

INSIGHTS

May // 2020

An aerial photograph of a dense urban skyline, likely New York City, featuring numerous skyscrapers and high-rise buildings. The image is overlaid with a semi-transparent white box containing the title text. A green diagonal line pattern is visible across the top portion of the image.

The Case for Minority Equity Investing in Mid-Sized Private Capital GPs



Anthony Maniscalco
Managing Partner and
Head of Strategic Capital Group

Anthony Maniscalco is Managing Partner and Head of Investcorp's Strategic Capital Group.

Prior to his current role, Anthony was a Managing Director and Co-Head of Credit Suisse Anteil Capital Partners. Prior to this, he was a Managing Director of the Hedge Fund Solutions business at The Blackstone Group. At Blackstone, he was a founding member and on the investment committee of Blackstone Strategic Capital Holdings, a USD 3.3 billion private, permanent capital vehicle focused on acquiring minority interests in alternative asset managers.

Prior to Blackstone, Anthony was Head of Alternative Asset Management Banking at Barclays (and its predecessor Lehman Brothers) within its Financial Institutions Group. Prior to this role, he was head of the Media and Telecom vertical within Lehman Brothers' Leveraged Finance Group. Early in his career, he worked at Bank of America and its predecessor Continental Bank in Chicago, focused on high yield, mezzanine, syndicated bank loans, and interim financing products.

Anthony holds a B.S. from Indiana University and an M.B.A. from the University of Chicago.

Table of Contents

- 01** Market Overview
- 02** Key Factors Driving GPs' Demand Broadly for Capital
- 06** Compelling Investor Economics
- 07** Why Mid-Sized GPs Represent the Most Compelling Opportunity for GP Investing
- 09** Common Areas of Consideration for Investors and Mitigating Factors
- 11** Alignment Between the GP, LPs and Minority Investor
- 12** Investment Process
- 15** Conclusion

MARKET OVERVIEW

BACKGROUND ON GP MINORITY INVESTING

GP Minority Investing (or “GP Staking”) is the acquisition of a minority equity interest (typically less than 25%) in the management companies and general partnerships of alternative asset managers (“GPs”). Unlike investing as a limited partner in a fund, GP minority investors have exposure to the GP, and benefit from the overall cash flow generation and growth of the GP as a whole as compared to solely investments as an LP in a fund.

EVOLUTION OF GP MINORITY INVESTING

Prior to the 2008 financial crisis, GP minority stake investing was episodic, and a relatively infrequent practice. Activities in this space were primarily executed by banks seeking hedge fund minority stakes to realize business synergies (e.g., prime brokerage, sales and trading, etc.) and/or institutional investors looking to acquire stakes in private equity firms to reserve access/capacity in future fund vintages. GPs typically sold primarily to obtain financial diversification and tax benefits.

Post the 2008 crisis, GPs increasingly appreciated the broader advantages of having a minority partner. Similar to how many private equity firms support portfolio companies, GPs recognized the potential benefits of having partners with the ability to provide permanent capital and add strategic value, while still allowing GPs to retain control and autonomy over their businesses. These buyers however became limited in their ability to continue to pursue minority investments (e.g., banks became more regulatorily constrained). As such, there was an unmet need for access to capital in this market resulting in the establishment of funds dedicated to GP minority investing. The mandates of the initial GP staking funds coming out of the financial crisis targeted hedge fund managers. Over the last several years, GP staking has evolved, expanding into multi-asset class strategies, especially private equity, private credit and real estate. Activity has also been focused over the last several years on the largest GPs given the need for the new stake buyers to deploy large amounts of capital based on the amount of capital that they have raised. Activity has increased awareness of the strategic and financial merits across all alternative asset managers of selling a stake in their business. These benefits are also widely understood and accepted by the market, and investors in the underlying funds.

Investor demand for GP staking has also grown over the last several years as it is a strategy expected to provide private equity like capital appreciation and high current cash yields across all market environments. It is viewed as a defensive way of investing in private market alternatives. Locked in management fees and accrued but unrealized carry on prior funds can provide investors with yield certainty and more rapid investment de-risking. Investing in a portfolio provides exposure across strategy types, fund vintages and geographies, adding a second layer of potential downside protection.

In terms of expectations in the post Covid-19 dislocation, GP staking is anticipated to be particularly well positioned and supported by the following themes.

Heightened Demand for Capital and Partnerships

GPs are increasingly seeking permanent capital to strengthen their balance sheets in order to:

- Meet GP commitments: A slow down in realizations on prior funds is creating an increasing need for GP capital while new fund launches can be enhanced by larger GP commitments in the current environment
- Seed new strategies: The market environment is creating a window to pursue adjacent opportunities (e.g., continuation and dislocation funds)

GPs are actively seeking partnerships to gain access to advice in order to navigate risks and opportunities presented by the current market and to selectively assist them with fundraising

Ability to Identify Differentiated GPs

- Once engaged, stake buyers are able to evaluate the impact of changing market conditions with heightened attention paid to the GPs investing experience across cycles, market positioning and amount of dry powder

