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Executive Editor, David Toll
(dtoll@buyoutsinsider.com/646-356-4507)

Editorial Advisor, Richard P. Jaffe
(RPJaffe@duanemorris.com/215-979-1935)

Research Editor, Paul Centopani
(pcentopani@buyoutsinsider.com/646-356-4506)

Editor-in-Chief, Lawrence Aragon

Contributor, Tom Stein

Creative Director, Janet Yuen-Paldino

Junior Graphic Designer, Allison Brown

Sales Director: Robert Raidt
(rraidt@buyoutsinsider.com/646-356-4502)

Sales Associate: Kelley King
(kking@buyoutsinsider.com/646-356-4504)

Publisher: Jim Beecher
(jbeecher@buyoutsinsider.com/646-356-4501)

LETTER TO OUR READERS

FOR EMs, FUND-RAISING MARKET GETS A B+ RATING

It's a good, but perhaps not a great, time for emerging managers to raise money.

Here's why. Institutional investors remain nervous when it comes to backing first-time funds. Firms do find more benign conditions for Funds II and III. But they simply can't get to that stage if they haven't raised a first one. So, in our first annual assessment, we're going to rate the market a B+ on how welcoming it's been to emerging managers over the last five years.

Investors point to the additional risks associated with emerging-manager funds as the main reason to avoid them. These include the challenge of assessing track records (particularly for spin-out groups), and the uncertainty regarding how well the principals will get along as an independent team.

These risks are borne out in the performance numbers. A recent analysis by sister publication *Buyouts Magazine* found that the performance of debut buyout and related funds is generally strong and consistent with that of other funds. But an especially high percentage of debut buyout funds—nearly one in five (19 percent)—have failed to generate a profit to date.

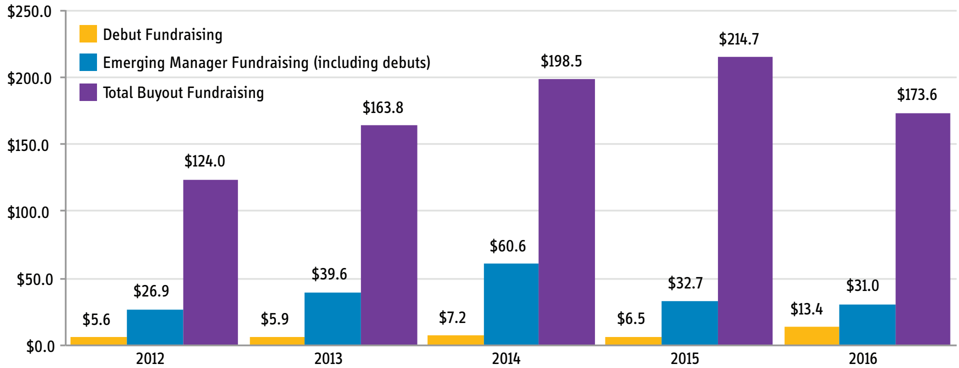
In fact, more than four in 10 (43 percent) institutional investors won't invest in first-time funds, according to a year-end survey by data provider **Preqin**. That number is up from just over one in three (35 percent) in a similar survey five years earlier.

Partly as a result, start-up firms have been having only modest success raising debut pools (not counting new fund families introduced by established managers). Over the five years from 2012 to 2016, U.S. buyout firms raised $38.7 billion for maiden funds—see accompanying chart. That represents about 4 percent of the total $874.5 billion raised during those years. The number of firms in the market trying to raise debut funds during those years gradually rose, to 88 last year from 33 in 2012, and capital raised generally moved higher. But it's rarely a cakewalk. New firms can easily spend upwards of 18 to 24 months on the road trying to secure commitments.

On the other hand, demand overall for emerging-manager funds, which many investors define as a first, second or third fund, appears to be stronger. According to Preqin, nearly two-thirds (65 percent) of large investors—those with more than $10 billion in assets under management—either have exposure to emerging managers or have an appetite for them; the same goes for half (50 percent) of smaller investors with less than $1 billion in AUM. *Buyouts* has identified close to a dozen public pensions that have set aside dedicated allocations to emerging managers—see table, p 10.

Among the most aggressive is **Teacher Retirement System of Texas,** which earlier this year said it would commit another $1.3 billion to young managers of private equity, real estate, energy, natural resources, public equities and hedge funds, according to *Pensions & Investments*. Not coincidentally, Texas Teachers' and sister pension fund **Employees Retirement System of Texas** for the last 10 years have run a popular emerging manager conference in Austin, Texas; this February the **Office of the New York State Comptroller**

BUYOUT FUNDRAISING 2012-2016 ($BLN)



Source: Buyouts Magazine*; totals include funds raised by U.S. firms*

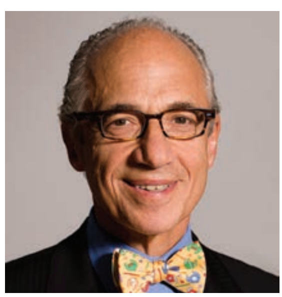
hosted a similar event in Albany. **Buyouts Insider**, the joint publisher of this magazine along with law firm **Duane Morris**, has itself held two successful events for emerging managers in New York City over the past year.

Strong investor interest has translated into success on the fundraising trail for a number of aspiring fund managers. All told, U.S. buyout firms on their first, second or third fund raised $190.7 billion from 2012 to 2016, or 22 percent of the $874.5 billion raised altogether, according to *Buyouts*. That works out to an average of $38.1 billion per year. In one of the most successful efforts during that time, technology buyout specialist **Siris Capital** in early 2015 closed a second broadly-marketed fund at $1.81 billion, blowing past the $1 billion target and original $1.5 billion hard cap.

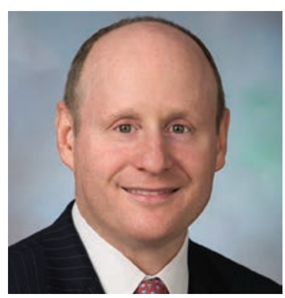
As for the overall strength of the fundraising market for emerging managers, we can't get around the lack of enthusiasm for debut funds, as illustrated in the results of the Preqin survey and subdued fundraising numbers.

When investors show more love by committing more capital to debut funds we'll consider an upgrade.

David Toll
Executive Editor
Buyouts Insider



Richard Jaffe
Partner and Chair of
Private Equity Group-U.S.
Duane Morris



Scott Gluck
Special Counsel, Duane
Morris and Legal Adviser to
ACG PERT

INSTITUTIONAL INVESTORS TAKE CHANCE ON EARLY PE FUNDS

BY DAVID TOLL, EXECUTIVE EDITOR, BUYOUTS INSIDER

Emerging managers have a lot going for them. Many offer co-investments. Their founders put an abundance of skin in the game and don't overdo it on the management fees. They pursue specialized strategies that can diversify plain-vanilla portfolios. They've performed well overall, although individual funds can be a bit hit-or-miss. Institutional investors have been embracing these virtues.

