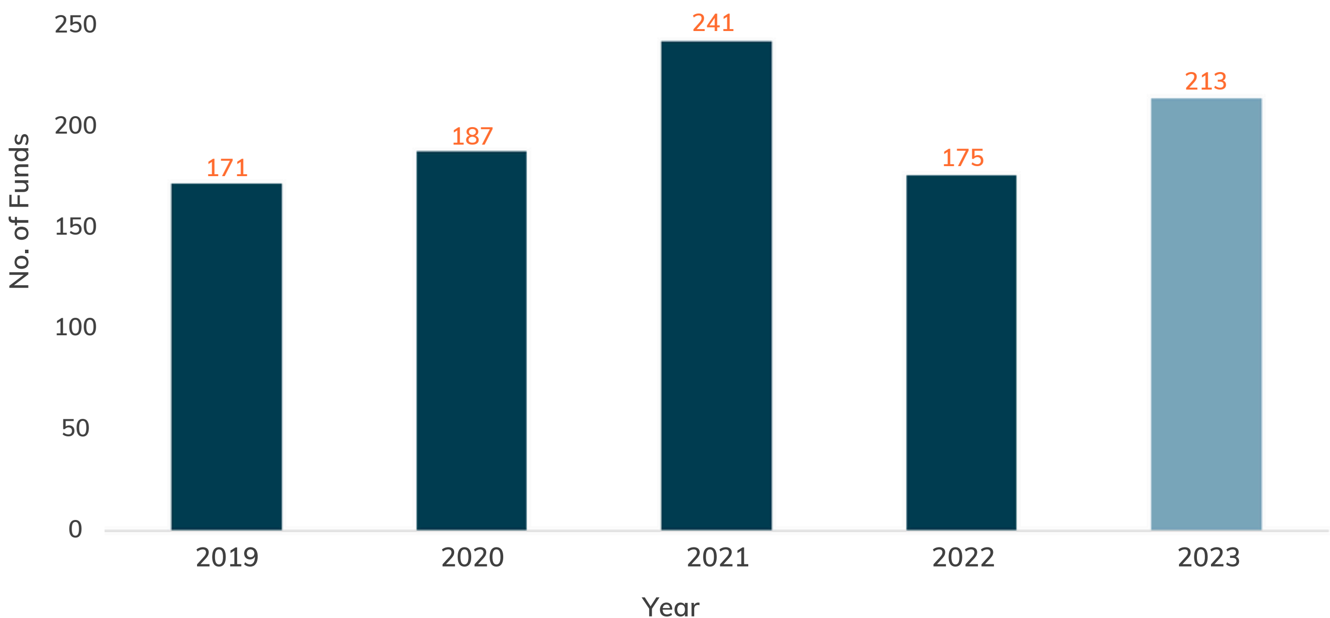
ASANTE CAPITAL GROUP

The Resurgence of First-Time Fund Managers

Market shifts gear as new managers emerge with strong debut funds

The pronounced slowdown in private equity fundraising over the past 30 months has seen even some of the most established GPs struggle to raise capital. As we enter the final quarter of 2024, there are no clear signs that the fundraising squeeze is subsiding. However, given the extent to which LPs have culled existing GP relationships and the broader public markets have stabilised, LPs have opened slots for new relationships and are hard at work filling them.

Despite the backdrop of what some consider an 'impossible fundraising environment,' a subset of new managers is emerging as full or partial spin-offs from firms that have not evolved their teams or aligned incentives as effectively as their peers. Many of these new managers are finding themselves to be prized opportunities for LPs looking to fill vacant spots in their portfolios. While many of these groups had been considering entering the market for some time, they held back on any initiatives until it became clear that the LPs' capital positions had improved.



Source: Preqin Pro, accessed September 2024

22% increase in first-time fund launches in 2023 vs 2022

In 2023, 213 private equity managers across Europe, North America, and APAC were in the market raising Fund I-III, a sizeable 22% increase compared to 2022. As green shoots start to emerge across the fundraising environment and LP allocations rebound, we expect this trend to continue. But what are the reasons behind this surge in spin-out ambition?

Why the renaissance?

Next-generation partners going “back to their roots”

Once the market had fully recovered from the GFC, private equity fundraising experienced record growth. GPs capitalised on advantageous macroeconomic conditions and attractive entry pricing, deploying capital rapidly and delivering outsized returns through robust exit strategies. Funds scaled significantly in size and at an unprecedented pace. Many GPs scaled up-market as they grew AUM and their franchises, leaving behind the lower-mid-market space where they had initially generated the returns that justified their accelerated growth. The chart below shows several well-known GPs that have significantly scaled their flagship funds since the mid-2000s.

