EMERGING MANAGER SHOWCASE

NOVEMBER 7, 2017 | NEW YORK, NY

Seven Habits of Highly Effective Emerging Managers

November 2017

ilpa

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Introduction

Welcome to the 2nd Annual Emerging Manager Showcase! Launched in 2016, the Showcase complements the ILPA Summit, the premier private equity event for connecting LPs, GPs and key service providers from around the world. Here, we hope that meaningful conversations will be had, individuals will be engaged and relationships will be forged.

In that spirit, we have aggregated seven thought leadership pieces which support the transition of our GP attendees from up-and-coming fund managers to established members of the private equity asset class.

The ILPA Emerging Manager Showcase and Summit are focused on GP-LP relationships. The briefs contained herein, while certainly not exhaustive, build on the decades of experience represented by the professionals who contributed to the document's creation.

In summary, the "Seven Habits" offer guidance around:

- Embracing a unique vision for your firm, based on the team that will bring that vision to life
- Maximizing alignment with your LPs from the outset to set your firm up for future success with early investors
- Demonstrating a clear view of your strategy for achieving alpha
- Adopting a practice of transparency around tools such as lines of credit
- Exploring outsourced service providers early to bring scale, reliability and best practices to bear on your operations
- Investing with the optimal reporting and compliance service providers to position for long term success
- Leveraging deep, accurate, appropriate and well-structured data to make a solid case in the market

We hope you find these thought pieces useful. Best wishes for an outstanding Showcase!

The ILPA Team

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Successful GPs Demonstrate a Compelling Vision

By Greg Durst, Head of Corporate Development, ILPA

Introduction

For many LPs, the decision to invest with an emerging manager means that they've signed up for that GP team's vision of what can be built over the long term. LPs can have many rationales for this buy-in - they may want to get into the next hot manager, get preferential fees or terms or start a co-investment program with a manager that has high incentives to align their interests with investors. These LP strategies are well founded. According to Preqin research, emerging PE managers offered LPs higher returns on an attractive risk-reward basis in every year before, during and after the Global Financial Crisis. These returns are driving the capital being committed to emerging managers. Preqin estimated that ~$450 billion had been committed to first and second time funds from 2006 through 2016. Though current fundraising levels remain below the pre-crisis peak, allocators continue to be active in the emerging manager category.

Give Them Your Why

At the end of the day, economics alone will not compel limited partners to invest. LPs want to know why you're building your fund, and specifically that your team has the people with right combination of experiences, incentives and interpersonal experiences to achieve a clear vision. Many institutional investors have deep allegiances to their beneficiaries – retirees, alma maters, family legacies – and they want to work with other like-minded stewards of capital. LPs provide the fuel for your private equity fund. They must trust that your team's passion for your niche will create differentiated returns to positively impact their beneficiaries. LPs are keenly aware of their "why" and are squarely focused on how their investments will help their constituents. They expect nothing less from their fund managers. Demonstrating genuine passion for an industry segment or investment theme, even if it's only a 30 second elevator pitch goes a long way towards articulating why you wake up every morning and can't wait to get to work.

It Starts With the Team

LPs have a full range of tools to assess established managers on financial terms and other "hard metrics." Yet, a lack of track records for emerging teams means investors will have to rely on less traditionally quantitative data in their approach, specifically when assessing the individuals and the team dynamics. Of course, they'll do all the reference checks (including back channeling with individuals not officially on your list). However, emerging managers have a great opportunity to showcase strong team dynamics and a complimentary mix of skills within the team. Even if all the principals come from the same firm or have worked together successfully for long stretches, you need to show that group think (and, therefore, poor risk management) will not be a feature of your investment committee meetings. How will you challenge each other? What are the checks and balances in place? And while the distribution of carry is a good indication of who's calling the shots, how you reserve carry (or don't) for other partners and new junior team members signal how much "team" means to the firm.