U.S. buyout firms raising a first, second, or third fund secured $190.7 billion from 2012 to 2016, or 22 percent of the $874.5 billion raised overall, according to estimates by sister *Buyouts Magazine*. The $31.0 billion raised last year was down from the recent average of $38.1 billion, but fundraising figures for any one year often reflect changes in supply as much as they do demand.

The emerging manager market has "really come of age," said **Irwin C. Loud III**, managing director and chief investment officer at **Muller & Monroe Asset Management LLC**, a

Chicago-based adviser that has carved out a niche backing emerging managers.

The firm, whose clients have included **California State Teachers' Retirement System**, **New York State Common Retirement Fund**, **Connecticut Retirement Plans and Trust Funds** and **Chicago Teachers' Pension Fund**, has seen assets under management grow from some $458 million in 2011 to more than $700 million this year. If Muller & Monroe succeeds in capturing three separate account clients up for renewal, it will be on track to break $1 billion under management in 2017, Loud said.

Another Chicago advisor, **GCM Grosvenor**, has also linked its fortunes to those of emerging managers. The separate-account specialist, which in early 2014 said it had acquired the customized fund investment group of **Credit Suisse Group**, has poured close to $10 billion into the coffers of some 285 funds raised by emerging managers over the last 15 years—mainly in private equity. Among its winning picks have been funds from technology specialists **Siris Capital Group** and **Vista Equity Partners**.

Meantime, a former GCM Grosvenor partner, **Mina Pacheco Nazemi**, last year spun out to create a new separate-account manager focused on emerging managers, **Aldea Capital Partners**, based in Los Angeles. The firm plans to make both fund commitments and direct investments. Nazemi said she anticipates having at least $100 million under management by year's-end, and that she'd be particularly focused on women-owned firms. "That's a function of my natural private equity network," she said. "At the end of the day, private equity is about the network."

Institutional investors with formal allocations to emerging managers include **California Public Employees' Retirement System**, Connecticut Retirement Plans and Trust Funds (through its **Connecticut Horizon Fund**), Chicago Teachers' Pension Fund, **Illinois Municipal Retirement Fund**, **Los Angeles Fire and Police Pensions**, **New York City Retirement Systems**, and New York State Common Retirement Fund (see table on p. 10).

Those without formal allocations but have nevertheless indicated an appetite for emerging managers include **Aberdeen Asset Management**, **Bowside Capital**, **Blennemann Family Investments**, **California Community Foundation**, **Grove Street Advisors**, **Private Advisors** and **Wilshire Private Markets**.

"Bob here is a top-quartile fund manager."

How investors pick winners

1. Talk to other LPs and placement agents that have had success with particular fund managers and that can provide recommendations
2. Analyze back office of firm to make sure it is capable of producing quarterly reports, hosting annual meetings, and providing ongoing communications at a quality expected by an institutional investor; big investors today have limited patience for firms with a raise-capital-now-hire-a-CFO-and-CCO-later approach, although family offices may be more understanding
3. Ensure the partners have relevant experience sourcing and doing deals together in the strategy promoted and that they have a track record that proves the strategy works—whether working as a fund-less sponsor, working at a conventional buyout fund, or doing something similar; investors will be leery of partners that sourced deals but relied on others to carry a deal the rest of the way; they also have an aversion for partners coming together for the first time, no matter how intriguing the investment strategy
4. Be on the look-out for cherry-picking when firms promote the deals that they've done; investors want to see it all—the good, the bad and the ugly—and want to hear about lessons learned and applied to new investments
5. Investigate whether the flow of deal opportunities generated by a firm matches up to the amount of capital sought given proposed investment period
6. Size up the likelihood that the firm will reach a minimum capitalization needed to sustain the firm and support the investment strategy; investors expect firms to take a year to 18 months but want to see a reasonable amount of traction after a year or so
7. Talk to the CEO and CFO of portfolio companies claimed as part of track records and former colleagues to see how much value the partners add as owners; investors will often look to go well beyond any reference list supplied by the emerging manager
8. Evaluate the terms to ensure the firm hasn't given away too much to attract investors—either in economics or in co-investment opportunities that belong in the fund or that might compel the firm to do larger deals that it's comfortable doing

To be sure, many investors view debut funds as especially risky: A recent survey by Preqin found that the percentage of investors that won't back them tops 40 percent. But these days it isn't easy to find an investor that says it doesn't have an appetite for emerging managers.

Family offices are particularly ripe for pitches from young firms. Said Heinz Blennemann, principal at Blennemann Family Investments, last fall at PartnerConnect Southwest in Dallas: "A family office tends to not have multiple layers and checks and balances." As a result, he said, "we're able to be much more nimble and invest in managers that might be a little bit too risky for some of the larger institutional LPs."

And why shouldn't money be pouring into these funds? According to a recent analysis of 1981-2011-vintage buyout and related funds conducted by *Buyouts Magazine*, firms on their first, second or third fund, including new fund families introduced by established managers, perform just about as well as those on Funds IV and higher.

"The reason why we invest in emerging managers is because of the returns," said Blennemann, echoing the performance-first mantra of many investors. "Just like in the hedge fund industry, in the private equity industry there's more and more concentration of money going into the larger funds. So if you want to buck the trend and find interesting areas that are not picked over as much," you have to go with emerging managers.

One notable difference in the returns of emerging managers: About 16 percent have lost money to date, according to *Buyouts Magazine*. The figure is just 11 percent for Funds IV and higher. "The dispersion of returns is higher" with emerging managers, said Bruce Ou, a managing partner at Grove Street Advisors. That is why, he said, many investors either earmark resources for emerging-manager programs—to ensure that they can handle the special demands of vetting them—or outsource the programs.

The siren call of investors for young fund managers has not been lost on buyout professionals—many entering prime work years at established shops just as the older generation of partners shows few signs of moving aside. *Buyouts Magazine* identified at least 88 firms in the market with debut funds in 2016, raising $13.4 billion altogether; among the more high-profile efforts, Angeles Equity Partners, founded by two ex-partners at Gores Group, secured $360 million earlier this year for a debut fund with a $300 million target. Backing came from Los Angeles City Employees' Retirement System and Montana Board of Investments.

Buyout professionals give a variety of reasons for launching their own firms—to have more say in strategy, to keep a higher share of the profits, to have an ownership stake in the management company. Some, like the two co-founders of Angeles Equity Partners, point to their frustration that their old firms migrated toward bigger companies. They see smaller companies as lower priced, and easier to wring improvements out of.

Scott Reed, head of U.S. private equity, Aberdeen Asset Management, sees the wave of firm launches extending well into the future. "I think it's tied to the maturation of the asset class," Reed said at the PartnerConnect Southwest conference. "Oddly enough, if we enter some sort of a downturn, where the larger firms are having more difficulty at the margins raising capital, then the folks who are on the cusp of becoming partner or getting that larger share of the pie may be more inclined to step out on their own..."

