
Motion:

That the Nebraska Investment Council (the Council) for the Defined Benefit Plans and Cash Balance Benefit Plans make a \$50 million commitment to Genstar Capital Partners IX, L.P. (Fund IX) subject to completion of a legal review and satisfactory agreement of terms.

Background

Genstar Capital Partners LLC (Genstar) is a private equity manager. In 1989, Genstar raised \$100 million to complete leveraged buyouts of industrial companies. In 1995, current CEO Jean-Pierre “J-P” L. Conte joined the firm and added more growth sectors. As of June 30, 2018, from Fund II (1996) to Fund VIII (2017), Genstar has invested \$7.5 billion resulting in \$15.5 billion in realized proceeds and unrealized value. In total, Genstar funds have a 38.7% Net IRR and 1.8x Net Multiple of Cost. The Council committed \$50 million to Fund VIII in 2017.

Council Staff (Staff) conducted an analysis of the investment opportunity that Fund IX possesses. The analysis included various attributes of Genstar and its funds, team, strategy and process, sourcing, exits, performance; and, terms and conditions. Staff utilized due diligence materials provided by Genstar and Aon Hewitt (Aon).

Team

- Genstar has an investment staff of 20. There are six Managing Directors (MD) (CEO J-P Conte, President J. Ryan Clark, Rob Rutledge, Anthony “Tony” Salewski, Eli P. Weissand and Katie Solomon). Ms. Solomon’s role is to identify and acquire talent to spur growth across the portfolio. Each of the other MDs has an industry specialization. The team includes two Directors and three Principals. There are also two Vice Presidents, with three more starting soon. This grouping of the team has been very stable in terms of tenure. This stability has led to an apprenticeship system at Genstar. Additionally, there are six Associates and one Senior Associate. Typically, Associates have a two-year life and incumbents move on. Genstar identifies associates who will have standing offers upon completion of business school. The Senior Associate is an exceptional third year.
- The Strategic Advisory Board (SAB) has 25 members who are former operating executives in one of Genstar’s four industry verticals. These verticals are Software, Financial Services, Industrial Technology and Healthcare. SAB members help source deals, assist in diligence of target companies and manage companies post-acquisition. They do this serving on boards and acting as advisors to both management and the investment team. This affords SAB members to remain relevant. SAB members’ activity is exclusive to Genstar.

Investment Strategy and Process

- Genstar employs a “Buy and Build” strategy that benefits from a methodical and repeatable process. This process includes developing investment theses for each industry vertical. The finalized theses must be clearly actionable. The investment team works with SAB members to identify target portfolio companies, often through their networks. These targets are middle market firms with certain “quality” factors. Quality includes revenue predictability, barriers to entry, competitive positioning cash flow characteristics, lack of customer dependability, return on capital, margin and the health of the market that the target operates within. Genstar is a control investor that pays market rates to buy its platform companies and then will buy more businesses to add onto its platform holdings. A key part of Genstar’s process is add-on investments. These give the platform companies growth and scale, while, typically, lowering the average cost of the platform company.
- Talent management is another key differentiator of Genstar’s strategy. Katie Solomon, MD and Director of Human Capital recruits and hires executives for fund companies. Genstar stated to Staff that it changes top management 85% of the time. A key tool is Genstar’s evaluation card used to rate its top managers of the platform companies. Senior managers are evaluated against operating results plus the incumbent’s ability to drive results; build teams & relationships; and setting & communicating strategy.
- SAB members are included in efforts to manage and advise on operating efficiency. Genstar views exits as a skill. To this end, SAB members and management work together to develop exit strategies and work toward the exit.

Critical View

- Fund IX's size is a concern. Fund VIII was \$3.3 billion. At \$5.0 billion, Fund IX will be 52% larger than the last fund. There will also be a \$1.0 billion co-investment fund along with a \$350 million GP Commitment. Genstar feels it will invest in similarly sized and slightly larger companies. It took Genstar approximately two years each to deploy its capital from Fund VII and VIII. At this rate and with similarly sized investments, Fund IX will just take longer (approximately 3.5 years) to deploy its capital.
- The prices that Genstar pays for platform investments is a concern. Purchase multiples have increased from Fund VI (8.6x EBITDA avg.) to Fund VII (10.9x avg.) to Fund VIII (13.1x). Basically, Genstar pays market rate for its platform companies and adds growth by using add-ons. These add-ons come cheaper, thus lowering the cost of the platform. This is Genstar's strategy and they have performed well over a variety of market environments.
- In the last five years, Genstar has lost three senior investment team members: an MD retired in 2016, and two Principals left the firm. One left in 2014 and the other in 2016.

Performance (As of June 30, 2018)

	<u>Vintage</u>	<u>Net TVPI</u>	<u>Net IRR</u>
Fund III	2000	2.7x	29.5%
Fund IV	2004	1.5x	8.9%
Fund V	2007	2.1x	15.2%
Fund VI	2012	2.5x	38.6%
Fund VII	2015	1.6x	31.5%
Fund VIII	2017	1.2x	28.9%

Terms and Conditions

- Management fee is 1.75% of commitments in the investment period. The investment period is 6 years. The management fee is 1.75% on invested capital thereafter.
- Carried interest is 20% and the preferred rate of return is 8%.