ALL ABOUT OPERATORS

The rise of private equity operating partners: what they do, how they’re paid, and the many models for success

Inside Bain Capital’s Operating Platform/ 9
What LPs Need to Know About Operating Partners/ 11
10 Operating Platforms Compared / 14
Three Operators Compare Notes / 24
How Operating Partners Are Paid / 28
Videos in this report

This special report includes the following new video programs. Watch them at Privcap.com

Operating Partners Compare Notes
A three-part series. Operating partners from Partners Group, Argosy Private Equity and The Riverside Company dive deep into the role of operating partners in today’s private equity firms.

Operating Partners in PE: Hiring and Compensation
Ben Sanders and Joseph Healey from Korn Ferry discuss hiring and compensation structures for PE operating partners.

Inside Bain’s Portfolio Group
Steven Barnes of Bain Capital describes the evolution of the firm’s Portfolio Group, which now has 70 operating executives around the world.

Operating Rock Star, or Window Dressing?
Kevin Kester of Siguler Guff describes how to perform due diligence on a GP’s operational bona fides.

A Portfolio Success Story
Aaron Money and John Roach discuss how FFL Partners integrate operating partners into the firm’s DNA.

COMING SOON on Privcap
Why KKR is Interested in Africa
The head of KKR’s European private equity operations paints a vivid picture of a recovering Europe.

Successful Co-Investing
AlpInvest’s Peter Cornelius on the importance of fee structures, beating the J curve and choosing deals for co-investing.

The Realities of Raising Capital
A candid discussion about what is involved in forming a fund. Panel includes experts from Catalyst Investors, Blue Wolf Capital Partners and MVision.

Defined Contributions and Private Equity
Pantheon’s Michael Risk discusses how transparency and liquidity in pension plans relates to private equity.

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April: Performance
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Charlie Ayres of Trilantic tells the harrowing story of his firm’s spin-out from Lehman Brothers.

Stories of Impact Success
Private equity experts from EY and Siguler Guff discuss how successful investments also yielded societal benefits, from an education company in Brazil to a timberland deal in Africa.

Stories of Growth and Impact
A director at Actis and the African Capital Alliance’s CEO talk about how investments and business initiatives in emerging markets have had societal impact.

How to Subtract Value Via Bad Tax Moves
Tax experts from McGladrey and Arsenal on transfer pricing, qualified stock purchases, and how getting these wrong can subtract value from a private equity deal.

From the Road: Fundraising in the Shadow of the Financial Crisis
PE fundraisers from Catalyst, Blue Wolf, and MVision talk about raising funds in the post-financial crisis era.

Africa’s Venture Capital Evolution
African Private Equity and Venture Capital Association members discuss their work, and opportunities in the region.

About Privcap Special Reports
Privcap Special Reports are exclusively for subscribers to Privcap, the definitive channel for thought leadership in private capital. Each month Privcap focuses on a critical theme and produces a “bundle” of thought-leadership content in multiple formats – a digital report, video interviews and panel discussions, and audio programs. We capture the market intelligence of leading authorities, whose expertise forms the core of each report. Privcap Special Reports help market participants better understand opportunities and practices in private capital, as well as gain deep insights into the people with whom they may become long-term investment partners.
Commentary
Privcap CEO David Snow on the evolution of GPs, the value of operating skill, and the role of LPs

Value Creation on the Regular
How operations talent can add value on a daily basis, a discussion with FFL executives

Bain’s Potential Realization
The firm’s Steven Barnes discusses how its Portfolio Group was a pioneer that continues to provide value

Due Diligence
LPs from Pantheon and AlpInvest compare notes on how they perform due diligence to the operating function

Taking A Team Approach
Siguler Guff’s Kevin Kester likens PE to football, looking for talent skilled at executing operating plays

10 Operating Platforms Compared
Overviews of the operating platforms at 10 private equity firms

A Peek Inside An Operator’s Mind
Three professionals discuss strategies they use in private equity and their interactions with deal partners

Compensation May Vary
Two Korn Ferry executives tell you what you need to know about operating partner compensation

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Everyone Says They Have the Best Operating Model

But the only thing that really matters about a PE firm’s operating structure is that it delivers results.

It is far from clear which model for incorporating operating talent into private equity works best.

A casual industry observer might come to the conclusion that a new model for investing has emerged – one that involves full-time, full-partner, in-house operating executives working with deal partners.

The last private equity firm to not flaunt the term “operating” in marketing material probably shut its doors several years ago. But people whose job it is to pick apart private equity firm structures and track records will tell you that for every private equity firm, there exists a different model for incorporating operating talent into the investment program. And it is unclear which model is the best.

LPs and their advisors have become jaded, having heard so many GPs insist that their respective approaches are superior. Recent interviews with fund due diligence experts at Pantheon Ventures, AlpInvest Partners and Siguler Guff (views presented in this Special Report), revealed an emphatic argument that operating partners must be in-house lifers at a private equity firm can be matched by an equally emphatic argument to the contrary.

The logic behind the full-partner operating executive is this: Only a partner who is fully integrated into an investment program, whose economic incentives and personal pride of ownership penetrate the entire firm, will be exert his or her full energies into optimizing the deal. An operating partner only assigned to particular deals, or brought in as a hired gun, will fail to give a damn about the fund as a whole, the culture of the firm and its long-term relationships.

But there is an equally compelling argument for the operating advisor/hired gun. A former corporate executive embedded in a private equity firm for years, scanning deal flow and jumping into portfolio companies, may become stale, especially in fast-morphing industries such as technology. Better to catch a mid-career superstar for a value-add project and then release them into the field.

Among investors there is even some ambivalence about the importance of individual operating talent versus systematic approach to adding value. Kevin Kester of Siguler Guff points out his firm tries to determine whether a GP’s operating platform is driven by the talent of key superstars or by a winning system that can plug in a variety of operators with similar results. Kester says he doesn’t favor one particular model.

Why the lack of conviction about which model works best? It could be that there has yet to be produced an authoritative study comparing the financial results of one operating model over another. More importantly, experience has shown investors that spectacular success and soul-crushing failure can result from all of these models.

What matters most is this – whatever way you try to extract value from a portfolio company, are you good at it? Are the right people being deployed in the right way? It is possible to create what appears to be a winning marriage between operating and transactional talent with a flawed incentive structure.
On the flipside, a firm that relies on accomplished, super-incentivized hired guns, may have a habit of buying hopeless companies for too much, at the wrong time. Such a portfolio company will fail to thrive, even in the hands of an operating superstar.

