

Woman and Minority-Owned Private Equity Firms

A market update and review of woman and minority-owned private equity firms actively raising capital in 2017 based on data collected by Fairview Capital

January 2018

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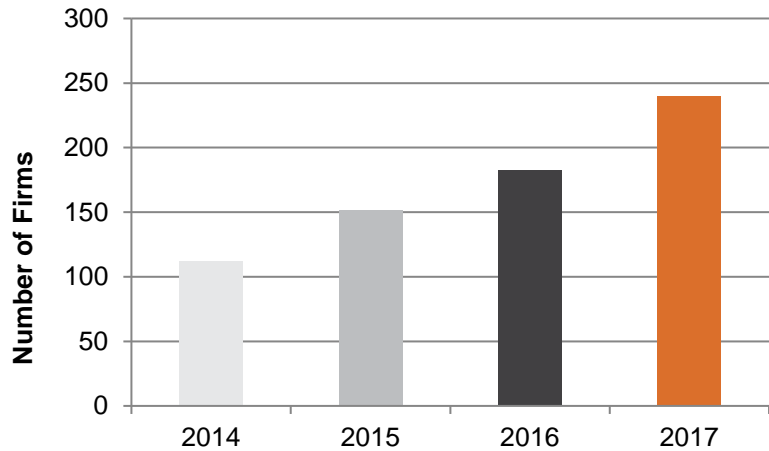
Fairview Capital's Market Review of Woman and Minority-Owned Private Equity Firms

The universe of woman and minority-owned private equity firms grew and evolved significantly in 2017. The number of woman and minority-owned private equity firms rose to 240 at year-end, up from approximately 185 at the end of 2016. The increase represented the largest ever in a one-year period since Fairview began tracking data on diverse firms. The universe has more than doubled over the past three years.

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

We identified 114 woman and minority-owned firms actively raising capital in 2017. In aggregate, these firms still represented less than 10% of all private equity firms in the market during the year.¹ As one of the most active investors with diverse managers, Fairview conducted due diligence on virtually every institutional quality woman and minority-owned firm in the market in 2017, providing the Firm a unique vantage point.

Exhibit 1: Universe of Woman and Minority-Owned Private Equity Firms



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2017

This past year, we observed the acceleration of trends that emerged over the last few years. In particular, a high rate of new firm formation as experienced women and minorities launched firms at a record pace. At the same time, there are now more established, tenured woman and minority-owned firms than ever before. We find that many of the woman and minority-owned firms in the market feature strong track records, compelling strategies, truly differentiated approaches, and meaningful competitive advantages.

In late 2017, The National Association of Investment Companies (NAIC), with assistance from KPMG, published "Examining the Returns: The Financial Returns of Diverse Private Equity Firms," a research report that provides insights on the investment returns generated by diverse-owned private equity firms in the US. The report found, consistent with previous studies, that diverse-owned private equity firms outperformed their relevant benchmarks. This data is consistent with Fairview's experience.

* 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

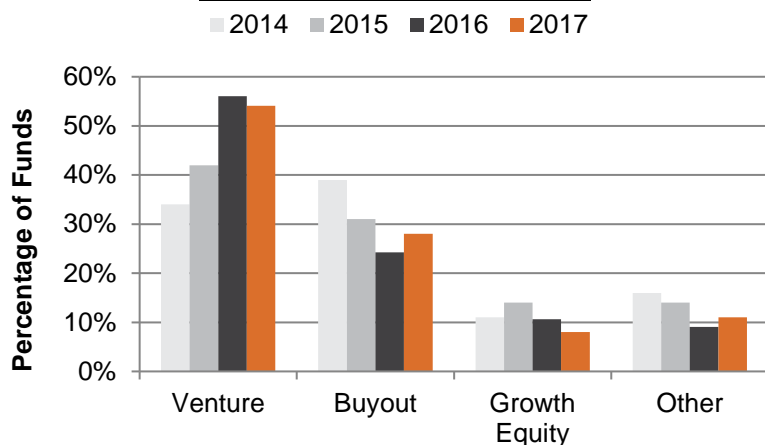
¹ Fairview Capital data and analysis, Preqin Q3 2017 Private Capital Fundraising Update

Awareness of the diverse manager opportunity set continued to grow in 2017, with increased social awareness, advocacy, and numerous studies and events designed to highlight the opportunity set. Despite these efforts, women and minority-owned funds continue to be significantly underrepresented in the portfolios of institutional investors, and traditional capital allocation processes remain challenged when it comes to inclusion. Further, most diverse firms remain below the radar of institutional investors and their consultants given their typically smaller fund sizes and the often-non-traditional fundraising approaches many managers take.

