PitchBook

The GP Staking Competitive Landscape

Examining the market segments and influential firms

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Contents

Key takeaways

- **The GP staking landscape has matured and now covers three distinct segments:** the top end where target GPs often have raised $8 billion+ over the last decade, the middle market where target GPs have raised $1.5 billion to $8.0 billion over the last decade, and the emerging or spinout space, which covers spinouts or managers that have raised $500 million to $1.5 billion over the past 10 years. Each segment has distinct supply-demand dynamics and firms dedicated to targeting GPs within the space.

- **The top end contains the largest target GPs, as well as the largest GP staking firms.** This segment has seen a gigantic influx of cash chasing deals, although few GPs are left in the space that have yet to sell a GP stake. Because of this, GPs selling a stake at the top end have some pricing power and often sell stakes at auctions to further bid up prices.

- **Today's firms staking middle-market or emerging managers or seeding spinout managers are all somewhat new, with none dating back more than five years in their current form.** The supply-demand dynamic favors GP staking firms in these corners of the market, with far more targets than buyers. This, coupled with the elevated risk of investing in less mature managers, means expected returns are higher than they are at the top end.

Previous research on the topic includes a primer on the space, analysis of the shift to closed-end managers and an examination of the targeted managers' characteristics.

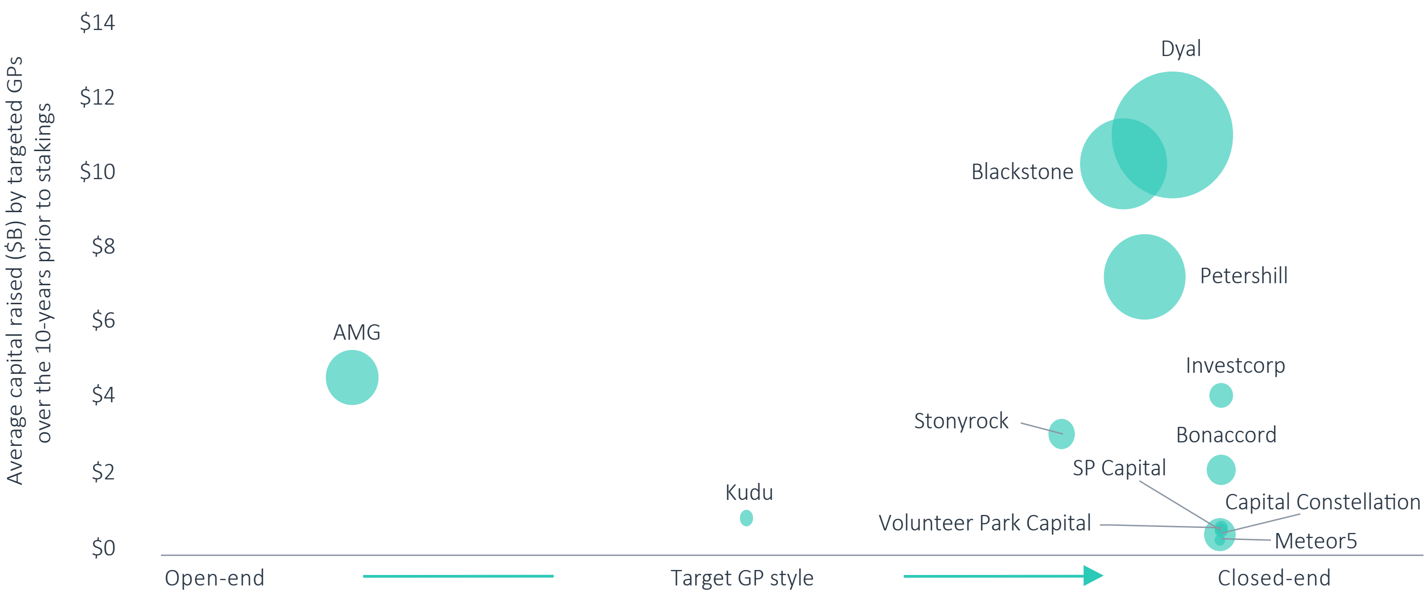
Published on July 8, 2020
This note was updated on July 27, 2020 to reflect more nuanced explanations of certain GPs.

Introduction

The GP staking landscape has grown and matured extensively since the global financial crisis (GFC). Perception around the deal type—whereby firms take a passive minority stake in a GP management company—has changed as well, with GPs recognizing the value in partnering with an outside manager to grow their business. The relationship between a GP staking firm and the GP in which they invest is akin to that between a typical GP and its portfolio company. As one GP stakes fund manager put it, "We are just a PE firm investing in and lending support to companies. The companies in which we invest just so happen to be alternative asset managers."

LPs, which were at first skeptical and critical of these partnerships, have also shifted their perspective, believing that the GPs forming them are often better managed and have more longevity. As LPs and GPs have come around to the investment thesis and grown more comfortable with the financial relationships, and as some early Dyal and Petershill funds have produced headline grabbing returns, capital has poured into the industry, and new GP staking firms have emerged. This note will focus on the competitive landscape, laying out the major market segments, discussing how each segment's investment characteristics differ, and identifying the major firms.

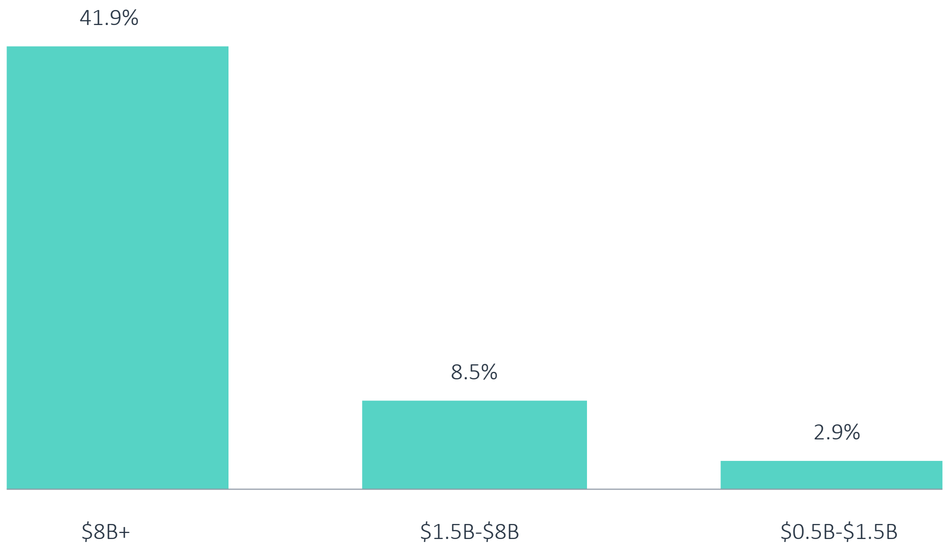
Competitive landscape*



Source: PitchBook, analyst estimates, manager discussions Investcorp white paper | **Geography:** Global
*As of May 31, 2020
Note: Bubble size indicates total capital raised for GP staking. This total includes the full amount of capital for any open funds. For AMG, the total is their current market capitalization.

We believe the GP stakes landscape is now divided into three segments: the top end (target GPs have raised more than $8.0 billion over the past 10 years), the middle market (target GPs have raised between $1.5 billion and $8.0 billion over the past 10 years) and spinout or emerging managers (spinout managers are seeking their first institutional fund, and emerging managers have raised between $500 million and $1.5 billion over the past 10 years). Each segment possesses unique risk-reward tradeoffs, and GP staking firms tend to stay within their lane, although firms targeting top-end GPs occasionally move down market with supply beginning to dwindle. All the newer GP stakes investors are targeting the middle-market or spinout or emerging managers. The top end, though, where approximately half of the eligible GPs have already sold a stake, is dominated by three gigantic incumbents capable of raising the multibillion-dollar funds that are needed to play in this space.

Proportion of GPs that have sold a GP stake by total capital raised over the last 10 years



Source: PitchBook | **Geography:** US
*As of May 31, 2020

In the following segments, managers are ordered in an unsystematic manner. The firms that received longer writeups were targeting funds of at least $200 million in size and were dedicated to GP staking and/or have completed several deals of this nature.

Top end

Within the broader GP stakes market, Dyal, Petershill, and Blackstone Strategic Capital Holdings (the big three) stand above the rest in terms of capital raised for GP stakes investments and the total number of such deals completed. These managers have teams dedicated to helping grow their partner firms and have massive networks that span dozens of partner firms that can share best practices. They are also backed by global financial institutions and/or asset managers, which GP staking firms leverage to assist the GPs in which they invest. As capital has continued to flow into the space, the big three have pivoted away from investing in open-ended managers such as hedge funds, a practice that was common a decade ago. They instead now focus almost exclusively on closed-end private capital managers. The better alignment of closed-end funds investing in closed-end managers is one reason the strategy has found such success in recent years.[1] These three managers have institutionalized the GP stakes space and seem to be perpetually fundraising and completing new deals within it.