Given the brutal GP culling by LPs, it is not good enough to just be good enough. Investors want to see evidence of consistently good results. A spectacular deal weighed against a couple of zeros can produce a good overall fund return, but it scares LPs that a firm has a fractured culture and lacks discipline. It also points to a GP team that puts itself at the mercy of circumstance and portfolio-level management, while lacking a house operating vision.

The head of a major endowment PE program, well known for his outspokenness and cynicism, once told me that he scoffs at any GP who claims to “add operating value.” Invariably this LP says he would find wipeouts and underperformers in these GPs’ track records and ask, “The special things you did to the winning deals, why didn’t you do them to these other deals?” Perhaps an unfair challenge but the dismissive attitude isn’t far from the well-resourced limited partners’ current state of mind. Showing them an operating platform that is supposed to work is very different than presenting an operating platform that works.
The Daily Grind of Value Creation

Operating partners play an integral role in FFL’s decision making process, say the firm’s Aaron Money and John Roach.

Middle-market companies are increasingly eager to team with private equity firms that can quickly leverage their industry knowledge to make an immediate impact on the business. That’s why more and more PE firms are adding operating partners to their ranks—because it’s no longer just about the end result, it’s about adding value on a daily basis.

“We founded our firm on the premise that we could bring to bear a diverse range of experiences and talents on middle-market companies and that we could not only make better investment decisions but also help our companies much more after we own them,” says Aaron Money, a managing director at mid-market private equity firm FFL.

Operating partners can be a significant asset for portfolio companies. But managing the various roles of investment partners and operating partners can be a balancing act. FFL does it by ensuring that interests are aligned.

“Our operating partners do well when our investments do well,” Money says. “It’s a combination of cash compensation and equity participation in the portfolio companies that we own. We feel that alignment is really im-
John Roach, an operating partner at FFL, has been a financial analyst, a management consultant, a successful entrepreneur and a CEO in the course of his career. What he's never been, at least at FFL, is a hired gun who rides in to save an investment, then rides out again.

“At FFL the operating partner is an integral part of all activities,” he says. “I sit in all the Monday morning meetings, reviewing all the investment candidates. I have a chance to comment if I feel like it. And then if something is particularly relevant I have a chance to jump in on that and go through the investigation and due diligence. And in a couple of cases, when that's gone all the way to an investment, I've been a very active operating member of the company subsequently.”

Money says operating partners at FFL are involved in everything from sourcing to diligence to investment-committee review to, ultimately, working with portfolio companies. “Really the only differences are in the tactical day-to-day execution of things,” he says. “I wouldn't take an inner role at a portfolio company to do an operations project of some sort and John doesn't get involved in legal documentation and arranging financing for a new transaction. Other than that, we're perfectly aligned to create value in the portfolio.”

That alignment also limits recriminations between the operating side and the investment side if an investment goes south. “There is no finger-pointing, as in the operating people couldn’t turn around a bad investment or they didn't do well with a good investment,” Money says. “Everybody is onboard with the plan for that company and everybody is moving forward in the same direction.”

AARON MONEY
Managing Director, FFL

Money joined FFL in 2003 from DB Capital where he evaluated and executed private equity and mezzanine debt investments and dealt with a variety of portfolio companies. He previously worked for Chase Securities Inc. as an analyst in investment banking, specializing in mergers and acquisitions and leveraged finance transactions.

JOHN ROACH
Operating Partner, FFL

Roach is part of the operating team at FFL and previously worked as a senior executive in building products, natural resources, aerospace and management consulting. He has been a senior executive at companies including Unidare US, Builders FirstSource and Fibreboard Corp. Earlier in his career he worked in financial analysis and as a strategy consultant.
Operating Partners:
The Bain Capital Way

Steven Barnes, head of the firm’s North American private equity group, explains how operational expertise forms the core of the its value-creation strategy.

Steven Barnes knows Bain Capital as well as anyone. He joined the firm in 1998, four years after its founding, and now runs its private equity group in North America. He is also intimately familiar with Bain’s founding concept of value-added support, having led the development of its Portfolio Group, which works with management teams to outline and execute strategies to help portfolio companies deliver on their potential.

“Working with portfolio companies was something that Bain Capital pioneered,” Barnes says in a recent interview with Privcap. “We started with a bunch of consultants and operating executives who came together into the private equity business. As the firm grew, the size of our deals grew, and the complexity of what we did grew, we decided in 1999 to form a dedicated portfolio group.”

Today, the team collaborates with deal teams from due diligence to exit. When a deal closes, members of the Portfolio Group typically serve as consultants to management, rather than filling specific management roles. That usually happens only when one of the firm leaders departs or has a health problem, and then it’s only a temporary arrangement.

“Our job is not to run these companies,” Barnes says. “Our job is to help these companies realize their full potential more quickly and more successfully.”

It requires a particular skill set. “You need the IQ—the strategic understanding and operating experience to understand where a company is, where you want it to be in five years and the road to get there. But you also need a special sauce called EQ [emotional intelligence]. You need the partnership skills and the ability to develop trust-based relationships with management teams so you can partner with them and help them get their companies to their full potential.”

As the Portfolio Group has grown—it’s now at 70 executives worldwide—it has recruited a number of specialists in areas such as talent management and sales growth.

Success is not always the case, of course. But the Portfolio Group has done a good job of minimizing the failures.

“Things happen in every situation,” Barnes says. “There are macro changes and micro-dynamics of an industry. That’s why we have the operating team partnered with the deal team—to make sure we’re doing everything we possibly can, reacting in a thoughtful, strategic way. Look at the massive macro-impact of the crisis of ’08 and ’09. Our ability to work with our companies and get them doing unbelievably well has been a cornerstone of this operating group.”
OPERATING PLATFORMS

Vetting & Comparing the Many Models

LP advisors from Siguler Guff, AlpInvest Partners and Pantheon Ventures discuss the way they approach the most challenging aspect of due diligence – trying to determine to what extent operating talent has driven private equity value creation.

This section also includes an overview of 10 different private equity operating functions.
Operations: What LPs Need to Know

Two major investors discuss their approach to vetting the operating platforms of GPs large and small

By Tom Stein

Just as it’s hard to find a general partner who doesn’t claim to be in the top quartile, it’s difficult to find a private equity team that doesn’t claim to “add operating value” by pairing “operating partners”—often former CEOs and senior executives with relevant industry experience—with their portfolio companies.