As diversity becomes increasingly critical in private equity and venture capital, limited partners play a uniquely influential role. Many sophisticated institutional investors have recognized that this segment of the market has been too often overlooked by their traditional capital allocation processes and have been proactive about change. Fairview has found that the implementation of a deliberate, programmatic approach often is most effective in achieving portfolios featuring more diversity. Given the high rate of new firm formation by diverse managers, even a “next generation” manager program targeting new firms and small funds will inherently feature significantly more diversity than the broader private equity portfolios of institutional investors.

Currently, Fairview manages several “next generation” mandates that include woman and minority-owned firms for public pension plans across the country. The goal of all of these programs is to achieve outperformance relative to the larger private equity universe. Given the firm’s level of activity and involvement in the space, Fairview maintains one of the largest databases on woman and minority-owned firms in the industry. The 114 woman and minority-owned firms that Fairview observed actively raising capital in 2017 are a strong representative cross-section of the state of the market for woman and minority-owned firms. The following report is a summary of the characteristics of the opportunity set today based on data from this group of funds.

Exhibit 2: Fund Strategy of Woman and Minority-Owned Firm in the Market



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2017

Investment Strategy

Regarding strategy, 54% of woman and minority-owned private equity funds in the market in 2017 were pursuing venture capital investments. This figure is down slightly from 2016 but still comports with a continuing trend in venture capital – a high rate of new firm formation, particularly by diverse managers. Venture capital funds are typically smaller (most seed and early-stage strategies can be executed

with funds smaller than \$150 million), which makes them less daunting to raise for newer firms. 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.

A major storyline in venture capital in 2017 was the topic of sexual harassment, sexism and inappropriate conduct by venture capitalists. The revelation of these issues has led to the upheaval of firms and brought a longstanding problem to the forefront. In the face of these challenges, there has been a rapid rise in the number of woman-owned venture capital firms. In 2017, there were 24 woman-owned venture capital firms in the market raising capital, 15 of which were first-time funds.

Limited partners play a critical role in shaping culture at firms by way of their capital allocation processes and influence. Weak diligence in the area of firm values and conduct or willingness to overlook shortcomings should not be tolerated by the institutional investor community. Limited partners can address the topic formally through channels such as partnership advisory boards. Of course limited partners can also empower women in leadership roles and now, more than ever before, there is ample opportunity to back firms that feature gender diversity. Critical to sourcing these opportunities is having the relevant affinity networks in place to identify the best talent.

In general, newer venture capital firms tend to be significantly more diverse and, in turn, are much more likely to back diverse entrepreneurs. In 2016, Fairview conducted a review of the portfolios of woman and minority-owned venture capital firms committed to during the year and found that an average of 63% of their investments were with companies featuring women and/or ethnic minority founders or co-founders (without this being an explicit part of the strategy). It remains clear that one way in which institutional investors can support diversity in the technology sector is supporting woman and minority-owned venture capital firms.

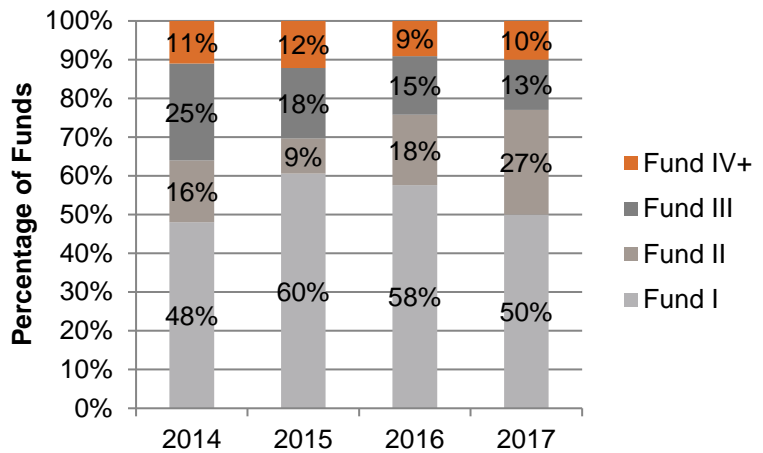
Just over 28% of woman and minority-owned firms in the private equity market in 2017 targeted buyout investments, the largest segment of the broader private equity universe regarding the number of firms and dollars invested. There was also a notable increase in new buyout firm formation. In fact, nearly half of the woman and minority-owned buyout firms in the market in 2017 were first-time funds, five of which were woman-owned firms. Similarly to what we have seen in venture capital, we find a much greater proportion of new buyout firms to be led by women and minorities.