“Tells” In the Room

Just as important as your pitch is your team’s ability to visually operate like a well-oiled machine. When you’re meeting with prospective investors, they’ll use both conscious and subconscious clues to get a measure of the team. Many experienced LPs report that they can see poor team dynamics in the first interaction, which, sadly, becomes the last meeting. Most of these meetings involve a leading founder (or two), but LPs are looking for how they treat one another and other team members in the room. Who do they invite to the meeting? Do the partners interrupt each other or, worse, interrupt LPs? Do they listen or take feedback during the meeting? Do team members defer to one another appropriately? Are junior associates and back office professionals made available during the evaluation process? Has the distribution of roles and responsibilities been well-demarcated in the firm and well socialized internally? It flows, therefore, to dry run the presentation well in advance with your entire team so that on the day you’re demonstrating your cohesiveness with familiarity, authenticity and ease.

Have Plans for the Future

In addition to the shorter- term plan for raising the fund in question, LPs expect that you’ll have longer term plans for deal sourcing, portfolio construction, performance improvement for companies and, yes, future funds, so that you may build a long-lived firm. Your first and second time funds are also entrepreneurial ventures. A simple concept of great results is a start, though truly successful managers present an authentic, well-vetted vision. A vision that will keep you and your partners motivated and engaged for the next 20 years will speak volumes to your investors.

The good news is that the LP who buys into your vision will be your greatest supporter and fan. Remember, success for an LP is multi-faceted: a GP team that works well together is more likely to have strong results, will easily raise new funds and ultimately will have provided a return on an LP’s thorough diligence efforts. LPs want to find long-term homes that generate the right results for long term capital - no LP is hoping for “one and done.” Sharing with limited partners an authentic vision upon which you can execute is the first step on the journey to becoming an established fund upon which a legacy can be built.

This Won't Be Your Last Rodeo: Proper Alignment of GP and LP Interests to Ensure Long Term Partnership

By Todd Boudreau, Partner, Chair of Private Equity, and Kevin McNiff, Associate, at Foley & Lardner LLP

Introduction

Given the difficult fundraising process for first-time funds, properly aligning GP and LP interests is critical for emerging fund managers to build investor relationships and generate strong portfolio returns. Whether in the context of a private equity, venture capital, real estate or debt fund, below are certain key areas for emerging fund managers to consider when negotiating with prospective limited partners.

Management Fee Size and Offsets

According to the 2017 Preqin Private Capital Fund Terms Advisor, respondents reported that management fees are the area most in need of GP-LP alignment. Management fees should be based only on reasonable operating expenses and reasonable salaries so that carry remains the fund manager's profit center. While 2% of committed capital remains the most common fee percentage, first-time funds may charge lower rates depending on manager overhead and fund size. While it is necessary to have adequate working capital, management fees can be reduced or waived for LPs fronting a sizeable percentage of the initial committed capital (although a fund with different management fees can be more difficult to market). Fees may also be reduced incrementally following the conclusion of a fund's investment period, or calculated as a percentage of invested (rather than committed) capital.

Funds today often offset against the management fees a percentage - typically 80-100% - of transaction-related fees that a fund manager may receive for its services to portfolio companies. A failure to offset can mean that a fund manager's incentives could skew to focus on transaction-based fees and not carry. Transaction fees may include breakup, origination, broken deal, commitment, cancellation, monitoring, financial advisory, and investment banking fees, among others. Fund managers should keep in mind that fee offsets may result in the recognition of UBTI or ECI for tax-exempt investors.

GP Commitments

GP and LP interests are best aligned when the fund manager has put skin in the game by committing some of its own money into its fund. GP commitments are typically 2% of the total committed capital or greater, although as reported in Preqin's 2017 Private Equity and Venture Capital Report, a significant percentage of commitments falls between 1-2%. Regardless of percentage trends, the commitment should be a meaningful portion of the fund manager's liquid net worth. Additionally, LPs typically expect that the GP commitment be in cash, as opposed to a deferral of management fees or waiver of carried interest.

Distribution Waterfalls

There are two main distribution "waterfalls": the deal-by-deal model and the back-ended model.

Deal-by-deal: The GP recovers carry on an investment-by-investment basis. Distributions are made regardless of losses incurred on subsequent investments, which benefits the GP as investors bear the risk of loss on future investments. This waterfall involves a clawback at the end of the fund's life cycle, the exercise of which can strain GP and LP relations.

Back-ended: The GP does not receive carry until all capital contributions on both realized and unrealized investments, plus the total preferred return on aggregate capital contributions, are made to investors. LPs generally favor the back-ended model, which incentivizes GPs to seek strong investment returns throughout the life cycle of the fund.

