comparing PE funds for this analysis, the same is likely to hold true for other strategies because large step-ups can create a cash crunch for the firms' partners.

So, who's next?

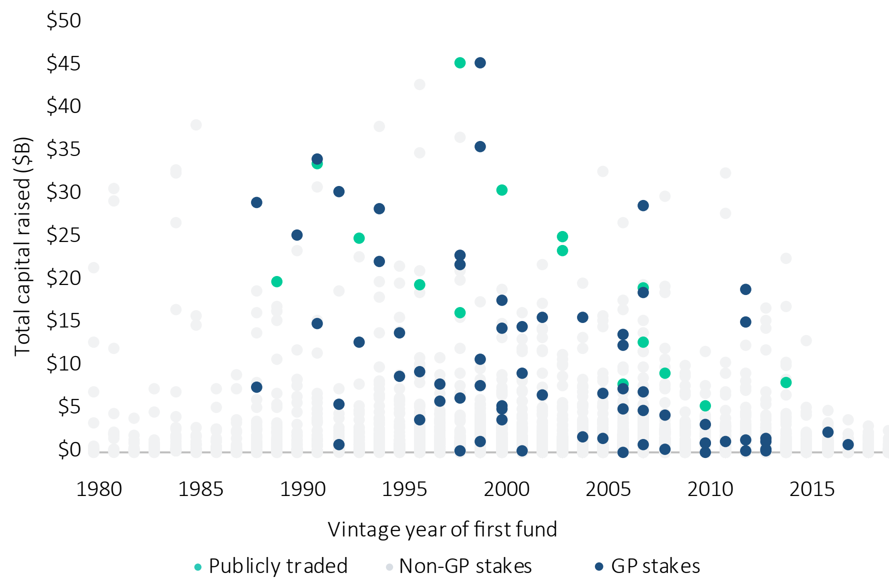
To create a more nuanced view of the investable landscape, we categorized PE GPs into four distinct groups, looking at the total capital raised.

Category 1: $25 billion+
Category 2: $10 billion-$25 billion
Category 3: $2 billion-$10 billion
Category 4: $0-$2 billion

3: This excludes The Carlyle Group's funds. Its significant fund count before the most recent stake was an outsized influence.

We focused our analysis on the PE firms that have raised between $2 billion and $25 billion, believing the newest managers do not yet have a track record that would support a typical GP stakes investment and that the larger managers are already claimed or have been approached for an investment previously. Though there are investors looking to "seed" GPs, that is outside the scope of this note. For debt, secondaries, and VC managers, we looked at managers across the spectrum since the opportunity set is so much fuller. Even with more than 100 GP stakes partnerships already inked, there is still a sufficient pool of GPs to sustain several more years of fervent investment.

GP comparison by backing status



Source: PitchBook | **Geography:** Global
*As of June 3, 2019

The group of PE managers that have raised between $10 billion and $25 billion appear to be the current sweet spot for GP stakes investors, but fewer than 50 of these GPs remain. At these levels, managers are often raising a multibillion-dollar fund or two before receiving an investment. GP stakes investing in this range seems to be heading toward saturation, meaning the current track is likely unsustainable longer term. But there appears to be an ample number of firms in the next tier down—those that have raised between $2 billion and $10 billion—likely to need a capital injection. There are hundreds of managers in this category, and a dozen or more join the ranks annually. High performers in this category seek outsized step-ups and are likely to need additional capital. We believe this will be where GP stakes investment goes in the coming investment cycle as the larger ranks become saturated. Using performance metrics for managers that have received a GP stakes investment, we compiled two lists for PE GPs: one of managers that raised between $10 billion and $25 billion and another list of smaller managers that raised between $2 billion and $10 billion.

Larger potential PE GP stakes targets

Firm name	Total capital raised ($B)	First vintage	HQ	Most recent fund step-up
Summit Partners	$21.8	1984	Boston	48.5%
GTCR	$21.5	1980	Chicago	36.4%
PAI Partners	$20.0	1999	Paris	54.5%
Genstar Capital	$16.5	1989	San Francisco	75.0%
Quantum Energy Partners	$15.7	1998	Houston	25.3%
Equistone Partners Europe	$14.3	2002	London	40.0%
Affinity Equity Partners	$13.3	2004	Hong Kong	57.9%
Roark Capital	$12.0	2004	Atlanta	100.0%
The Jordan Company	$11.9	2002	New York	13.4%
TDR Capital	$10.2	2002	London	64.3%
MBK Partners	$10.0	2006	Hong Kong	51.9%

Source: PitchBook | **Geography:** Global | **Note:** Step-ups are for most recent flagship funds.
*As of June 6, 2019

