

GP stakes Mid-market opportunities are luring investors

Most of the focus these days on the burgeoning GP stakes investment market has been on its upper end. But some investors see opportunities with smaller firms looking to grow and build long-term relationships, *writes Justin Mitchell.*

Among them is Christopher Zook, founder, chairman and chief investment officer of Houston-based multifamily office CAZ Investments. "This is one of the most compelling areas of investment that I have ever seen in 30-plus years," he tells *Buyouts.*

Zook has moved CAZ into a new segment of the GP stakes market. In September, the firm announced a partnership with Bonaccord Capital Partners, a unit of Aberdeen Standard Investments, that focuses on GP stakes investments in mid-sized firms. CAZ expects to commit more than \$250 million as part of the deal.

Up until now, CAZ has focused on the larger-cap GP stakes space, deploying \$750 million alongside Dyal Capital Partners, a unit of Neuberger Berman Group. Dyal operates in the upper segment of the GP stakes market along with Petershill, a unit of Goldman Sachs, and Blackstone Strategic Partners.

Mid-market primed for action

"We still think there are good opportunities in the large-cap space, but we see an even more robust opportunity set as the market matures in the mid-cap space," Zook says. "There's a really good reason for many of these firms to need growth capital to provide them with the ability to leg-up their business faster than if they just tried to do it organically."

The advantages of GP-stakes investing include the downside protection that comes from a steady stream of management fees and the locked-in nature of GP-LP agreements. "You know what to



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expect in those investments," Zook says.

Like the upper market, the mid-market has three major players: Bonaccord, Stonyrock Partners and Investcorp. And they have plenty of options.

According to a Pitchbook report from July, 41.9 percent of large-cap PE firms, that is, those that have raised at least \$8 billion over the past 10 years, have sold GP stakes. In the mid-market – firms that have raised between \$1.5 billion and \$8 billion – only 8.5 percent of firms have sold GP stakes.

The raw numbers of managers are also very different. The report estimated about 30 to 40 managers remained for Dyal, Petershill and Blackstone to target.

"That top market is not getting necessarily picked over, but I

think there are just fewer great opportunities," says Pitchbook senior analyst Wylie Fernyhough, who authored the report.

Ajay Chitkara, the head of Bonaccord, says his firm identified 800 GPs it could potentially invest in. It measures the mid-cap space as firms with fee-paying assets under management between \$1 billion and \$10 billion, a slightly different measure than the Pitchbook report.

Chitkara says there is less than \$3 billion chasing these investments – meaning there is plenty to go around.

All about cashflow

GP stakes in the mid-market space also fulfill a different function. In the large-cap space, Chitkara says selling stakes is usually used as an alternative to an IPO, because it does not subject the GP to public listing regulations.

But for mid-cap GPs, proceeds from stake sales can be used for growth initiatives like launching new strategies and funding larger GP commitments. Pitchbook's Fernyhough says it can also provide growing firms with access to experienced LPs as partners who can help guide a firm's development.

But Fernyhough says bigger partnerships like the one between CAZ and Bonaccord are likely to be the exception and not the rule. Most family offices he has spoken to that are interested in GP stakes want to commit to funds, whereas a few years ago they may have invested directly in a GP. A commitment allows them access to the 10 or 12 GPs in which the fund has invested, which is more efficient than doing investments one at a time.

Zook says the reason why GP stakes are attractive to family offices comes down to cashflow. "In this environment, it's so hard to find cashflow with safety," he says. "That's what we look for and what we like about GP stakes." ■