If the prospect of delaying carry through the term of the fund is unpalatable, a fund manager can, as an alternative to the back-ended model, offer distribution-related concessions, such as having losses carry forward from prior divestments of fund assets, providing interim clawbacks or setting aside a significant portion of carried interest (30% or more) in escrow.

Preferred Return Hurdle

Many limited partnership agreements impose a 7-9% hurdle rate, which is the minimum percentage return the fund must achieve before the fund manager receives carried interest. A "hard hurdle" limits the carried interest calculation solely to profits over and above the hurdle rate, while a "soft hurdle" is calculated on the entirety of the fund's profits if the hurdle is achieved. The "blended hurdle" balances GP and LP interests by instituting a soft hurdle on the condition that the overall return to investors meets the hurdle rate.

Fund-Level Transparency

Both the SEC and institutional limited partners have taken a keen interest in inadequate disclosure by fund managers of conflicted transactions, particularly with respect to transaction fees and co-investments. To uphold their fiduciary obligations, fund managers should be as transparent as possible and provide their LP advisory committees with approval rights for payment by the fund of transaction fees and services provided by the fund manager's affiliates, as well as other potential conflicts of interest. In addition to great advisory committee engagement, we've also seen quite wide adoption of the ILPA's Fee & Expense Reporting Template among LPs, GPs and the service provider community. We believe this is an important tool to maintain appropriate transparency with limited partners.

Co-Investments

Where LPs are granted co-investment rights, a fund manager must ensure that LPs will be treated *pari passu* and offered investment opportunities at the same time and on the same terms as the fund. Co-investment opportunities could potentially come at the expense of the fund, necessitating a determination of whether the fund has the capacity to exploit the opportunity at the time the co-investments are made.

For further information on how to properly align GP and LP interests, please contact Todd Boudreau at tboudreau@foley.com. You can access other fund formation and investment management-related materials on Foley Intelligence.

Where's the Alpha? How Concise Examples of Value Creation Connect With LPs

By Christopher Godfrey, Senior Partner, CEPRES

Introduction

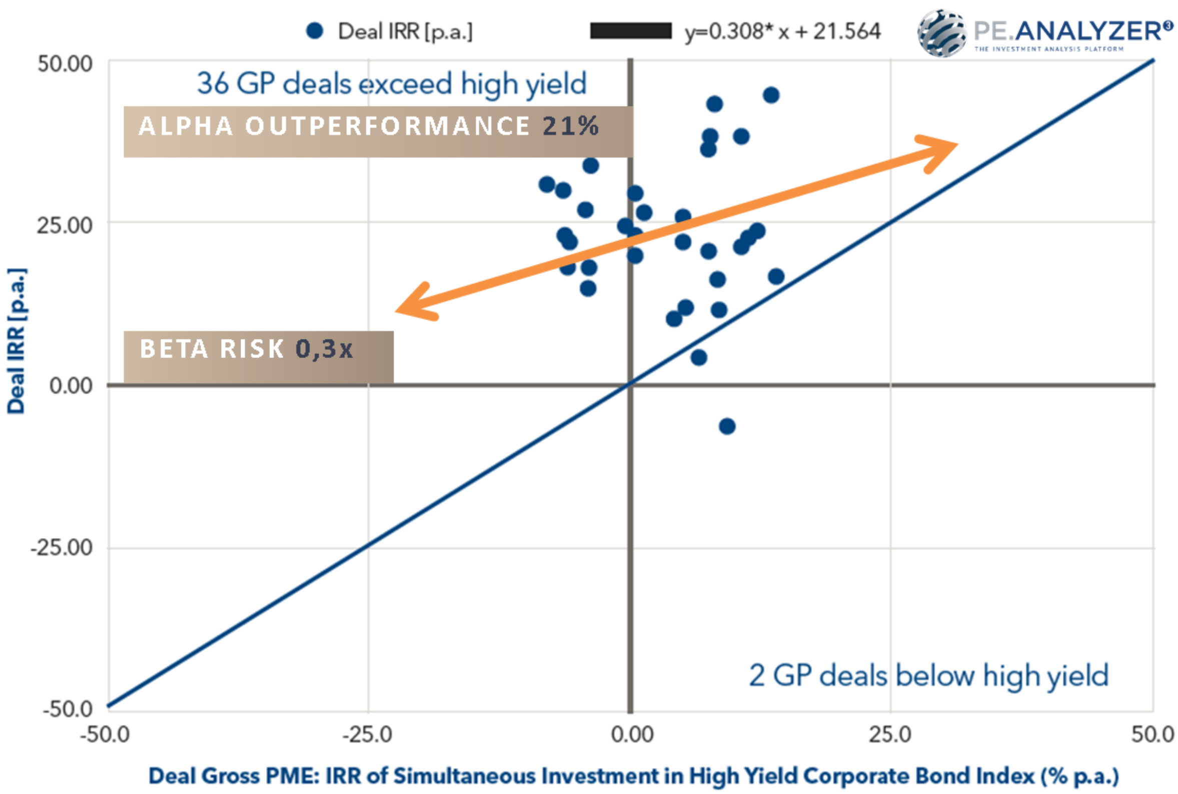
With allocations increasing to private markets and concern over current pricing and leverage in the market, institutional LPs now demand to know how a new commitment contributes alpha to their portfolio. Consequently, it is in the GPs own interest during fundraising and due diligence to be transparent and demonstrate how they create true value in their operating companies to drive stronger investment returns. Communicating your alpha returns and value creation relative to peers in your specific market segment will help you differentiate your strategy and engage investors.