Scaling Brand Name GPs

$m

GP	Earlier fund	Year	Size ($m)	Later fund	Year	Size ($m)	Increase
Virtuvian Partners[1]	Fund I	2007	$1,207	Fund V	2023	$8,103	7.9x increase
Nordic Capital[1]	Fund VI	2006	$1,665	Fund XI	2022	$9,990	6.0x increase
Insight Partners	Fund V	2005	$551	Fund XIII[2]	2023	$12,500	22.7x increase
Francisco Partners	Fund II	2006	$2,300	Fund VII	2022	$13,500	5.9x increase
New Mountain	Fund III	2007	$5,000	Fund VII	2023	$15,400	3.1x increase
Vista Equity	Fund III	2007	$1,287	Fund VIII	2022	$20,000	15.5x increase
Silver Lake	Fund III	2007	$9,400	Fund VII	2022	$20,500	2.1x increase
CD&R	Fund VII	2005	$4,000	Fund XII	2022	$23,550	5.9x increase

Source: Preqin Pro, accessed September 2024

We have observed smaller, emerging GPs stepping in to fill the void at the lower end of the market. These groups typically consist of entrepreneurial senior dealmakers who have spun out of well-known GPs, bringing with them a strong and attributable track record, as well as the drive and passion to capitalise on high-alpha opportunities, often in less efficient market niches. These are the same opportunities that generated the successful returns that enabled their previous firms to scale. The opportunity to start with a “blank canvas,” without the burden of managing a wider portfolio, allows teams to focus their attention on sourcing the most interesting opportunities and doubling down on driving value across a narrower set of portfolio companies. Those expected to fare best will remain disciplined and laser-focused on their sectors and strategies, applying the battle scars and experience of investing through market downturns and leveraging their deep network of operators and entrepreneurs to identify the best deals, beating their competition, in order to maximise value through the hold period.

1 Virtuvian Partners & Nordic Capital fund values converted into USD from EUR (conversion rate 1:1.11 EUR:USD)
2 Fundraising target. GP is yet to hold a final close

Alignment and Incentivisation

Many of the strongest GPs have proliferated new fund launches through product extensions, in parallel to their flagship strategies. Consequently, these groups have become asset managers, with billions in assets under management. Their sheer size and scale can lead to bureaucracies, both with regard to decision-making processes, broader incentivisation and alignment. Navigating these intra-firm politics can prove challenging for the next generation of partners, resulting in less time being spent on investing and more on burdensome operations and compliance processes. This can influence top talent to part ways and set up their own funds with an entrepreneurial culture, focused solely on maximising returns both for their investors and themselves.

These internal pressures can compound further as succession plans unfold. According to Barnes & Thornburg, only 41% of GPs have a succession plan in place[3] and we have witnessed poorly managed succession arrangements play a key role in driving "star" dealmakers to spin out and start again. This is particularly prevalent where founding partners are reluctant to share fund economics or GP ownership with a wider group of staff, despite taking a back seat in dealmaking activities, creating misalignment across the investment team.

We have also seen an increasing emphasis placed on alignment and incentivisation during LP DD processes. LPs are demanding >3% GP commitment, and many favour teams that share the carried interest outside of partner benches to drive incentivisation throughout the ranks and serve as a catalyst in attracting the best talent. First-time funds and emerging managers are well-positioned to cater to these preferences. They typically commit a significant portion of personal capital to the fund and don't have the cushion of earning passive income via management fees accumulated on billions of AUM that larger GPs benefit from, creating a high degree of incentivisation to deliver outperformance. Many of these talented professionals also have not yet reached their massive "payday" milestone in their careers and remain fully motivated to make that happen. Stronger alignment equals stronger incentive to outperform.

3 Barnes & Thornburg: 2023 Investment Funds Outlook

Suboptimal Fundraising Outcomes

It's not news that some of the industry's leading GPs have fallen short of fundraising targets over the past two years. One in four funds closed below target across the first three quarters of 2023, up from one in five vehicles during 2022 and 2021 combined.[4]

Whilst a successful fundraise is merely one of the factors LPs consider when assessing future commitments to a manager, it undoubtedly plays a role in shaping the market's perception and, at times, is difficult to spin into a positive story. The impact of a suboptimal fundraise can be detrimental to a GP's brand and in these instances, it isn't out of the ordinary to see an outflux of senior-ranking staff.