Said Reed: "If you're talented and your track record is good there will always be money to support a new, interesting group."

INVESTORS

How to define emerging managers remains a fluid topic. Many investors define them to be firms raising a first, second or third fund; others draw the line at fund II, noting that a buyout shop can easily be into its second decade before raising a third fund.

Some further limit the population of emerging firms to those managing funds below a certain size, such as $500 million or $750 million or $1 billion. Others, particularly public pensions, add an element of diversity, earmarking their emerging-manager dollars to firms owned by minorities, women and others sparsely represented in the asset class.

The **New York City Comptroller's Office**, which manages a collection of pensions totaling some $170 billion, falls in the latter camp. All told about $4 billion of the city pension system's $18 billion private equity program has been allocated to emerging managers.

Alex Doñé, promoted earlier this year to deputy chief investment officer for the **New York City Retirement Systems**, joined the city pension system in 2012 as head of the private equity emerging-manager program. Since starting the program around 2000, the pension system had backed emerging-manager funds indirectly through funds of funds. One of Doñé's first big achievements, he said, was to bring the program in-house. The system has been an early backer of such groups as **Blue Wolf Capital**, **Clearlake Capital Group**, and Siris Partners.

Today, Doñé said, speaking at the Emerging Manager Connect Outlook conference in New York City in late January, the pension system earmarks about 15 percent of its $2 billion to $2.5 billion in annual private equity commitments to emerging managers—mainly small buyout shops. That includes a $500 million evergreen program earmarked for Roman numeral I, II and III funds of less than $1 billion in size. "You invest in the best managers as the opportunities dictate, and when you're done you re-up and reload and continue to invest," said Doñé of the evergreen program.

Doñé described the city's definition of emerging manager as "fairly broad and flexible" and the primary goal of the program as generating strong returns. That said, the city, while having no formal quota or goal, also emphasizes diversity in its manager selection. Of the $15 billion that the city pension fund has committed to emerging managers across all asset classes, $12 billion has gone to "MWBE" firms—those owned, operated and controlled by minorities or women.

"At New York City, we are very focused on working with and targeting small entrepreneurial firms that happen to be led by women and minorities and others," said Doñé. "We are vested in their growth, development and ultimate success."

Earlier in his career Doñé worked at the Minority Business Development Agency at the Department of Commerce, helping minority-owned and women-owned companies secure loans and government contracts.

Looking ahead, Doñé said, New York City will continue to look for ways to back emerging managers after they "graduate" from the program and to continue diversifying into growth equity, special situations and credit-oriented strategies. The city pension also plans to launch a co-investment program by the end of the year.

As in New York City, diversity looms as an important investment goal at the **California Community Foundation**, whose mission includes creating opportunities for women and minority entrepreneurs.

The foundation, which has discretion over some $900 million in assets, is in the midst of broadening its alternative investment program from just hedge funds and real estate to include private equity. Eventually the foundation expects to have close to 10 percent, or $80 million, of its assets in the asset class. During a panel late last year at the PartnerConnect Southwest conference in Dallas, Trustee **Melvin Lindsey** said that it wants its consultant, the recently hired **Meketa Investment Group**, to show them emerging-manager funds.

"We feel it's a limited opportunity set if you don't get a chance to look at new, next-generation managers," said Lindsey. "If you always have the same [firms] being presented year after year I don't know that it gives you diversity of thought, and you end up with group-think when it comes to managing the portfolio."

Lindsey said that the foundation has an "open-door policy" for asset managers. "We think diversity, we think small managers can add value if given the opportunity."

Prudential Strategic Investment Research Group, a consulting division that vets third-party asset managers for the insurance giant, also makes diversity part of its investment program. The division is considering expanding the scope of its emerging manager program from long-only managers to private equity, according to Vice President **Cherrise Cederqvist**, speaking during the same panel as Lindsey at PartnerConnect Southwest.

Said Cederqvist: "One of the beliefs that is held throughout the Prudential organization, that emanates from the very top--from the board, from the CEO--is the importance of diversity, the importance of how great decisions get made when you have a variety of thought processes around the table."

SUCCESS STORIES

A number of buyout professionals have taken advantage of emerging-manager allocations to get their start-up firms off the ground.

SELECT LPS WITH AN APPETITE FOR EMERGING MANAGERS

INVESTOR	SIZE OF PE PROGRAM	EMERGING MANAGER INSIGHTS	CONTACT
Aldea Capital Partners	The firm, started by a former partner of GCM Grosvenor, launched late last year to advise institutional investors on their emerging manager programs. The firm anticipates having at least $100 million in assets under management by year's end.	Through separate accounts and possibly co-mingled funds the firm plans to back emerging-manager funds as well as make investments directly in companies.	Mina Pacheco Nazemi, founder and owner
Archean Capital Partners	This joint venture between asset managers Veritable LP and Moelis Asset Management, unveiled in early 2017, plans to seed new private equity shops with up to $100 million each.	Along with money, Moelis Asset Management can provide turn-key support in the form of office space, back office platform, while Moelis & Co.'s private funds advisory group is available to provide placement services.	Christopher Ryan, managing director Moelis Asset Management
Blennemann Family Investments	This single family office was formed in 2001 after the family sold its position in Juniper Networks. The firm backs a variety of fund strategies, including buyouts, venture capital, growth equity and mezzanine.	Especially interested in backing the second and third funds of newer groups; favors specialists over generalists.	Heinz Blennemann, Principal
California Community Foundation	All told the foundation has discretion over $900 million.	The foundation is in the process of expanding a hedge fund and real estate portfolio into private equity, including funds managed by emerging managers; it plans to build a PE portfolio of about $80 million.	Melvin Lindsey, trustee
California Public Employees' Retirement System	A Pension Consulting Alliance report from earlier this year notes that the $307 billion pension fund has 8.4 percent of its assets invested in private equity. That's above an 8 percent interim target allocation.	Last year CalPERS said it plans to allocate as much as $11 billion to emerging managers in private equity and real estate and to transition managers—those that have demonstrated early promise—by 2020. Advisers in this area have included Centinela Capital Partners, GCM Grosvenor and Grove Street Advisors.	Réal Desrochers, managing investment director, private equity
Chicago Teachers' Pension Fund	As of mid-2015 the pension fund had $297.5 million of private equity assets out of a $9.7 billion pension fund.	As of mid-2014 the pension had a more than 10-year-old mandate to back emerging firms, including ones targeting minority-owned and women-owned businesses and those based in Illinois and the Midwest; the pension fund has channeled money to emerging managers through funds of funds managed by Muller & Monroe as well as on its own.	Angela Miller-May, director of investments
Connecticut Retirement Plans and Trust Funds	As of late 2015, two of the roughly $30 billion pension fund's main sub-pensions, the Teachers' Retirement Fund and State Employees' Retirement Fund, were just below their 11 percent target allocation to private equity; the Municipal Employees Retirement Fund was about 1 percentage point above its target allocation.	The state, as part of its Connecticut Horizon Fund initiative, has set a goal of having 2.5 percent to 5 percent of its assets managed by emerging managers, Connecticut-based firms and minority- or women-owned firms. The pension fund has worked with advisors Fairview Capital, JP Morgan, Muller & Monroe and StepStone.	Laurie Martin, interim chief investment officer

SELECT LPS WITH AN APPETITE FOR EMERGING MANAGERS (CONT.)