Making Your Case

At every conference and every pitch, LPs now hear the refrain 'I generate alpha,' but few GPs back this up with any proof. As an emerging manager, you have to compete with 'safe' brand name GPs who are the go-to choice for many investors. Many GPs rely on simplistic value creation methods and basic fund level returns that don't illustrate their alpha. Also, these basic methods do not account for risk, which is a powerful topic for investors in today's market who are worried about the next down-cycle.

Showing Real Risk-Adjusted Alpha

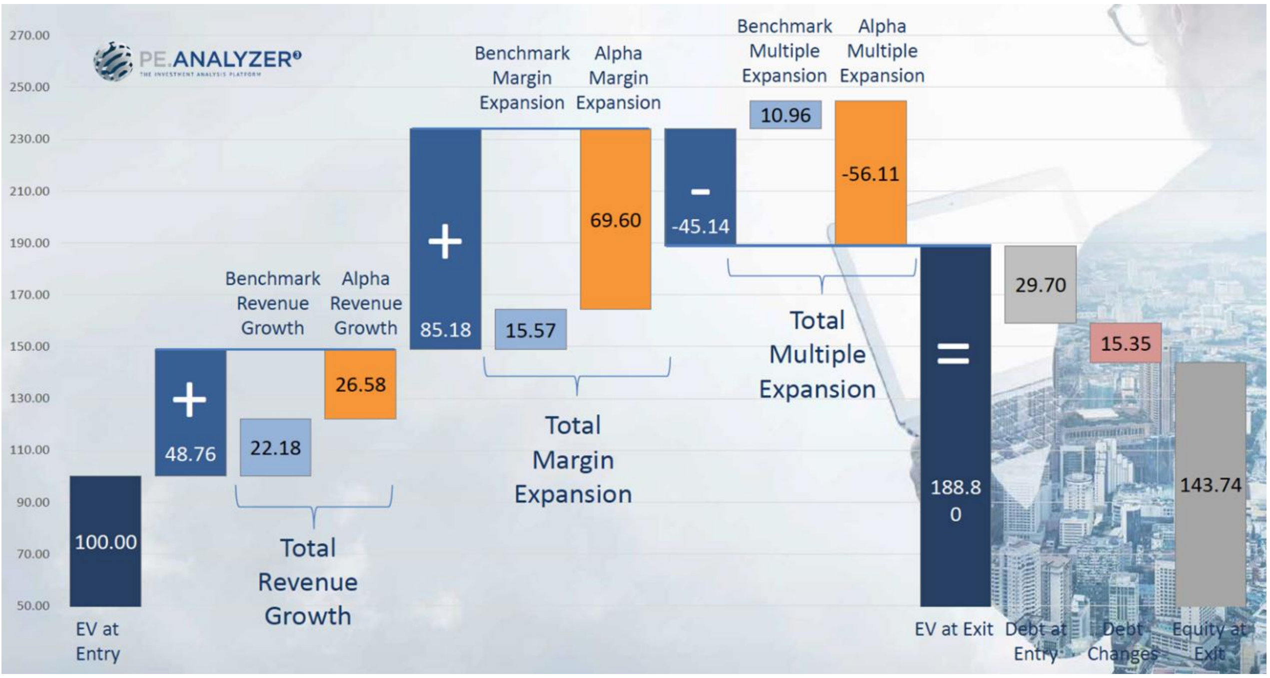
In the context of returns, *risk-adjusted alpha* is the outperformance generated by a set of investments versus a comparative market when taking into account the underlying market movements. Referring to the CEPRES method shown below, we take the performance of deals in a US private debt track record and plot them against the performance they would have generated if their cash flows had instead been invested in the High Yield market (a comparative liquid market for private debt). We then calculate the regression between the two and calculate the risk adjusted alpha and also the beta correlation to the comparative market.