1: Capital is locked up at both the GP staking firm level as well as the target GP level. Hedge funds can suffer from redemptions, even if gated, and capital is often locked up for far less time.

Fundraising profiles for select GP staking firms*

Firm	Total capital raised ($B)	Most fund recent size ($B)	Current fund name	Current fund target size ($B)	Parent company
Dyal	$18.1	$9.0	Dyal Capital Partners V	$9.0	Neuberger Berman
Petershill	$4.5	$2.5	Petershill V	$4.0	Goldman Sachs
Blackstone Strategic Capital Partners	$3.5	$3.5	Strategic Capital Holdings II	$6.0	Blackstone

Source: PitchBook | **Geography:** US
*As of May 31, 2020

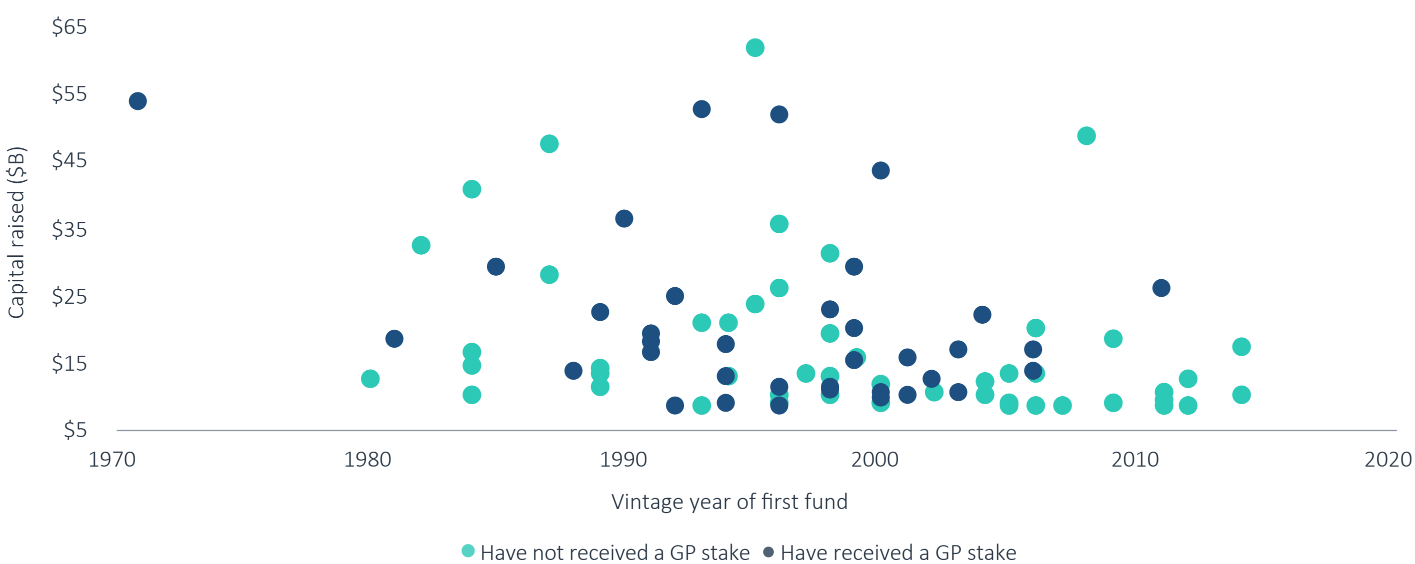
GPs targeted by Dyal, Petershill, or Blackstone tend to be more mature and at the top end—though Dyal and Blackstone often target even larger managers than Petershill. Stakes at the top end of the market are typically valued far north of $150 million, which is one of the main reasons these three GPs are raising a combined $19.0 billion with their current fund offerings. Recent GP staking activity by these firms includes Blackstone's deal with BC Partners for €500 million ($560 million) and Petershill's purchase of a €500 million stake in Permira. To receive a stake from any of these three firms, GPs will likely have raised over $7 billion in the past decade and be well on their way toward creating a multigenerational firm.

Investing in more mature managers presents fewer short-term risks but unique long-term challenges. GPs selling a stake to Dyal, Blackstone, or Petershill are likely looking to expand into new strategies and/or geographies and solve generational ownership and employee retention issues. Each GP staking firm offers a unique suite of solutions, but broadly speaking, they are all equipped to solve these challenges. They can leverage their already-established partnership networks to determine what worked and what did not when a buyout firm rolls out a credit strategy, for example. Furthermore, the GP stake investments can be used to clean up ownership structures and make equity available to the next generation of employees, helping with retention.

Another unique aspect of GP staking at the top end is that deals are often won at auction, meaning a target GP has likely held talks with the two other large firms seeking a stake in its business. The auction process, usually run by Evercore, Berkshire Global Advisors, or Goldman Sachs, creates an environment where price is often the crucial factor. Historically, deals won at auction have also tended to be comprised of mostly secondary equity, often due to retired founders or silent partners exiting their stake. However, in the past decade, deals won at auction have seen a lift in their proportion of primary equity, and that figure continues to rise. GP staking investors prefer primary equity because it finances the balance sheet and can be used to raise GP commitments or seed new strategies. GP stake investments into middle-market or emerging or spinout managers are almost always 100% primary equity.

Competition tends to be higher for stakes in GPs at the top end not just because many deals go to auction— compared to investments in middle-market GPs, which are closer to 50/50 between proprietary and auction, and emerging GPs, which are almost entirely sourced in a proprietary manner—but because there are so few massive GPs without backing. However, competition for $500 million+ GP stakes is much lower than other segments of PE. This market is an oligopoly with most GP stakes auctions having three or fewer participants, far fewer than the dozens that often compete for middle-market software buyout deals, for example. We estimate that there are only 30 to 40 GPs left at the top end for Dyal, Petershill, and Blackstone to target, only enough to last another couple of years at their current rate of capital deployment—although new sourcing channels and maturing middle-market GPs could add to supply over time. Further, GPs may elect to sell another stake down the line. For example, Vista and H.I.G. have sold a second stake to Dyal after initial sales. A source at a top-three GP staking firm believes deploying additional capital with existing partner firms alone could provide Dyal, Blackstone, and Petershill enough opportunity to invest another $20+ billion over the coming five to seven years. The supply-demand imbalance at the top end favors GPs selling stakes, which has—along with generally mammoth check sizes—led to some target GPs securing two GP staking firms on one deal. For example, Petershill and Blackstone both invested in Francisco Partners, and Petershill and Dyal both invested in Clearlake.

Top-end GPs by total capital raised in the past decade and current backing status*



Source: PitchBook | **Geography:** Global
*As of May 31, 2020
Note: Includes PE, VC, real assets, credit, and secondaries managers

While the current environment may appear to favor the sellers, some new deal sources may be coming down the pike that could lift supply. Several large LPs that invested in private capital managers a decade or more ago are actively shopping their GP stakes. For example, China Life Insurance owns a stake in TPG Capital and Kuwait Investment Authority, and GIC owns one in CVC Capital (not to say these specific investments are on the market). As mentioned earlier, their current portfolios present Dyal, Blackstone, and Petershill ample opportunity to buy additional stakes and deploy tens of billions of dollars. Furthermore, GP staking targeting the middle market believe some of their investments may eventually be better served by a larger firm and have expressed interest in selling them when that time comes. However, just as many middle-market GP stakes deals are expected to eventually be sold back to management once the next generation of managers has enough wealth to buy in. While buying GP stakes from LPs or other GP staking firms may seem like a departure from strategy, the acquisition of secondary equity is already common at auction deals, so the only change would be buying this equity from other investors rather than from a retiring founder. These potential (and for the moment, theoretical) deal-sourcing supplies could augment other sources and allow the big three GPs to continue investing at their current rate for years to come.

One side effect of sourcing deals from auctions, beyond pushing up prices, is that GP staking firms have less ability to structure bespoke deals. Any use of overly cumbersome covenants, liens on assets, or revenue shares may cause the GP to walk away and seek the second-highest bidder. This means that while the largest GP stakes investors are buying into more established—and subsequently less risky—managers, their deal structure is riskier because they have the least ability to design investments for downside protection. Other types of deal structuring exist, though. Deals are often structured beyond simple ownership sales of 10%. For example, a GP staking firm may choose to buy 15% of future management fees and only 9% of future carry, which may average around 12% of the GP's annual cash flows. This effectively allows GPs to securitize future management fees and invest that capital into their own funds, effectively making the GP's fund performance more meaningful to the partners' bottom lines and providing better alignment with LPs.

Investing in the largest and most established GPs is also accompanied by the lowest return expectations on the GP staking investment continuum. As we have seen elsewhere when the largest funds target the most sizable companies, including with PE mega-funds, performance tends to be slightly below what smaller funds achieve, although with less volatile returns. Initial cash yields do tend to be the highest in this market segment, though, because less of the purchase price is based on growth. Growth is still a key component of these valuations, though. Francisco Partners had raised $9.5 billion in the decade before the firm sold a stake to Petershill and Blackstone in 2018. Its most recent fundraising round of $9.8 billion across three funds has already eclipsed that figure and includes Francisco's first-ever credit fund.