INVESTOR	SIZE OF PE PROGRAM	EMERGING MANAGER INSIGHTS	CONTACT
GCM Grosvenor	GCM Grosvenor, which said it acquired the customized fund investment group of Credit Suisse in 2014, manages close to $50 billion across private equity, hedge funds, real estate and infrastructure.	Has committed some $10 billion to emerging managers over the last 15 years, mainly to private equity but some to real estate and infrastructure as well. Clients have included Allstate, CalPERS, New York City Retirement Systems, and Texas Teachers'.	Derek Jones, managing director investments-private markets; Jason Howard, director investments-private markets
Grove Street Advisors	Over its 17-year history some 12 clients, including Finland's Local Government Pensions Institution, have committed about $8.3 billion to the firm.	Commits $300 million to $400 million per year to buyout and venture capital funds, much of it to Roman numeral I and II funds.	Bruce Ou, managing partner
HarbourVest Horizon (formerly BAML Capital Access)	Clients have included California State Teachers' Retirement System, CalPERS, New York State Common Retirement Fund and New York State Teachers' Retirement System.	As of mid-2014 the group had committed more than $1.5 billion to funds—mainly ones managed by emerging managers run by women and minorities raising funds of up to $700 million in size.	Sanjiv Shah, managing director
Illinois Municipal Retirement Fund	As of Sept. 30 2015 the then-roughly $33.4 billion pension fund had an alternatives portfolio valued at $1.5 billion; its target allocation was 9 percent.	In late 2015 the pension fund set an "aspirational goal" of allocating at least 20 percent of its fund assets to emerging managers, defined as firms owned by minorities, women or people with disabilities. Muller & Monroe has done asset management work.	Elizabeth Govea, investment officer-private markets
Illinois State Universities Retirement System	As of June 2016 the roughly $17 billion defined-benefit pension had about $916 million invested in private equity; its target allocation is 6 percent.	Last spring the pension hired Muller & Monroe to manage a $100 million separate account earmarked for firms owned by women or minorities.	Douglas Wesley, interim chief investment officer
Los Angeles Fire & Police Pensions	As of year-end the $19.5 billion pension fund had $1.8 billion in private equity assets; its target allocation to private equity is 12 percent.	Last summer allocated $100 million to Portfolio Advisors and $50 million to Fairview Capital earmarked for emerging managers.	Ruben Navarro, vice president
Muller & Monroe Asset Management LLC	This specialist in backing emerging managers has between $700 million and $800 million under management; it focuses mainly on buyout, growth equity, distressed debt and special situations.	In addition to raising and managing co-mingled funds of funds the firm has managed separate accounts for a number of large pension clients. Clients have included Chicago Teachers' Pension Fund (funds of funds) and New York State Common Retirement Fund (separate account).	Irwin C. Loud III, managing director and chief investment officer
New York City Retirement Systems	The $170 billion New York City pension system has about $18 billion in private equity assets; It commits $2 to $2.5 billion per year to private equity—primarily buyout, growth equity, special situations, value-oriented managers and credit-oriented managers.	Commits $300 million to $375 million per year to emerging managers, which the pension defines as firms on funds I, II or III and raising less than $1 billion; the city also has a strong focus on firms owned by women and minorities; advisers have included GCM Grosvenor.	Alex Doñé, deputy chief investment officer

SELECT LPS WITH AN APPETITE FOR EMERGING MANAGERS (CONT.)			
INVESTOR	SIZE OF PE PROGRAM	EMERGING MANAGER INSIGHTS	CONTACT
New York State Common Retirement Fund	As of March 2016 the $179 billion pension had roughly $14 billion invested in private equity.	In 2011 the state put Muller & Monroe in charge of running a $200 million allocation as part of its emerging manager private equity program. It also uses advisers Farol Asset Management and HarbourVest Horizon. As of March 2016 the pension had $1.2 billion in private equity assets managed by emerging managers.	Sheryl Mejia, director of emerging managers
Portfolio Advisors	The firm, a specialist in private equity, real estate and private credit, manages 29 funds with more than $15 billion in investor commitments.	Selects emerging managers for two California pensions, Los Angeles Fire and Police Pensions and Los Angeles City Employees' Retirement System.	Liz Campbell, senior vice president
Prudential Strategic Investment Research Group	This in-house consulting group is responsible for advising clients on money-managers representing more than $340 billion in assets; includes emerging manager program.	The firm may expand the scope of its emerging manager program to include private equity.	Cherrise Cederqvist, vice president
Teacher Retirement System of Texas	The target allocation for private equity is about 12 percent of the trust's more than $130 billion in assets.	In early January the pension fund said it would commit another $1.3 billion to emerging managers, including private equity, real estate, public equities and hedge funds, according to *Pensions & Investments*. GCM Grosvenor advises on the private equity portion of the program.	Sylvia Bell, managing director of the emerging manager program and investment operations
Teachers' Retirement System of the State of Illinois	As of June 30 the $45.3 billion pension had 12.3 percent of its assets invested in private equity; its target allocation is 14 percent.	Created a $500 million emerging managers program in 2005 that expanded to include private equity and real estate in 2008.	Stan Rupnik, chief investment officer

Source: Connections in the Middle Market

RLJ Equity Partners, launched in 2006 by billionaire media tycoon **Robert L. Johnson**, founder of Black Entertainment Television, has backing from emerging-manager allocations at CalSTRS (channeled indirectly through a Banc of America fund of funds now part of **HarbourVest Partners**), New York State Common Retirement Fund (through a program run by Muller & Monroe) the New York City Retirement System (through a program run by **StepStone**) and Chicago Teachers' Pension Fund. The firm, which manages a $230 million, vintage-2007 debut fund, this June held a $130 million first close on a successor pool targeting $300 million with a $400 million hard cap. Managing Director **Jerry Johnson** said that with its second fund RLJ Equity is 100 percent owned by Robert Johnson (having late last year purchased back a 20 percent stake from **Carlyle Group**) and that all of the firm's investment professionals are from minority groups. Said Johnson: "Our belief is that diversity is not a nice-to-have. It's a must-have with the changing demographics of this country. We have to make sure we bring all the best ideas, all the best people to the table."

Siris Capital, whose $1.81 billion second broadly-marketed fund closed in early 2015, took more than two years, from roughly the summer of 2010 to the fall of 2012, to raise its first fund with help from the placement team at Greenhill (now at Moelis & Co). According to Frank Baker, one of three co-founders and managing partners, backing for a late 2011 first close of $150 million came largely from emerging-manager allocations. It included money from the customized fund investment group at Credit Suisse Group, now at GCM Grosvenor, and Teachers' Retirement System of the State of Illinois.

