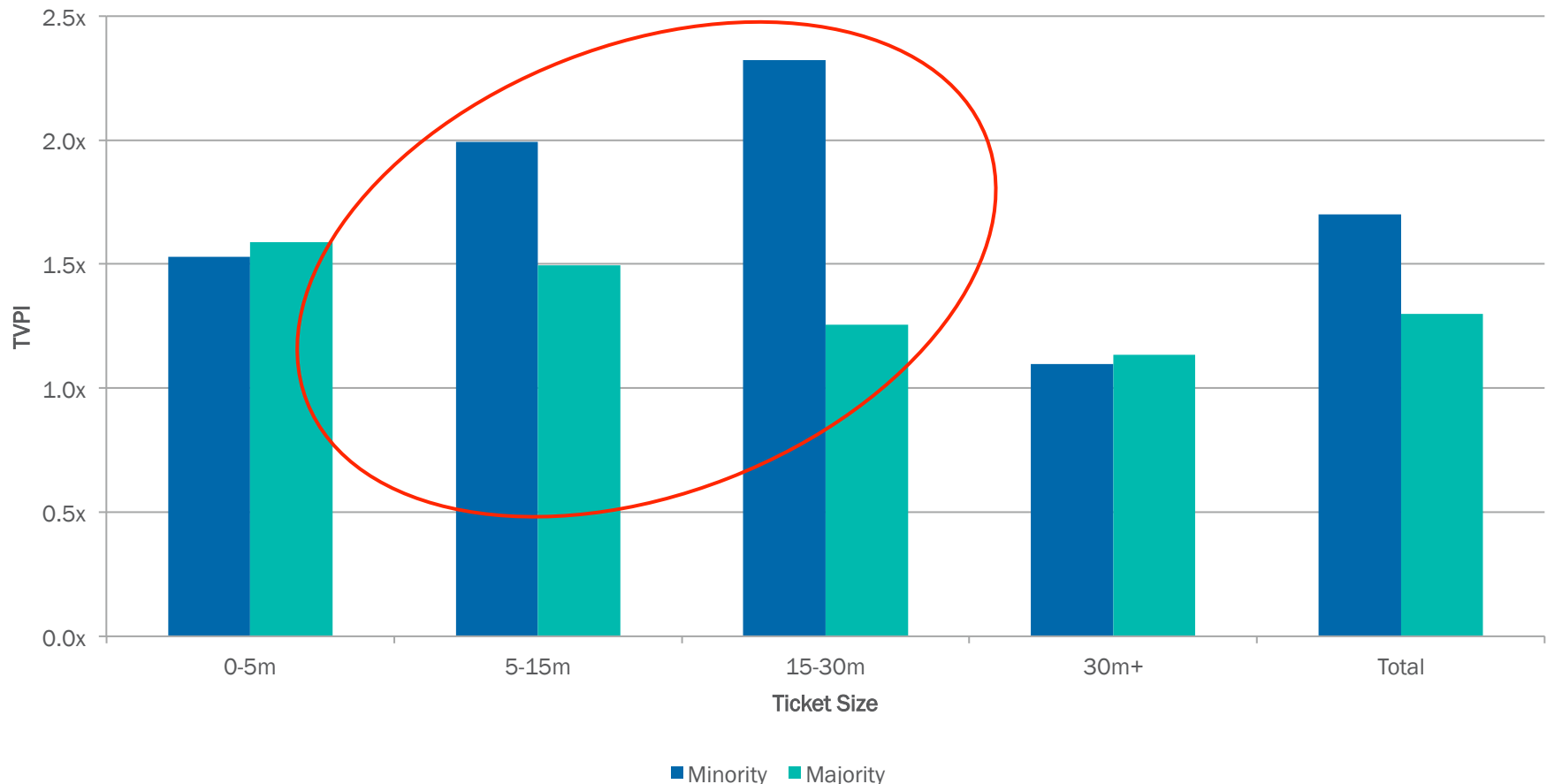


GROWING PAINS: Growth capital and what happens when it goes wrong

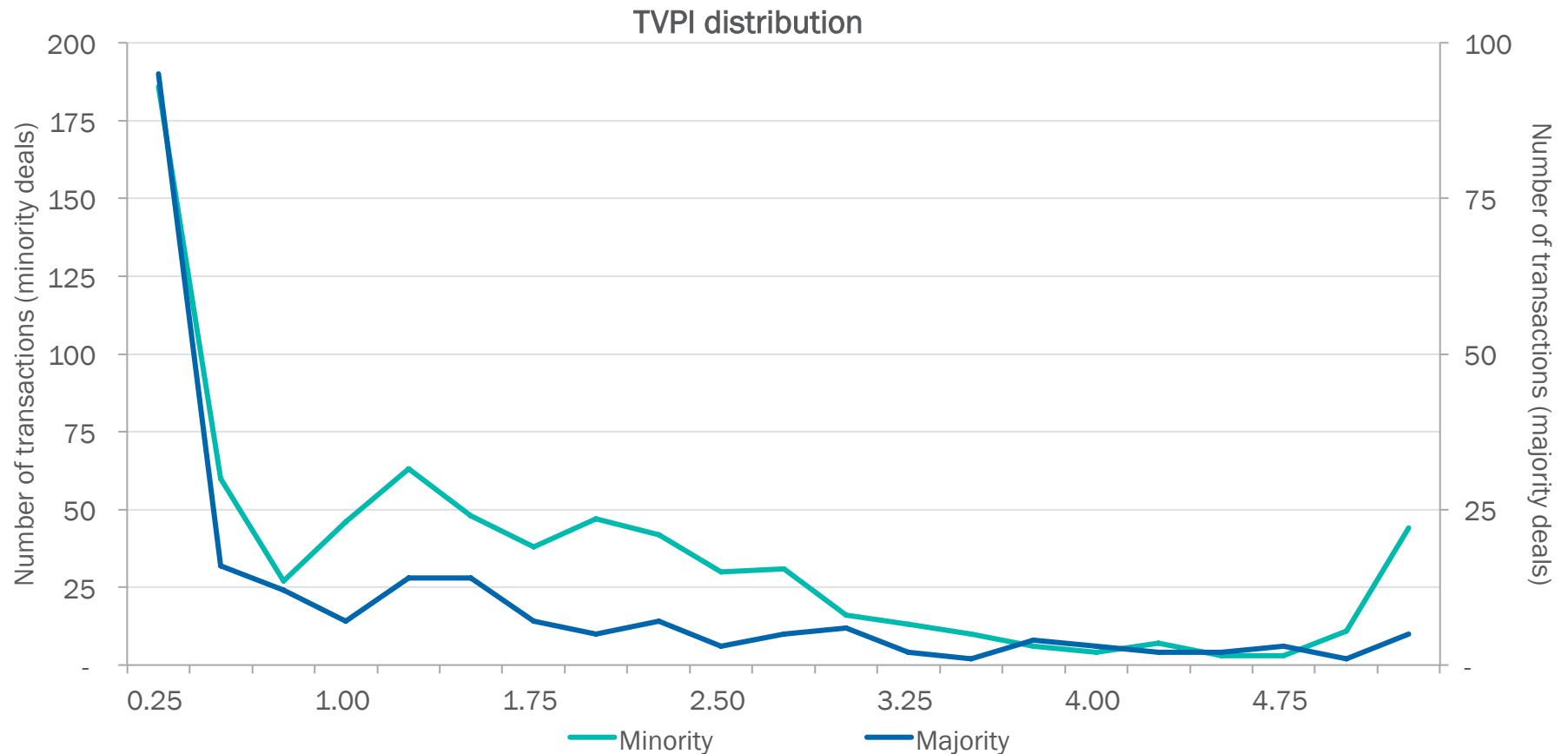
Troy A. Weeks
August 2016

Evidence suggests that minority growth deals should provide higher returns - something we've found in our own portfolio

Minority significantly outperforms majority in the sweet spots



Where we see higher performance in minority growth deals



Minority: higher average, fatter tails

And strong outlier dependence

TVPI	Majority	Minority
Max	20.8x	19.4x
1st quartile	1.5x	2.2x
Average	1.2x	1.7x
Median	0.4x	1.2x
Min	0.0x	0.0x