In the example above, we see the GP has a strong risk adjusted alpha versus High Yield of 21% and a very low beta correlation of only 0.3 (see the top of the graph). This is great evidence to show investors that the manager has outperformed high yield substantially over a long period and their returns are significantly less volatile, providing downside protection to fluctuations in the wider debt markets. In the case of buyout managers, a fitting regional stock index could be used as an indicative index.

Value Creation Elements & Attribution vs. the Market

Many LPs are now also focused on value creation in the underlying operating companies. One reason for this is the concern about the impact of leverage and high market pricing on future returns. Smart GPs will focus on this topic to show their LPs how they added value to their investments. It is straight forward to calculate the impact of revenue growth, margin expansion and multiple expansion on the enterprise value of operating companies (note leverage does not itself change the enterprise value, rather the equity stake). What is more challenging is to show what impact you as the GP has versus the wider market. In the CEPRES method below, we directly account for the GPs own contribution to their operating companies by decomposing the value creation attributable to the market versus that generated by the GP.



In this example for a mid-market European Buyout, we see the GP directly generated 27% of revenue growth versus the market growth of only 22%. Even more impressively, they drove directly 70% of bottom line growth versus the market's 16%. They lost value through multiple expansion, so were not depending on market pricing to generate significant growth in enterprise value of their holdings.

What it Means for Emerging Managers

In both these methods, you can see that rather than just claiming alpha, you can use empirical evidence to prove your own alpha. As shown in these examples, using risk adjusted alpha and value creation alpha to demonstrate your superior ability to drive operating company growth and investment returns is compelling and a great technique for emerging managers to differentiate themselves in the market.

Subscription Lines: How GP Transparency Can Manage Fund Risks and Meet LP Needs

By Jennifer Choi, Managing Director, Industry Affairs & Greg Durst, Head of Corporate Development, ILPA

Introduction to Lines of Credit for Emerging Managers

Sophisticated fund managers across the strategy spectrum are using credit facilities to bridge deal financing needs, manage capital calls and smooth cash flows. In this note, we want to illuminate some of concerns around subscription lines and suggest best practices for disclosure around the use of these facilities. Specifically, we hope that increased clarity related to their use and impact will allow emerging managers to work with their LPs to enhance disclosures, while appropriately managing any attendant risks. For a deeper dive on the topic, we encourage you to review ILPA's Subscription Lines of Credit and Alignment of Interests: Considerations and Best Practices for Limited and General Partners issued in June, 2017.

Our Definition

Subscription lines, lines of credit or bridge financing may have specific distinctions in definitions or usage for the manager. In this note, we'll refer to ILPA's definition:

These are short term loans secured by limited partners' uncalled commitments and are generally revolving facilities. Typically, the facility is granted at the fund level or through an SPV held by the fund with a guarantee from the fund.

These facilities are provided by a range of lenders focused on the asset management community, either niche players (e.g., Silicon Valley Bank or The Private Bank, now CIBC Private Bank in the US) or specialized arms of global banks (Citibank and Wells Fargo), to name a few.

Risk Areas Identified

In general, LPs understand the use of these facilities and, in many instances, understand that they are, when used appropriately, helpful for the smooth operation of the fund. Recently, however, we've seen increased use of these facilities in ways that raise a number of issues that can and should be addressed. These issues fall into three main categories; macro risks, structural risks (i.e., credit risk) and impact on reported fund performance.