“There’s a lot of emphasis on [operating platforms], especially at the larger end of the market,” Maarten Vervoort of AlpInvest Partners told Privcap recently. “Including plain vanilla actions like leveraging is something people already know, and it’s so clearly already priced into the deal.”

Within the portfolio company, the operating partner’s role is typically straightforward: they serve as an advisor to existing management or as a replacement until a new leader is found. Within the private equity firm itself, the structure is far less defined: in some cases, operating partners are members of the firm, get a piece of the carry, and return to the mothership once their work is done; in others, they are hired guns who helicopter in and out of portfolio companies on a deal-by-deal basis.

Each arrangement has its pros and cons, and limited partners need to understand them clearly before committing capital. To help guide the way, Privcap recently spoke with Vervoort and Helen Steers of Pantheon, two deep-pocketed LPs with extensive experience conducting due diligence on a GP’s value-creation capabilities.

In-House vs. Hired Gun
The most significant differentiator among operation platforms is where the operating talent calls home. In other words, are they partners within the private equity firm or are they brought in on a deal-by-deal basis as consultants and board members?

Neither Steers nor Vervoort expressed a preference for one model, but they did stress that each private equity firm needs to assess what’s appropriate given its size and investing style. If a firm considers a certain industry silo a “core capability,” then it makes sense to employ operating partners within the firm, says Vervoort, but only if it has the proper scale. “If you only have one or two people on the operating team, the skills can get stale over time,” he says.

Steers adds, “Some of these skill sets can get obsolete if the industry experts remain within a private equity firm. Certain skills, like supply chain management, can get used and replicated again and again within portfolio companies. But if you’re talking about a sector skill, people outside the firm might be more up to date on technologies and practices.”

Deal sourcing
Another area the pair investigates is the role the operating partner plays in deal sourcing and, if they source a deal, the way they’re compensated.
for doing so. “What you quite often see is the operating partners don’t get any carry to the extent that the investment partners would receive,” Steers explains. “So who is ultimately responsible for the deal and how is it aligned with the investors?”

“The easier model is, the guy who sources the deal is responsible for managing it. Tensions can arise if an operating partner says, ‘you sourced the deal with a strategy that is not working.’ The better model is where you have people on the operating side involved pre-deal, helping to assess the opportunity. Then there is a pre-agreed 100-day plan that’s put into practice.”

Vervoort also prefers to see the industry experts involved in sourcing, even if it’s just assessing the opportunities found by others. “It sounds like a cliché, but the sourcer needs to be able to ask the right questions. For example, if you look at the reporting that a GP will get from a potential portfolio company, it can be very financially driven, looking at sales, etc. But the best GPs are operating driven and they’ll want to know different sets of KPIs [key performance indicators].”

**The Question of Carry**

The only “wrong” compensation structure for operating partners is one that does not properly align the partner to the success or failure of the portfolio companies. The many GPs that AlpInvest and Pantheon invest with pay their operating partners in different ways.

Those with the scale to afford a large operating staff typically offer carry to operating partners, Vervoort says. “But typically the amount of carry is lower than the deal partners usually receive.”

That’s not necessarily a problem, he adds, as it may allow the GP to have a more dynamic operating function. “In order to make sure that the operating gene pool is fresh and healthy, you want to over time refresh the pool of people,” he explains. “Carry is so long term it might not be appropriate.”

**Attribution**

A key focus among sophisticated LPs today is to look beyond the top-level performance history of a private equity team and actually determine where that performance came from. For firms that claim to significantly improve the operations of their portfolio companies, a potential LP must try to determine whether operating improvements were the result of GP skills rather than market momentum, the existing management team or just plain luck.

“It’s very difficult, and gets to the heart of private equity due diligence,” Steers says. “How do we determine that a private equity team turned a so-so company into a much better company? We look at realized deals, look at profit attribution. We look at how much value was created through financial leverage and how much came through profit improvement.”

Vervoort adds: “When we look at a realized deal, we look at leverage, multiple appreciation, and talk to management to get their perspective for what the GP has done. Clearly, success has many fathers. You can analyze it and talk to the management and look at board minutes, etc. But really pinpointing it to a causal relationship—that’s the hardest part.”

Ultimately, Pantheon and AlpInvest share a distinct advantage in vetting GP performance. As active co-investors, they get direct insight into how a GP approaches the operating-improvement process. “Being a co-investor brings you really close to the war stories,” says Steers. “It is an interesting window into what’s really going on.”
Peeling Back the Onion

For **Kevin Kester** of **Siguler Guff**, due diligence into the operating function means separating fact from fiction.

Private equity firms are like great sports teams; sometimes one or two star players carry the load; other times a well-defined playbook and collective grit leads to success.

“Look at Bill Belichick and the Patriots,” Kevin Kester, managing director at Siguler Guff, recently told Privcap. “They have a great system and they can plug people in and out.”

Kester has spent a lot of time thinking about the impact of operating talent on the performance of private equity funds, specifically funds that target small and mid-market buyout opportunities.

Before placing a single dollar with a private equity firm, Siguler Guff does extensive scouting and recruiting. The process begins with interviews of fund managers and specific questions about the types of operational value they bring to their portfolio companies.

“We’re looking for managers to be explicit about such things as cost-structure improvement, sales and marketing improvement, gross-margin improvement, R&D improvement and lean-manufacturing improvement,” Kester says. “Whatever they’re doing at a particular company to add operating value, we want to understand their take on it.”

Siguler Guff also wants to see the hard data backing up those claims.

Then he’ll follow up that conversation by speaking directly with the CEOs of portfolio companies, because they will often give an unvarnished account of what’s really going on. It’s Kester’s job to determine what’s true and what’s wishful thinking.

“These CEOs are often not scripted,” he says. “If you specifically ask them where they received help or how often they interact with the private equity fund, you’re really going to uncover what’s truly happening on a day-to-day basis. You may determine that this is really a part-time operating partner who spends 85 percent of his time doing other things. So you can quickly differentiate between what’s real value add and what’s window dressing.”

“**Whatever they’re doing at a particular company to add operating value, we want to understand their take on it.**”

-Kevin Kester, Siguler Guff
**KKR**

The captive consultant model

KKR seeks operating improvements via KKR Capstone, its internal operational consulting team.