Turning to performance figures, the top-three GP staking managers typically underwrite deals at between 1.8x and 2.3x MOIC and a 15%-20% net IRR, but they often use some financial engineering to achieve it. As with other market segments, the top-end deals are underwritten to achieve a 1x MOIC on the worst-case scenario, and GP staking firms should make their money back on management fees from the target GP alone in 10-12 years. The typical target is a seven- to eight-year payback, with carry factored. However, to boost returns, GPs will look to delay capital calls from LPs by way of industry standard subscription credit lines. These managers also do not pay out all the money upfront but instead dole out capital over two or three (sometimes four) payments over time. These firms also use three to four year term leverage on portfolios to boost early returns to LPs. The early return of cash and multi-staged payments boost the IRR. Public documents support the notion that GP stakes funds have put up healthy performance figures with juicy cash yields.[2,3] The question is whether this can continue as capital pours into the strategy, especially into deals with firms at the top end. There already appears to be a valuation gap between how GP staking firms and target GPs value themselves. One GP told our analyst, "You'd have to be an idiot not to sell at these prices." With so much capital chasing GP staking deals, we will have to wait and see if the current round of funds delivers performance similar to previous fund generations or if competition will pull down returns for this class of GP staking funds.

Unlike other areas of PE—and even other segments within GP staking—full liquidations of GP stakes investments are unlikely. Many times, the stakes are too large for company management to buy back, and the GPs that sold a stake benefit from continuing the relationship with an operational partner. When underwriting deals and pitching themselves to GP targets, the top three managers think of themselves as permanent capital, which is one reason people invest in these funds. As one investor said about a Dyal fund, "I cannot replace this kind of cash flow, predictability and downside protection."[4] While the sale of an entire portfolio is unlikely, recent media reports noted that Dyal was considering a strip sale of one or more of its holdings out of its $5.3 billion 2017 vintage Fund III, although it is unknown if anything came of those talks. Michael Rees of Dyal also toyed with the idea of floating the portfolio of stakes on the public market, in a manner similar to Affiliated Managers Group (NYSE: AMG). However, multiples of publicly traded alternative asset managers, such as Blackstone and Apollo, are not attractive enough for this route to be feasible, despite their steep share-price jumps after converting to C-Corps. A recent discussion with a managing director at one of the top three firms confirmed that the public listing route is currently untenable. We have seen some dividend recaps as the portfolios grow in value and are likely to see more, with Dyal recently reportedly seeking a $1.0 billion recap and other firms currently looking into this option. LPs invested in GP staking funds targeting the top end who wish to recover their capital can sell their fund stakes on the secondary market.

Dyal

Of the top three GP staking firms, Dyal is the clear market leader in terms of capital raised and high-profile deals closed. Dyal has several advantages over its peers, Petershill and Blackstone Strategic Capital Partners. Two of the largest advantages that have led to its enviable position are history and competitive positioning. Michael Rees, the founder and head of Dyal, has been in the GP stakes business since his time at Lehman Brothers, which means he has been conducting GP stakes deals for over a dozen years. Over that time, Dyal has raised four commingled funds, netting over $18 billion (including co-investment capital) and closed on over 45 GP stakes transactions, including those in Silver Lake, Vista Equity Partners, and Platinum Equity. The firm tends to buy stakes of between 12% and 14% of the GP, which leaves the selling firm's partners with enough equity to sell Dyal (or another GP staking firm) another stake or two down the line. The deals may also not be for an even split, and a 12% stake may equate to 14% of management fees and 10% of carry, for example. Dyal tends

2: "Buying Stakes in Private-Equity Firms, Not Just Their Funds, Pays Big," The Wall Street Journal, Miriam Gottfried, November 18, 2018
3: "Investing in Private Equity Firms Draws More Interest," Pensions & Investments, Arleen Jacobius, January 8, 2018
4: "Private Equity Titans Quietly Discover How to Get Richer," Pensions & Investments, October 23, 2019

to target buyout, credit, and real estate GPs, though the firm has done deals in infrastructure and other GP types. These GPs also receive access to Dyal's business services platform (BSP), a 32-person team spread across New York, London, and Hong Kong that focuses on post-investment value creation. The BSP concentrates on asset raising and enterprise value creation.

Another of Dyal's unique advantages among the big three is its competitive positioning. Dyal and its parent company Neuberger Berman are active in the asset management space but play a limited role in broader private market activities. This is important because, unlike Petershill and Blackstone Strategic Capital Partners, Dyal's parent company's business lines often do not directly compete with potential GPs seeking investment. For example, if a larger buyout manager was seeking to sell an equity stake, that same manager may be competing for deals with Goldman Sach's West Street Capital Partners or Blackstone's Capital Partners fund; however, there is no competition with Dyal or Neuberger Berman. Neuberger Berman does have a sizable private credit operation, though, which may put Dyal in conflict with private-credit GPs. In conversation with a PE firm that sold a stake to Dyal, the fact that Neuberger did not have any competing interests was something that put them at ease. Capitalizing on these advantages has allowed Dyal to seemingly raise capital at will. The firm closed on Fund IV 50% oversubscribed at $9.0 billion in 2019. Dyal is already back on the road fundraising for a $9.0 billion fund that—if previous fundraises are any indication—will likely eclipse the $10 billion mark.

Dyal, with its largest-in-class funds, typically looks to assume stakes in the biggest GPs. In the last five years, Dyal has targeted GPs that had raised an average of $9.1 billion in the past 10 years. This often means bidding at auctions, typically against Blackstone and/or Petershill. With deal sizes near the top end and many won at auction, Dyal's expected net IRR on staking deals is around 15% to 20%, although there is room for upside. Dyal's 2014 vintage $1.8 billion Fund II posed a 24.3% net IRR as of late 2015, according to New Jersey Division of Investment documents,[5] and 2016 vintage $5.3 billion Fund III was posting an approximate IRR of 26% net of fees in late 2018, according to sources who spoke to the Wall Street Journal. Dyal has been opportunistic and creative with its dealmaking, which is one reason some funds have posted returns above its cost of capital. For example, the firm has recently purchased a GP stake through the secondary market. Dyal's acquisition of a stake in RXR realty from Colony Capital may pave the way for other secondary transactions of GP stakes, from large institutions or middle-market staking firms.

Dyal has been innovative in other ways, too. It has doubled down on GPs, such as Vista Equity and H.I.G. Capital and is raising $1 billion for the first-ever GP stakes debt fund, which could be used in conjunction with equity during future GP staking. Recent reports claim Dyal is looking into a strip sale of one or more firm partnerships from Fund III. While all investments are expected to be permanent partnerships, Dyal may be a willing seller if the senior executives at the partner firms are on board and it can secure an above-market price. The firm is allegedly also looking to do a $1.0 billion recap on its $5.3 billion Fund III and capitalize on marked portfolio

5: "Proposed Investment in Dyal Capital Partners III L.P. & Related Co-Investment Separate Account," The New Jersey Division of Investment, September 23, 2015 appreciation. These constant innovations have helped Dyal remain ahead of the pack. The firm's success and innovation have even pushed it to go beyond GP stakes investing. The firm is now seeking to raise $2 billion for the only NBA-sanctioned fund that will buy minority stakes in professional basketball franchises.

Petershill

Petershill has been managing outside capital solely dedicated to the GP staking strategy for more than a decade, with its first fund dating back to 2007. In fact, its first fund's sale of five GP interests for around $800 million in 2016 to Affiliated Managers Group was a pivotal moment in the history of GP stakes. It marked the beginning of the current frenzy by proving there were exit opportunities. The firm, which is headed by Robert Hamilton Kelly, is the GP staking business of Goldman Sachs, under its Alternative Investments & Manager Selection (AIMS) group. Since its founding, Petershill has completed over two dozen GP staking deals. Like its competitors, Petershill has pivoted to invest in closed-end firms. But Petershill has also branched out and invested in VC firms—including General Catalyst and Industry Ventures—while Dyal and Blackstone have not. VC firms are typically harder to underwrite because carry, which is harder to predict and valued lower, makes up a larger chunk of revenue than other private market strategies.

Petershill also tends to go after smaller GPs than Dyal or Blackstone and is the only one of the top managers to claim to be targeting the middle market. According to sources, Petershill tries to avoid the auction process, and most of the deals it does are proprietary, as it believes the increased growth prospects make up for the reduced fee and carry income that accompanies raising larger funds alone. PitchBook data confirms this, showing that Petershill tends to target firms that have raised between $3 billion and $10 billion in the decade prior to selling a stake. However, it is quite flexible and can target managers that have raised as little as $1 billion and up to $30 billion or more in the 10 years prior to selling a stake. Concurrent with targeting smaller GPs, Petershill is seeking capital for a $4.0 billion fund—in which it plans to take 10-12 stakes—which marks the smallest of the big three's vehicles and less than half of Dyal's $9.0 billion offering.