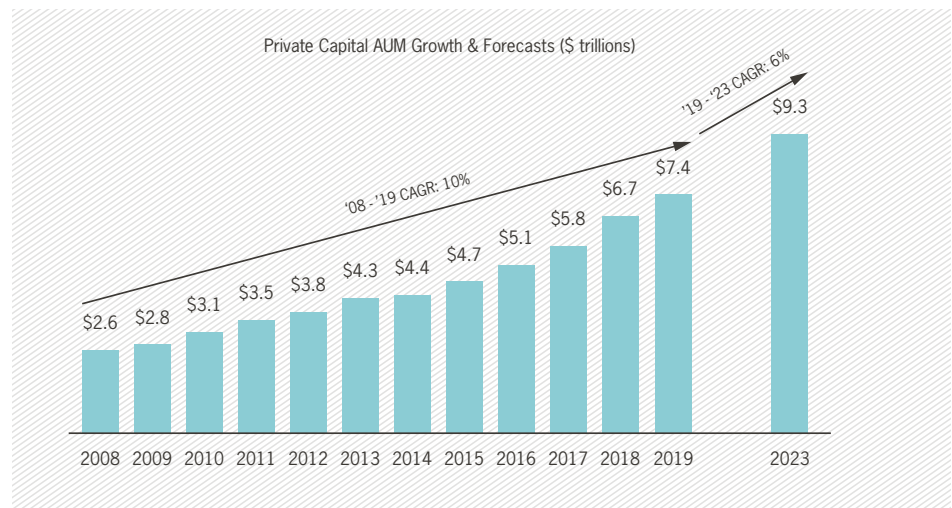
More Attractive GP Valuations

- Changing market conditions are likely to result in lower stake valuations as public comparables have come down while underlying underwriting assumptions are more conservative and discount rates are higher

KEY FACTORS DRIVING GPS' DEMAND BROADLY FOR CAPITAL

Strong Underlying Environment for Alternative Asset Managers with Favorable Market Dynamics

The alternative asset management industry has experienced substantial growth over the last ten years driven by factors such as increased allocations by institutional investors seeking strong risk-adjusted returns and the growth of the retail wealth base. These dynamics have propelled the entire alternative asset management industry, with Private Capital AUM (i.e., private equity, private credit, real estate, and infrastructure) reaching \$7.4 trillion as of June 2019.



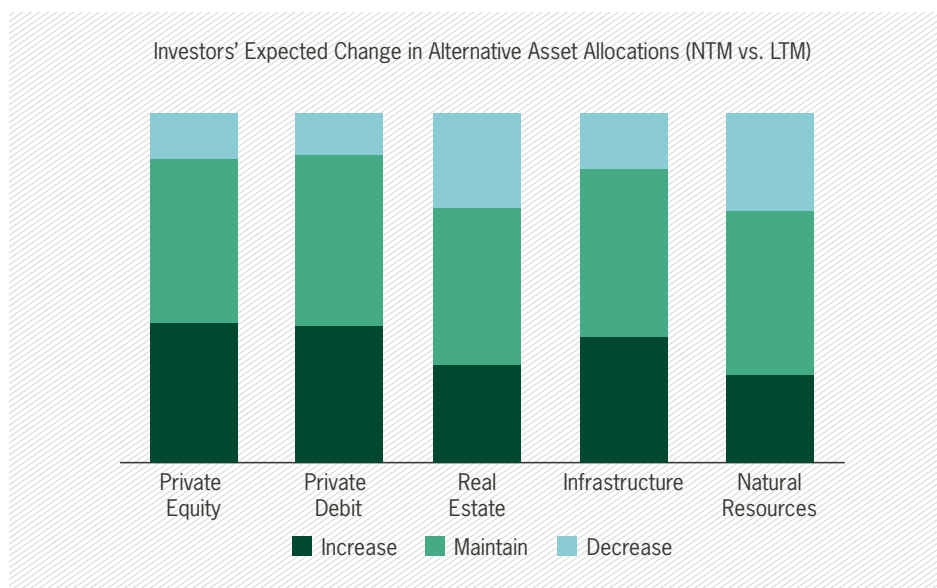
Source: Preqin Pro and Preqin Future of Alternatives Report (October 2018).

Market research suggests that long-term growth prospects for the industry remain robust. According to Preqin, Private Capital strategies are anticipated to reach \$9.3 trillion in AUM by 2023.

We recognize that the continued spread of coronavirus is creating economic uncertainty. Certain investor segments are expected to slow near-term allocations to private market strategies due to a need for short-term liquidity and / or to rebalance their portfolios. However, there continue to be a number of key trends that are driving strong secular demand for private market alternative investments and which are only becoming more pronounced in the current environment, including:

- Low interest rates that are continuing to decline globally, and which are expected to remain low for the foreseeable future.
- Private markets' outperformance compared to public equity markets, which are experiencing extreme volatility.
- Select investors with defined liabilities needing to allocate more to private market strategies to achieve acceptable yields and returns.

Allocations are further anticipated to increase across all primary Private Capital strategies.



Source: Preqin Investor Update: Alternative Assets (H2 2019)

Current market conditions are expected to create attractive investment opportunities for well capitalized Private Capital GPs who are sitting on record dry powder while at the same time assets are expected to command more reasonable valuations in the current environment.