St dev	2.030	2.017

Average-Median Spread: Outlier dependence

But does this always justify the risks ?



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What are the risks with minority growth and is it worth mitigating this by focusing on control investments?

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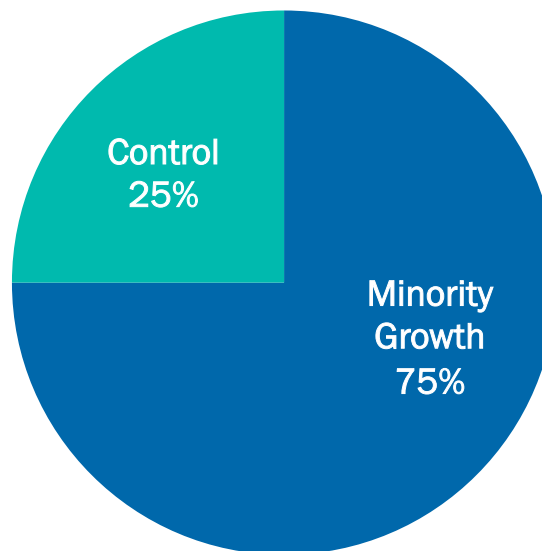
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"Our investments in growth platforms allowed us to sustain momentum in numerous key metrics and leverage that into continued strategic collaborations. Then Larry here messed up big time!"