Smaller potential PE GP stakes targets

Firm name	Total capital raised ($B)	First vintage	HQ	Most recent fund step-up
Inflexion Private Equity	$9.3	2003	London	92.3%
Boyu Capital Advisory Company	$9.1	2011	Hong Kong	20.0%
Sycamore Partners Management	$8.3	2012	New York	90.0%
Charlesbank Capital Partners	$7.8	1998	Boston	57.1%
Veritas Capital	$7.5	1997	New York	89.3%
Investindustrial	$7.1	2000	Lugano, Switzerland	60.0%
American Industrial Partners	$6.8	1989	New York	62.6%
Vitruvian Partners	$5.8	2008	London	100.0%
Arsenal Capital Partners	$5.3	2003	New York	81.5%
Sentinel Capital Partners	$4.7	1996	New York	65.4%
Ridgemont Equity Partners	$4.2	2012	Charlotte, NC	65.8%
Tailwind Capital	$3.6	2007	New York	71.4%
Atlas Holdings	$2.9	2010	Greenwich	86.1%
Linden Capital Partners	$2.8	2005	Chicago	100.0%

Source: PitchBook | **Geography:** Global | **Note:** Step-ups are for most recent flagship funds.
*As of June 6, 2019

Additionally, we separated out VC, private debt, and secondaries. These relatively untapped categories for GP stakes investing seem to offer fertile ground to early investors, who are able to pick from the best managers. Using previous investments and PitchBook data, we put together lists of potential target GPs for each asset class, believing these firms are the prototypical GP stake investments.

Potential debt GP stakes targets

Firm name	Total capital raised ($B)	First vintage	HQ	Most recent fund step-up
CarVal Investors	$19.5	2005	Minneapolis	0.0%
Castlelake	$9.1	2005	Minneapolis	27.3%
Alchemy Partners	$7.7	2004	London	50.0%
GoldenTree Asset Management	$7.3	2010	New York	47.8%
Strategic Value Partners	$7.0	2006	Greenwich	82.7%
Catalyst Capital Group	$4.9	2002	Toronto	98.1%
Czech Asset Management L.P.	$4.3	2010	Old Greenwich, CT	19.3%
Glendon Capital Management	$3.6	2014	Santa Monica	125.2%
Proventus	$2.8	2009	Stockholm	128.7%

Source: PitchBook | **Geography:** Global | **Note:** Step-ups are for most recent flagship funds.
*As of June 6, 2019

Potential VC GP stakes targets

Firm name	Total capital raised ($B)	First vintage	HQ	Most recent fund step-up
Accel	$15.4	1989	Palo Alto	50.0%
Bessemer Venture Partners	$8.2	1995	Boston	15.6%
Battery Ventures	$7.0	1984	Boston	23.1%
Lightspeed Venture Partners	$6.8	1999	Menlo Park	110.0%
GGV	$5.8	2001	Menlo Park	51.1%
Canaan Partners	$4.7	1993	San Francisco	33.3%
Spark Capital	$2.8	2005	Boston	63.4%

Source: PitchBook | **Geography:** Global | **Note:** Step-ups are for most recent flagship funds.
*As of June 6, 2019

Potential secondaries GP stakes targets

Firm name	Total capital raised ($B)	First vintage	HQ	Most recent fund step-up
Coller Capital	$21.1	1996	London	30.0%
Pomona Capital	$7.9	1994	New York	1.6%
Newbury Partners	$4.3	2007	Stamford	31.3%
Glendower Capital[4]	$2.4	2011	London	176.9%
Montana Capital Partners	$1.7	2013	Baar, Switzerland	97.0%

Source: PitchBook | **Geography:** Global | **Note:** Step-ups are for most recent flagship funds.
*As of June 6, 2019

Looking forward

With the top three investors in the GP stakes space all currently fundraising and with a flood of new capital likely to be raised this year, GP stakes investing looks to accelerate its current trajectory. These funds will put the top three managers at over $10 billion in assets devoted to the strategy. With such a gigantic pool of capital, much of the focus has been on dealmaking, but some investors are thinking forward to eventual liquidity events. The smaller firms with smaller funds have more optionality, including selling to a strategic investor or sovereign wealth fund, or selling via secondary sales. Dyal, Goldman, and Blackstone, meanwhile, will almost certainly have to publicly list their stakes and create an entity that is reminiscent of Affiliated Managers Group (NYSE: AMG) if they decide to give all LPs a liquidity option. At sizes of $10 billion and over, these GP stakes listings likely eclipse The Carlyle Group and Ares (and potentially Apollo) in size. But Dyal's Rees has stated that many of the LPs see GP stakes as a yield play and may not want to focus on an exit. Rather, Dyal may decide to hold these assets in perpetuity, forcing LPs to use the secondaries market for any liquidity needs.

LPs are wondering whether the good times can last for GP stakes fund performance. Reports suggest Dyal's 2016 fund is earning net returns in the mid-20 percent range.[5] Such outperformance naturally draws others into the fold, and it appears performance for GP stakes may be pressured as capital chases outsized gains, subsequently driving down returns. Furthermore, the strategy is no longer a secret as all of the targets are aware of Dyal, Blackstone, and Goldman. Target GPs also know how much capital is looking for a home, hoping they can force buyers to pay up, which may lower returns. GP stakes investing is a relatively non-competitive market, however. There are just three major players, which could keep pricing reasonable, though others are coming into the fray.

4: Glendower was spun out of Deutsche Bank. This seasoned management team may want liquidity for its founders. The GP may also require capital due to large step-ups recently.
5: "Buying Stakes in Private-Equity Firms, Not Just Their Funds, Pays Big," The Wall Street Journal, Miriam Gottfried, November 18, 2018