Industry Growth Creating a Need for Increased Capital

The continued growth and maturation of private markets is creating a desire from GPs for capital and partnerships to capitalize on the strong demand and market opportunities for alternative assets. While large publicly listed alternative asset

managers have the ability to access public capital markets, there is a large portion of GPs, particularly mid-sized firms, where the ability to tap public markets remains limited. In addition, public listings require significant upfront and ongoing costs, disclosures and increased regulatory oversight. The experience for many of the GPs that have gone public has largely been mixed primarily given these considerations.

Majority sales can be disruptive given alternative asset management firms are people businesses driven by intellectual and human capital. Many GPs recognize that maintaining their firm's culture, compensation flexibility and economic upside are crucial to driving sustainable and multi-generational longevity. Further, portfolio managers by nature are risk takers. They are mandated by their own investors to accept an appropriate level of risk in exchange for potentially higher returns. This balance is fundamental to GPs' success and selling a controlling interest has the potential to disrupt their risk / reward equilibrium.

Given these dynamics, a natural development in the growing alternative asset management industry has been the mainstreaming of GP minority staking. These partnerships allow sellers to maintain operational autonomy and financial flexibility while preserving their long-term options. Some of the compelling reasons GPs pursue minority stake sales are driven by either 1) financial or 2) strategic considerations:

Financial

Minority stake sales can provide GPs growth capital to:

- Finance larger GP commitments to support future fundraises.
- Seed products in new adjacencies.
- Fund operating requirements, strategic hires and talent expansions for new initiatives.
- Opportunistically pursue inorganic business expansion such as geographically driven M&A.

Minority stake sales can also provide GPs capital to optimize their ownership structure and create long-term employee incentive mechanisms such as to:

- Buy out passive and/or legacy shareholders (e.g., seeders, banks, transitioned founders).
- Facilitate equity redistribution among the leadership team.
- Provide a credible third-party valuation to support hiring and retention initiatives.
- Fund cash-based retention mechanisms to retain key employees.

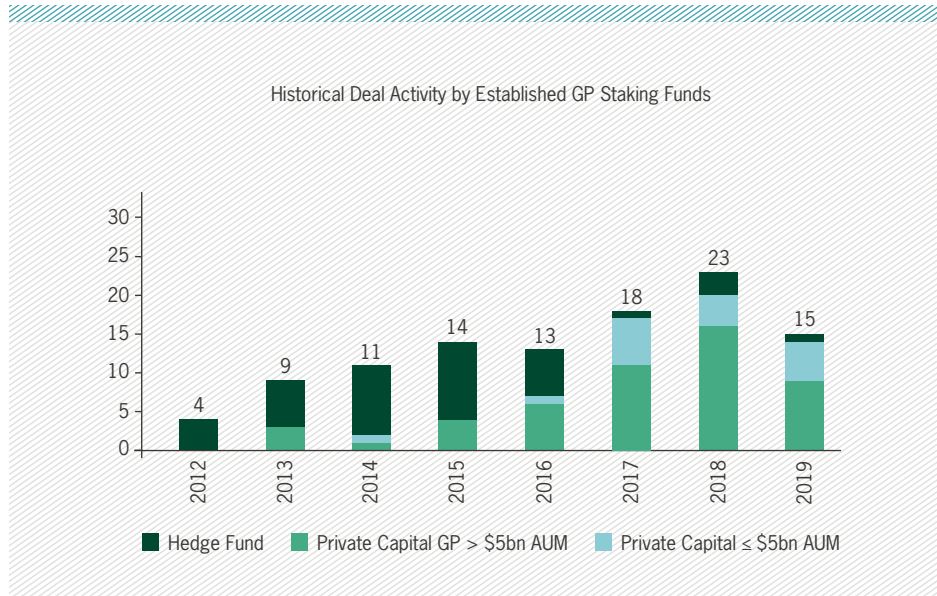
Strategic

Minority stake sales can provide GPs multiple strategic benefits such as:

- Enhanced reputational value with the validation of a long-term investment from an experienced and sophisticated buyer.
- Access to greater scale and resources from the acquiring firm such as balance sheet and global distribution.
- Support business development initiatives (e.g., marketing strategy, product expansion, M&A).

- Advice and counsel to support firm longevity (e.g., succession planning, talent management, governance, operational best practices).

Strong demand for capital has caused the GP staking space to experience significant growth, as demonstrated by the below chart.