"It's a long, painful journey," cautioned Baker to those considering a debut fundraise. "Make sure you're ready for it."

Many buyout professionals would agree, and say the key to making the progress a little less painful is nailing down a deal or two.

Angeles Equity Partners, launched in 2014, found the going easier after purchasing its first company, Applied Acoustics International, in early 2016. The deal brought home to potential investors that the firm could execute on its strategy of finding struggling or underperforming companies in the lower middle market.

"It definitely catalyzed the fundraising in the spring of last year," Timothy Meyer, co-founder and managing partner, told *Buyouts Magazine* in an interview this January. The firm had help in the fundraise from the fund placement group at Moelis & Co and GCA Savvian Advisors LLC.

Robert Langley, a co-founder and managing partner of Align Capital Partners, said that signing a letter of intent last year to purchase the firm's first portfolio company, Alliance Source Testing LLC, proved a catalyst in its debut fundraising.

Originally Langley and his partners figured they'd finance the deal outside of their fund, which had launched in April of last year. "LPs sort of said, 'no,' that they'd move to a first close fast enough to get it in the fund," Langley said. "Ultimately that first close became the only close." Working with placement agent Capstone Partners, the firm ended up needing just four months to raise its oversubscribed, $325 million debut fund.

The relatively speedy fundraise illustrates one of the challenges for investors in a market where so many limited partners want to discover the next Kohlberg Kravis & Roberts before anyone else does. There's not always a big window of opportunity.

While its first broadly marketed fund took more than two years to raise Siris Capital's second took just a few months and attracted far more demand than it could accommodate. The firm rewarded its first-fund investors by offering them at least their minimum-commitment threshold, if not their full allocation request, said Baker. But that didn't leave much room for anyone else.

The firm took in just two new investors of significant size. B+

Jim Milbery, partner

Devin Mathews, partner

PARKERGALE: A DIFFERENT KIND OF PRIVATE EQUITY FIRM

BY TOM STEIN, CONTRIBUTING WRITER, CONNECTIONS IN THE MIDDLE MARKET

ParkerGale Capital is redefining how PE outfits should look and act—especially when it comes to diversity.

If you look at most PE websites, it's shameful. It's one white guy after another. They are not even trying," said **Devin Mathews**, founding partner. "I have two daughters, so it's important to me to bring more women and minorities into PE. You have to try harder people."

What exactly does it mean to try harder? Well, ParkerGale, which has four male partners and one female partner, was recently in the market for a new associate. It received a stack of resumes from the usual suspects—white males with Ivy League degrees. The firm knew it had to do better—it had to attract equally talented candidates from across the demographic spectrum.

So the ParkerGale partners worked their respective networks, asking friends and business colleagues to recommend female and minority candidates who the firm might otherwise overlook. In the end, the firm had two even stacks of resumes. One comprised of white males, the other comprised of everyone else. The job ultimately went to a woman because she was the most qualified.

"The first cut wasn't a very deep pool of candidates," said Mathews. "But once we tried a little harder, it was a very deep pool. Most guys in PE will say that diversity is a pipeline problem. No, it's an effort problem."

ParkerGale, a small private equity firm that buys technology companies in the lower middle market, seems to delight in breaking all the private equity rules. While many firms are happy to operate in virtual secrecy and squeeze their limited partners for every last penny, ParkerGale proudly offers LP-friendly terms.

For instance, the firm, which recently closed its debut fund at $240 million, provides a "European style" waterfall distribution structure. LPs are paid back all contributed capital, plus fees and an 8 percent preferred return, before ParkerGale can collect carried interest. This type of distribution, also known as "back-ended" carry, is preferred by LPs, but hasn't been especially popular in the United States.

"Why put up a roadblock in fundraising?" asks Mathews. "Why say, 'Ok, you've never heard of us before, but we've got premium carry and all these nasty terms that are GP-friendly.' That makes us an easy no. We wanted to make the no's hard. That's why we didn't let terms get in the way."

"In our reports we share way more information about our companies than most PE firms."

—Devin Mathews, partner, ParkerGale

ParkerGale also believes in transparency—both internally and externally. To begin with, everyone in the firm knows everyone else's compensation and carry. What's more, operating partners and investment partners are on totally equal financial footing. "We don't believe in a caste system like other funds where the investors rule and the operators clean up the mess," said Mathews.

That transparency extends to LPs. ParkerGale's quarterly reports to LPs are almost novelistic in their scope. "In our reports we share way more information about our companies than most PE firms. For example, we actually tell our LPs exactly how much we paid for our companies," he said wryly, with the implication that most GPs do not provide the true, unadulterated purchase

ParkerGale

Snapshot

NAME: ParkerGale Capital

OFFICES: Chicago

PARTNERS: Devin Mathews, Jim Milbery, Kristina Heinze, Ryan Milligan, Dave Chandler

STRATEGY: A small private equity firm that buys profitable technology companies at the small end of the market. Investment sweet spot is $20 million to $40 million.

FUND: $240 million first fund closed in November, 2016.

LPS: 25% Endowments; 23% Pensions; 22% Family Offices; 14% Managed Accounts; 7% High Net Worth Investors; 6% Funds of Funds; 3% General Partner.

Source: Connections in the Middle Market

price, including all fees and other acquisition costs. "Our reports get sent around to other GPs as an example to follow."

ROOTS AT CHICAGO GROWTH PARTNERS

Who exactly is ParkerGale? They were the entire technology team, plus the CFO, from Chicago Growth Partners. In 2012, the firm hit the market with plans to raise up to $500 million for its third fund. By 2014, it was clear that the new fund was not going to materialize. So the partners decided to go their separate ways.

"We knew the ParkerGale team when they were at Chicago Growth Partners, and we really liked them, even though we never invested in CGP," said John Brooke, managing director at Brooke Private Equity Associates and an LP in ParkerGale. "To be honest, we were happy when they decided to break out on their own and build a new firm. That usually portends good things. They were not being held back anymore and could really do what they want, which makes for a good investment opportunity."

The former CGP partners, led by Mathews, Kristina Heinze, Jim Milbery, Ryan Milligan, and Dave Chandler along with CFO Corey Dossett and office manager Sharon Janowski, rebranded as ParkerGale. And no, there is nobody at the firm named either Parker or Gale. The name comes from two houses that Frank Lloyd Wright designed early in his career for the Parker and Gale families in Oak Park, Illinois. He used those successes to launch his own architecture firm in 1893.

Mathews knew his new firm wouldn't command the same respect as say, the energy team coming out of Carlyle Group. But he and his partners felt they were in the right place at the right time for a new tech fund focused on smaller deals.