Successful attributes of FTFs

While there are many reasons to back first-time fund managers, it also presents unique risks and challenges that the GP must address head on in order to succeed. The most successful groups have common attributes, including:

Thoughtful Firm Set-Up

- A clear and compelling story on "why" the new firm was launched – a clear 'right to exist'
- Support from anchor LPs and entrepreneurs who have invested with them in the past and are willing to back the new team
- Hiring reputable service providers (e.g., fundraising advisor, law firm, fund administration, tax advisors, etc.)
- Thoughtful and reasonable fund size; a target that the track record supports and that the team will be able to deploy, underscoring a quick fundraise

Cohesive Team

- Experience working together, demonstrating cohesion and a strong culture
- The ability to grow and attract top talent at both senior and junior levels
- A well-aligned team that is hungry for success, including a materially high GP commitment (validating that the team has been successful and senior in past live(s))
- Diverse senior leadership throughout the organisation, avoiding key man risk
- A combination of investment and operational experience, especially for operationally intensive strategies

Differentiated Strategy

- Have a differentiated and repeatable strategy with a disciplined approach
- Congruence with the strategy supporting the track record presented
- Target less competitive markets where the new firm has distinct advantages
- A clear and robust deal sourcing process that demonstrates the ability to consistently source and track interesting opportunities
- The ability to add value to portfolio companies by utilising team experience or external operating partners

Strong Attributable Track Record

- A strong attributable track record, specifically in the space the new fund is targeting

Pipeline of New Opportunities

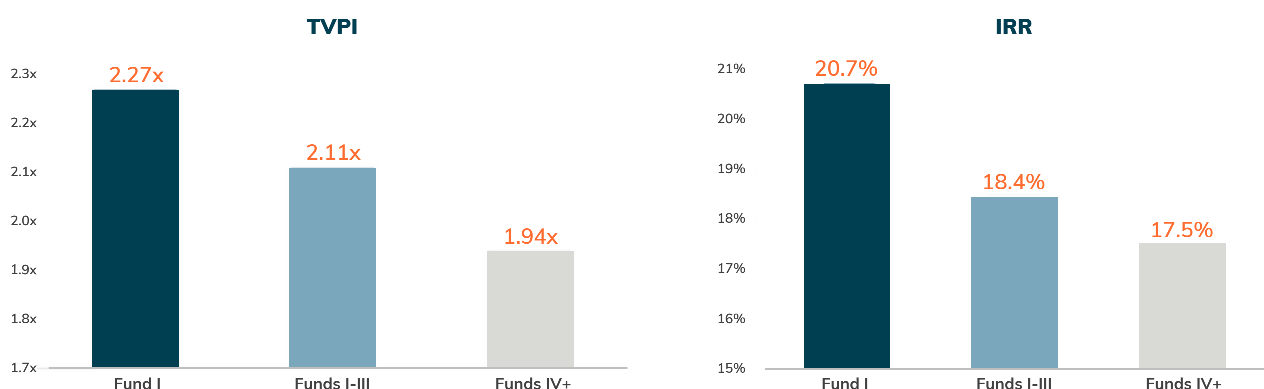
- A robust pipeline of near-term actionable opportunities; it is beneficial to have co-investment opportunities that LPs can diligence alongside the manager

4 Buyouts data

Outperformance of emerging managers

As investors become increasingly selective when determining their allocations for re-ups and new GP relationships, fund performance remains top priority. Despite the perceived risk attached to first-time funds and emerging managers, these groups are typically less reliant on leverage and the IPO market, making them well-positioned to generate outperformance in the current macroeconomic environment. In addition, they often have strategies that generate truly proprietary deal flow, avoiding congested auction processes, and therefore benefiting from acquiring businesses at attractive entry multiples.

Average net returns of global fully realised buyout and growth funds



Source: Fully realised buyout & growth funds, Preqin Pro, accessed August 2024

When comparing the performance of fully realised buyout and growth strategies of emerging funds (Funds I-III) and established funds (Funds IV onwards), the data favours the former. Younger funds have delivered stronger overall performance across net IRR and TVPI, with first-time funds reporting a 3.2% higher IRR on average versus Funds IV+. This positive trend could be linked to several factors, or a combination thereof:

- **Alignment.** First-time fund managers are highly incentivised to succeed. Personal and professional reputations are directly tied to the success of the fund, and failure to perform will reduce investor confidence in backing subsequent vintages. It is "make or break" and this survival bias leads to more diligent, hands-on investment processes, resulting in stronger returns and helping to secure long term investor support.
- **Focused strategy.** Generally, first-time fund managers raise smaller funds, typically leading to more concentrated portfolios. Investment teams are highly selective in the sourcing process and can dedicate greater resources in the value creation of fewer assets. However, this also presents greater portfolio management risk, as small mistakes can lead to a larger negative impact on the overall fund performance compared to a larger diverse portfolio.
- **Entrepreneurial culture.** While the established groups may benefit from more proven and institutional setups, the flexibility of investing with no legacy processes allows emerging groups to start with a clean slate, often leading to greater innovation and the ability to adapt quickly to changing market environments.
- **No legacy portfolio.** This is a double-edged sword; a legacy portfolio performing well could set a firm up for greater success in the future, but it could also weigh the firm down if it is underperforming. For first-time funds, they do not have any of this so the sole focus is on the Fund I in which they are investing, with the knowledge that this is make or break.