Source: ISCG Proprietary Research and Estimates, 2019

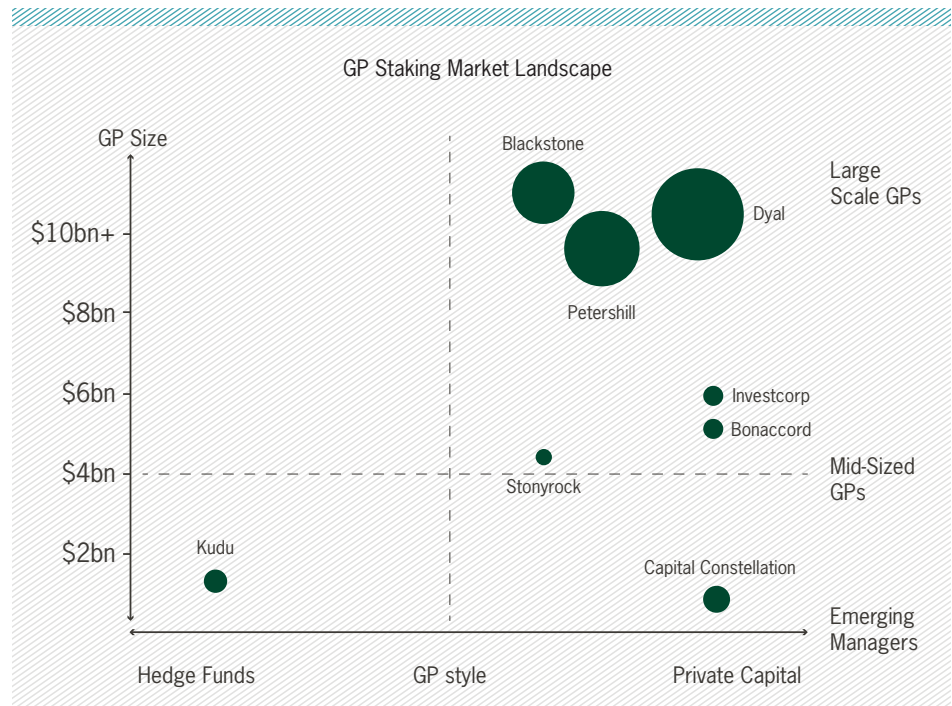
Investcorp's Strategic Capital Group ("ISCG") strategy seeks to acquire minority equity interests in mid-sized alternative asset managers, with a primary focus on GPs that derive a significant portion of their revenue from the sponsorship and management of closed-end funds or other funds with lock-up features. Utilizing a disciplined investment process, ISCG seeks to identify and partner with businesses that it believes to be well-established, with successful track records and that are poised for growth.

This white paper is for informational purposes only and does not constitute an offer to sell, or a solicitation of an offer to buy any investment interests in any jurisdiction.

Competitive Environment

The growth of GP stake investments has been largely driven by a small community of established industry participants including: Dyal Capital (sponsored by Neuberger Berman), Blackstone Strategic Capital Holdings (sponsored by Blackstone) and Petershill (sponsored by Goldman Sachs). As the GP staking asset class has continued to evolve, these entities have launched larger funds, and their investment sizes have also trended up as they focus on larger-scale GPs. In 2018 and 2019, the average AUM of a GP seller was over 10\$ billion (ISCG Proprietary Research and Estimates, 2019). This has created an opportunity in the mid-sized segment of the market that is characterized by favorable supply / demand dynamics.

There are a limited number of firms seeking to acquire stakes in GPs within the mid-sized market segment (ISCG Proprietary Research and Estimates, 2019).



Note: Bubble size represents total capital raised.
Source: ISCG Proprietary Research and Estimates, 2019

Despite compelling investor economics, barriers to entry present challenges to new entrants. Capital raising requires:

- Patience, persistence and a long-term commitment of working capital as GP minority stake investing in fund format remains early in its life cycle, despite the growth it has experienced.
- Teams with networks to source proprietary investment opportunities and buy-side experience to conduct diligence and execute investments.
- A highly credible platform to support the strategy (e.g., sourcing, diligence) and offer value to the GPs post acquisition (e.g., strategic advice and fundraising support).

COMPELLING INVESTOR ECONOMICS

Economic Profile of a GP Stake Investment

Individual GP stake investments benefit from multiple streams of cash flow including management fees and carry on existing and future funds as well as balance sheet returns. Additionally, they seek to deliver private equity like multiples of invested capital ("MOIC") with private credit / mezzanine like ongoing cash-on-cash returns and potential downside protection:

MOIC: Individual investments are typically priced at a base case to generate 3.0x plus gross MOICs. This result is split relatively equally between current cash yield, investment cost and GP capital appreciation. Stake buyers typically seek to leverage their platforms to help GPs grow and thereby enhance further multiples on invested capital.

Cash on Cash Returns: Stake buyers typically seek individual investments providing

an average annual gross cash yield of 10 to 15% over the course of 10 years. We estimate that this cash yield, along with base case assumptions on future fundraising activity by the GPs, could achieve a gross distribution to paid-in capital of 1.0x by year seven or year eight following the year in which the applicable investment is made.¹

Potential Downside Protection: Individual investments are priced with the intention of providing strong principal protection. In “downside economic scenarios”, whereby a GP continues its business in the current state without any additional funds raised and fails to achieve projected returns on their existing portfolio investments, individual investments can still achieve a gross MOIC of close to 1.0x.² This would be achieved through cash flows generated by the GPs’ existing capital base.

Portfolio Characteristics

Investing in a GP minority staking fund that has a diversified portfolio across strategies, geographies and vintages provides the potential for downside protection and more consistent cash flows. At the same time, a portfolio provides investors exposure to the longer-term secular growth in alternatives, particularly private market strategies.

Given the unique characteristics of a portfolio of GP minority investments, it can meet the criteria for allocation across different buckets of investors’ portfolios including: private equity, private credit and / or opportunistic.