At the macro level, it should be recognized these facilities have not been stress tested for systemic disruptions like a global liquidity crunch or interest rate spike. Further, there's a reasonable concern that these facilities may create a roadblock for secondary transactions (buying or selling of individual LP interests in the fund). Finally, there could be increased regulatory scrutiny regarding overall fund leverage.

On the structural side, we've seen three trends that deserve a closer look and guidance:

- Repayment terms extending beyond one year
- Time between capital calls being stretched to one year or more
- Terms that have the facility secured by the uncalled capital of the fund, with underwriting on advance rates based on a fund's most creditworthy LPs, while retaining joint and several liability for all LPs.

With more funds using these credit lines, transparency around the facilities' impact on returns to LPs must improve, especially with respect to the calculation of the preferred return and carried interest (and possible clawback situations) as well as relative performance comparisons. Institutional investors evaluate PE program performance based on fund-level IRRs or returns on capital deployed ("times money returned"). Depending on which of these two performance measures carries more weight, some LPs favor delays in capital outlays enabled by subscription lines, whereas others prefer "money out the door." An institutional investor's view on program performance and how they like their cash to work will shape their view on the use of these lines. Regardless, LPs increasingly request to see both levered and unlevered IRRs, particularly when benchmarking a prospective manager's track record against peers in the market.

ILPA Recommendations

In general, GPs need to work with their LPs to help them understand these lines' impact on waterfall provisions, joint and several liability for the LPs, drawdown limits, disclosure obligations and approval rights – and ultimately what sorts of limits or requirements should be prescribed by the LPA.

At ILPA, we believe GPs should provide greater disclosure around the use of these lines, as well as meeting LPs' needs for greater clarity and specificity in the partnership agreement provisions that address the parameters for these facilities' future use:

<u>Disclosure:</u>

- Quarterly releases should include 1) amount drawn from facility (both in terms of amount and as a percentage of uncalled capital), 2) days outstanding and 3) costs incurred by partnership related to use of lines
- LPs should understand the terms of credit facilities, with emphasis on obligations on the fund and the manager
- Fund performance should be reported both with and without leverage

<u>Fund Terms</u>

- Preferred return calculations should begin when capital is put at risk (and not when first called)
- Credit lines should be capped at an agreed percentage of uncalled capital
- Fund documents should explicitly state intended use of proceeds from lines
- Agreed leverage maximums for the fund should take into consideration amounts outstanding in lines of credit

In-house or Outsourced? How Outsourced Administration Impacts Costs, Reliability and Your Relationships with LPs

By Bob Woosley, National Practice Leader - Private Equity, FD Fund Administrators

Whether you are an emerging fund manager or an established firm with multiple fund vintages, the decision to retain or outsource certain back office functions can have a significant impact on your operations, as well as how you are perceived by institutional limited partners.

According to Chris Andraca at Base Venture, approximately 30% of private equity firms currently deploy fund administrators, with that number expected to dramatically increase to 48% by the end of 2018. What is driving leading private equity firms to make the decision to outsource fund accounting, investor relations and other compliance functions?

Investor Demands for Greater Transparency

Investors are increasingly demanding third party validation of AUM and Net Asset Values, as well as greater transparency in reporting. In their due diligence and ongoing monitoring programs, LPs are evaluating middle and back office capabilities of a fund, including the fund's practices around accounting and reporting. The same study showed that 71% of GPs say are seeing a dramatic rise in demand for transparency, specifically providing more visibility into risk, operations, performance and valuation. These demands are a perhaps the biggest driver for GPs to outsource administration.

Evolving Technology and Streamlining Internal Operations

Technology is increasingly seen as a means of differentiation among private equity and real estate fund managers for internal reporting, investor relations and compliance. When it comes to technology there have been two traditional approaches. The first approach is often for the GP to try and handle the entire technology stack on their own, including attempting to build out their own applications and infrastructure. The second approach (often after being unsuccessful on the first approach) is for the GP to try and manage an external technology vendors/platforms.