"There has been a lot of success in tech buyouts with firms like Vista Equity Partners and Thoma Bravo," said Mathews. "The good news for us is that with success comes ambition, and those firms have gotten very ambitious in their fundraising. Our competitors are completely abandoning the small end of the market. And they continue to leave in droves. There is a pocket of opportunity here that didn't exist five years ago."

ParkerGale's bread and butter are little known but successful tech companies with at least $2 million in profits. The firm always takes a majority position and it insists on being the first institutional capital in the deal. In other words, these companies have to be 100 percent bootstrapped and cannot have raised a penny in venture capital.

Which leads to the inevitable question: Are there actually good tech companies out there that haven't received VC money? "There are 20,000 private technology companies in our space," said Mathews. "The ones who raise venture capital are the exception, not the rule. We just need to buy one or two a year. That's it. So there is more than enough deal flow for us."

FIRST TWO PLATFORMS

ParkerGale targets founders who have built their business over the course of several decades, but have suddenly become what Mathews calls Chief Worry Officers. They are enjoying the fruits of their labor, both financially and lifestyle-wise, but then they wake up in a cold sweat one morning and realize all their wealth is tied to the business—and that they aren't working nearly as hard as they were ten years ago. That's when ParkerGale comes in with a check of between $20 million and $40 million to acquire the company.

"We never back the founder to run the business after the transaction," said Mathews. "They are selling to get liquidity, because they want to step aside and buy a boat. And I sincerely hope they invite us on that maiden voyage."

> "There are 20,000 private technology companies in our space. The ones who raise venture capital are the exception, not the rule."
> —Devin Mathews, partner, ParkerGale

So far, ParkerGale has acquired two platform companies. The first is Aircraft Technical Publishers (ATP), which provides content management software and safety and compliance information to the aviation market. The founder, Carol Daniels, had run the business for 30 years and was ready to step aside. Since buying the company, ParkerGale has added a new CEO, CFO and head of sales. It also purchased a competitor in Canada, CaseBank Technologies, as an add-on acquisition. It has expanded the company's product line and introduced a new mobile platform for the software. And it

PARKERGALE INVESTMENTS			
COMPANY	DESCRIPTION	ADD-ON ACQUISITION	PROGRESS
Aircraft Technical Publishers	Aircraft Technical Publishers (ATP) is a provider of information tools and services to the aviation industry. The company helps businesses manage all of their maintenance processes on a unified, cloud-based SaaS platform.	In December 2016, ATP acquired CaseBank Technologies, Inc., a diagnostic, troubleshooting and fault detection solutions for the aviation industry.	Added a new CEO, CFO and head of sales and has expanded the company's product line and introduced a new mobile platform for the software. Also introduced a new stock option plan that enables employees to own equity in the business.
OnePlus Systems	OnePlus Systems provides waste monitoring systems and software that helps major corporations save millions of dollars annually by efficiently manage their waste disposal.	In June 2016, OnePlus Systems acquired SmartBin, an intelligent waste monitoring firm that helps municipal and private waste management companies service waste containers through a combination of smart wireless fill-level sensors and analysis software.	Added a new CEO, CFO, CTO and hired the company's first salespeople. Also upgraded back-office technology, moving the company from Quickbooks to NetSuite, and from spreadsheets to Salesforce.com.

Source: ParkerGale

introduced a new stock option plan that enables employees to own equity in the business.

Charles Picasso, CEO of ATP, uses adjectives not normally associated with PE firms to describe his experience with ParkerGale. "They are very genuine people and very down-to-earth partners," he said. "They are very good listeners. They are not lecturers."

Without going into detail, Picasso said ATP encountered some problems when it recently acquired CaseBank. "When we told ParkerGale about the challenge, they didn't start to tell us what we should have done," he said. "They engaged in a constructive dialog and really tried to understand the situation. Because of that, they were able to provide valuable advice and a different angle on the situation that was very productive in the end."

ParkerGale's second platform acquisition is **OnePlus Systems**, a sensor and software business serving the global waste management industry—or what Mathews calls the "Internet of trash." The company helps major corporations such as the **Home Depot**, **Coca Cola**, and **Zappos** save millions of dollars annually by efficiently managing their waste disposal. The OnePlus sensor alerts haulers when large waste containers are full and ready to be serviced.

"Some of the largest retailers and property owners in the world were finding this company in Illinois when it had just 12 employees and no sales people," said Mathews. "We saw a $50 billion waste industry with low technology adoption and an opportunity for real growth."

OnePlus wasn't for sale originally, so ParkerGale kept in touch with the owner for two years before he finally decided to cash out. The first thing the firm did was hire salespeople, because there were none. The partners also added a new CEO, CFO and CTO. They upgraded the back office technology, moving the company from Quickbooks to NetSuite, and from spreadsheets to Salesforce.com. And they closed an add-on deal, acquiring SmartBin, an Irish company that makes sensors for the waste industry and helps waste collectors plan their pickup routes.

> "What's impressed us most about ParkerGale is their sense of urgency in creating value in the companies they invest in."
> —John Brooke, managing director, Brooke Private Equity Associates

"What's impressed us most about ParkerGale is their sense of urgency in creating value in the companies they invest in," said LP Brooke. "A lot of firms buy companies and take their time making the improvements. They just don't operate with a real sense of urgency. But in both deals, right from the start, ParkerGale has really gotten moving. It hasn't just sat around thinking about things. Not all managers do that."

Mathews said that finding hidden gems in the technology industry can be tricky. Unlike in the venture world, the best companies don't come knocking on your door. But that's one of the reasons that ParkerGale now hosts a weekly podcast, called the Private Equity FunCast, complete with its own theme song.

The podcast, with over 20,000 monthly listeners, peels back the curtain on how the business of private equity works. All the segments are designed to appeal to company founders. Topics include "Bootstrapping and Selling Your Software Company," "Board Meetings—the Good, the Bad, and the Ugly," and "After the Letter of Intent: Everything That a Founder Needs to Know."

"PE benefits from an asymmetry of information: We have all the answers and you have none. But if we give people the answers to the test, maybe they'll choose to work with us," said Mathews. "How many GPs who've made tons of money have an incentive to do a weekly podcast? Zero."

But ParkerGale is not like other PE firms. Said Mathews: "We're crazy enough to do things they'd never do." B+


PHOTO BY BUYOUTS INSIDER

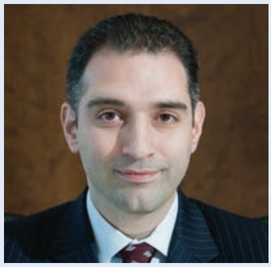
ACG PERT roundtable participants in Washington DC on Feb. 13 2017 (from left to right, going around the table): Moderator David Toll and speakers David Gershman, J.B. Dollison, Béla Schwartz, Julianne Lis-Milam, Amber Landis, Ben Marsico, Joshua Cherry-Seto and Jason Brown

ACG PERT MEMBERS DISCUSS VERSION 1.0 OF THEIR COMPLIANCE RECOMMENDATIONS

About two years ago the Private Equity Regulatory Task Force at the Association for Corporate Growth began work on a set of principles to provide guidance for private equity compliance officers as they respond to the regulatory requirements under various Federal laws.