WHY MID-SIZED GPS REPRESENT THE MOST COMPELLING OPPORTUNITY FOR GP INVESTING

Supply and Demand Dynamics

Based on data published by Preqin, we estimate that there are more than 600 alternative asset managers within the private equity, private debt, real estate and infrastructure sectors that have raised between \$1 billion and \$10 billion over the past 10 years. These managers are investing out of or beyond their second fund and their latest funds range between \$500 million and \$2.5 billion in aggregate capital commitments. We estimate that this represents approximately \$90 billion of aggregate enterprise value (assuming the midpoint) in the market potentially available for GP minority investing.

This market size estimate does not reflect the growth of existing firms within the present investible universe, nor new firms entering the space in the coming years. Despite the opportunity set, there is limited capital actively seeking to invest in this segment of the market. As described earlier, most participants in the GP minority investing industry have focused on larger entities and we expect this to create significant opportunities and needs for GP minority investing in the mid-sized segment of the market.

We believe that the recent impact of the coronavirus will further reinforce the demand for permanent capital from GPs, especially amongst mid-sized managers, as they seek to strengthen their balance sheets to:

¹ The information provided is intended to illustrate the return profile of a hypothetical investment under a “base case” scenario. There is no guarantee that such performance or return can be achieved, or that this type of investment can be made. The “base case” scenario is based on models, estimates, and a number of assumptions which may or may not prove accurate.

² The information provided is intended to illustrate the return profile of a hypothetical investment under a “downside case” scenario. There is no guarantee that such performance or return can be achieved, or that this type of investment can be made. The “downside case” scenario is based on models, estimates, and a number of assumptions which may or may not prove accurate.



- Continue to meet GP commitments for existing and future funds. Delays in realizations on prior funds is expected to increase the need for capital to fund GP commitments. At the same time, the ability to commit larger dollars to future funds will provide an advantage to better capitalized GPs.
- Seed capital and associated working capital requirements for new products. Market disruptions create the opportunity to pursue broader, yet adjacent opportunities beyond existing products.
- Take advantage of short to medium term, more time sensitive investment opportunities created by market dislocations.

Strong Underlying Businesses

GPs that have progressed beyond their second fund typically have a solid investor base and established track record. Among the current universe of private equity firms that have raised more than 2 funds with their last fund ranging from 500\$ mm to 5 .2\$ billion, less than %5 of these firms have not raised a new fund in the last + 10 years. We also believe that the GPs in this universe are at an attractive stage in their growth trajectory by facing much less risks than a GP on their first fund and ample growth capacity in both existing funds / structures as well as adjacent strategies.

Proprietary Sourcing

Sales tend to be accessed through pre-existing relationships as opposed to broad auctions. This allows buyers to engage directly and focus the discussion on their value proposition while also creating bespoke transaction structures protecting investors while solving a problem for the GP.

Emphasis on Partnership

GPs tend to be earlier in their life cycle and place a greater value on partners' advice and resources. Firms are looking for advice from partners on how to increase franchise value while also creating a more sustainable business.

We believe these dynamics relative to large-sized GP stake sales result in (i) better risk-adjusted pricing, (ii) less reliance on GP growth to meet expected returns and (iii) the ability to structure more customized and aligned investments.

We also believe the investment size of a mid-sized GP stake as well as the earlier stage in the GP's lifecycle increases the probability of an individual investment exit versus large-sized GPs. This allows buyers to capture investment capital appreciation versus just the ongoing yield.

COMMON AREAS OF CONSIDERATION FOR INVESTORS AND MITIGATING FACTORS

GP Staking Exposure to Market Cycles

We recognize that the continued spread of coronavirus is creating near term market volatility and uncertainty. While no industry is immune to these challenging dynamics, we believe that GP staking may provide investors with the potential for downside protection in the face of such volatility and a deeper economic correction. Further, we believe the current environment provides investors with a highly attractive entry point to invest in the GP staking space, particularly within the less competitive segment focused on investments in mid-sized GPs.

Given the ongoing market disruption in connection with the coronavirus outbreak, GP stake valuations are likely to become more attractive. In spite of the overall positive secular outlook for private market strategies, recent volatility creates an opportunity to factor into DCF models more conservative underlying assumptions (particularly marking the existing positions to market and applying more conservative growth on future fund raises) and higher discount rates. In addition, although it is not a primary form of valuing private stakes in GPs, the sell-off of the publicly traded alternative asset managers improves the relative comp and deal negotiation dynamic for stake sales.

We further believe that a portfolio of minority ownership interests, particularly in mid-sized alternative asset managers focused on private assets, will deliver value irrespective of market conditions. Our conviction in this opportunity is driven by several compelling factors: i) individual investment cash flow characteristics, ii) portfolio diversification benefits and iii) structural protections.

Individual Investment Cash Flow Characteristics

Successful, established GPs managing private capital strategies generate cash flows from several fee streams that underlying GP owners are entitled to:

Management Fees (on existing funds): Income from locked-in management fees on funds already raised are highly certain and typically only tied to the credit worthiness of the GPs' fund investors. The duration of fees is sticky in weak markets, which imply longer asset holds and longer periods of fee generation as a result. On the other hand, if markets become more favorable, exits typically pick up, and carried interest distributions would be expected to rise in exchange for management fees.