Either way, the experience often ends up with the same result – managing technology takes more time and personnel, costs more and has higher error rates than they expect. This reality is pushing more GPs to look to a fund administrator to adopt and manage their technology platforms. Ultimately, GPs are looking to fund administrators to decrease costs and drive reliability by spreading the cost of technology across the administrator's clients and applying industry-standard best practices.

Increased Regulatory & Compliance Pressure

A 2016 Longitude Research study showed that regulatory compliance was the number one concern of GPs, with 8 out 10 saying that compliance costs are climbing faster than other operating costs. The last thing GPs want their LPs to see is a regulatory issue! An increasing number of GPs see outsourcing administration to a full-time independent administrator as a critical part of reducing the risk of regulatory non-compliance.

Fund Administrators as Keystone for Emerging Managers

When thinking about whether to outsource, more GPs are taking a step back and realizing that their core value proposition is simply the creation of great risk-adjusted returns for their investors. That does not, therefore, include managing a world-class investor relations, financial reporting and compliance functions powered by the latest technology platforms. Fortunately, fund administrators, particularly those familiar with the challenges faced by emerging managers, can fill this need. An increasing number of LPs understand that GPs that engage fund administrators have taken the steps necessary to meet LPs' demands for reliability, transparency and industry best practice in critical functions.

In the words of Tom DiEgidio, partner at FD Fund Administration: "In today's competitive environment, the perception of a strong back office has become a 'must have' requirement for institutional investors."

Emerging Private Equity Managers' "Right Scale Model" for Success with Audit Providers

By Patterson Chiweshe, Principal, Audit Principal in the EisnerAmper Financial Services Team

Emerging private equity fund managers and their service providers often have their work cut out for them. The manager – provider relationship is often challenged by high compliance costs relative to fee-earning assets, conflicting schedules and execution priorities in the short term. A successful relationship between an emerging manager and its service provider correctly assesses these realities and builds strategies to balance competing resource requirements to allow each party to focus on their strengths to build sustainability for the enterprise.

Fund Managers Want to Build the Best Firms They Can

Most managers, and especially emerging managers, aspire to build and manage enduring, large investment platforms. The reality, however, is that the trajectory from a small fund to a seasoned manager with hundreds of millions or billions in AUM takes time and sustained focus. Though primarily a function of investment success or track record, institutionalized administrative capabilities are increasing important to securing and retaining large capital commitments on the path to growth. The industry's 50+ year history confirms this premise, where the largest firms that control an outsized share of the total PE allocations have been in business for 30 years or more. To achieve their growth aspirations and meet their increasing LP needs for transparency, predictability and reliability, managers must differentiate themselves in not only their investment record, but also in the quality of their investor relations, communications and in the day to day management of their operations.

Managing Support Functions Absorbs Scarce Manager Time and Energy

For emerging managers, the tension is acute in managing resources between investing, capital raising and back-office development and compliance. Often there is simply not enough financial capital and time to acquire the talent or resources necessary to meet acceptable standards of financial reporting, communication and compliance. In some cases, emerging managers under-prioritize the back-office functions, which, in our opinion, can undermine the long-term viability of the business and tarnish their reputation with LPs.

When operational problems become significant, they typically absorb the time and attention of the general partner, potentially reducing attention paid to portfolio investment and or capital raising decisions. In situations where the back-office functions have been under-prioritized, financial reporting and compliance, and, in particular, audit execution, can suffer. Operational complications in the back-office function (late filings, low quality financial reporting), if left unresolved, undermine a managers' goal to consistently deliver financial returns on the funds under management to their LPs expectation.

Right Scale for Today

There is a world of difference, of course, in the scale of resources and capabilities between large and small funds. The professional standards required in the accounting and auditing of a mega fund are the same as those applied to a smaller first-time fund. To reduce the resource allocation tension in smaller funds, many emerging managers sensibly outsource as many of these functions as possible, including accounting and tax services, to outside service providers. In response, a vibrant eco-system of talented and capable service providers has emerged to service emerging managers' needs.

Typically a skilled audit or tax professional understands the challenges and opportunities imposed by scale differentials in the execution or delivery of a professional assignment based on the depth of their professional's experience across the spectrum of fund sizes. Right-scaling is of great significance for emerging managers in the provider selection process. The temptation to select providers that match their aspirations (and not necessarily their needs) can be very difficult to resist. Certainly, there is an inflection point on the growth trajectory, below which emerging managers must accept and absorb reporting and compliance costs required of all participants in this industry. Above that inflection point, scale decisions become much easier to make, principally because the manager is delivering investment returns and raising capital successfully.