The Dodd-Frank financial reform law had required most private equity firms, starting in mid-2012, to register as investment advisers under the Investment Advisers Act of 1940. However, the U.S. Securities and Exchange Commission, thrust into a market it had little experience with, didn't provide much guidance to the industry on how to comply with its rules and regulations. Frustratingly, many of those rules seemed geared toward managers of public equities and credit instruments.

Jason Brown, partner, Victory Park Capital, ACG Global Board Chairman, 2016-2017



Joshua Cherry-Seto, CFO, Blue Wolf Capital, member of ACG PERT Steering Committee

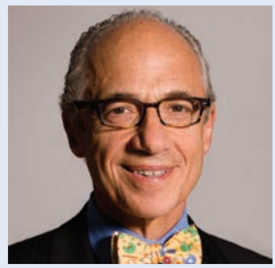
Blinn Cirella, CFO, Saw Mill Capital, member of ACG PERT Steering Committee

J.B. Dollison, managing director, Crutchfield Capital Corporation, ACG Global Vice Chairman of the Board

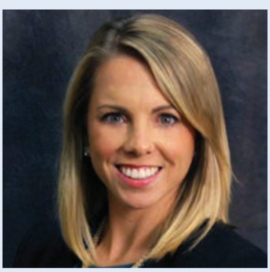
April Evans, partner, CFO and CCO, Monitor Clipper Partners, member of ACG PERT Steering Committee

David Gershman, general counsel, partner and chief compliance officer, Trivest Partners, member of ACG PERT Steering Committee

Scott Gluck, special counsel, Duane Morris and legal adviser to ACG PERT



Richard Jaffe, partner, Duane Morris, immediate past chairman of the ACG Global Board



Amber Landis, VP of public policy, ACG

Julianne Lis-Milam, partner, general counsel and CCO, Hammond, Kennedy, Whitney & Company Inc, member of ACG PERT Steering Committee

Béla Schwartz, CFO, The Riverside Company, member of ACG PERT Steering Committee

David Toll, executive editor, Buyouts Insider

ACG PERT set out to fill in the gap. It formed sub-groups of CFOs and CCOs to develop recommendations in six areas: fees and expenses, cyber-security, co-investments, valuations, broker-dealer registration and advertising/marketing. The sub-groups started with extensive surveys to gather industry feedback on best practices in each area. They wrote draft recommendations, and gathered feedback from the industry and SEC staff (informally) to fine-tune them.

After evaluating a set of public comments received in November 2016, ACG PERT released its final recommendations in four areas in January. It held off on issuing recommendations in broker-dealer registration and advertising/marketing, to enable it to seek more direction from the SEC. Below we highlight comments from people involved in the development of the ACG PERT principles. They come from a roundtable discussion held at the ACG Public Policy Summit in Washington, DC, on February 13, as well as follow-up interviews.

IMPORTANCE OF PERT PRINCIPLES

J.B. DOLLISON: We wanted to make sure that the provisions of Dodd-Frank and any other provisions on the regulatory front were really germane to our industry. This was an opportunity to make that happen.

RICHARD JAFFE: What's important about these principles is that they come from the industry itself—from the practitioners. The PERT group is comprised of CFOs, CCOs and in-house general counsels—people actually in the trenches, on the front lines addressing these issues. Getting a consensus from this group was really important.

JULIANNE LIS-MILAM: In picking areas to focus on, we identified those where we felt there was market confusion—where there were conflicts, or where compliance and regulatory issues were impacting our businesses. Each one of us has compliance consultants that we retained, and we were getting different advice on how to address a particular statute. We also focused on SEC alerts and any guidance that they issued.

RICHARD JAFFE: The Investment Advisers Act of 1940 was designed to regulate true investment advisers. So we didn't have the kind of guidelines that were needed. Although there was, and is, a culture of compliance on the part of private equity funds, there was no clarity and no consistency among industry practices. That's what the principles were designed to achieve in large part. Hopefully these will be adopted not just by middle market funds but by the PE industry in general.

JASON BROWN: We have 19 investment vehicles, many of which are foreign. We also have a public listed vehicle that's foreign. So we have a massive amount of complexity. We struggle with a lot of these issues daily. So I was beyond impressed at what PERT put together, and it certainly resonates with me.

APRIL EVANS: We wanted to give firms a sense of confidence that they're handling compliance well, that they're doing it right, and that they will not have issues when the SEC comes in to examine them.

DEVELOPMENT OF THE PRINCIPLES

AMBER LANDIS: For the last three years ACG PERT met with SEC regulators at least twice a year if not more. We had a consistent dialog with regulators. Over time we collected their thoughts on the principles. We also got feedback from LPs. We reached out to ILPA during a comment period in November, in which they gave back very detailed comments. They were supportive of the process. The Investment Adviser Association also participated, as well as other private equity trade associations.

DAVID GERSHMAN: We think the SEC has been a very good partner. They've been very responsive. We had a special session this summer with many PERT members and members of the SEC on the phone. We had a good dialog on advertising and marketing as it relates to private equity funds.

JULIANNE LIS-MILAM: The SEC was very welcoming to discuss issues. They were also open to us helping to supplement their knowledge on middle-market private equity and how we operate, and why certain things are important to us and certain things are not important.

"We think the SEC has been a very good partner. They've been very responsive."
—David Gershman, general counsel, partner and CCO, Trivest Partners

BÉLA SCHWARTZ: What surprised me was the unanimity among all the people we talked to. You've got 40-50 folks providing input into this group. There may have been differences of opinions on the margin. But in general everyone agreed about disclosure, transparency and clarity. I think that spoke volumes about the attitudes of GPs. Every GP wants to make his or her LPs happy. Creating a systemic set of guidelines to create clarity and disclosure helps the SEC, it helps the LPs, and it helps the GP and that's a win for everybody.

INSIGHTS: FEES AND EXPENSES

BÉLA SCHWARTZ: The biggest challenge on fees and expenses was similar to what ILPA struggled with in developing its reporting guidelines. It was definitional. Who's an affiliate of your firm, and how do you choose to define it? What does your LPA say? You have to look to your documents and see what you're permitted to do and what you're not permitted to do. Is this a prohibited person to pay? Or is this someone who's OK to pay? Regardless of what you determine, we believe you should disclose it. It never hurts to tell more than less. The LPs will appreciate it.

JOSHUA CHERRY-SETO: A lot of this boils down to issues related to conflicts of interests. We all believe we're good players in the market. But certain things can be perceived as conflicts of interest. When you're doing a transaction with somebody who has a relationship with the GP, people can wonder if it's arm's length. A lot of the recommendations in fees and expenses have to do with making sure everything is done at arm's length, such as how to handle compensation of operating partners.