Carried Interest (on existing funds): Income from carried interest that has already been earned, but not yet realized on existing portfolio investments as well as carry associated with appreciation of existing portfolio assets and new purchases. Stake buyers take both a macro and micro approach to examine forecasted carry realization on existing funds. From a macro stand point, buyers have access to track record data relative to the GPs' peers to assess the GPs' ability to perform in line with expectations. From a micro standpoint, sophisticated buyers diligence existing underlying positions to ensure the quality of existing marks and to analyze the GPs history of realizations versus marks.

Management Fees and Carried Interest (on future funds): Management fees and carried interest on future funds carry higher risk than management fees and carried interest on existing funds. The biggest factor in the success of raising future funds is the relative performance of prior funds. Investing in managers with strong track records mitigates these risks. However, adverse market conditions have the potential to create challenges in terms of the timing and size of fund raises, even if there are more attractive conditions for investing. Importantly, valuation should be set so that in the event an asset manager's ability to raise future funds is impaired, the buyer would still have high confidence in receiving at least its investment basis back from existing funds and incentive fees.

Portfolio Overlay

The goal across a portfolio of GP minority investments is to create diversification which provides a second layer of potential downside protection. First level diversity can be achieved across strategies, vintages, geographies and size. At a level deeper,

diversification can be achieved within strategies such as across approach, sector focus and firm age. Investing through a portfolio also smooths the investors' cash flows and provides investors with exposure to the overall secular growth in private market alternative investments.

Structural Protections

In addition to the potential downside protection inherent in underlying individual investments and the benefits of portfolio diversification, the structure of the investment can play an important role in mitigating risk. While the GP investor is technically a passive (albeit typically value-creating) common equity owner, investments can be protected through several mechanisms. Note that not all mechanisms may be found in all deals as these transactions are executed on a bespoke, case-by-case basis.

Consent rights: This refers to certain actions that the GP cannot take without the buyer's consent. Typically, the types of action that would fall under this category include incurring indebtedness, changing the business, changing the tax structure and other actions that may be disproportionately detrimental to the buyer.

Long-term employment agreements: Investments are typically conditioned upon entering into long-term employment agreements with key principals at the GP. This ensures that the GP investor remains fully aligned with the key people at the GP.

Put rights: In the event key principals commit "bad acts" that would rise to the level of triggering a "key man" event in their underlying funds, the GP investor would be entitled to selling their interest back to the GP at a price that would provide the buyer with its investment cost back.

Earn-outs: In certain situations, stake buyers may seek to bifurcate some of the purchase price in the form of an upfront payment plus an earn-out, which is typically tied to the GP meeting or exceeding their stated business plan. This structure is not as common within private capital GP stake sales but can be used in select circumstances.

ALIGNMENT BETWEEN THE GP, LPS AND MINORITY INVESTOR

LPs Prefer Smaller, More Focused GPs

Over the past 10 to 15 years, the alternative asset management industry has significantly evolved. Access to capital is increasingly critical to drive growth, compete in the marketplace and attract and retain talent. Selling a minority stake to create liquidity for partners does not enhance value or create alignment. Rather, the collaboration between the GP and an engaged, minority owner to invest and grow the business, with a focus on serving existing and new LPs, is an ideal approach for driving value. The GP and minority owner should ensure that there is alignment between the two parties on the GP's growth strategy and how the capital will be utilized to advance these objectives. During this process, it is critical that the GP and minority partner do not lose sight of the most important constituent: the GP's clients. This means maintaining a focus on growth areas that are synergistic with the GP's core competencies and client's demands – both now and in the future. Having a diverse firm with the ability to serve clients through multiple products is a positive outcome for the GP and their LPs.

LPs Benefit from and Push for Lower Fees and Now They Benefit from Fees as an Owner of the GP

GP minority investing is premised upon supporting the business as a whole and their efforts to meet the long-term needs of their clients. Like all good businesses, it is critical for GPs to continuously listen to their clients and stakeholders, including LPs' concerns regarding fee levels, and adapt their models accordingly. Having long-term relationships with a supportive LP base is key for optimizing sustainable value for the GP. As the investment landscape evolves, GPs and LPs will need to continue to engage on a range of topics to ensure a strong alignment of interests, including on fee structures that appropriately reflect the nature of the investment product and track record of the manager.

A parallel can be drawn to GPs implementing strong ESG policies into their investment processes. While a GP could make an outsized short-term profit by investing in companies with questionable ESG practices, it is not likely to enhance long-term value creation, nor is it aligned with the constituents that both GPs and LPs serve. The GP would also likely suffer reputational damages and dissuade current and future LPs from committing capital. Without clients there is no business. As stewards of LP capital that own minority interests in GPs, GP investors play an important part in supporting GPs to meet the evolving demands from LPs from fee structures to strong ESG practices. Not only because these are the right things to do, but because it is good business and creates long-term value from attracting capital to the best industry talent.

INVESTMENT PROCESS

As the alternative asset management industry continues to mature and grow, GP staking players should seek to maintain a disciplined investment approach and partner with businesses that are poised for growth.