Help the Process Help the Manager

The fallout from under-prioritizing in a competent back-office capability can have significant long-term costs and implications, though there are ways emerging fund managers can help their own cause. While they do not necessarily need to be accountants, managers should have an understanding and appreciation of the requirements of the accounting and audit process. When managers understand the compliance environment in which they operate and their own responsibilities thereunder, they can make informed selection decisions and scale their back-office functions within parameters that make economic sense. This will help them meet their clients' transparency needs (to position them for future fundraising), and meet regulatory requirements.

Learn more at https://www.eisneramper.com/private_equity/.

Use the Right Data to Help LPs Understand How a GP Meets Their Needs

By: Simon Tang, Partner, CEPRES

Today's LP & the New Reality

The private markets asset class continues to grow and mature, and with that, LPs are now increasingly more sophisticated. LPs are not simply reviewing general IRR and return multiples, comparing fund level performance against fund benchmarks, and making a few reference calls. LPs are doing much deeper due diligence and looking to understand the risk/return drivers in a GP's track record. In the era after the Global Financial Crisis, LPs are now rolling up their sleeves and looking under the hood during due diligence on GPs. As their post-crisis stakeholder scrutiny and fiduciary responsibilities are expanding, LPs are required to be more pro-active than ever and demanding ever-increasing transparency from GPs. The LPs' requirements are also expanding like never before, including deep dive analyses of track records at the deal level and investigating the underlying operating financials of portfolio companies. Plus, as the industry continues to grow, there are more GPs coming to market and approaching LPs. The combination of increased pressures and diversified opportunities increase every year for LPs, they are demanding *efficient transparency*.

Show Me the (Raw, But Clearly Presented) Data

As an emerging manager, it's an absolute must to prepare the raw data around your track record before fundraising starts because LPs will ask for it. This includes gross & net cash flows, fund-level data such as management fees, fund expenses and carried interest, and portfolio company data including purchase multiples, debt multiples and operating financials. As an important starting point for these diligence questions, we see GPs using the ILPA DDQ in preparing their responses to multiple questionnaires. At the end of the day, LPs want to see and understand the data behind the returns shown in your pitch book. (As a best practice provider, CEPRES offers the PE.Analyzer to ILPA members. The PE.Analyzer allows GPs to assess their track record and provide LPs all the information they need in a clear and concise format).

You Vs. The World

You'll need to use real, unbiased deal level benchmarking market data to understand risk/return, pricing, leverage and value creation metrics of the market segment that you play in. It is insufficient and inaccurate to lump yourself into a generic category such as "middle market buyout" when the definition of "middle market" can vary greatly. Your superior performance may be overshadowed by broader market statistics that aren't comparable, or even relevant, to your investment strategy. Define your terms and make your case with well-structured data.

Self-Reflection

Analyze yourself before prospective LPs do. The best way to prepare for LP due diligence questions is to perform the same analysis that LPs will do on your track record. Not only should you analyze your returns, but also your risk and default profile, liquidity curves, and operating analyses including value creation. Do a side-by-side benchmarking of your portfolio companies against real, market peer equivalents and understand your strengths and weaknesses.

Standing Out in a Crowded Field with Non-Marketing Marketing

Build your marketing pitch based on your track record data analysis and demonstrate to LPs your systematic thought process – why you would invest in you. Instead of avoiding a discussion about your portfolio or track record weaknesses, use this as an opportunity to share with LPs your "Lessons Learned." Remember, LPs don't expect perfection, but they appreciate humility and the self-awareness to learn from mistakes – and of course, more transparency than ever before.

With the breadth of funds coming across an LP's desk, you know you need to stand out from the crowd, especially as an emerging manager with all the attendant disadvantages. So prepare your track record data, get the right benchmarking data and do the LP-style analysis first. LPs can and often will discuss managers in consideration with other LPs. Use *efficient transparency* upfront to help the LPs make your case in the market and in their decision-making processes. Then you will truly stand out in the crowd.

Try standing out from the crowd by registering at https://www.pe-analyzer.org.

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