Woman and Minority-Owned Private Equity Firms

A market review of woman and minority-owned private equity firms actively raising capital in the first half of 2016 based on data collected by Fairview Capital

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Fairview Capital's Mid-Year 2016 Market Review of Woman and Minority-Owned Private Equity Firms

The criteria for classifying a private equity firm as woman and/or minority-owned often varies. In this market review, we only consider private equity firms that are majority owned (>50%) by ethnic minorities[1] and/or women. The firms must be based in, and primarily investing in, the United States.

The universe of woman and minority-owned private equity firms continued to evolve in the first half of 2016. From a very small group in the early days of the private equity industry, the number of woman and minority-owned private equity firms had grown to over 150 at the end of 2015, and at mid-year 2016 had eclipsed 160. Fairview observed 50 woman and minority-owned firms actively raising capital in the market in the first half of 2016, compared to 65 for the full year 2015. In aggregate, these firms represented just under 6% of all private equity firms in the market in the first half of 2016.[2] While still underrepresented, these managers cover a wider range of strategies, industries and geographies than ever before. They are also increasingly experienced and highly competitive with the broader private equity industry. In fact, many of the woman and minority-owned firms in the market feature strong track records, compelling strategies, truly differentiated approaches, and meaningful competitive advantages.

Sophisticated institutional investors continue to undertake efforts to be more inclusive of diverse managers in their private equity portfolios through various means. This includes numerous public pensions plans with active or pending mandates that target woman and minority-owned firms. More broadly, efforts continue across the industry to increase opportunities for women and minorities. One example is the National Venture Capital Association's Diversity Task Force which continues to engage in initiatives aimed at developing opportunities for women and underrepresented minorities across the venture capital ecosystem. More recently, in June, the National Association of Investment Companies (NAIC) and the American Investment Council (AIC) partnered to form the Private Equity Women's Initiative. According to the NAIC, women make up just 10% of the senior employee ranks in private equity. The Initiative has the goal of increasing the number of women entering and advancing in the private equity industry and will be led by a Working Committee of which Fairview's JoAnn Price is an initial member. As progress continues to be made, Fairview believes real opportunity to foster diversity in the industry exists for institutional investors by building programs that include funds managed by women and minorities. This can be done without compromising results, and in fact can provide the potential for outperformance.

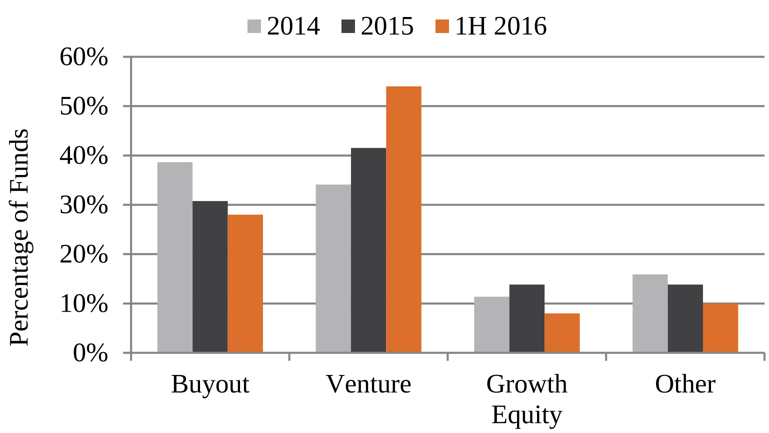
Fairview was the first private equity investment management firm to broadly articulate the investment opportunity with diverse managers and remains one of the most active firms investing with diverse managers today. Fairview's investment activity with diverse managers has always focused first and foremost on the outperformance these mangers can generate. Given the firm's level of activity and involvement in the space, Fairview maintains one of the most robust databases on woman and minority-owned firms in the industry. The 50 woman and minority-owned firms Fairview observed actively raising capital in the first half of 2016 are a strong representative cross-

[1] Defined by the U.S. Census Bureau as American Indian or Alaska Native, Asian American, Black or African American, Hispanic or Latino, and Native Hawaiian or Other Pacific Islander
[2] Fairview Capital data and Preqin Q2 2016 Quarterly Private Equity Update (North American private equity)

section of the state of the market for woman and minority-owned firms. The following report is a summary of the characteristics of the universe today based on data from this set of funds.