These factors combined create an environment where emerging funds can thrive and play a key role in driving outperformance in comparison to their established peers while creating new lifeblood for our industry.

Key trends

There are several recent trends in the emerging manager landscape with regard to investor allocations and fund offerings. Given the number of first-time funds and the research that supports its outperformance, there has been an increased focus from LPs which has led to more allocations and expanded capabilities for them to invest, which is typically in the form of specific emerging manager buckets or through anchor / seeding platforms. In order for these managers to attract the dollars flowing to the space, they need to make the offering more attractive, which can come in the form of co-investments or seeded portfolios.

Increase in Emerging Manager / Diversity Allocations

- Diversity is a key topic at the forefront of the increased appetite for Environmental, Social and Governance (ESG) investing. We have witnessed diverse emerging managers (i.e. female and/or minority controlled, owned, or directed GPs) step in to cater to this renewed focus.
- Leading consultants, including Aksia, Cambridge Associates, GCM, and Hamilton Lane, have been mandated by some of the largest US Public Pension Plans to identify the best and most diverse emerging manager talent.
- As an example of this growth, 60% of Cambridge Associates' clients now have at least one diverse investment in their portfolio.[5]

Rise in Anchor / Seeding Platforms

- Many LPs have become more comfortable being anchor investors or first closers in first-time funds. Over the years, we have seen the emergence of several GP seeding platforms (e.g., Blue Owl, Capital Constellation, Goldman Sachs Petershill, Hunter Point), who have similar rights as anchor investors but seek to acquire an economic interest in the GP, which includes a share of the management company and/or carry in the fund.
- First-mover advantage allows investors to establish strong relationships with high-octane teams early in their development, which often leads to preferential access to future funds and/or co-investment opportunities, as well as greater influence on fund terms.
- The benefits of backing GPs early also include fee breaks and co-investment rights. Management fee breaks typically vary and can scale with commitment size. Co-investment rights are normally in the form of right of first refusal.
- Some larger GP platforms are also funding new GP teams, especially when they see the investment as another portfolio company, giving them exposure to a segment of an interesting market below where the fund size allows them to invest.

Co-Investment

- New GPs often take a more conservative approach to setting fund size targets given the unproven nature of the firm setup and the increased scrutiny faced by investors for raising funds that are "too large".
- To balance raising a sensibly sized fund and building a portfolio of assets in line with the fund strategy, co-investments are utilised to ensure the correct portfolio construction.
- Not only does this enable the GP to deploy their desired equity size ticket, regardless of fundraising outcome, it also demonstrates proof of concept and provides LPs with an opportunity to diligence the firm's underwriting processes.
- In most cases, these co-investments are fee-free, allowing LPs to blend down the overall costs incurred from committing to a blind pool fund, thus providing a 'sweetener' whilst deepening their knowledge of, and relationship with, the GP.