Despite raising smaller funds and targeting smaller GPs than other top-tier managers, Petershill still offers levels of service that are similar to other GP staking firms. The firm can leverage relationships throughout Goldman Sachs and has access to its GP services team, which is there to help with fundraising, product strategy, operations and more. However, there are some Chinese walls set up to help Petershill avoid muddying the water between Goldman Sachs's investment banking offerings and Petershill's partner firms' needs. Petershill's unique offering has been a selling point, with one GP stating it chose Petershill because it wanted the top-tier service available only at the big three managers but didn't feel its size would have been as important to Blackstone or Dyal because they deal with such large managers.

When it comes to returns, Petershill tends to underwrite deals at a 20%+ net IRR, since it tends to target middle-market GPs with ample room to grow. The GP uses some unsecured or LP commitment-secured, fund-level leverage for capital calls but does not use permanent leverage on funds. Liquidity is another method of boosting returns, although full exits are not typically a factor. Petershill pitches itself as permanent capital, and sources confirm the base case is for the GP to hold these investments into perpetuity. Selling an additional portfolio of stakes or bringing them public is unlikely, especially because the firm believes public alternative-asset-manager multiples are still too low in the public market, even after a sharp run up in share prices. Petershill has done a dividend recapitalization on a previous fund to bring forward cash to LPs but believes that LPs can get liquidity on the secondary market if they are seeking to exit the fund.

Blackstone

Although Blackstone Strategic Capital Partners came to the party in 2013, later than Petershill or Dyal did, the firm has effectively leveraged the "Blackstone platform" to become another goliath in this space. The group, led by Scott Soussa, has taken advantage of Blackstone's in-house capabilities and unparalleled LP connections to raise multibillion-dollar funds and now regularly competes for deals with Dyal and Petershill. The firm is raising its second fund and expects to hold a final close in mid-to-late-2020. Reports peg the number at $6.0 billion, nearly twice the firm's first fund, which closed on $3.3 billion.

Not only has Blackstone Strategic Capital Partners effectively leveraged its parent company's platform to raise capital and scale quickly, but the manager provides the same benefits to companies in which it takes a GP stake. This partnership with the world's largest alternative asset manager, spanning dozens of private market strategies, is one of the most compelling points to potential GPs. Chances are when a partner firm wants to expand offerings, Blackstone has been managing that strategy through several vintages already. Francisco Partners recently closed on its initial credit fund after Blackstone bought a stake in Francisco in 2018.

Blackstone Strategic Capital Partners treats its partner firms as portfolio companies and offers the GPs and all their portfolio companies access to Blackstone's in-house group purchasing organization (GPO). Buying through GPO saves portfolio companies an average of 20% on purchases,[6] making GP staking transactions with Blackstone about more than just the upfront price. This has helped continue to change how LPs view GP staking and is pushing the strategy forward at the top end. The unparalleled portfolio company cost savings has already proven to be a difference maker in winning deals. One GP who took a stake from Blackstone Strategic Capital Partners and wished to remain anonymous told our analysts, "Everybody [Dyal, Petershill, and Blackstone] was throwing around roughly the same valuation. Allowing our portfolio companies to leverage Blackstone's global procurement capabilities was the difference maker." The GP went on to say that Blackstone Strategic Capital Partners was the only firm to present the GP stake as an operating partnership, while Dyal and Petershill presented it as more of a financial partnership.

6: "Blackstone's Strategic Capital: Learn How Blackstone Strategic Capital Advisors Helps Alternative Asset Managers Tap into the Power of Our Network," Video, Blackstone, John McCormick, December 5, 2019

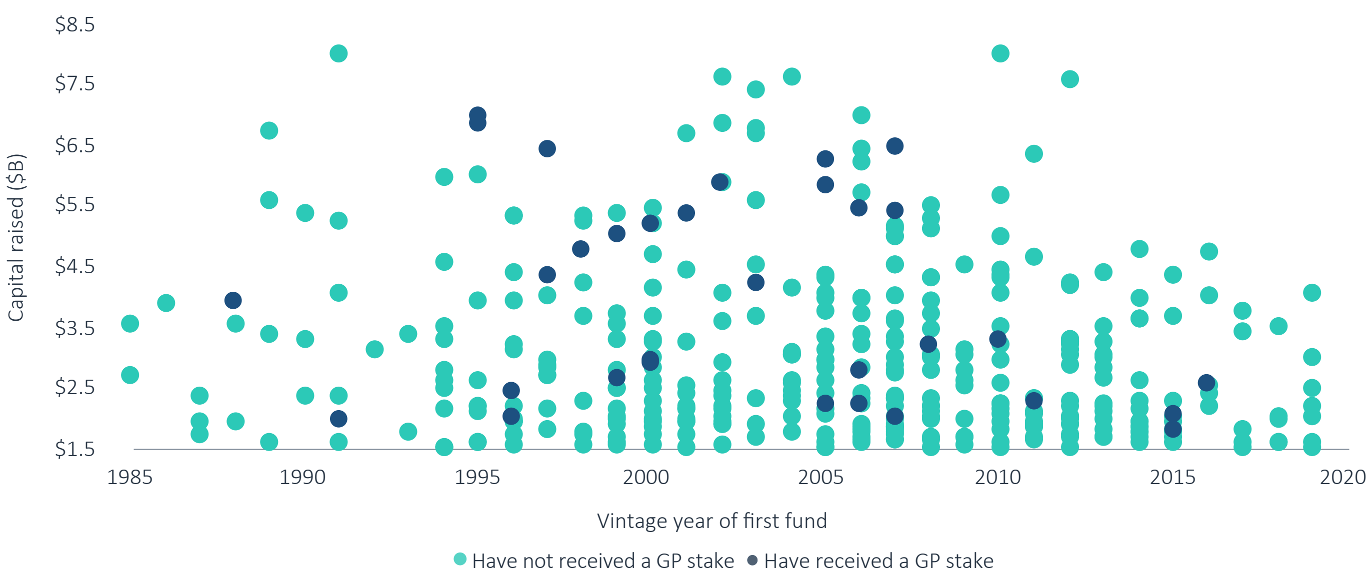
Blackstone Strategic Capital Partners tends to acquire stakes in the largest GPs, typically those who have raised an average of more than $10 billion in the decade preceding the stake sale. Blackstone's target GPs are marginally larger than Dyal's and much larger than Petershill's. For example, Blackstone recently purchased a stake in BC Partners, which had raised over $17 billion in the 10 previous years. As with Dyal, Blackstone Strategic Capital Partners underwrites GP stakes investments at a 15% to 20% net IRR. However, through GPO savings and additional operational help, the firm hopes to achieve net returns above the 20% mark.

Middle market

The three firms solely targeting middle-market GPs are all newcomers, although some of the founders of these firms have been investing in GP stakes for a decade or more. As the three largest players have scaled and now pursue the top end of the market, an opportunity has opened for GP stakes investors to target slightly smaller GPs—often ones that have between $2 billion and $8 billion in AUM. These firms tend to be somewhat mature, typically raising their fourth to seventh fund, and the stakes are usually valued between $50 million and $150 million.

GP staking in the middle market is unique and often more growth oriented than at the top end of the market. A white paper by Investcorp,[7] one of the GP staking firms targeting firms in the middle market, explains much of the space and how middle-market-staking deals are distinctive. Most—if not all—middle-market GP stakes transactions are composed of primary equity that

Middle-market GPs by total capital raised in the past decade and current backing status*



Source: PitchBook | **Geography:** Global
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Note: Includes PE, VC, real assets, credit, and secondaries managers

7: "The Case for Minority Equity Investing in Mid-Sized Private Capital GPs," Investcorp, Anthony Maniscalco, May 2020 puts capital on the balance sheet. These deals are about helping a GP scale and/or maximize its capital, often by expanding into new strategies or funding larger GP commitments with bigger follow-on funds. For example, Bonaccord Capital took a stake in MSouth Equity in June 2019, just a few months before the GP closed its most recent fund at $940 million. This new buyout fund was 60% larger than MSouth's 2015 $584 million vintage fund. The stake allowed management to subsidize a larger GP commitment on a much larger fund.

Supply and demand in this market segment favors GP staking firms, unlike at the top end. There are over 400 GPs that have raised between $2 billion and $8 billion in the past decade without any backing, while there are just a few GP staking firms dedicated to the space. This supply-demand dynamic means that deal sourcing is more proprietary, though there are still many GP stakes won at auction. We understand that DC Advisory and Berkshire Global Advisors have run auctions for middle-market GP stakes and that Houlihan Lokey is building out a practice to advise GPs and potentially run middle-market auctions. Deals in the middle market tend to rely on personal networks and relationships. It also means that GP staking firms have a bit more power, and price is less important than at the top end.