In terms of strategy, 54% of woman and minority-owned funds in the market in the first half of 2016 were pursuing venture capital investments. This figure is up from 42% in 2015. This comports with a continuing trend in venture capital – a high rate of new firm formation, particularly by diverse managers. Venture funds are typically smaller in size (most seed and early stage strategies can be executed with funds less than $150 million in size), which makes them less daunting to raise for newer firms. In many cases, these new firms are formed through spinouts or team-ups of managers from more tenured venture capital firms. Many of the new firms continue to be "millennial-friendly" and are more reflective of, and relatable to, the entrepreneurs and markets in which they invest. The rise in woman and minority-owned firms in venture capital has also occurred against the backdrop of continued advocacy for increased gender and ethnic diversity in venture capital as well as in the technology industry broadly.

Exhibit 1: Fund Strategy



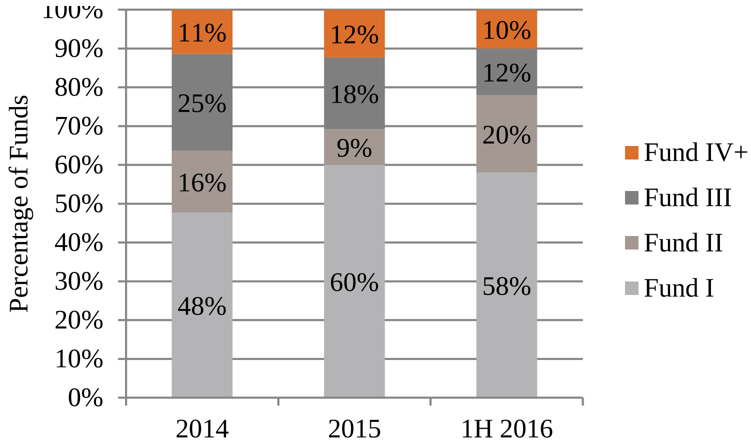
Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of June 30, 2016.

Nearly 30% of woman and minority-owned firms in the market continue to target buyout investments, the largest segment of the broader private equity universe in terms of number of firms and dollars invested. Buyout investing can benefit as much from transactional experience as relationships. This can make the transition to private equity for new diverse managers with relevant backgrounds, such as investment banking, more appealing. The vast majority of woman and minority-owned buyout funds are targeting small and middle-market opportunities. As was the case in 2015, there was again a notable increase in woman-owned buyout firms raising funds in 2016. In fact, woman-owned buyout firms represented half of the woman and minority-owned buyout firm opportunity set.

Many woman and minority-owned firms pursue other private equity investment strategies such as growth equity and debt-related investments. In the past, a sizeable portion of debt funds sought to take advantage of the U.S. Small Business Administration's Small Business Investment Company (SBIC) program, but there was a strong decline in such funds observed in the market in 2016.

Growth in the woman and minority-owned firm market equates to a rise in first-time funds. Through the first half of 2016, first-time funds represented 58% of the opportunity set – in line with what was observed for the full year 2015. While first-time funds comprise a significant

Exhibit 2: Fund Sequence



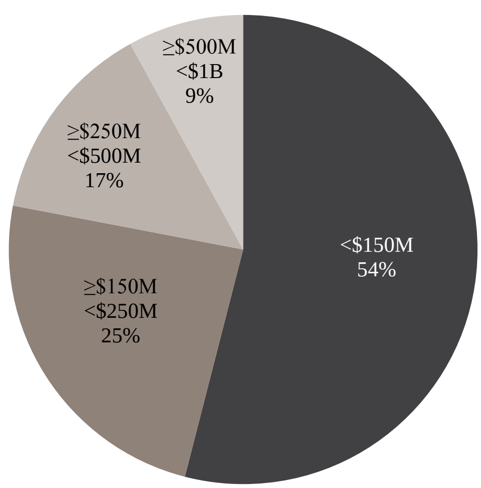
Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of June 30, 2016.

proportion of the opportunity set, it is important to note that virtually all managers tend to be experienced investors, simply investing through newly constituted firms.