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>KKR</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$90.2 billion*</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Retail, Healthcare, Industrials, Media and Communications, Financial Services, Tech</td>
</tr>
</tbody>
</table>
| Size of Deals | Varies by fund and deal type  
Best known for major equity investment in large-cap companies |
| Overview of Firm | A pioneer in private equity investing, KKR improves the value of its portfolio companies by leveraging its operational acumen and through active monitoring of its investments |
| Number of Operating Partners | 60+ at dedicated operational unit, KKR Capstone  
20+ in Senior Advisor Group that often play operational role in portfolio companies |
| Notable Operating Partners | **Dean Nelson, founder and head of KKR Capstone:**  
Currently serves on boards of food giant Del Monte and mattress manufacturer Sealy  
Before joining KKR, was a senior partner with The Boston Consulting Group  
Worked closely with KKR portfolio companies First Data, The Nielsen Company and Toys ‘R’ Us  

**Joseh Plumeri, senior advisor:**  
Served 12 years as CEO of The Willis Group, a leading insurance brokerage and KKR portfolio company  
Oversaw integration of Citicorp and Travelers Group  
Board Member for KKR portfolio company First Data  

Other notable members of the “Senior Advisors Group” include former chairmen of HSBC, Caterpillar, and Accenture |
| Details of Operating Platform | Created in-house operating platform in 2000  
Capstone team spans North America, Europe, and Asia and is organized according to operational expertise rather than industry acumen  
Capstone typically works with companies for an 12-24 month term |

*As of Sept., 2013. Includes capital from non-PE investment vehicles.*
ARSENAL
The flexible operating model
Arsenal deploys its industry-savvy operating unit in different forms for different managers

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>Arsenal Capital Partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$1.675 billion</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Specialty Industrials, Healthcare</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>Typically invests in companies with enterprise value between $50 and $250 million</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>Typically makes sector-specific investments in companies with positive cash flow and opportunities to enhance productivity</td>
</tr>
<tr>
<td>Number of Operating Professionals</td>
<td>Operating Committee: 6 Operating Partners: 9 Senior Advisors: 8</td>
</tr>
<tr>
<td>Notable Operating Partners</td>
<td>Shawn Abrams, operating partner 30 years of experience in global chemical and materials industries Prior to joining Arsenal in 2013, served as President of industrial chemical-company Grace Catalysts Technologies Began career at FMC Corporation</td>
</tr>
<tr>
<td></td>
<td>Per Peterson, senior advisor Former chairman of research and development of pharmaceuticals for Johnson &amp; Johnson Former chairman of the department of immunology at Scripps Research Institute in San Diego</td>
</tr>
<tr>
<td>Details of Operating Platform</td>
<td>Leverages operating resources in varying roles depending on management needs Possess both general management and functional skill sets Offers assistance in IT, human capital, supply chain, six sigma, and international expansion</td>
</tr>
</tbody>
</table>
**SILVER LAKE**
The tech exec model
Silver Lake utilizes a handful of former tech execs of high-profile firms in its "Value Creation" unit.

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>Silver Lake</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$20 billion across multiple platforms</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Technology, tech-enabled industries</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>Varies by fund, but includes investments in large-cap and middle-market companies</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>Silver Lake focuses on companies with leading market positions, strong management teams, and proprietary core technologies.</td>
</tr>
</tbody>
</table>
| Number of Operating Professionals | At “Value Creation Unit”: 10  
Advisors to Value Creation Unit: 16 |
| Notable Operating Partners | Mark Gillett, managing director and head of value creation  
Led firm’s investment in Skype, where he served as Chief Development Officer and COO  
Served as corporate vice president at Microsoft upon its acquisition of Skype  
Originally joined Silver Lake in 2009 after working as a managing director and partner for Alvarez & Marsal  

Charles Giancarlo, senior advisor  
Joined Silver Lake in 2007  
Currently serves on boards of Mercury Payment Systems and Vantage  
Formerly executive vice president and chief development officer at Cisco |
| Details of Operating Platform | Often involved in creation and introduction of new products and services  
Assists in deal sourcing and due diligence  
Operating unit consists primarily of former tech execs of brand-name firms |
The Blackstone Group

With the aid of its internal operational consulting unit, Blackstone maximizes operating efficiencies across its portfolio.

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>The Blackstone Group</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AUM</strong></td>
<td>$63 billion (in private equity platforms as of Sept 30, 2013)</td>
</tr>
<tr>
<td><strong>Targeted Industries</strong></td>
<td>Spans a wide range of industries from clean-tech to financial services</td>
</tr>
<tr>
<td><strong>Size of Deals</strong></td>
<td>Varies significantly by fund and investment type, but most well-known for major equity investments in large-cap companies</td>
</tr>
<tr>
<td><strong>Overview of Firm</strong></td>
<td>Publicly-listed asset management firm with investment vehicles focused on private equity, real estate, hedge funds, and debt investing</td>
</tr>
</tbody>
</table>
| **Number of Operating Professionals** | Operating Partners on Private Equity Team: 4  
|                                  | Portfolio Operations Group: 21  
|                                  | Portfolio Operating Advisors: 2  
|                                  | Industry Advisors: 10 |
| **Notable Operating Partners**   | Dave Calhoun, senior managing director and head of PE Portfolio Operations  
|                                  | Joined Blackstone in January 2014  
|                                  | Oversees Blackstone’s in-house operational consulting team, the Portfolio Operations Group  
|                                  | Former CEO of television-ratings firm Nielsen Holdings  
|                                  | Worked at General Electric for 26 years  
|                                  | James A. Quella, senior managing director and senior operating partner  
|                                  | Prior to joining Blackstone in 2004, served as a Senior Operating Partner with DLI Merchant Banking Partners-CSFB Private Equity  
|                                  | Co-author of the book “Profit Patterns: 30 Ways to Anticipate and Profit from the Strategic Forces Reshaping Your Business”  
|                                  | Currently serves as a Director of Freescale Semiconductor, Michaels Stores, and Vanguard Health Systems |
| **Details of Operating Platform** | “Portfolio Operations Group”, Blackstone’s in-house operational consulting unit, works across the entirety of Blackstone’s portfolio  
|                                  | “CoreTrust Purchasing Group” manages $2 billion in annual spending over nearly 60 portfolio companies.  
|                                  | The Portfolio Operations Group also offers “Equity Healthcare LLC” to Blackstone portfolio companies. The health insurance program covers a total of 320,000 members. Focused on revenue realization, operations, services and infrastructure, purchasing and cross-selling, leadership development and healthcare. |
### CLAYTON, DUBILIÈR & RICE
The original “operators as partners” model
CD&R’s operating partners have been the heart of the firm since 1978

