KEYNOTE INTERVIEW

Underpinning emerging GPs' growth

Next-generation managers may be an acquired taste for asset owners, but the potential for alignment can create attractive GP opportunities, according to Wafra's Adel Alderbas and Gustavo Cardenas

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Q How would you describe the development of the GP stakes market over the past 15 years, and what kind of approach has that required?

Adel Alderbas: As the world of GP stakes is still a relatively young market, it really pays to be a lifecycle investor, providing solutions to investor entrepreneurs throughout their development. For instance, over the past 10 years, we have been able to participate across the different life stages of asset managers and provide the various tools that firms might require.

Investing in GP stakes might mean backing funds when they are early in their journey and need seed capital; when they are more mature and looking for accelerant capital to propel their success; or further down the line when they might need support from investment capital as they look to institutionalise and evolve the business for the next generation.

Right now, of course, there is a lot of demand at both ends of the spectrum, both because next-generation funds are seeing an investment opportunity set that is ripe for them to launch into, and because of the challenges in the fundraising environment for established firms. Sometimes funds simply need additional backing to address the particular challenge they face, no matter where we are in the macroeconomic cycle.

In our case, we believe that the congestion we have seen in the more established part of the GP stakes market really boosts the value of capital invested in an emerging manager. Indeed, the larger part of the GP stakes market has become heavily intermediated of late. That's not necessarily a problem; more market participants coming in – whether GPs, investment banks or financing

Q How do GP stakes transactions help set up newly launched firms for long-term success?

AA: The best investor entrepreneurs view GP stakes as a tool to get their business off the ground and institutionalised in a speedier fashion. We are looking to build businesses that will outlive the initial holders and create enterprise value, and that is a mindset that an investor can bring to the table and really help develop.

By transacting at the pace of a GP, but with the DNA of an asset owner, we are able to help our GPs understand how the various investors in our network think and allocate.

GC: It's all about helping managers understand how LP capital operates. Capital is the lifeblood of these managers, and we can provide that support and help them navigate a route to appropriate growth.

It's also a question of helping emerging GPs avoid common mistakes. For instance, a GP stakes investor can help a firm think about things like compensation and alignment with the team, what it takes to build best-in-class LP communication and reporting, when to use a placement agent in a certain jurisdiction, and so much else.

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ADEL ALDERBAS

providers – ultimately creates a healthier environment for further investments and exits as the market matures.

The next-generation manager side of the market, by contrast, is characterised by less competition and more alignment between those investor entrepreneurs, GP stakes investors and LPs. This market is structurally disintermediated too, which means using your network to source deals directly when managers are at the start of their thinking. These conversations are often highly confidential and privileged, as the investor in question may still be in their current seat. But for us, that simply means there's a higher barrier to entry, and we are able to curate differentiated returns as a result.

Typically, these individuals are leaving behind big shops and established economics, so the potential for tailored alignment is extremely attractive on all sides. Asset owners have historically been reluctant to allocate to first-time funds, but providing a multiplier on their cheques helps to create a really valuable proposition.

Q How have market conditions affected emerging managers lately?

Gustavo Cardenas: The desire to start your own firm is something we have found to be really acyclical. Last year we closed four transactions to help launch new asset managers, at a time when market conditions were generally considered to be difficult. In fact, people want to align with something that they are helping to create, and they want to build new strategies. Despite the market conditions, entrepreneurs are actively deciding to start something new.

We've been doing GP stakes for well over a decade, so our position in the market means that we get a good insight into what LPs are looking for, allowing us to target emerging managers that we know will get good support,

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whether that is in energy transition or technologies sectors, for example.

Through Capital Constellation, our platform focused on next-generation investor entrepreneurs, founded in partnership with a group of institutional asset owners, we aim to evaluate all the new GPs being formed each year where there is an opportunity to help accelerate their asset management businesses. The LPs we work with on this are very actively engaged with the underlying firms, because they themselves are looking to build their emerging manager exposure. That connectivity is essential.

Q What are the attributes that GP stakes investors should look for when seeking an emerging manager to back?

AA: Finding investors to back is a science, which involves looking at track record and how past deals have performed. But identifying a genuine entrepreneur within that space is more difficult, and that is an art that requires fine-tuning over time.

There are a lot of great investors out there, but there are not a lot of great entrepreneurs that can also build businesses. As GP stakes investors, we are looking for that special someone that can build a thriving enterprise and has the courage to leave a comfortable place and the humility to seek out others. There is a lot of hard work involved beyond investing in building their own business, managing people and investors, and doing all the other less flashy things that a lot of investors do not really want to do.

GC: The point of differentiation we are looking for is an investor who understands that the investments they are making sit within somebody else's portfolio. What they are doing for the LP's portfolio is critical, and so is how they operate within the broader ecosystem. A lot of investors fail to understand that nuance.

Q Which market segments and geographies are currently home to the most promising emerging managers?

GC: Both North America and Western Europe have historically been core geographies, with the US accounting for about two-thirds of our investments. In terms of geographies, both markets are busy; what is perhaps more interesting is where certain segments have tailwinds that are creating a niche for asset managers and asset owners.

One example is energy transition, where we find asset owners looking for more opportunities. We conducted a white paper in 2023 and found some great managers emerging in the energy transition space, and have since done the same in the sports and secondaries segments. We have found that outbound searches result in better opportunities.

AA: There is a deep focus on differentiated strategies and the right to win. We always ask ourselves why the world needs another private equity firm. Funds need to have differentiated strategies, and we test those out with our network of asset owners.

A great example of that is the last investment we executed, with a newly established private equity firm called Niobrara Capital, focused on investing in technology and technology-enabled services businesses in both the US and Europe. In that case, we are backing an investor entrepreneur called Chip Schorr, who is a pioneer in technology investing with more than three decades' experience, working alongside fellow tech veteran Todd Bradley and Mike Pompeo, the former US secretary of state.

We had been talking to Chip about his idea for a firm for more than a decade, and we recently backed him launching his fund. He is focused on a number of themes we like, namely trends around AI and onshoring. His first deal was for a semiconductor manufacturing facility in Minnesota, and he has a really differentiated value proposition.

That's what we – and LPs too – ultimately need to see in order to have confidence to invest in a next generation manager.

Q What is the outlook for GP stakes investing in emerging managers?

GC: We continue to be bullish on the market and excited about what we see happening. There is a growing acceptance of GP stakes investing, and when we back these investor entrepreneurs there is a recognition that we are creating a future supply of firms writ large. The whole market is excited about the lifecycle approach of providing value to GPs throughout their growth journey. ■

Adel Alderbas is chief investment officer and Gustavo Cardenas is managing director at Wafra