Managers have been encouraged and motivated to form new firms amid what has been a relatively strong fundraising environment that has featured more receptivity towards new firms and funds. Diversity in the industry has been building for some time and many women and minority investment professionals have now advanced their careers to the point they are comfortable striking out on their own. While not all first-time funds will succeed, many are being raised by experienced investors who have previously invested and managed funds with other organizations. This fact, coupled with the ample number of experienced firms in the market, means that first-time, or even second-time, fund risk is not necessarily present when investing with woman and minority-owned firms. There remains a comparable proportion of more tenured firms in the market relative to 2015. In 2016, there was a notable increase in second-time funds, reflecting the success of prior first-time funds that have been raised and invested with managers now returning to the market with additional experience.

In general, expected fund sizes for most woman and minority-owned funds are correlated to fund sequence and strategy, reflective of observations in the broader private equity market. The average expected fund size for woman and minority-owned funds in the market through the first half of 2016 was $156 million. In aggregate, these funds were targeting $7.8 billion in capital. The broader private equity industry featured nearly 850 funds in the market over this same time period, targeting a total of $203 billion in capital – an average of $240 million per fund.[3] Part of the disparity in average fund size can be explained by the fact that the majority of woman and minority-owned firms are raising first-time funds which are typically smaller than average. Also, within the buyout segment, there are very few managers leading large and mega buyout firms – whose funds drive up the overall industry average. In the first half of 2016, Fairview did not observe any woman and minority-owned firms raising funds in

Exhibit 3: Fund Size

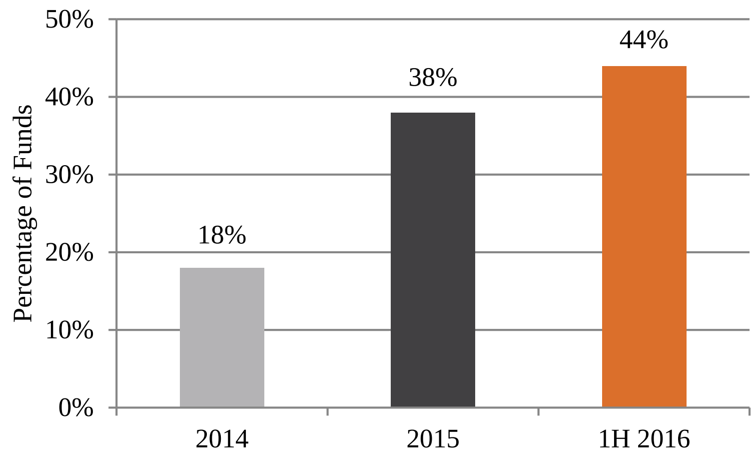


Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of June 30, 2016.

[3] Fairview Capital data and Preqin Q2 2016 Quarterly Private Equity Update (North American private equity)

excess of $1 billion. In 2015, just 5% of woman and minority-owned funds in the market were targeting a raise over $1 billion – compared to 18% of all private equity funds.

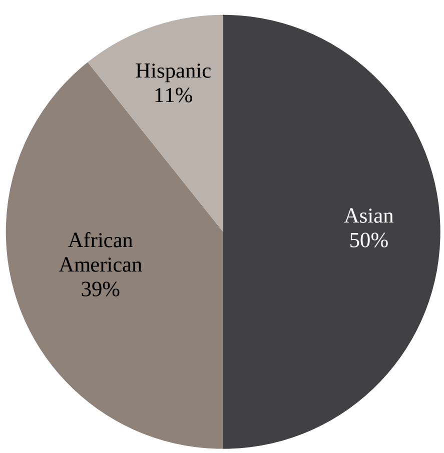
Exhibit 4: Woman-Owned Firms



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of June 30, 2016.