INSIGHTS: VALUATIONS

BLINN CIRELLA: The valuation guidelines aren't necessarily one-size-fits-all. If you're not doing something we've identified in the principles, that isn't necessarily a bad thing. By the same token, you may not be able to follow everything in the recommendations, and that is also fine. They're meant to be practical guidelines.

INSIGHTS: CO-INVESTMENTS

BLINN CIRELLA: We tried to be forward-looking and address areas that are still evolving, like charging carried interest at the co-investment level. On that and other questions it's always important to refer back to your LPA and ask whether your LPA allows for something you'd like to do.

INSIGHTS: ADVERTISING/MARKETING (DELAYED)

DAVID GERSHMAN: We've had a lot of dialog with the SEC over what is appropriate in advertising and marketing—what's a general solicitation through the website, what does a proper website look like, when does it look like you're trying to solicit for investors as opposed to using your website to solicit for investment opportunities. That's been our guiding principle regarding advertising and marketing and websites. You want to be out using your websites looking for deals, not looking for investors.

SCOTT GLUCK: Amber [Landis] and I had a call with representatives from the SEC, and in delaying we just wanted to make sure we weren't running afoul of either the Securities Act of 1933 or Investment Advisers Act of 1940 or advocating for anything that the SEC might view as something that would not be condoned.

JULIANNE LIS-MILAM: Version 1.0 of the principles will be amended with the advertising and marketing recommendations at some point. We've really come a long way in having suggested principles for websites, for press releases, for speaking to Preqin, Pitchbook, and magazines such as *Buyouts*. This afternoon we are going to continue the dialog with the SEC, and get some input on the draft recommendations.

> "I don't think we get to retire at this point."
> —April Evans, partner, CFO and CCO, Monitor Clipper Partners

INSIGHTS: BROKER-DEALER REGISTRATION (DELAYED)

SCOTT GLUCK: In the Securities Exchange Act of 1934, the definition of broker-dealer is very broad, and could be interpreted to cover everybody who is receiving compensation in connection with a securities-based transaction. So, as with advertising/marketing, there is a strong statutory overlay in this area. We're continuing to talk to the SEC, and the best course of action may be to fashion a no-action letter. We didn't think it would behoove us to put out principles given the strong statutory overlay. And we just haven't gotten a lot of clear direction from the SEC.

WHAT'S NEXT

AMBER LANDIS: We don't expect the SEC to take a position on the principles. The SEC would never come out and say one way or the other what they think of them. They do think it's a step in the right direction. They think it's very important any time an industry takes it upon itself to work on compliance issues and have discussions with members.

APRIL EVANS: We do have to contend with other areas of regulation. So it's a matter of prioritizing. I don't think we get to retire at this point. Many of us are subject to AIFMD regulations in Europe. That could become an area of focus.

Edited for readability and clarity B+

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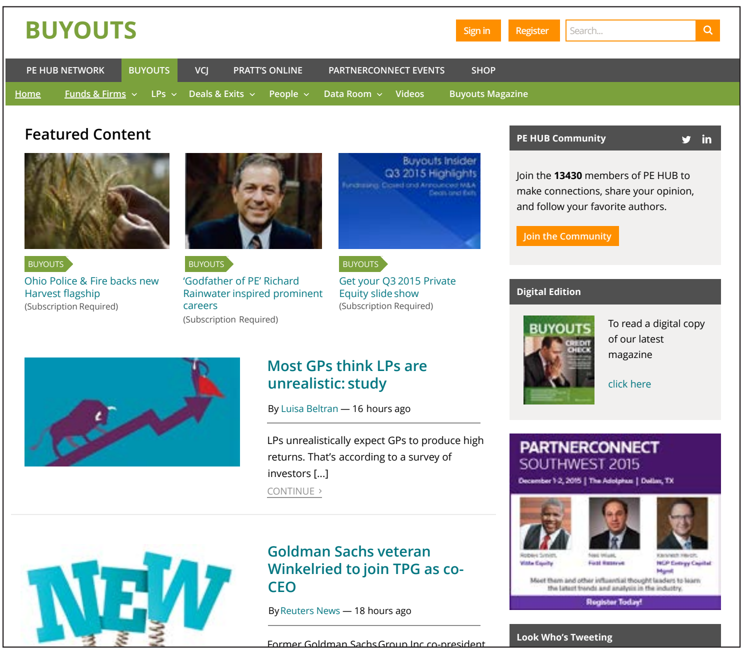

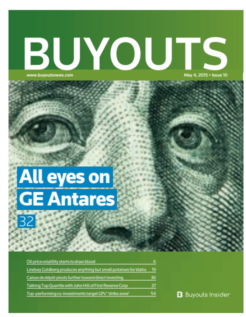

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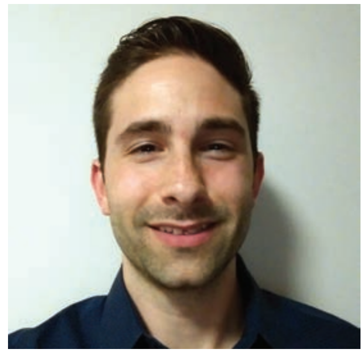
CONTRIBUTOR PROFILES

David Toll,
executive editor,
Buyouts Insider

DAVID TOLL is the executive editor of Buyouts Insider, where he oversees the editorial direction of Buyouts Magazine, Venture Capital Journal and the peHUB.com community website. David has been writing about the private equity markets since 1997, and publishes a bi-weekly column in Buyouts Magazine. He is the co-author of several survey-based studies on the private equity and venture capital markets, covering such topics as partnership terms and employee compensation. He is the chief cartoonist at privateequitycartoon.com.

Tom Stein,
Contributor,
Buyouts Insider

TOM STEIN provides a range of editorial and marketing services to corporate clients, including Yahoo!, Facebook, Sony, Oracle, Saatchi & Saatchi, Marvell, Microsoft and PayPal. His services include contributed articles, newsletters, white papers, website copy, social media content, and speeches. He has contributed to leading business and general interest publications including Buyouts Magazine, Wired Magazine, Forbes, Tennis Magazine, and Venture Capital Journal. Previously, Tom was a senior editor at Red Herring, a magazine where he covered start-ups and venture capital. He also worked as a staff writer at the San Francisco Chronicle, where he covered the tech industry. Additionally, Tom served as a senior editor at InformationWeek and Success Magazine.



Paul Centopani,
research editor,
Buyouts Insider

PAUL CENTOPANI is a writer and developer of media and editorial in print, online and presentation formats for Buyouts Insider. His work centers on plumbing the private equity industry for trends and ideas that can be turned into thought-provoking, high-quality content. His stories have been regularly featured in Buyouts Magazine, Venture Capital Journal and the peHUB.com community website. Earlier in his career Paul was a pricing analyst and senior consultant for defense contractor Booz Allen Hamilton. There he managed more than 600 proposals representing nearly $900 million in value.

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