KEYNOTE INTERVIEW

How can I monetise my general partnership?

GPs are increasingly looking to raise or release equity against their management companies. But what are their options, asks Investec Fund Finance's Slade Spalding

Q Historically, a GP's funding requirement has focused on its need to finance the GP commitment. How have you seen those requirements evolve and what are the key challenges?
GPs requirement for capital has increased in line with the growth in the private capital markets. Shorter fundraising cycles, diversification in both strategic and geographical focus, succession planning and more recently accessing value in a GP, has created this shift and requirement for capital.

There are a few consideration such as balance sheet value, track record and future fund raising to support longer-term leverage, which will impact the capital available from traditional capital markets. We have seen providers lending to GPs on a more relationship basis with a focus on solving a specific issue versus providing a holistic financing option for GPs.

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A big growth area of this market has seen GPs sell a stake in their management companies, crystallising the value of a GP and providing the required capital needed for the partnership. This option has been limited to the larger managers but we are seeing movement towards the mid-market players. The challenge is that there are limited options for GPs trying to access value in their management companies without selling a stake of their business and sharing future upside, which has been created historically.

Q What is driving the demand?
We have seen GPs commitment to their funds increase over the past decade, which is a positive trend for the market. However, shorter fundraising cycles and multiple fund strategies have created a success challenge for GPs matching liquidity requirements from new funds with significant value locked in prior funds.

Additionally, GPs may need to build teams around new strategies, which requires either acquisition capital or incentive initiatives. These have typically been funded by the management company due to lack of financing option in the market.

Moving to valuations and as the market has opened up to the sale of GP stakes, more GPs are looking to access the value they have created through a very buoyant private capital market. Successful fundraising cycles along with relative performance can demonstrate long-term income earning potential and strong valuation multiples.

Finally, more GPs are looking for capital to support succession planning. As founder/senior partners look to step back from their partnerships they are looking for suitable options to facilitate the transition. A significant consideration is timing either pre- or post-fundraising, which is likely to affect the valuation and have a direct impact on the partners increasing their ownership and new equity participants.

Q How are general partnerships being valued right now?

We are seeing larger managers being valued based off their net fee income on a multiple of between 10 and 15 times (this may also include the GPs commitment and future carry). I would like to add a caveat that those multiples are dependent on strong historical track record and future ability to generate carry from previous funds and successful future fundraising.

Q What are the key routes to liquidity available to GPs?

There are four key liquidity sources available to GPs. The first is an IPO. But IPOs are rare because of the required scale of the manager. Then, there is the option of selling a minority equity stake in the manager. Third, involves a preferred equity structure and finally a debt option.

Q What are the relative pros and cons of the IPO as a source of liquidity?

With the right valuation, an IPO can provide a GP with the required capital for the partnership. It also provides a big marketing push and potentially opens up new investors to support future fundraising. In addition, an IPO offers a very clear and credible valuation and GPs can use to attract talent through share incentive plans.

On the flip side, IPOs can be very disruptive to the business and the public markets are clearly far more regulated. Where previously the manager's relationship with its investors was governed by the LPA, after an IPO, the manager will be beholden to its board and the public markets more generally. EQT successfully listed recently while KKR, with a market cap of $16 billion listed in 2009 and seen significant growth since its listing. Unfortunately, the IPO market has been a limited option for mid-market managers due to size.

"While we are seeing new funds raised for acquiring equity stakes … the credit market will be confined to lenders with … a real understanding of the associated risk"

Q Selling an equity stake has also become increasingly common with several specialist managers raising dedicated funds for the purpose. What are the relative advantages and disadvantages there?

Of the top 50 private equity firms by assets under management, at least 30 have sold a stake in their manager. This option currently is available to larger GPs due to the scale of investment these specialist managers are looking to deploy in each asset.

A clear advantage are the valuation multiples GPs can attract through selling a stake in their management company. Additionally, GPs will have a partner in a similar sector who could potentially assist with introductions to new investors for future fundraising. Unlike the IPO market, GPs won't be subject to regulation or additional reporting requirements.

However, GPs are selling a piece of their management company in perpetuity for liquidity today.

Q What about the credit options that are beginning to emerge?

We see a big gap in the market in terms of credit options. Some capital has been raised to provide a more "credit-like" option by one of the equity stake players. However, there are very few active providers at this point in time. It comes back to the question of valuation, and what is the appropriate level of leverage.

We have been working with GPs for over 11 years and are excited how GP financing has evolved. We are one of the only global players to have GP financing as a core business of Investec Fund Finance and are looking to assist GPs monetise the value created in the management companies.

A credit option would be sized off a three to six times multiple against free cashflow, and/or against the GPs fund interest and carry. There would be some associated covenants and the GP would expect to make repayments over a fixed time period of anywhere between seven and 10 years. This long-term capital enables GPs to better match their fund lifecycles.

Q How do you expect this issue of the monetisation of general partnerships to evolve going forward?

I think the market will continue to get a lot more sophisticated. We have already seen this happen in the funds space. Ten years ago, capital call lines were simply bridging facilities. Now GPs have access to hybrid, NAV-based facilities and preferred equity solutions. I think we will see a similar evolution in the GP space, albeit with more limited appetite from lenders.

While we are seeing new funds raised for acquiring equity stakes, the credit market will be confined to lenders with solid experience of the funds market and a real understanding of the associated risk. ■