The majority of capital from the GP staking industry has focused on larger GPs, but there is a broad and growing universe of mid-sized alternative asset managers that will require financial, operational and strategic resources that GP staking firms are able to bring to bear. In addition, maintaining a specialized and differentiated focus on mid-sized asset managers has the potential to provide a key competitive advantage and be highly selective when it comes to partnering with GPs. These mid-sized firms tend to be more open to bespoke investment structures that support their businesses while providing greater downside protection for investors.

Selection

Quantitative elements of evaluating a GP staking opportunity will typically include an investment performance and track record review with comparisons to both typical industry benchmarks and proprietary benchmarks, as well as, in some cases, individual portfolio investment reviews. Qualitatively, investing in management teams with the highest integrity and that are seeking partners for the right reasons is a key factor that should inform the analysis. The GP staking Firm's existing networks and relationships are critical to sourcing the right opportunities and partnerships.

Valuation

There are several techniques to determine the fair market value of a GP. The primary way is to project the streams of cash flow the GP should generate through management fee

income, net carried interest and other investment-related activities. Determining the net present value of expected cash flows helps inform the discounted cash flow valuation. In light of the ongoing market disruption in connection with the coronavirus outbreak, it is appropriate for GP stake buyers to factor more conservative underlying assumptions and higher discount rates. In addition, market-based trading multiples of similar publicly traded asset management firms and precedent M&A transactions can also help inform valuations. The recent sell-off among publicly traded alternative asset managers should also help to improve the relative comp and deal negotiation dynamics.

Due Diligence

The due diligence process involves extensive document review; several on-site diligence meetings with the investment, business, marketing, legal/compliance, operations and finance professionals at the target firm; background and reference checks; and an in-depth analysis of the target GP's investment performance and attribution analysis, both on a stand-alone basis and when compared to peers. In addition, it is critical to conduct a comprehensive evaluation of both realized and unrealized portfolio companies. The due diligence process is particularly focused on the sustainability of front-office excellence and assessing franchise risk along the following categories:

- Investment Excellence (e.g., track record over multiple cycles, persistence, and ability to source, add value to and monetize investments)
- Business Sustainability (e.g., platform diversification, quality of team, quality and breadth of capital / investor base, and retention mechanisms, including distribution of equity and carry)
- Growth Profile (e.g., investment capacity, management vision, performance of marketing and IR functions and scalable infrastructure)

Portfolio Construction

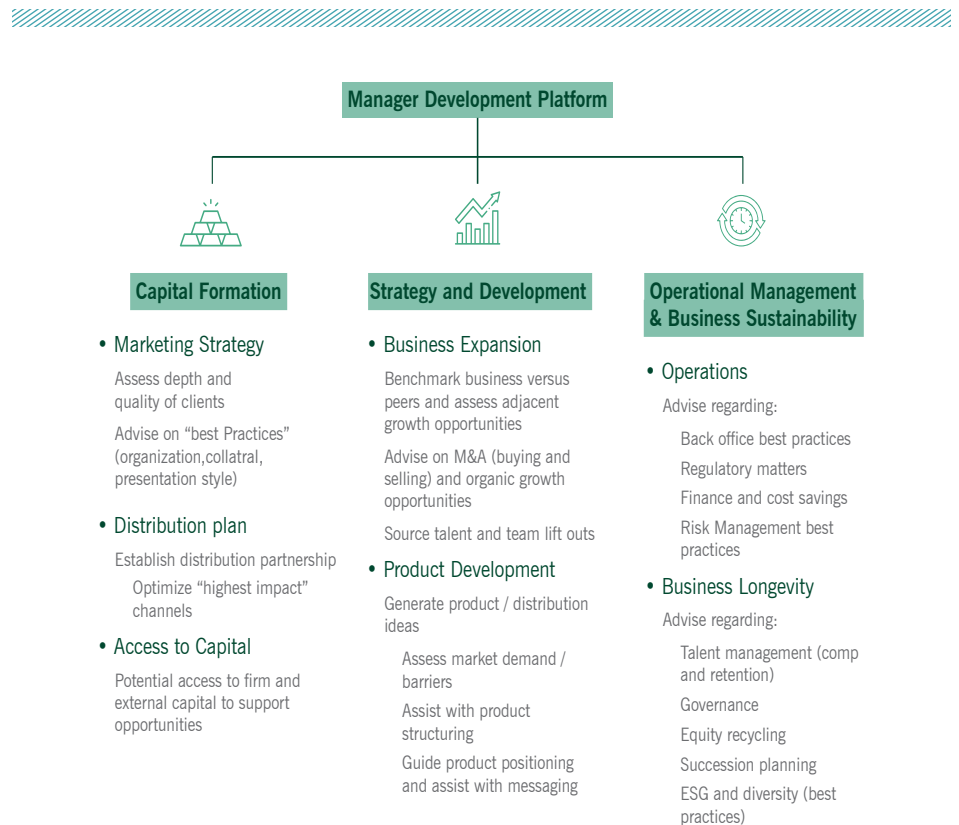
Thoughtful portfolio construction can provide multiple benefits for investors including (i) providing diversified exposure to the growth in alternatives, (ii) mitigating risk and (iii) smoothing cash flows / reducing equity and fixed income beta.