Minority growth investing brings its own sets of risks and challenges

Instances of Alleged Fraud & Malfeasance by Deal Type During the Financial Crisis



That are seen time and again



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- Its about management, management, management...counterparty risk
- Cash control is critical, in particular in growth transactions
- Ensure a plan exists for implementation of financial systems and controls
- Identification of CFO/CAO is essential – it can't be left as a TBC – appointed by the fund with loyalty also to the investor. This was an issue in every deal.
- Excessive reliance on Big 4 standard financial DD is not enough – what else has been done?
- Know the owner and respond to signals - if there are DD red flags or a history of cash leakage then don't assume it will change – don't underestimate an owners knowledge of the business and employees' loyalty to him/her.
- Owners often won't acknowledge problems until the situation has deteriorated to such an extent that restructuring is even more challenging - swift and decisive action is key to minimise damage and preserve any ability to recover the investment
- Deal structure and rights – ensure the ability to step in if owners are responsible or start to wobble, share escrows, etc.
- Not all that glitters is gold - don't underestimate the challenges of the market

Beware the HiPPO (Highest Paid Person's Opinion)



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Fundamentally, can an owner adjust to increased oversight and relinquishing degrees of control or does the HiPPO rule.



And this can cause knock-on problems for funds



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- Cases of malfeasance or management failures even in just one of a fund's portfolio companies can cause problems for the portfolio and significantly erode returns to investors through:
 - Fund manager distraction,
 - Costs of forensic investigations and due diligence,
 - Costs of protracted litigation and dispute resolution,
 - Reputational damage and loss of deal flow,
 - Increased general fund operating costs,
 - And of course, write-offs.
- This can destroy a fund's net returns to investors and cause GP's with an otherwise good portfolio to miss their carry.

At the cost of missing carry even with better gross returns

Fund A

Gross IRR: 15.8%

Net IRR: 6.5%

Spread: 9.2%

Fund B

Gross IRR: 10.3%

Net IRR: 8.9%

Spread: 1.5%

And the spread can be very expensive for LPs and GPs

Cash cost of the spread for a 100 million invested over 10 years

		Gross to net spread								
		0%	2%	4%	6%	8%	10%	12%	14%	16%
Gross IRR	2%	0	10,408,080	-	-	-	-	-	-	-
	4%	0	11,257,210	21,665,290	-	-	-	-	-	-
	6%	0	12,157,268	23,414,477	33,822,558	-	-	-	-	-
	8%	0	13,110,250	25,267,517	36,524,727	46,932,808	-	-	-	-
	10%	0	14,118,192	27,228,442	39,385,710	50,642,920	61,051,000	-	-	-
	12%	0	15,183,168	29,301,361	42,411,611	54,568,878	65,826,088	76,234,168	-	-
	14%	0	16,307,290	31,490,458	45,608,651	58,718,900	70,876,168	82,133,378	92,541,458	-
	16%	0	17,492,708	33,799,997	48,983,166	63,101,358	76,211,608	88,368,876	99,626,085	110,034,166
	18%	0	18,741,610	36,234,317	52,541,607	67,724,776	81,842,968	94,953,218	107,110,485	118,367,695
	20%	0	20,056,224	38,797,834	56,290,542	72,597,832	87,781,000	101,899,192	115,009,442	127,166,710
	22%	0	21,438,816	41,495,041	60,236,651	77,729,358	94,036,648	109,219,816	123,338,009	136,448,259
	24%	0	22,891,690	44,330,506	64,386,731	83,128,340	100,621,048	116,928,338	132,111,506	146,229,699
	26%	0	24,417,188	47,308,877	68,747,694	88,803,918	107,545,528	125,038,236	141,345,525	156,528,694

Note: Assumes holding period of 5 years

Compounding concerns with the costs of the asset class



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"It's not you. It's fee."

- Minority growth can and does work in our markets
- Succeeding at it depends on understanding where deals can go wrong and getting the basics right
- Mistakes and poor fund management discipline costs investors and ultimately GPs in a big way – every single point of gross to net leakage matters