Features - Industry News

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Six Emerging Managers Find A Way To Succeed

Times may be tough, but Institutional investors continue to search for new firms to replenish their alternative asset investment portfolios.

U.S.-based emerging managers—loosely defined as buyout, distressed and growth equity firms raising their first or second fund—raised approximately $7 billion in the first half of 2010, or more than a fourth (25.5 percent) of the $27.4 billion raised by all buyout shops. Last year, emerging managers raised $10.7 billion, or 17 percent of the $61.3 billion raised in all of 2009, according to Thomson Reuters data. Below are six firms, listed from oldest to youngest, considered to be among the best of the next generation, based on interviews with limited partners and placement agents.

Harren Equity Partners

Charlottesville, Va.

Founded: 1999

Strategy: Mid-market buyouts with an operational focus. Typically invests in companies with $20 million to $150 million in revenue in energy services, aerospace and defense, automotive, business services, and building products and services, among other industries.

Top Executives: Founder Thomas Carver, a former partner at H.I.G. Capital; Partner Lee Monahan was an associate at H.I.G. Capital. The firm has 11 investment professionals.

Fundraising History: Currently investing from a $200 million Fund II. Raised $35 million for first fund in 2000.

Buzz: Virginia shop with blue-collar ethos takes operational approach to companies found in obscure locations; first fund generates 4x invested capital.

Even teams with a track record at respected buyout shops can have a difficult time fundraising. **Thomas Carver** admitted that he was naïve in thinking **Harren Equity Partners** would garner institutional support simply because he had helped spearhead successful deals for **H.I.G. Capital**, the global firm that manages $8.5 billion across several funds. But not one institutional investor backed Harren Equity's premier effort, a $35 million fund closed in 2000 that targeted investments across a variety of industries, including energy services, aerospace and defense, automotive, and business services.

It took a stellar performance with that humble fund for Harren Equity to prove itself: The fund, which is fully realized, has generated more than 4x investors' capital on a gross basis. "We were able to generate similar returns to those generated while at H.I.G. but on our own platform," Carver said.

As a result, the Charlottesville, Va.-based shop was able to raise $200 million for Fund II in 2007 from notable funds of funds managers such as **Grove Street Advisors** and **RCP Advisors**, as well as international LPs, including **Danske Private Equity**, the investment arm of Copenhagen-based Danske Bank.

Limited partners also liked the fact that executives fund about 10 percent of their funds with their own money, and are able to sniff out deals in markets ignored by typical New York-based firms. For example, Virginia Drilling Co., a drilling company Harren Equity bought with its first fund that serves the mining industry, is based in Vansant, Va., a town with a population of 989 based on the 2000 Census. Carver and Partner **Lee Monahan** are more apt to attend management meetings in jeans and a golf shirt than in a pin-stripe suit. "They tend to have more of a 'roll up your sleeves' approach and less of a Wall Street-financial approach," said **Frank Angella**, general partner at Grove Street.

Sorenson Capital

Lehi, Utah

Founded: 2003

Strategy: Invests between $10 million and $30 million in companies based in the Mountain West and West Coast regions

Top Executives: Fraser Bullock, veteran of Bain & Co. and Bain Capital who was CEO of the Salt Lake Organizing Committee for the 2002 Winter Olympics alongside fellow Bain alumnus and presidential candidate Mitt Romney

Fundraising History: Investing from $400 million second fund, closed in 2008.

Sorenson Capital launched in 2003 thanks to its founders' **Bain Capital** lineage and a unique strategy that calls for a hands-on, operational approach to companies in the Mountain West and West Coast regions. "We wanted to focus on our proprietary relationships in this region, which is an underserved region in private equity," said co-founder **Fraser Bullock**, who started at Bain & Co. as a consultant in 1980 and was an original partner of its investment arm, Bain Capital, in 1984.

Bullock founded Sorenson Capital with **Ron Mika**, who in 2003 was a managing director at Bain Capital looking to get back into smaller buyouts. The firm has 18 investment professionals and seven operating partners who are typically former executives from the business consulting, manufacturing and technology sectors.