Constructing a portfolio that is broadly diversified across investment strategies, vintages, geographies, industries and sectors would serve to mitigate the following risks:

- Macroeconomic Risk: under-emphasize strategies that have high correlations to markets that are considered overvalued and are likely to be most vulnerable to market corrections.
- Single Investment Risk: a diversified portfolio consisting of multiple GPs adds incremental protection against single GP performance or attrition risk.
- Single Event Risk: maintain time series diversification by deploying capital sensibly throughout the commitment period and by investing in GPs that, when aggregated with other GPs, create balanced vintage diversification looking through to the underlying funds.
- Industry Risk: avoid partnering with alternative asset managers whose underlying strategies face competition from passive investment products or other strategies that may be experiencing relatively high fee compression or other secular headwinds.

Value Creation Approach

Making the investment in the GP is the first step in the process as the “secret sauce” comes from how the new partner supports the GP in enhancing value creation. GP partners should serve as a strategic, financial and operational resource for the underlying GPs to help execute on their objectives, whether it is to raise capital, expand product offerings, manage talent and succession planning challenges, and/or streamline back-office operations.



Liquidity and Exit

The primary form of liquidity will be through the distributions received from GPs. These distributions are expected to result from the fund’s pro rata share of cash flows from management fee profits, net carried interest and other incentive fee allocations as well as investment income. The estimated payback period for investments is approximately seven to eight years.

Secondly, contemplating the potential exit opportunities should start in advance of forming the partnership so the GP and its new partner are fully aligned on the approach. One tactic is to only focus on investments that have compelling exit scenarios whereby a potential future buyer of the GP stake may have a desire and capacity to consummate such acquisition (whether it is a larger scale financial sponsor or for enabling the next generation of the GP’s management team to acquire equity in the GP).

CONCLUSION

The growth of GP minority staking is a natural consequence of the maturation of private market strategies and offers significant opportunities for investors to have exposure to this potential growth with defensive characteristics that mitigate risk, while having greater diversification and potential cash flow generation as compared to investing as a traditional LP in a fund. As the private markets outperformed public markets in the wake of the financial crisis, we expect that there will be a number of GPs that are able to take advantage of the current environment.

Individual GP stake investments benefit from multiple streams of cash flow including management fees and carry on existing and future funds as well as balance sheet returns. However, these investments carry their own unique set of risks and challenges, which makes the structuring of the transaction and partner selection critical. As increased capital flows into GP staking, GPs must utilize the financial and strategic resources of their engaged minority owners to better meet the needs of their LPs. The GP stake investment represents a conviction in the GP's ability to deliver performance over time, including their ability to recognize and adapt to evolving market demands and opportunities.

We believe that GP minority stake sales will continue to proliferate as there are many strategic and financial benefits for capital and partnerships. These range from supporting larger GP commitments to expanding into new adjacencies, strategic hires, as well as inorganic expansion through M&A. Likewise, as alternative asset management firms experience generational shifts, minority stake sales can provide GPs the ability to optimize their ownership structure, retain and attract key talent. An engaged and supportive minority owner can also support GPs' ongoing efforts to better serve LPs with greater resources and expertise.



ABOUT INVESTCORP

Investcorp is a leading global manager of alternative investments. Led by a new vision, Investcorp has embarked on an ambitious, albeit prudent, growth strategy. The Firm continues to focus on generating value through a disciplined investment approach in six lines of business: private equity, real estate, absolute return investments, infrastructure, credit management and strategic capital.

As at December 31, 2019, the Investcorp Group had \$31.1 billion in total AUM, including assets managed by third party managers and assets subject to a non-discretionary advisory mandate where Investcorp receives fees calculated on the basis of AUM.

Since its inception in 1982, Investcorp has made over 195 Private Equity deals in the U.S., Europe, the Middle East and North Africa region and Asia, across a range of sectors including retail and consumer products, technology, business services and industrials, and more than 800 commercial and residential real estate investments in the US and Europe, for in excess of \$61 billion in transaction value.

Investcorp employs approximately 450 people across its offices in New York, London, Bahrain, Abu Dhabi, Riyadh, Doha, Mumbai and Singapore. For further information, including our most recent periodic financial statements, which details our assets under management, please visit:

www.investcorp.com

www.twitter.com/Investcorp



www.instagram.com/investcorp

www.linkedin.com/company/Investcorp

INVESTCORP

New York | London | Bahrain | Abu Dhabi | Riyadh | Doha | Mumbai | Singapore

www.investcorp.com

   @investcorp

The information provided in this document is for informational purposes only and is not to be relied upon as investment or other advice. This is not an offer, nor the solicitation of any offer, to invest in securities in any jurisdiction. Although some of the information provided in this document may have been obtained from various published and unpublished sources considered to be reliable, Investcorp does not make any representation as to its accuracy or completeness nor does Investcorp accept liability for any direct or consequential losses arising from its use, nor does Investcorp undertake to update any of the information herein contained. This document is intended solely to provide information to the client to whom it has been delivered.