The firms targeting stakes in the middle market typically underwrite investments at a 20%to 25% net IRR range and a 2.5xto 3.0x MOIC. Management fees are expected to recoup the initial investment in approximately a decade, and with carry included, the payback period is expected to be seven to eight years. Since the underlying companies are riskier, the investments have more growth potential, and there is a more favorable supply-demand balance. Therefore, firms targeting middle-market GP stakes expect to earn higher returns than firms at the top end. Middle-market deals also exhibit a greater amount of structuring than deals at the top end, meaning that although the underlying GPs are riskier, the deal structure helps GP staking firms reduce risk and protect their downside. GP staking deals in the middle market often have long-term employment contracts for the managers selling a stake. Deal terms also frequently include preferred preference on any distributions, liens on firm assets and more.

Fundraising profiles for select GP staking firms focused on the middle market*

Firm	Current fund name	Current fund target size ($M)	Parent company/ sponsor
Bonaccord	Bonaccord Capital Partners I	$1,000	Aberdeen Standard Investments
Stonyrock	Stonyrock Partners I	$1,000	Leucadia Asset Management
Investcorp	Investcorp Strategic Capital Partners	$750	Investcorp
PA Capital	PA Capital GP stakes fund I	$1,000	New York Life Insurance Company

Source: PitchBook | **Geography:** Global
*As of May 31, 2020

Moreover, the COVID-19 pandemic may tilt the odds further in the favor of GP staking firms. A reduction in portfolio company valuations is likely to lead to fewer realizations in the next few years, delaying and possibly reducing carry payments to GP management. This means firms without healthy reserves of capital will struggle to finance GP commitments on upcoming funds. Middle-market GPs may also seek to expand into new strategies post-COVID-19, making strategic capital and advice even more important.

Exiting GP staking partnerships is different in the middle market compared to the top end, where partnerships are assumed to be perpetual. Firms in this market segment usually look to exit after seven to 10 years, and they have two options for selling stakes, the first of which is selling stakes back to management, facilitating a generational ownership transfer. The second option is to sell stakes to a strategic partner, meaning a top-three GP staking firm or a financial institution hoping to expand its alternatives offerings, such as AMG, Fidelity or T. Rowe Price. Within the space, GP staking managers expect a roughly 50/50 split on exits back to management or another strategic buyer. However, there are difficulties to selling stakes to a party other than management. The GP staking firm and the GPs in which they are invested will have to agree on which strategic buyers are right for each GP. For example, if a firm is looking to sell its remaining middle-market GP investments to larger strategic buyers, some of the GPs may prefer to partner with Dyal while some may want to partner with Blackstone. The GP staking firms lose some of the pricing power because the managers that sold a stake have a say in who will buy it. This could dissuade GP staking firms from selling stakes at an auction and may cause softer pricing.

Investcorp

Investcorp's Strategic Capital Group is the GP staking business of Investcorp, a global alternative asset manager with approximately $31 billion in AUM. The GP staking unit is headed by Anthony Maniscalco, who previously headed Credit Suisse's GP staking business, Anteil Capital Partners, and was a founding member of Blackstone's Strategic Holdings group. The firm is currently fundraising for its inaugural GP stakes fund—which seeks to have 10-12 GP stake investments—and has closed on $160 million of its $750 million target, according to recent media reports. They have closed on at least one deal and have several more in the pipeline, according to sources, though the GPs will remain unnamed for the time being. Investcorp tends to target managers with AUM typically ranging between $1 billion and $10 billion. These managers are often investing out of or beyond their second fund, with their latest fund ranging between $500 million and $2.5 billion. For credit managers, where fee and carry income is lower per dollar of AUM, the targets for AUM and fund sizes rise from these levels. The fund also tends to target only minority investments in which Investcorp, its principals and/or advisory board members maintain a pre-existing relationship. These deals generally avoid broad auction processes.

Investcorp's equity often helps GPs solve for generational transitions. It can be extremely difficult to transfer equity to the next generation because mid-level employees need to be able to write large check sizes in order to buy in, but they do not have senior partner earnings. One unique aspect to

Investcorp's strategy is that going in, the firm needs to have conviction in who the next owner will be. They are open with GPs going into any stake sale and will not sell without the GP's support. The thesis is that they are middle-market-oriented GP stakes investors. Seven to 15 years down the road, the target firm's management could opt to buy back the stake once new partners can afford it, or the firm may decide it has outgrown Investcorp and would be better assisted by a new owner.

Since Investcorp has an ultimate buyer in mind for these stakes, they can build an eventual exit into the investment structure. Examples may include ratcheting down ownership over time to make a stake easier to sell back to the next generation of management, which gives them a higher likelihood of achieving the desired exit, whether it be a sale back to management or perhaps selling to Dyal or Blackstone once the firm has grown and matured. Investcorp is also willing to structure deals beyond buying purely common equity to give themselves additional downside protection. Return expectations change depending on the deal structure, but generally the firm underwrites deals with a 20% net IRR and a 3.0x MOIC target, according to sources familiar with the strategy.

Investcorp's Strategic Capital Group leverages several entities to assist in firm building. One of these assets is Dock Square Capital, a firm run by former Florida governor Jeb Bush, which possesses relationships with myriad LPs and has economic incentives in Investcorp's fund through its strategic partnership. Investcorp's Strategic Capital Holdings also grants its GP partners access to Investcorp's 60+ person global distribution team, which has substantial connections in the Gulf region, and to Mercury Capital, a placement agent owned by Investcorp that specializes in fundraising. Lastly, the GP staking firm has an advisory board staffed with partners tasked with helping GPs institutionalize operations, strategize new and existing offerings and/or raise capital.

Stonyrock

Stonyrock, led by Craig Schortzmann and Sean Gallary, launched in mid-2019. Schortzmann was a founding member of Blackstone's Strategic Capital Holdings, and Gallary was formerly the head of Partnership Strategy at Carlyle Group. The firm is currently raising a $1.0 billion fund with a global mandate, targeting GPs in the US, Europe, Asia and Latin America, and plans to use it to invest in 10-12 GPs. The GPs that Stonyrock targets typically have between $1 billion and $5 billion in fee-paying AUM, with the most recent funds having raised between $1 billion and $3 billion. In terms of manager strategy, Stonyrock is willing to invest in credit, real estate, buyout, infrastructure, venture and more, because it chooses to be strategy agnostic and focus on finding managers with unique offerings and a distinguishable performance edge. The firm plans to invest 80% or more of its capital in illiquid/drawdown strategies, leaving around 20% to be more opportunistic across liquid and illiquid strategies.

Stonyrock was seeded by Leucadia Asset Management—a division of Jeffries—to boost its offering to GPs. Leucadia has been instrumental in the life of the fund so far, contributing up to a $150 million seed investment to the fund as well as warehousing any deals for Stonyrock before the firm holds its initial close. This allowed Stonyrock to close its first deal in Oak Hill, a middle market buyout firm. Leucadia's balance sheet is also a meaningful contribution because it can participate in co-investment opportunities with firms that Stonyrock partners with. Those GPs can also leverage the Jeffries platform. Because Jeffries has built its franchise in the middle-market sponsor space, Stonyrock can sell partnerships with them as a way to see increased deal flow opportunities. GPs partnering with Stonyrock also receive access to Leucadia's 15-person global marketing team, which can help GPs augment their LP base and expand globally. Stonyrock's internal offerings include a team, consisting of eight operating partners who were senior executives at firms such as Hellman & Friedman, that focuses on building out products, distribution and firm infrastructure.

In terms of deal-specific details, Stonyrock looks to leverage the supply-demand imbalance in the middle market and invokes a highly customized deal structure. The firm is open to using hybrid structures to mitigate the downside, including revenue shares that ensure payment even if margins diminish at the GP level. It can also incorporate preferred economics and non-financial aspects, including key person agreements, board representation, and provisions related to capital structure, product lines, and transfers/sales. Regarding eventual exits, Stonyrock looks to retain flexibility as well. The fund is structured as an evergreen vehicle to prevent the firm from ever being a forced seller. Stonyrock believes it will hold stakes for 10-12 years but is prepared to hold for up to 20 years. Eventual liquidity paths include a fund recapitalization and public or private equity issuances. It says it will look to single asset sales and larger portfolio sales, believing most of them will fall to larger financial sponsors (including GP staking firms and non-specialist PE firms), permanent capital LPs such as sovereign wealth funds, or to a strategic firm. This contrasts with Investcorp, which believes half of its GP stakes will be sold to a GP's management with the remainder going to larger staking firms or strategics.

Bonaccord

Bonaccord Capital Partners, led by a trio of former Guggenheim Partners and Swiss Re executives—including Ajay Chitkara, Farhad Dehesh, and Brad Pilcher—targets GP stakes in managers with between $1 billion and $10 billion in AUM. However, the fund's sweet spot is in the $2 billion to $5 billion AUM range. Credit managers will trend toward the top end of this range because they earn less per dollar of AUM. While corresponding check sizes are around $50 million to $150 million, the firm will entertain deals between $30 million and $200 million—though the latter would likely be accompanied by coinvestment. Bonaccord targets GPs across three main groups: buyout, real assets, and credit. Of the three deals the firm has completed, two have been in the buyout space and one—which will be announced shortly—in real estate. We expect additional deals to close in the near term. The fund has a global mandate and is geographically agnostic, though the majority of deal flow to date has been with US-based managers. The firm is targeting approximately 10 to 12 investments out of the fund.