The ethnic and gender diversity mix within the set of woman and minority-owned firms has been constantly changing over the past few years. One notable trend has been the rise in woman-owned firms. In 2014 woman-owned firms comprised 18% of all woman and minority-owned firms in the market. In 2015, that figure jumped to 38%, and in the first half of 2016, woman-owned firms represented 44% of the opportunity set. Of the 22 woman-owned firms in the market though the first half of 2016, roughly half were pursuing venture capital strategies with the other half primarily pursing buyout strategies. First-time woman-owned funds represented 14 of the 22 firms actively in the market raising capital.

Exhibit 5: Minority-Owned Firms



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of June 30, 2016.

African American, Asian American and Hispanic managers together tend to comprise the majority of funds being raised by ethnic minority-owned firms; however, this year we have observed a significant increase in the number of Asian American-owned firms in the market – up from 30% of minority-owned firms in the market in 2015 to 50% through the first half of 2016. There has also been a moderate increase observed in African American-owned firms in the market in 2016.

Fairview's data reflects the primary diversity characteristic of each firm and fund. Recognizing gender and ethnic diversity are not mutually exclusive, additional analysis shows that at least one-third of woman-owned firms feature additional ethnic diversity amongst partners. Additionally, African American, Hispanic and Asian-owned firms tend to more often feature women partners on the team.

Geographically, as with the broader private equity universe, woman and minority-owned private equity firms tend to be headquartered in the nation's financial hubs. The top city in terms of the number of firms is New York City – not a surprise given the diversity of the city itself, as well as

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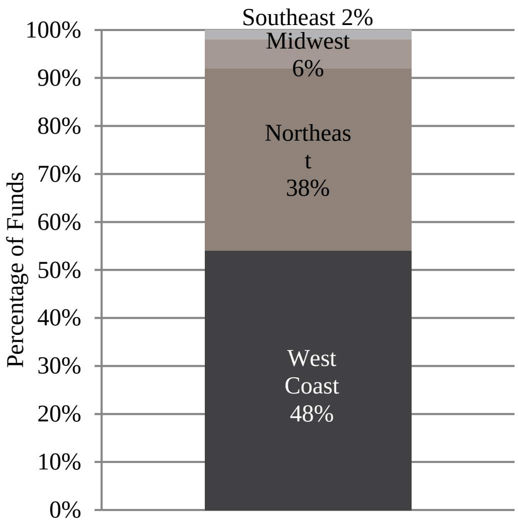
the resources, mentorship and accessibility to financial firms available to woman and minority-owned firms. The Northeast in general is home to 38% of firms in the category, with Boston and Washington, D.C. areas typically ranking behind New York City.

Exhibit 6: Firm Location



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Unsurprisingly, the West Coast, particularly the San Francisco Bay Area, is home to most woman and minority-owned firms focused on venture capital. In the Midwest, almost all woman and minority-owned firms in the market are based in Chicago and most focus on buyout and buyout-related investments – in line with the competitive advantages afforded by Chicago's financial ecosystem.

The woman and minority-owned segment of the private equity industry continues to expand at a disproportionately higher rate relative to the overall private equity market. The universe is likely to continue to expand in the coming years as woman and minority managers find themselves in leadership positions at legacy firms and continue to launch their own firms.

Despite the continued expansion of the universe and efforts on the part of some institutional investors to be more inclusive of woman and minority managers, these firms face significant challenges in raising capital and building their organizations. Too often, these managers are not on the radar of larger institutional investors and their consultants, or are associated with higher levels of risk. As has been indicated in this report, these managers certainly do not lack experience, nor does investing with them have to be linked to risks associated with investing with new firms. From a performance perspective, Fairview has ample experience building programs in the space that have outperformed the broader private equity programs of large institutional investors. These programs have helped larger institutional investors efficiently access the opportunity set, which, in addition to being overlooked, tends to feature smaller funds that are more challenging for these larger institutions to deploy capital into. Given its own history and the experiences of its team, Fairview is confident that opportunities to invest with high-quality woman and minority managers will continue to be plentiful and rewarding. We remain optimistic that these opportunities will continue to be recognized more broadly and that institutional investors will find ways to participate in this dynamic and promising segment of the private equity market.