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>Clayton, Dubilier &amp; Rice</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AUM</strong></td>
<td>$17 billion</td>
</tr>
<tr>
<td><strong>Targeted Industries</strong></td>
<td>Span multiple industries, but frequently invest in distribution or services-related industries</td>
</tr>
<tr>
<td><strong>Size of Deals</strong></td>
<td>Typically make large equity investments in companies with enterprise value between $1 billion and $15 billion</td>
</tr>
<tr>
<td><strong>Overview of Firm</strong></td>
<td>Invest in market-leading companies that are underperforming, targeting enterprises with large customer and supplier bases and diverse revenue streams.</td>
</tr>
<tr>
<td><strong>Number of Operating Professionals</strong></td>
<td>Operating Partners: 10+ [includes senior advisors] Operating Advisors: 7</td>
</tr>
</tbody>
</table>
| **Notable Operating Partners** | Jack Welch, senior advisor  
Former Chairman and CEO of General Electric  
Joined CD&R in 2001  
Assists firm in investment screening, portfolio management, and co-chairs the portfolio company operating reviews  

  Vindi Banga, operating partner  
Joined CD&R in 2010 after 33-year career at Unilever  
Led operating improvements in firm’s investment in portfolio company Diversey  
Serves on Prime Minister of India’s Council of Trade & Industry |
| **Details of Operating Platform** | Operating partners typically installed as chairman of the board at portfolio companies  
Operating partners typically at helm of 1-3 portfolio companies at a time  
More than 1/3 of company profits go to operating team  
Prides itself on making counter-cyclical operational improvements  
Responsible for some of the most widely-publicized turnarounds in private equity history, including Kinko’s, Hertz, and Lexmark |
**SUN CAPITAL PARTNERS**

The South Florida blend

Sun Capital mixes former industry execs with business function specialists

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>Sun Capital Partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$10 billion</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Varies widely, but includes automotive, chemicals, consumer products, food and beverage, healthcare, industrial, and paper</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>Companies ranging from $50 million to $3 billion in revenue</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>Typically makes control equity investments and leveraged buyouts in middle-market companies. The firm often targets enterprises undergoing a corporate divestitures or operational challenges.</td>
</tr>
<tr>
<td>Number of Operating Professionals</td>
<td>At Operations Team: 35+</td>
</tr>
</tbody>
</table>
| Notable Operating Partners | Clarence E. Terry, senior managing director  
Joined Sun Capital in 1999 as first operating managing director  
Led creation of in-house operations unit  
Former vice president of consumer products at Rain Bird Sprinkler Manufacturing  
T. Scott King, senior managing director  
Joined Sun Capital in 2003  
Former CEO of water treatment systems company Waterlink  
Former president of consumer brands division of Sherwin-Williams |
| Details of Operating Platform | Operating imperative for portfolio companies stresses liquidity and performance benchmarking  
Significant experience in automotive sector  
Ten members of operating team are managing directors at the firm  
Blend of geography-specific functional specialists and former industry execs |

**OPERATING PLATFORMS COMPARED**

Privcap Special Report • Operating Partners | Q1 2014 / 19
The Riverside Company
The “growing small” operational model
Riverside employs industry expertise to grow small companies over the long term

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>The Riverside Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$3.5 billion</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Healthcare, Education, Software and IT, Consumer Products, Manufacturing, Business Services, Franchisors</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>Invests in companies with enterprise value of under $250 million</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>Leading private equity firm focused on the smaller end of the middle-market. Focused on operational improvements, organic growth and add-on strategies.</td>
</tr>
</tbody>
</table>
| Number of Operating Professionals | Managing and Senior Operating Partners: 4  
Operating Partners: 10  
Operating Executives: 9  
Senior Advisors: 10 |
| Notable Operating Partners | Ron Sansom, managing partner and global executive operating partner  
Prior to joining Riverside in 2005, served as president of sensing & control at engineering giant Honeywell  
Co-fund manager of Riverside Micro-Cap Fund  

Michael Michienzi, senior operating partner  
Operates out of Dallas office  
Worked as senior principal for PE firm American Capital  
Managed Black & Decker Household division at Applica Inc. |
| Details of Operating Platform | Instrumental in Riverside’s focus on organic earnings growth as the most important factor in value creation  
Operating professionals range in professional background from Fortune 500 executives to small company founders  
Created a “Riverside Toolkit” that assists small companies in marketing, pricing, and lean manufacturing |
## TPG

The turnaround consulting model

TPG employs both consulting generalists and functional specialists in pursuing companies other firms shy away from

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>TPG</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$54.5 billion across multiple platforms</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Varies widely and by fund, but includes financial services, travel and entertainment, technology, biotech, consumer products, and healthcare</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>Varies by fund. Principal investment platform TPG Capital focuses on companies requiring equity capital between $10 million and $1 billion</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>Executes global public and private investments through leveraged buyouts, recapitalizations, spinouts, growth investments, joint ventures and restructurings</td>
</tr>
<tr>
<td>Number of Operating Professionals</td>
<td>In-house “Ops Group”: 60+</td>
</tr>
</tbody>
</table>
| Notable Operating Partners | Antonio Cao, operations director for TPG Capital  
Currently supervises TPG investment in Ontex  
Previously served as senior director at turnaround management firm Alvarez & Marsal and as CEO of Italian packaging producer Irplast  

Scott Gilbertson, head of operating group for TPG Growth  
Currently serves on board of Fender Musical Instruments and 3-Day Blinds  
Prior to joining TPG, headed merchandising at Under Armour  
Served as CEO and COO of J. Crew, one of the firm’s most successful investments to date |
| Details of Operating Platform | Ops partners full partners in all profits  
Ops Group members typically have blend of direct management and management consulting background  
Prides itself on full integration with investment team  
Operating assets also include a “Field Operations Advisors Group”, focused on cross-portfolio business functions |
## WELSH, CARSON, ANDERSON & STOWE

The blended industry/functional model

Welsh, Carson, Anderson & Stowe utilizes both industry execs and functional specialists in its operational unit.