The Bonaccord team, led by Chitkara, has history in the space, having deployed approximately $1 billion into growth-oriented GP investments at Swiss Re in the mid-2000s. Now investing in GP stakes at Aberdeen—a global asset manager with $600 billion in AUM, $80 billion of which is dedicated to alternative investments—Bonaccord seeks to leverage the firm's connections. Aberdeen's funds-of-funds (FoF) business typically invests in GPs with fund sizes of $1 billion or less. Bonaccord uses this platform as an origination source and can utilize the capabilities of the over 120 Aberdeen employees focused on manager research globally. As GPs outgrow Aberdeen's FoF business, they may become attractive targets for Bonaccord. Sources estimate that of the 400 GPs in Bonaccord's target market, Aberdeen has invested with approximately 25% of them. Leveraging this network, as well as potential synergies with its global LP base, has helped Bonaccord secure deals, even in cases in which it is not the highest bidder.

Bonaccord is said to have attracted over $250 million of its $1.0 billion target to date, not including co-investment capital, $200 million of which came from an anchor investor in Asia. Sources say the firm is nearing a deal to secure a substantial investment from a US-based firm that would put Bonaccord more than halfway to its fundraising goal and ahead of other firms pursuing GP stakes in the middle market. Bonaccord has sought out LPs that wish to be active in its investments, unlike other GP staking funds in which they are typically passive. LPs have also been attracted to the performance potential. Sources say Bonaccord will seek unlevered gross dividend yields in the mid-to-high teens and a gross multiple of 3.5x-4.0x over the life of the fund. In terms of exits, the fund is set up to last 12 years with the option for a couple extensions. However, Bonaccord believes it will be able to deliver liquidity to LPs' investments around the 10-year mark. While Bonaccord believes there will be many options for monetizing the portfolio, the most likely is a split recap—offering some LPs liquidity or the ability to retain holdings—or a sale of all or some of the portfolio to a strategic or financial buyer. Certain strategies with a greater prevalence for control stake activity may provide Bonaccord with idiosyncratic, single-stake exit opportunities through an eventual GP-driven majority sale to a strategic.

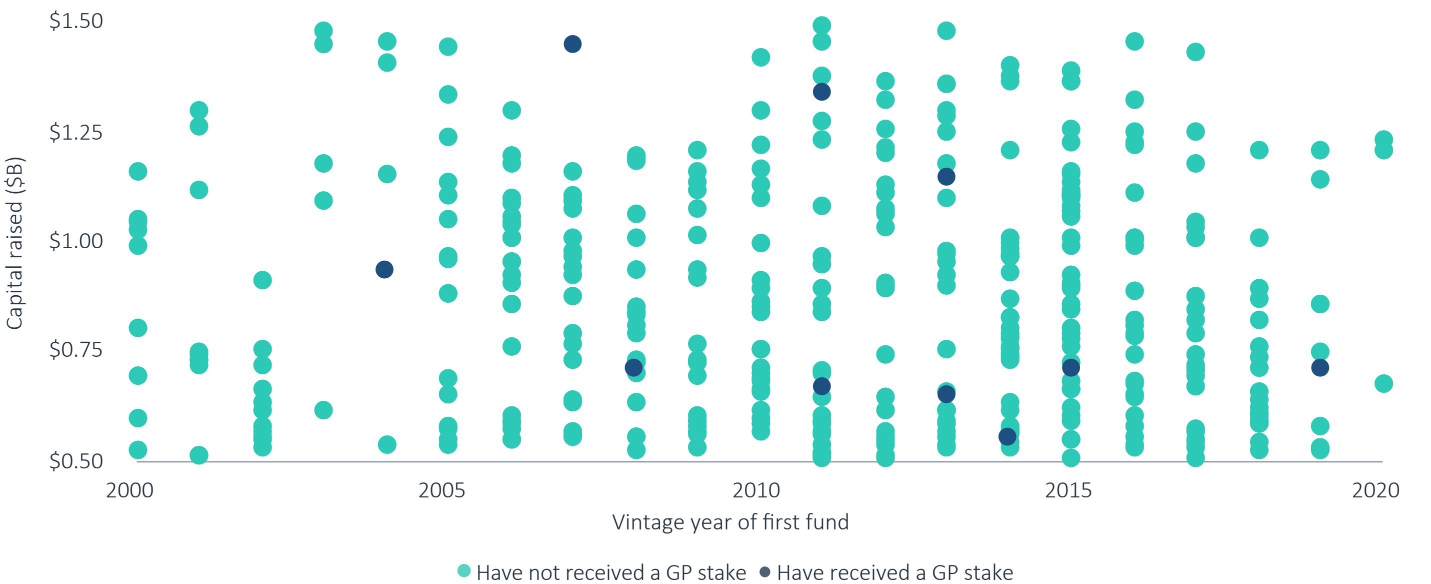
PA Capital

PA Capital, formerly Private Advisors, is a newcomer to the GP stakes space. According to the firm's website, PA Capital has closed on a $500 million commingled GP stakes fund. This is likely seed capital from New York Life, PA's majority owner. Sources say the firm is targeting $1 billion for this fund. PA Capital says it will target middle-market GPs with between $1 billion and $5 billion in AUM, though does not mention which specific strategies. We believe the fund will likely target firms with $2 billion to $5 billion in AUM because the check sizes would lead to extreme concentration at the upper end of the $1 billion to $10 billion AUM spectrum in a $1 billion fund. The typical 10 to 12 investments seen in other funds would equate to a average check size of $100 million or less. It is unclear if PA Capital has completed any GP staking deals. We will update this section in the coming months when more details come to light.

Spinout and emerging managers

The smallest end of the GP stakes market, with spinout and emerging managers, contains the highest risk and highest reward opportunities. We will be discussing these two disparate strategies together because many of the investors in the space look at both deal types. However, there are several GPs that focus on either spinouts or emerging managers only. GPs on the emerging side typically have under $2 billion in AUM and between one and three funds raised. Spinout managers, meanwhile, are looking to raise an initial fund. To receive backing in this field, first-fund sizes often need to exceed $250 million and do not have an upper bound, although they will many times fall below $1 billion. Fund stakes at this end of the market tend to mirror GP sizes and are on the smaller end, with checks usually below $50 million.

Spinout and emerging GPs by total capital raised in the past decade and current backing status*



Source: PitchBook | **Geography:** Global
*As of May 31, 2020
Note: Includes PE, VC, real assets, credit, and secondaries managers

The investments in spinout or emerging managers are unique in many respects. The deals are the most growth-oriented (compared to the top end or middle market) and focused on quickly institutionalizing managers. With such small fund sizes, step-ups of 100% or higher are possible for top-quartile GPs. In general, managers that sell a GP stake at this level are looking to raise larger funds with more sizable GP commitments on a condensed timeline and quickly become institutionalized. Investments in these managers contain considerable risk because the GPs receiving a stake are the least proven and on a tight leash. Managers early in their lifecycle are not afforded the same leeway as a Silver Lake or KKR, for example, when it comes to poor-performing funds because these managers have already earned their track record. The due diligence in this segment is more subjective and qualitative than in the middle market or top end because there are fewer numbers on which to base a decision. GP staking firms are betting on people and will

Fundraising profiles for select GP staking firms focused on spinout and emerging managers*

Firm	Current fund name	Current fund target size ($M)	Parent company/ sponsor
Capital Constellation	N/A	N/A	Wafra
SP Capital	N/A	N/A	Sixpoint Capital
Volunteer Park Capital	Volunteer Park Capital I	$200	Goodhart Partners
Kudu	N/A	$1000**	N/A

Source: PitchBook | **Geography:** Global
*As of May 31, 2020
**Kudu is seeking to raise $1 billion in equity capital through balance sheet investments rather than a traditional closed-end fund structure.

often want to see track records and documented performance (often called attribution) dating back to a prior firm if the manager has yet to launch its first or second fund.

As in middle-market GP staking, there is a supply-demand imbalance with spinout and nascent-manager GP staking. There are three or four firms strictly committed to investing in GPs at this level, with another handful that dabble in the space, and thousands of potential managers to target. Simply put, there are more deals than capital. One GP staking investor in the space has a current pipeline of 20 deals and is actively working on three of them. In each case, this GP staking firm is the only one the nascent managers are meeting, and in most cases nascent and spinout managers do not even know equity financing is available. There is even less competition for deals in this segment than in the middle market, and virtually all deals are sourced via proprietary channels.

With higher risks and better supply-demand dynamics, expected returns in the emerging or spinout GP-staking field are above those in the top end and middle market, with most deals underwritten at a 20%to 25% net IRR or higher. This lack of competition also grants GP stakes investors targeting spinout or emerging managers leverage to construct investments with provisions tailored for more safety and downside protection than is available at the top end or in the middle market. There is typically more structure surrounding the exit as well. Many deals with spinout or emerging managers will include step-downs or sunset provisions to reduce equity ownership after these GPs hit certain milestones. Deals may also include preferred equity, revenue shares or liens on assets, forcing the GP commitment onto the balance sheet with the GP stakes investor maintaining preferred preference over the asset and more. With the customized deal structuring, GP staking firms in this space expect MOIC to be between 0.8 and 1.0 on worst-case scenarios.