5 Cambridge Associates data

Seeded Portfolios

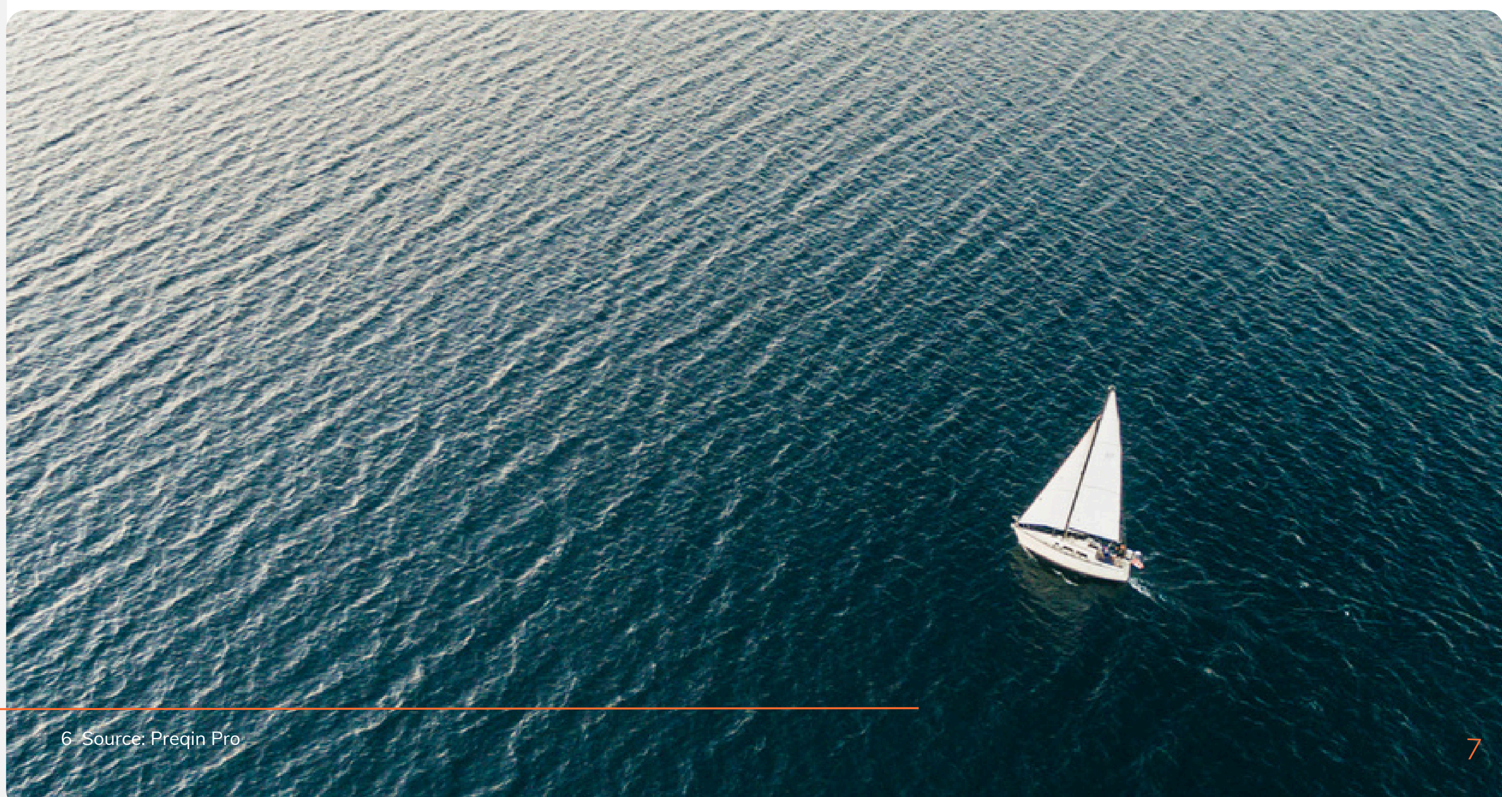
- Given the increased time it has taken for first-time funds to hold final closes,[6] there will typically be deals already completed in the fund. This provides visibility for LPs and enables them to diligence a segment of the portfolio, which can provide comfort on the opportunity set and GP's ability to successfully execute the strategy.
- Seeded portfolios also open up additional pockets of capital, specifically for secondaries investors who have allocations for "late-stage" primary scenarios.
- Additionally, LPs will typically be allowed to invest in a marked-up portfolio at cost plus a ticking fee (generally ~8%), which reduces the j-curve and makes the proposition even more attractive.

Conclusion and outlook

As fundraising conditions improve, Asante is seeing an increase in the number of first-time fund approaches and a resurgence in demand for emerging managers. LPs look for a well-integrated team culture, strong attributable track records, operating in attractive market niches with a focused strategy with a high degree of alignment. These attributes are not unique to emerging managers but are less apparent at the outset and thus vital they are as clear-cut as possible. New groups that can deliver these ingredients provide strong rationale for investment. When supported by data demonstrating the outperformance of emerging managers compared to their established peers, they present a compelling opportunity for LPs that, when well positioned in the market, can deliver market-beating fundraise outcomes in every sense.

Emerging Managers Asante Has Closed Over The Last 18 Months

Year	Manager	Fund	Size
2024	Mill Point Capital	Fund III	USD 1.7bn
2024	eevolve	Fund I	EUR 372m
2024	Tenzing	Fund III	GBP 909m
2024	Maguar	Fund II	EUR 306m
2024	GRO	Generation Fund I	EUR 150m
2023	Equip Capital	Fund II	NOK 3bn
2023	Gemspring	Fund III	$1.7bn



6 Source: Preqin Pro

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