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>Welsh, Carson, Anderson &amp; Stowe</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>Since inception, has organized 15 funds with total capital of $20 billion</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Information/business services, Healthcare</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>No standard deal size</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>Welsh Carson typically makes control investments in the healthcare and business services space, focusing on operational improvements and partnering with talented management teams</td>
</tr>
<tr>
<td>Number of Operating Professionals</td>
<td>Generalist Professionals: 6</td>
</tr>
<tr>
<td></td>
<td>Functional Specialists: 8</td>
</tr>
<tr>
<td></td>
<td>Senior Industry Executives: 5</td>
</tr>
<tr>
<td></td>
<td>Affiliated Industry Experts: 4</td>
</tr>
<tr>
<td>Notable Operating Partners</td>
<td>Tony F. Ecock, general partner and generalist professional in Resources Group</td>
</tr>
<tr>
<td></td>
<td>Joined Welsh Carson in 2007</td>
</tr>
<tr>
<td></td>
<td>Previously worked at General Electric as vice president of GE Healthcare’s Enterprise Sales division</td>
</tr>
<tr>
<td></td>
<td>Also worked for consulting firm Bain &amp; Company</td>
</tr>
<tr>
<td></td>
<td>Mark M. Tomaino, senior industry executive</td>
</tr>
<tr>
<td></td>
<td>Joined Welsh Carson in 2010</td>
</tr>
<tr>
<td></td>
<td>Previously worked for health information technology firm The TriZetto Group and for Bausch &amp; Lomb</td>
</tr>
<tr>
<td>Details of Operating Platform</td>
<td>In-house operational team called the “Resources Group”, which is comprised of both functional specialists with cross-portfolio expertise (such as procurement experts) and former industry chief executives</td>
</tr>
<tr>
<td></td>
<td>Maintains a group of affiliated former chief executives who also assist with deal sourcing and due diligence</td>
</tr>
<tr>
<td></td>
<td>Since 2000, 90% of investment returns generated by operational growth</td>
</tr>
<tr>
<td></td>
<td>Develops “Value Maximization Plans” for newly-acquired companies</td>
</tr>
</tbody>
</table>
**CERBERUS**
The operation-by-affiliation model
Cerberus keeps a fleet of 100+ experts on-hand at its affiliated operational unit

<table>
<thead>
<tr>
<th>Name of Firm</th>
<th>Cerberus</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$25 billion (includes non-PE investment vehicles)</td>
</tr>
<tr>
<td>Targeted Industries</td>
<td>Varies widely, but includes manufacturing, government services, transportation, and financial services</td>
</tr>
<tr>
<td>Size of Deals</td>
<td>Varies, but typically makes large-scale investments in large-cap companies</td>
</tr>
<tr>
<td>Overview of Firm</td>
<td>In addition to its distressed, real estate, and commercial lending platforms, Cerberus makes control and minority investments in its private equity vehicle</td>
</tr>
<tr>
<td>Number of Operating Professionals</td>
<td>Cerberus Operations and Advisory Company (COAC): 100+</td>
</tr>
</tbody>
</table>

**Notable Operating Partners**

- **Chan Galbato, chief executive officer, COAC**
  Prior to joining Cerberus in 2009, owned and directed CWG Hillside Investments
  President of services at The Home Depot from 2003 to 2005
  Former minor league baseball player with the Montreal Expos
  Currently chairman of Cerberus portfolio companies Blue Bird Corporation and Guilford Automotive

- **John Bozzella, senior operating executive, COAC**
  While vice president of external affairs and public policy at Chrysler, involved in government restructuring efforts
  Spent 10 years at Ford Motor Company
  Former chief legislative representative for Albany mayor’s office

**Details of Operating Platform**

- Heavily involved in turnaround of the bankrupt car rental company that owned Alamo and National brands
- Roughly half of operating team currently employed by portfolio companies
- Also assists in sourcing deal opportunities
Smooth Operators

Three private equity operating partners open up about their role in the world of PE, how compensation is structured, and their relationship with deal partners. With Fredrik Henzler of Partners Group, Don Charlton of Argosy Private Equity and Ron Sansom of the Riverside Company.

By Ainslie Chandler

Privcap
Fredrick, how is the operating team at Partners Group structured?

Fredrik Henzler, Partners Group
We are a team of 21 operating professionals, organized in six industry verticals and we spend about a third of our time in the investment process, alongside the investment team looking for companies, doing due diligence on the companies, developing an investment thesis, aligning the investment thesis together with the management and then, winning management over to sell their company. Two-thirds of our time is spent implementing what we developed as an investment thesis alongside the management team, given the holding period.

Privcap
Don, does that sound similar to Argosy?

Don Charlton, Argosy Private Equity
I think it depends on the size of the private equity firm. We are a lower middle market firm so we are typically buying from founders and sellers who started the business. Our operating partners are allowed to source and work deals. In most traditional private equity firms there’s segmentation: there’s a deal partner, there’s an operating partner, and they play at different segments along the deal process.

Privcap
Ron, how is the operating function structured at Riverside Group?
Ron Sansom, Riverside Company
We’re involved from the beginning of the investment through the exit process. We help determine what investments to make, we’re involved in the whole period—the diligence period and then in the exit period—then we back off a little bit, and the deal partner takes over. On the other hand, we do work to get the SIM right and we work with the management team to get them prepared for the presentation.

Privcap
How has the role of operating partner evolved? Are you actively out sourcing deals?

Charlton
I would say the operating partner sourcing is not typical. But it makes a lot of sense. Most of the operating partners sitting here at the table have operating experience; we run companies, we’ve started companies. That’s a big asset when you’re up front trying to get a deal, or sitting across the table from an owner who started something from their garage and you can identify with some of the things that he or she went through.

Sansom
If you went back 20 years, most operating partners came in when a company’s in bad shape and needs help. In that time frame to the present, it’s evolved to where operating partners are now involved from the beginning of the investment all the way through the exit. Our operating partners don’t originate either—but we have an entirely separate deal origination organization. We do go along on first visits, which adds credibility.

Privcap
Fredrick, is your team helping to shape the macro view of the firm, even before certain companies are looked for?

Henzler
As a global company it’s important we know which region we like, which industry we like and where we want to be overweight. We also want to find out which segments and sub-segments of the industry we’ll want to work with.

Privcap
When your team is brought in to meet with potential sellers, what questions do they ask? Do they take comfort from the fact that you are on the team, post-acquisition?

Henzler
We like finding a regional champion and then helping them expand globally. They often know their niche markets well, but they feel they need assistance stepping into a new region.

Having somebody beginning to talk through what challenges we will face, the success stories we can create together makes it more tangible. This can be critical in getting the buy in from founders and managers.

Privcap
It’s important for operating partners to feel they’re part of the team, but then there’s an actual alignment of interest with the rest of the firm. How are operating partners economically brought into the deal?

Charlton
There are some firms that treat the function separate, but I would think the majority [of operating partners] are going to be included in the equity carry of the fund. That’s the way it is at our department.