Beyond returns, GP staking deals in the emerging or spinout manager space have some clear tailwinds. LPs across the board are looking to raise exposure to private capital strategies, and many of them are seeking to lift commitments to emerging or smaller managers. Because early funds tend to outperform, the LPs want to build strategic relationships with co-investment rights, but these relationships are usually only possible to establish with newer managers. However, due diligence of early managers is time consuming, and LPs are unable to research all promising firms, which means spinout or emerging managers who can prove they have a higher likelihood of remaining in business long enough to raise Funds V, VI, and beyond are more likely to secure LP bets. Selling a GP stake can help prove exactly that, because a firm that specializes in picking GPs has already given a certain manager a vote of confidence beyond simply investing in an early fund. Furthermore, the GPs that sell a stake this early in the game often have larger commitments to align interests with LPs, better governance, and a more institutionalized structure than comparable managers without backing from a GP stakes firm.

The COVID-19 pandemic may also prove to be good for business with emerging managers since many of them are highly valued but cash poor. Pandemic-related delays in exiting current portfolio investments is likely to impede cash flow at the firm level because the carry a GP would have collected and rolled into the GP commitment in a follow-on fund is being pushed back. Many of these GPs will struggle to supply sizable commitments to new funds unless they can realize portfolio investments; all the while, expenses remain. The emerging managers who survive the shakeout are likely to be more open to selling a stake to finance the GP commitment and/or expand strategy offerings stemming from the downturn.

Turning to exits, as with the middle market, GP staking managers in the spinout or emerging manager segment do not plan to own these stakes into perpetuity. The firms often model owning a stake for 15 years but plan to sell it back to management before then. Managers typically expect to own a stake for between seven and 13 years. Selling back to management is expected in two-thirds or more of the deals and is the standard base-case assumption. When certain sunset clauses or preferred payouts are included in the deal structure, this outcome becomes even more likely because the equity stake tends to dip after a few years, making the purchase more manageable. Beyond selling back to management, GP staking firms in this segment have discussed selling to larger GP stakes investors or to strategics, including asset managers desiring to offer more alternative products or ones who hope to buy a majority stake. However, Capital Constellation often does plan on owning forever.

Capital Constellation

Capital Constellation is the most unique GP staking or seeding firm operating in the space today because it is an entity owned by institutional investors, which typically act only as LPs when it comes to closed-end private market funds. The firm is advised by Wafra, which is owned by The Public Institution for Social Security of Kuwait (PIFSS) and was founded by RPMI Railpen, The Alaska Permanent Fund Corporation, and Wafra on behalf of PIFSS. These founding members contributed $700 million of discretionary capital and own the firm pro rata, and a representative from each institution sits on the Capital Constellation board. The goal was to create an organization that allowed large asset owners to back promising young managers in order to gain access to the value creation of these private capital firms. Furthermore, Capital Constellation's members seek to invest alongside the GPs in which they invest in their funds, as well as in co-investments, deal warehousing, direct deals, direct lending to portfolio companies, and more, making the firm utterly unique.

While Capital Constellation originally sought to seed first-time and spinout managers, the firm has pivoted to taking stakes in emerging and nascent GPs (defined as having approximately $2 billion to $3 billion in AUM). The firm plans to make three or four investments per year, has completed four deals, and is under exclusivity with two additional GPs. Daniel Adamson, President of Capital Constellation and Senior MD at Wafra, believes the firm may eventually partner with 50 GPs over the coming decade. The membership count has also grown. Third National Swedish Pension Fund (AP3) and Kuwait Investment Authority (KIA) have joined in parallel, despite their charters disallowing ownership of operating companies. AP3 and KIA contributed a total of $300 million of discretionary capital, bringing Capital Constellation's total to approximately $1.0 billion. For now, Capital Constellation has backed only managers in North America and Europe. However, the firm is looking to take stakes in firms in Asia, South America, and Africa, though it will likely look to partner with another LP in a given region before backing local firms. For example, Capital Constellation could partner with an institutional investor based in Asia before taking stakes in GPs also based in the continent.

Capital Constellation receives access to Wafra's 37-member investment team, which performs due diligence on managers and makes the seeding decisions. The firm had been doing GP seedings and stakings since 2011 and completed about 12 transactions before Capital Constellation was formed. Decisions on staking more mature managers go to the three-member board, which speaks collectively for the balance sheet. In general, Capital Constellation can back any illiquid alternatives, including infrastructure, private credit, PE and real estate, anywhere in the world. The firm typically takes 20% equity stakes that are meant to be held into perpetuity, unlike other managers in this space, who typically plan to exit around the decade mark. However, the firm is open to selling stakes back to management or a third party down the line. There is no word as of yet on how Capital Constellation values GPs or what its cost of capital is when underwriting transactions.

SP Capital

SP Capital, a part of placement agent Sixpoint Partners, typically targets spinouts with attribution at a previous role or lower-middle-market managers either undergoing a transition or in need of acceleration capital. Spinout managers must be targeting at least $250 million for their first fund. For the non-spinout managers, SP Capital seeks to invest in GPs with between $250 million and $1 billion AUM. Unlike many firms outside of the top end, SP Capital has already raised its first fund, a 2018 vintage vehicle focused on seeding spinout managers that collected $200 million in commitments. The fund is now more than half deployed, and SP Capital will likely return to market at the end of 2020 or in early 2021 for a successor fund. Jeff Lavoie, SP Capital's head, also spent a few years at Dyal before founding this new entity to focus on smaller GPs and transactions.

The ability to leverage Sixpoint Partners' fund placement resources to help these nascent GPs fundraise has proven valuable beyond SP Capital's ability to write a check. SP Capital also helps the GPs in which it invests build out the firm, IR team, and operations. This can be especially helpful to spinout managers who may be great investors but may not know how to lift a business off the ground and scale it. SP Capital's focus is also another differentiating factor. The GP focuses only on middle-market buyout or distressed/turnaround managers. This allows it to hone its value creation playbook because it specializes on two types of managers.

Looking to the portfolio, SP Capital seeks to invest in GPs across several sectors, including consumer, healthcare, tech, and industrial. Since it is so focused on the narrow categories of middle-market buyout and distressed/turnaround, SP Capital tries to achieve diversification through the portfolio GPs' underlying strategies. SP Capital claims that around half of the GPs with which it has worked sought the firm out while the other half of the deals were initiated by SP Capital.

Like many in this segment of the GP staking market, SP Capital does not count on holding these stakes forever. Especially with spin-out managers, SP Capital is open to working with management on an eventual exit. With spin-out partnerships, sunset clauses and earn outs can be included, but perpetual stakes are common as well. The base case seems to be having management buy back SP Capital's stake down the line once its finances allow it.

Volunteer Park Capital

Volunteer Park Capital, led by Michael Daley and a part of London-based Goodhart Partners, only firms at an inflection point. This usually occurs when emerging managers are raising their third to sixth funds. The target GPs are only closed-end fund managers and mostly located in North America. These GPs, typically with between $500 million and $2 billion in AUM and seeking to raise a fund between $300 million and $750 million, are usually on their way to becoming valuable GPs on paper but cash poor. The cohort may receive a little carry from smaller, in the ground funds but need to write a hefty GP commitment into their upcoming fund. These GPs may also want to expand into new strategies. Currently, Volunteer Park Capital is fundraising for an initial $200 million fund and has raised an unknown amount. While it has yet to hold a first close, it has made several investments, with more in the pipeline.

While the types of GPs in which Volunteer Park Capital invests tend to be stringent, the firm is willing and able to vary deal structures heavily. The underwriting of deals often look more like a debt-equity hybrid, with high downside protection until the investor receives back at least 1x its capital. Volunteer Park collateralizes investments in every deal through the structure of balance sheet GP commitments and preferred payouts. This has the effect of mostly chopping off the left side of the distribution tail, while retaining equity-like upside. Volunteer Park Capital wants the cash infusion to be used to fund the GP commitment on the balance sheet and overall growth at the target firm.

Beyond capital, Volunteer Park Capital brings an EU regulatory passport for fundraising, a unique proposition for small, US-based GPs. Distribution in Europe is often untenable because these managers have to rely on reverse inquiry to market their funds in Europe. Volunteer Park Capital's connection to Europe-based Goodhart Partners allows it to assist the GPs with which it partners to market funds in Europe, vastly broadening their potential LP base. The team also helps these target GPs with governance and institutional structure that can set them up for success at the next level.

Heading into a deal, Volunteer Park Capital does not count on a certain type of exit. While the firm does not believe it will own the stakes 10-15 years from the investment date, it does not plan on any exit type at the onset. Often, these GPs receiving a stake will be in a much better financial position by Fund 4 or Fund 5 and may be able to buy back the stake. Alternatively, some traditional asset managers have showed interest in partnering with alternative asset managers, either through full acquisitions or by purchasing minority stakes.

