KEYNOTE INTERVIEW

Standing out from the crowd

The highly recurring revenue profile of our businesses and the customized capital structures that we create provide downside protection but maintain upside potential similar to traditional private equity, says Thayer Street Partners' Josh Koplewicz

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Q What would you say particularly resonates with LPs when it comes to an emerging manager fund from a strategy perspective?

We focus on creating unique risk-adjusted returns for our LPs through the combination of several different characteristics of our investment strategy.

We're not a conventional buyout shop or pure-play lender. We provide flexible hybrid growth capital to lower mid-market companies that aren't a perfect fit for traditional lenders or buyout firms. Based on the needs of the business and preferences of management, we create a customized structure that may include both preferred equity and debt with warrants, or a hybrid, and often uses little-to-no third-party leverage. Sometimes we'll incorporate minimum return guarantees, negative consents or affirmative rights. These structures create downside protection for us but retain our upside participation in the company's growth and value creation.

Our structures also have benefits from the company's perspective. In terms of governance, we don't take unilateral control, we have co-control or sometimes rights typically associated with a meaningful minority interest. Unlike raising traditional debt, the company makes little or no cash payments to us in the short term, which allows them to recycle cash and reinvest more in the business to compound on growth initiatives more quickly. Unlike selling to a buyout firm, management and pre-existing owners retain significantly more of their economic upside in, and potentially influence on, the business.

We target companies in the business services, financial services, or

Q Why should companies take capital from a lesser-known manager like Thayer Street?

I've been investing in our target sectors for nearly two decades, first at Goldman Sachs, and then at Thayer Street. Our team members have similar experience at other highly regarded institutional investing platforms. Together, we've built a deep relationship base as well as meaningful expertise in these industries, particularly in issues that businesses in our target size range may face during the growth process.

Over the years, we've become an active member of the ecosystems that we invest in. As a result, in many cases, we've had the benefit of collaborative and consultative dialogues with management teams we've partnered with for multiple years before we ultimately commenced an investment with them.

We're passionate about using our knowledge and relationships to contribute to the growth and development of our partner companies. We've introduced customers, advised on building critical financial and data analytics systems and other key business infrastructure, and assisted with executive recruiting and team building strategies as they've scaled their team. If they're pursuing a roll-up strategy, we've provided hands-on assistance with sourcing, underwriting, diligence and structuring prior to them fully building out their internal M&A capability. I think our portfolio companies have acquired close to 50 or so bolt-ons in the last four years, a large portion of which we've helped with.

real estate services sectors with highly recurring revenues that are resilient, growing, and historically less correlated with most economic cycles. They often provide a critical, non-discretionary service. Growth may be driven by a secular theme, like migrating products and services to a more tech-enabled system, a change or increase in regulations, or something idiosyncratic to that subsector. For certain companies, there is additional inorganic growth potential through a roll-up of competitors, customers or contracts.

For example, one of our portfolio companies is a provider of elevator maintenance, a service that is required by law, where demand is less affected by shifts in the economy. The company has organic growth potential by acquiring new customers, and grows revenue from existing customers by enhancing the service offering and raising prices in excess of inflation. They have also been adding scale by acquiring smaller players at attractive multiples and extracting synergies.

In some cases, we'll construct a de novo platform with a management team we know well to invest alongside them. We've built de novo platforms to consolidate businesses in niche sectors, such as marinas and boat storage, and to develop specialty finance businesses with unique origination models, such as residential HVAC leasing.

We think our strategy resonates with certain LPs, because the highly recurring revenue profile of our target businesses combined with the customized capital structures we create provide downside protection but maintain similar upside potential as more traditional private equity, while still using little, if any, third-party leverage.

Q Why should investors be open to backing emerging managers?

Based on my experience, investment managers in the early stages of their lifecycles often have more hustle and scrappiness in both identifying investment opportunities and helping portfolio companies execute their growth plan. Newer managers are also potentially less constrained by legacy bureaucracies or internal investment committee politics.

Early-stage managers generally have less of a need and bias to target larger companies, which are usually more competitive and expensive. We target investments of between $10 million and $75 million in businesses with enterprise values of between $50 million and $250 million. Investment opportunities of this size in the lower mid-market, particularly non-buyout

capital raises, often don't have a bulge bracket investment bank running a wide-reaching and fully-optimized auction process. To date, we haven't invested in any deals from banker-led auction processes; all of our deals have been sourced through direct relationships that we've cultivated over time.

By staying nimble and allocating capital down-market to smaller deals, we've found some inefficiencies on price, higher potential to add value, and longer runways for businesses to scale.

Independently of the specifics of our investment strategy, we believe some LPs are excited about the benefits of investing with a smaller firm that can provide lower middle market exposure. Also, certain LPs appreciate having greater access to data and insights into the manager's portfolio companies. The level of transparency and partnership available with an emerging manager may not exist at larger firms where LPs may be interfacing with only the business development or investor relations groups.

Q What approach did you take to your early fundraisings and what were your experiences?

The firm began by doing deals on a one-off basis through SPVs, without the benefit of a committed fund. When we first started the business, our relationships, specific industry knowledge and potential value-add were compelling enough to afford us investment opportunities even though we didn't have standby capital.

As our SPVs matured, we continued to build relationships with our LPs, who saw us in the trenches identifying opportunities and driving value. Many of these LPs committed to our first comingled fund and recommitted to our second comingled fund. The existing LPs provided not only a strong foundation as we progressed through the fundraises, but also guidance and feedback along the way.

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The process has been fairly organic. We simply focused on executing our core strategy successfully and, through that, cultivating relationships with LPs.

Q Is the ability to offer co-investment important for getting a newer fund underway?

I wouldn't say that we built or adjusted our co-investment strategy to help fundraise, however, it remains a consistent and robust part of our business and does often have benefits for LPs. We've found that some LPs prefer to collaborate with us on a co-investment deal prior to committing to our commingled fund. Other LPs want to scale their fund capital allocation via co-investments to the specific deals that they find most attractive.

For our portfolio companies, the co-investment platform allows us to double or triple our capital commitment beyond our funds' initial commitment. We can provide capital to them on an ongoing basis over a long time period as the company scales. This enables management to avoid the distraction and risk of raising money from new investors during critical periods of growth and allows them to focus solely on running their business.

Q What do you anticipate for your third fundraising, as you graduate out of what many LPs would define as the emerging manager category?

We are currently focused on deploying our second fund, and we are not actively fundraising. As we consider our next (third) fund, I imagine that we'll primarily continue to execute the very same strategy that has been successful for us historically, and continue to focus on the same sectors, investment types and investment sizes. As we sit here today, we're expanding our capabilities to add value to our portfolio companies, and I'm hoping that we'll continue to progress in that area. ■