Sorenson Capital bought 16 companies with its $250 million debut fund, which garnered support from **James Lee Sorenson**, an entrepreneur in Utah, as well as Grove Street Advisors, **Wilshire Associates Inc.** and RCP Advisors. The firm has already exited 12 of those companies, generating a gross internal rate of return of more than 40 percent, according to Bullock. Earlier this year, the firm sold Provo Craft and Novelty Inc., a Spanish Fork, Utah-based maker of printers and other electronic products used for educational crafts, generating 10x its invested capital in just under five years of ownership.

The firm is currently investing from its second fund, a $400 million pool of capital it closed in 2008.

Mainsail Partners

San Francisco, Calif.

Founded: 2003

Strategy: Buyouts and growth equity investments in technology-enabled services, software, e-commerce, Internet marketing, wireless technology, for-profit education, financial services.

Top Executives: Managing Partners Gavin Turner, a former vice president responsible for West Coast media and communications technology investments at Summit Partners, and Jason Payne, who also began his career at Summit and helped manage one of its portfolio companies, American Dental Partners.

Fundraising History: Raised $33 million for first fund in 2005; raised $110 million in 2008.

Buzz: Firm replicates cold-calling program pioneered by Summit Partners, earned 3x its invested capital on first exit.

Gavin Turner and **Jason Payne**, managing partners of **Mainsail Partners**, gained invaluable experience at their previous firm, **Summit Partners**, the Boston-based, growth-oriented firm that has raised $11 billion since its inception in 1984. But instead of pitching an independent fund to prospective LPs based solely on their Summit Partners experience, Turner and Payne got financial backing from a few Silicon Valley entrepreneurs to buy Cash Management Solutions, a St. Louis, Mo.-based company that helps companies manage receivables. That was 2003. With the investment made, Turner and Payne then started soliciting investors for a proper fund. "The goal was to prove that we would be good stewards of capital outside of Summit, to develop a track record that people could evaluate when deciding whether to invest in Mainsail," Turner said.

The firm raised $33 million for its inaugural fund in 2005, and followed that up with a $110 million fund in 2008. Mainsail Partners has sought to replicate Summit Partners's cold-calling program, in which four associates are charged with identifying attractive companies and initiating relationships with their management that might someday lead to a deal. Mainsail Partners has seven portfolio companies, including eSecuritel Holdings, a company that provides insurance for cell phones and other wireless devices.

Cash Management Solutions has so far been the firm's only exit, but it was a good one: In 2008 Mainsail Partners sold the company, making 3x its invested capital.

Bertram Capital Management LLC

San Mateo, Calif.

Founded: 2006

Strategy: Mid-market buyouts and growth financing of companies generating $3 million to $15 million of EBITDA in the business services, health care, manufacturing, aerospace and clean technology industries.

Top Executives: Managing Directors Jeff Drazan, a long-time venture capitalist who co-founded Sierra Ventures, and his brother Ken Drazan, M.D., a former liver transplant surgeon who oversees health care investments.

Fundraising History: Raised $350 million in 2006; at deadline was expecting to close Fund II, which had already attracted more than $500 million in commitments.

Buzz: Successful veteran venture capitalist tries his hand at buyouts, attracts big name investors including CalPERS and Boeing Co.

Bertram Capital Management LLC relied primarily on its founder's track record as a venture capitalist to raise its first buyout fund. Over a 22-year career in venture capital, **Jeff Drazan**, who co-founded Menlo Park-based **Sierra Ventures** in 1985, said he posted a 65 percent gross internal rate of return. On the strength of that record, Bertram Capital raised $350 million in 2006 from investors including the **California Public Employees Retirement System** and Grove Street Advisors. The firm targets mid-market buyouts and growth financings of companies with $3 million to $15 million of EBITDA in the business services, health care, manufacturing, aerospace and clean technology industries.