Kudu

Kudu Investment Management, led by Rob Jakacki and Charlie Ruffel, seeks minority investments in open-ended and closed-ended managers with approximately $500 million to $5 billion in AUM, though the LP tends to target firms with $2 billion or less in the closed-end sphere. Jakacki, the co-founder and CIO of Asset Management Finance (AMF), which was bought by Credit Suisse in 2008, has overseen 35 investments into asset management firms to date, totaling approximately $1.2 billion in deployed capital. AMF pursued minority investments into open-ended managers with a passive construct, and this has influenced the Kudu philosophy. Kudu looks for investment managers that it believes can deliver alpha and is agnostic to open- or closed-end managers. The firm has completed 13 minority transactions totaling nearly $400 million in deployed capital, three of which are in PE, as of July 2020. Going forward, Kudu anticipates completing more closed-end deals. The firm's goal is to be hands-off in its investments and to be seen primarily as a capital solution. However, Kudu offers help in terms of introductions to the partners' network, assistance with inorganic growth, and advice on the recruiting, PR, and marketing front.

Kudu, with $475 million in capital commitments ($350 million in equity commitments from White Mountains Insurance Group (NYSE: WTM) and a $125 million credit facility), is reportedly targeting a raise of another $500 million in capital. Kudu's capital structure stands out in the space. Rather than raising capital in a closed-end vehicle, with a set or perpetual fund life, the firm raises balance sheet capital from outside investors. This balance sheet approach is a unique offering and could allow investors to categorize a stake in Kudu differently than a traditional closed-end fund. This means investors do not pay out a traditional management fee to Kudu for their investment, but the firm does have a standard promote structure to pay out Kudu's management team above a hurdle rate. Kudu believes new investors benefit by participating in an existing portfolio, in addition to future investments. However, these future investments still pose some blind pool risk going forward.

Via its credit facility, the firm can, and often does, use some leverage on a deal-by-deal basis. This leverage seeks to buoy investment returns. Kudu targets a 9% to 10% gross yield on capital and a net IRR in the mid-to-high teens. The deals are typically structured as preferred equity with a quarterly dividend tied to a gross revenue percentage, though Kudu does bottom-line deals as well. Despite expecting to hold its balance sheet investments indefinitely, the firm cannot, for example, prevent a partner investment from selling itself. For Kudu investors, potential exit paths at the holding company level could include an IPO, a recapitalization, or some form of securitization.

Other firms

While they are smaller in size or close GP stakes deals less frequently, there are half a dozen other firms active in the GP stakes market. These firms are either not solely focused on the closed-end funds or do not have active strategies solely focused on GP staking.

Meteor5

Meteor5 Capital is a smaller firm that targets spin-out teams with the potential to raise $300 million or greater for their first fund. The firm successfully raised a $125 million fund in 2018, though it is unknown how much of the capital has been deployed and when or if the firm will raise a follow-on fund. The geographic focus is also limited to the US because of the smaller fund size, but the fund will consider Western European strategies. Within these geographies, Meteor5 targets buyout, growth, and other PE strategies. Similar to geography, though, the scope is limited. The firm generally shies away from infrastructure, real estate, and credit-focused funds.

Affiliated Managers Group (AMG)

AMG is a publicly traded holding company with whole or partial ownership in approximately 35 asset managers with more than $700 billion in cumulative AUM. The company has a market cap of $3.3 billion at the time of this writing. Its investment targets typically include traditional asset managers and hedge funds, including AQR and Winton Group. AMG also owns interest in several closed-end private capital firms, including Baring Private Equity Asia and Pantheon. In 2020, AMG purchased a stake in PE firm Comvest Partners in 2020. With assets continuing to flow into alternatives, AMG is likely to do more investments in closed-end, private capital firms in the future. The firm is one potential buyer that other GP stakes investors plan to consider in the future because of its previous acquisition of Petershill assets and interest in closed-end managers.

Landmark Partners

Landmark Partners, while more known for secondary investing, has entered the GP stakes game with two recent purchases. The firm teamed up with Wafra to purchase a stake in Siris Capital, a tech-focused GP. Landmark also teamed up with Dyal and Petershill in a GP stakes transaction involving another tech-heavy investor, Clearlake, though they were existing investors in Clearlake since they helped Clearlake buy out its seeder, Reservoir Capital. Landmark has completed some preferred equity financings to other GPs as well, and it is our understanding it is pursuing more of these transactions.

17Capital

While not technically GP staking transactions, 17Capital has done several GP preferred equity financings. There are many GPs out there unwilling to part ways with ownership in the management company and have gone with a preferred solution instead. However, many of the partnership benefits, such as a dedicated value creation team that specializes in alternative asset managers, are also missing. 17Capital underwrites deals based on portfolio cash flows and plays in three areas: LP portfolio financings (for LPs who want to monetize some of their PE portfolio while retaining upside), GP portfolio financing (which allows GPs to forgo saving reserve capital and dragging on returns), and GP management company financings. Since the investment goes on the balance sheet, 17Capital still underwrites the same capital call and distribution cash flows as its other strategies. While the firm does not pursue the strategy in a standalone fund, approximately 40% of its most recent fund went to GP financings. This runs the gamut from GPs managing just the partners' capital to firms with $10 billion or more in AUM.

The common uses for this type of GP financing follows GP stakes. Most of 17Capital's GP financing deals are used to increase the GP commitment, then to buyout founders, and finally for strategy expansion. With a preferred equity investment that sits higher on the capital stack than common equity, risk is also reduced compared to GP staking. Because of this, the firm has a cost of capital in mid-teens, just below the managers targeting stakes in top-end GPs. 17Capital does not do perpetual deals and makes only its target rate of return when it fully exits.

Whitehorse Liquidity Partners

Whitehorse, like 17Capital, pursues preferred equity deals within the secondaries space. The firm has only been around since 2015 and has already closed on three funds and nearly $3.5 billion. Their fourth fund is currently seeking to raise at least $3.0 billion. While Whitehorse pursues preferred equity transactions, typically tied to secondaries, we understand that the firm has completed several GP financings as well. With the swelling interest in preferred equity GP financings, we expect Whitehorse to continue inking these deals going forward.

Out of business or struggling firms

Despite the lucrative investment returns and billions of LP dollars flowing to GP stakes managers, success is not assured for GPs looking to enter the GP staking game. The risk of business failure, whereby a GP stakes firm raises a fraction of its target and closes on one to three deals before going out of business, is perhaps the largest risk to LPs backing firms targeting the middle market or the spinout and emerging manager space. We have seen a handful of managers fail over the past decade and some never even launched. Several firms, such as Credit Suisse's Anteil Capital Partners, AMF (which was sold to Credit Suisse in 2008), or Carlyle's AlpInvest, once had somewhat successful franchises, but the parent company shuttered operations because of regulatory issues or before they could produce results. AMF, which had made more than 20 minority investments, was also shuttered by Credit Suisse after the Volker Rules began to bite. Anteil was seeking to raise $2.0 billion while

AlpInvest had been targeting $500 million. In these two cases, management shifts and shorter-term expectations prevalent in public companies outweighed the ability of the strategy to add to the bottom line quickly, despite deep benches of people that would go on to other GP staking firms. The top three firms were finding success because of deep LP connections and storied track records.

More recent examples, though, illustrate that the risk LPs face of backing the wrong horse is real. Luckily, the firms to fail more recently were not able to do a couple deals and leave LPs with a concentrated, zombie portfolio of GP stakes. GP Interest had been seeking to raise a $750 million GP stakes fund and stayed around for a few years. Hycroft had also been seeking to raise a GP staking fund before experiencing a massive staff exodus. The firm has made some hires within the past year and reportedly plans to pursue a GP stakes fund, though it is doubtful the firm will be able to hit its target. One of the Hycroft's co-founders, Tom Morgan, left after two years and joined Magnetar Capital, a hedge fund that sold a stake to Blackstone, to raise a GP stakes fund exceeding $1 billion. This attempt was even shorter lived, though, and Magnetar shut down the fund in under two years. These more recent failures all have a lack of a financial sponsor in common. Without a large-scale institution with which to partner that could help with broader strategic capabilities, from fundraising to back office solutions, new entrants in the GP stakes market are bound to fail.

Conclusion

The GP staking landscape has grown and evolved rapidly in the past few years, with multiple new players entering the market and looking to buy stakes in underserved market segments, such as the middle market. Staking managers have now begun utilizing preferred equity in some deals—occasionally bringing in a different firm for the preferred investment—and Dyal is looking to raise and deploy a debt fund whereby it may lend to target GPs as well as offer equity financing from its traditional funds. Others may follow. LPs looking to allocate to managers in the space must be aware of the different market segments and how each of the firms in these segments stack up. Two GPs targeting the same type of manager may have different deal structure preferences, which could have an impact on downside protection, holding times, and MOIC. We believe LPs must dig deeper into firms' strategies and understand that the market is bound to see continued change during the LPs' investment horizon.