Henzler
The first operating partners that were there often weren’t part of the company; they were external freelancers or kept as consultants outside of the GP. Then they started getting hired and put on to the cash and bonus, and later they got carry in their deals.

Privcap
Most operating partners come from corporate backgrounds, often banking or financial fields, and they’re plugging into private equity firms. How does that work?
Charlton
As it relates to deal partners, whether they're accepting of operating partners, I'd say they're receptive. I respect their involvement in the banking field, although I didn't come from banking. I was in startups for 12 years before I joined this firm. They respect that we've run companies, these operating partners, and they leverage that experience.

Sansom
The deal team and operating partners really have to work together. If you don't, then you have a serious issue within your firm. We've never had much of an issue within Riverside. Typically, they're joined at the hip in order to understand and implement the strategy.

Henzler
It's important for the long-term success of an operating partner that you're seen as peers, and integrated into the private equity team.

Sansom
There's always going to be some tension now and then between a deal partner and an operating partner. The key is to work through those issues like any professional deal team would, whether it be in corporate America or private equity.

Henzler
The tensions can be valuable because they flush out the problem you didn't think about. They can make you focus on an issue and find a solution that wasn't there.

This article is based on a 3-part video panel series found exclusively on Privcap.com.
Paying Operating Partners

Operating executives are now a key part of many private equity firms’ strategies. Privcap spoke with Korn Ferry’s Joseph Healey and Ben Sanders about the evolution of the operations role, and how firms compensate and retain their teams.

Privcap
Have private equity firms reached a point where they have conceded that they need to lift their operating game and bring more operating talent in house?

Sanders
It’s something that can be afforded by large-cap firms. Most large-cap firms have some version of operating partners, with many different functions within the firm. If you look at a lot of the middle-market firms, they might have one. Not every firm follows the same model.

Privcap
It’s hard to find firms that don’t say they add operating value, yet not every firm out there has a deep bench of people with a background in running corporations.

Sanders
One of the reasons why you see more and more operating partners is that LPs look for that when they evaluate whether to invest in a fund. So being able to speak to that is important. During the recession in 2008/2009, a lot of private equity firms realized they needed to get involved with companies and it was better to hire an expert to do that rather than try to do it themselves. That created demand for operating partners, too.

Healey
Even firms that don’t have an operating partner bench and don’t have a roster of people listed on their website as operating partners, they seek to draw in those capabilities on a project-by-project basis. They’ll have senior
advisors or former CEOs of their own portfolio companies they’ve come to know and they seek to draw in that expertise on an as-needed basis, as opposed to making them a part of the infrastructure. Even if the operating partner team isn’t deep, the need to have a greater degree of sensitivity to operating issues is at play across the industry.

Privcap
To what degree do operating executives have their pay tied to the deal they have been assigned, compared to the health of the whole fund? Is there a perception among limited partners that you’re a real operating partner if you are incentivized by the whole fund, versus a hired gun with just the deal you hunted?

Healey
Limited partners care about the outcome and the individual firms leave it to themselves to determine what’s optimal. If you want to think about it in a theoretical sense, the idea is that you have a group of very smart people—some of whom have an investment background, some an operating background— whose interests are aligned to a common outcome across a portfolio. There are some firms that that think they’re backing great CEOs and they don’t feel they need an operating partner on their bench to oversee their activities. Their objective is to let the CEO do what he or she does well.

Sanders
The one distinction that comes to mind is that for the large-cap firms, they probably would have an operating partner for a specific industry sector rather than going across five or six, whereas for a mid-market firm, the operating partner would focus more firm-wide, especially if it’s someone with a finance background and they’re really there to help the CFOs.

Healey
Some feel the need to build the operating partner and make it an in-house capability. In some models, there’s one senior operating partner who’s effectively a general contractor or the architect of the operating partner kind of thinking within the firm. They create this network of operating partners that can be drawn in on a one-off basis.

Privcap
What are some models firms use to integrate their operating talent into their investment teams?

Sanders
There are four used regularly. One is for business development where they call them a senior advisor or operating partner, and they have industry contacts, evaluate the investment opportunity, and then win the deal. The second is for functional expertise, like an investment sector within a private equity firm.

Another is more of a generalist, perhaps a former CEO or a business president who is going to work with the management team once they’re in place. The fourth is a former portfolio company CEO of the private equity firms or someone they’ve brought in from the outside to look for and run deals.

Healey
This is an idiosyncratic industry and every firm has their own approach. What you find is a range as to whether they’re full-time, permanent members of the team or they’re brought in on an ad hoc basis.

You could have senior advisors who are less than full time and standard operating partners, oftentimes deeply embedded in the investment team, and the pay structure is identical to the investment team members.

Privcap
Are you sensing reluctance or a hesitation on the part of some firms to open up their partner economics and bring in these new people who may or may not have an impact on profits?

Healey
I don’t think there’s much of a choice, to be honest. There’s an expense to be incurred. Sometimes these expenses can be billed back to the portfolio companies directly and some firms underwrite the cost of a very large group and then throughout the course of a year they bill back the costs of that group on a project by project basis as the functional expertise is brought to bear on individual companies.
Sanders  
I think it’s always challenge to get the investment side of the firm to share their economics but they look at it as an investment decision. Is this operating partner that we’re going to bring in going to create more value than he’s going to cost over the life of the fund?

Privcap  
What percentage of the operating partners have a direct interest in the incentive whether it’s a portfolio wide or with specific companies?

Healey  
I think the answer to that is probably very high. Some have specific economics and a specific deal and some have carry in the broader pool. That might be more. Of those who have direct participation that might be 50/50.

Sanders  
If you go back, six, eight, ten years ago, it was probably a much lower percentage and it was more people being paid on a kind of project by project basis and being paid cash rather than carry much to their chagrin. But now it’s become a more highly valued function and the best people are going to want carry, with the around whether that’s firm wide or deal specific.

Healey  
And it shouldn’t be overlooked that some operating partners are not pursuing these types of roles purely for kind of W2 cash income or even carry participation. They may be in a position to seek highly attractive co-investment opportunities with the private equity firms. They might find that to be much more valuable so they can make their own kind of direct investment in these companies with the benefit of having done their own due diligence on these deals because they are working side by side with the private equity firm. It is very idiosyncratic depending on the firm and the circumstance and even the individuals who are in an operating partner capacity.