Bertram Capital owns four companies, including Author Solutions, a publishing business whose cash flow Drazan said the firm has increased to $20 million from $1 million in three years; and Power Distribution Inc., a company that makes energy management equipment for data centers and alternative energy facilities, whose revenues Drazan said have increased to $120 million from $28 million in three years. At deadline, the firm was closing in on an acquisition of Supra, an apparel company. The firm has yet to exit any companies, though through the end of 2009, its first fund had generated an IRR of 18.4 percent and an investment multiple of 1.3x for CalPERS.

The firm is wrapping up fundraising for its sophomore effort, already having surpassed its target of $500 million. New investors include **Boeing Co**.

Excellere Partners

Denver, Colo.

Founded: 2006

Strategy: Mid-market buyouts in business services, education, health care, industrial technology and services, and specialty foods.

Top Executives: Managing Partners Robert Martin and David Kessenich.

Fundraising History: Raised $265 million in 2007.

Buzz: KRG Capital spin-out goes back to lower mid-market roots.

In 2006, **Robert Martin** and **David Kessenich** founded **Excellere Partners** to stay focused on lower mid-market deals. Their prior firm, **KRG Capital Partners**, a Denver-based buyout shop where both were directors, had raised successively larger funds, starting with a $202 million fund in 1999, and, most recently, in 2007, raising close to $2 billion for its fourth fund. "We think the returns are better" at the smaller end of the market, Martin told *Buyouts* in May 2007.

The result was Excellere, which invests in companies generating EBITDA of between $4 million and $15 million. Sectors of interest include health care, which accounted for more than half of Martin and Kessenich's deal-making at KRG Capital, as well as business services, education, and industrial technology and services. The firm has made five investments. Most recently, in December 2009, it bought MTS Medication Technologies Inc., a St. Petersburg, Fla.-based company that makes drug packaging equipment.

Raising a first-time fund had its challenges at a time when huge firms such as **Blackstone Group** were commanding LP interest: On their first day of meeting with five prospective LPs, all five, including **Adams Street Partners**, an influential manager of funds of funds, passed. "There was a pretty high bar for first-time funds," Martin told *Buyouts* in July 2007. "What they really want is a differentiated model, especially in the sub-$500 million range. The more defined your strategy is, the comfortable the LP gets."

The firm was able to raise $265 million, with blue-chip investors such as the **Los Angeles County Employees Retirement Association** and **Zurich Alternative Asset Management**. The firm's strategy looks even more cogent now, as many LPs have turned away from the mega-fund in favor of novel mid-market strategies.

High Road Capital

New York

Founded: 2007

Strategy: Lower mid-market buyouts targeting distribution services and manufacturing companies with EBITDA of at least $3 million.

Top Executive: Bob Fitzsimmons, founder, formerly a managing partner at Riverside Co.

Fundraising History: Raised $150 million in 2007.

Buzz: Respected Riverside Co. veteran launches his own firm

New York-based Riverside Co., with $3 billion under management, has built a unique niche for itself as a global enterprise targeting lower mid-market firms. So when one of its managing partners, **Bob Fitzsimmons**, became the first and only executive of the 22-year-old shop to start his own firm, investors listened. In 12 years at Riverside, deals that Fitzsimmons led generated, in the aggregate, 4x invested capital. Fitzsimmons also poached two junior investment pros from Riverside, vice presidents **Jeff Goodrich** and **Bill Connell**, who are partners at High Road. Riverside even promoted the effort. "At the last investors' conference before I was leaving Riverside, [co-CEO] **Bela Szigethy** actually stepped in front of LPs, and said, 'These guys are spinning out and if they call, you should answer.'"

With his record and Riverside's endorsement, Fitzsimmons raised $150 million for High Road's debut fund in 2007 from respected backers such as funds-of-funds manager **Hamilton Lane Advisors Inc**., the **Indiana State Teachers Retirement Fund** and the **New York State Common Retirement Fund**.

Now Fitzsimmons is replicating the lower mid-market strategy Riverside helped pioneer. The firm, with eight investment professionals, has made five acquisitions. Its portfolio includes Advanced Sleep Medicine Services, a company that provides sleep disorder diagnostic services, and All Current Electrical Sales, a wholesale re-seller of circuit breakers, conduit fittings and other electrical parts and components used in the energy industry.

By Bernard Vaughan