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**BEN SANDERS**
Principal, Korn Ferry

- Works with private equity companies and their portfolio companies
- Previously an associate at Heidrick & Struggles and vice president with FleetBoston Financial Group
- Holds a master’s degree in business administration from the Darden School of Business at the University of Virginia and a bachelor of science in business administration from Stonehill College, where he graduated magna cum laude
- Author of Transatlantic: Dream to Destination

**JOSEPH HEALEY**
Senior Client Partner, Korn Ferry

- Spent two decades in executive search advising private equity investment firms and alternative asset managers on their talent strategies
- Founder of Sextant Search Partners and former private equity practice leader
- Graduated from Hofstra University
- Board member of the Manhattan Theater Club
From the Archives

Check out Privcap's full coverage of the private capital markets

**HUMAN CAPITAL**

In Search of Diverse Managers
With Carmen Heredia-Lopez, CIO of Chicago Teachers’ Pension Fund

Why LPs Care About Diversity
With Yokasta Segura-Baez, a Principal at Pantheon

Promoting Underrepresented Talent
With Julian Johnson, Senior Vice President at Sponsors for Education Opportunity

Why We Support Toigo Foundation
With Carlos Rangel, Senior Portfolio Manager at the W.K. Kellogg Foundation

Private Equity and the Human Capital Challenge
With James Dimitriou, National Practice Director at Private Equity Tatum

**SECONDARIES & LIQUIDITY**

Dealing in Direct Secondaries
With David Wachter, Founding Partner of W Capital Partners

Facebook and the Rise of Early Stage Liquidity
With Daniel Burstein, Managing Partner at Millenium Technology Value Partners

Pain and Liquidity in Real Estate
With Josh Cleveland, Partner at Clairvue Capital Partners

Success in Secondaries
With Ian Charles, Partner at Landmark Partners

**VENTURE CAPITAL**

Profit with Purpose
With Dr. Andrew Kuper, Founder & President of LeapFrog Investments

From Russia, With Capital
With Axel Tillmann, CEO of RVC-USA

IPOs and the New VC Exit Reality
With James Robinson, Co-Founder and Managing Partner of RRE Ventures

Corporate Venturing Grows Globally
With Dr. Martin Haemmig, a noted academic and expert on corporate venturing

The View From Venture
With Kate Mitchell, Co-Founder and Managing Director of Scale Venture Partners

Venture and Innovation in China
With Kai-Fu Lee, CEO and Co-Founder of Innovation Works

Picking Winners – and Good Partners
With Rory O’Driscoll, Managing Director of Scale Venture Partners

**REAL ESTATE**

Private Equity Real Estate in Mexico
With Antonio Ruiz Galindo, CEO of Industrial Global Solutions

Financial vs. ‘Creative’ Real Estate in NYC
With Sonny Kalsi, Founder and Managing Partner at GreenOak Real Estate Advisors

The Real Estate Rebound
With Dan Vene, Head of Real Estate Capital Raising at Fir Tree Capital

Retail, Hospitality, Multi-Family
With Dean Adler, Co-Founder at Principal Lubert-Adler Partners LP
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How does competition drive the need to expand into new global markets?

Once one of the bigger firms learns that a competitor is charting new territory, it’s not very long before someone from the operating board starts asking, “Firm X is there—why aren’t we there?” Or “What’s our strategy to enter that market?” They get very, very competitive.

We have received urgent calls from clients seeking to enter Africa, Latin America, and countries outside of China in the Asia-Pacific. Many of those markets are evolving very, very quickly. And it’s not just the traditional U.S. or European buyout-capital deals that are being employed in these locations. In many cases, growth capital is used to build these businesses out. In many parts of the world, the traditional senior bank lending market just doesn’t exist. They don’t have access to a local bank, bond market, or capital market to fund growth. They’re literally relying on family, friends, and other resources.

So the opportunity for private equity is to use growth capital to join the foundation of these entities. It is an opportunity to make nice returns from the exit. It’s also an opportunity to help these emerging societies advance in some way. Private equity can make money and at the same time deliver socially-responsible components to these countries.

Can you describe the range of services EY provides to private equity firms investing in the emerging markets?

The hunt for higher returns continues. On a global basis, all private equity funds are diversifying along different service lines, capabilities, and geographies.

They're looking into the emerging markets more seriously. The focus used to largely be on China. Now they're thinking: What's our Latin American strategy? What's our African strategy? And do we need to be in India? Then they realize there are private equity funds that have already been there for a long time.

Many of the larger, name-brand funds that operate very successfully in the Americas and Europe suddenly find themselves playing catch-up in the emerging markets.

Once the funds recruit a team and seek transactions in the new geography, they instantly want their service providers to follow them and remain by their side in every deal they do. EY positions itself to meet the needs of our clients as they expand globally.

Clients expect our work to be on par with what they get in New York, Hong Kong, or London. We handle issues in transactions and transaction support, the diligence process, and tax structuring. Tax work becomes critical because of very complex jurisdictions. The diligence of financials goes hand in hand with tax work. We’re also engaged in valuation work and human-capital decisions. Once clients make successful investments, they seek other traditional services, such as audits.
Case Study:  
Real Estate Financial Solutions in Poland: H&M

Jeffrey Lefleur, W. P. Carey exec discusses why the $85 million purchase of an H&M distribution center in Poland was the acquisition of a critical asset.

This is a core hub for H&M’s business, supplying thousands of stores throughout Europe. H&M is a superb credit with about 10 billion Euros a year in revenue and virtually no debt. In terms of the deal, we got a good lease term with a good yield relative to the market. In Poland, we can achieve good yields relative to Western Europe and find available mortgage financing. On a leverage basis, this deal can become attractive in the years to come.

**Privcap**
Can you talk about the scope of this facility as a hub for H&M’s retail distribution, but also their e-commerce activity?

**Lefleur**
It’s roughly 900,000 square feet in two buildings, which for a logistics warehouse is massive. One building is their Eastern European logistics hub for well over 1,000 stores; the second provides online fulfillment and distribution for all of Europe. Both buildings operate 24/7, every day of the year, with almost 1,500 employees. It’s a critical asset for H&M’s operations.

**Privcap**
What is the difference between deals in Poland and Western Europe? What was unique about the source or structure of this deal that’s illustrative of Eastern Europe?

**Lefleur**
This deal shows how much Poland is like Western Europe: it’s one of the few markets in Eastern Europe with a lot of competition from respectable buyers with big pockets. The country still has active mortgage financing, and a lot of liquidity available. We are not seeing double-digit Eastern Europe yields that you would expect to see in a challenged market.

For the most part Poland has set itself apart to be more like the healthier Western European markets than like the weaker markets in Eastern Europe.