The vast majority of woman and minority-owned buyout funds in the market in 2017 featured teams with track records of working together and in many cases teams spun-out of larger buyout firms. Most woman and minority-owned buyout firms feature targeted strategies, often focused on small and middle-market opportunities.

Firm Tenure and Fund Sequence

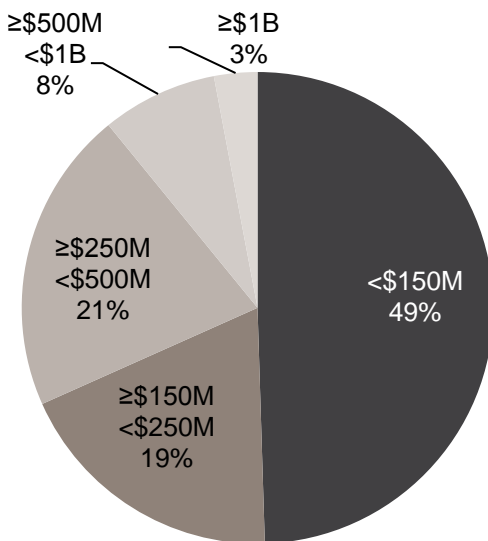
Growth in the woman and minority-owned firm market is directly correlated to new firm formation. The majority of the opportunity set over the past few years has been comprised of first-time funds being raised by new firms. In 2017, 50% of woman and minority-owned firms in the market, 57 firms, were raising first-time funds. While the proportion of the opportunity set that is first-time funds declined relative to the prior two years, on an absolute basis, we have witnessed a clear increase in new firms. Additionally, many firms who are raising second-time funds, 27% of the opportunity set in 2017, entered the institutional market for the first time following first funds often structured as smaller, “proof-of-concept” vehicles. Approximately one-third of second-time woman and minority-owned firms in the market in 2017 would fall under this category. The vast majority of new firms in the market feature experienced investors with track records developed at larger, more well-established firms. Many of the new firms are “millennial-friendly” and are more reflective of, and relatable to, the entrepreneurs and markets in which they invest.

Exhibit 3: Fund Sequence of Woman and Minority-Owned Firms in the Market



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2017

Exhibit 4: Fund Size of Woman and Minority-Owned Firms in the Market



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2017

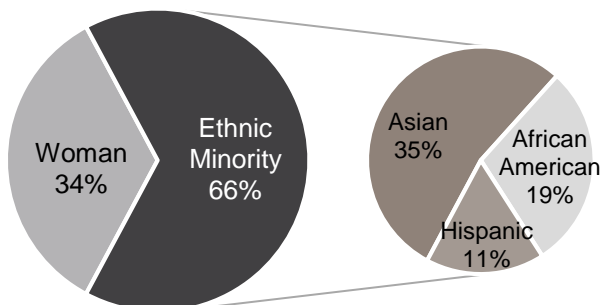
Another major storyline in 2017 has been the rise in experienced, tenured woman, and minority-owned firms in the market relative to prior years. Institutional investors often associate lack of experience as a risk related to diverse managers – this is simply no longer the case.

Fund Size

In general, expected fund sizes for most woman and minority-owned funds are correlated to fund sequence and strategy, reflective of trends in the broader private equity market. The average expected fund size for woman and minority-owned funds in the market in 2017 was \$223 million, up from \$191 million in 2016. In aggregate, these funds were targeting \$24.7 billion in capital. The broader private equity industry featured

an average target fund size of over \$374 million through the third quarter of the year.² 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. Smaller than average fund sizes also explain why diverse managers are often below the radar of many institutional investors and their consultants.

Exhibit 5: Ethnic and Gender Diversity of Woman and Minority-Owned Firms in the Market



Ethnic and Gender Diversity

The ethnic and gender diversity mix within the set of woman and minority-owned firms has constantly been changing over the past few years. One notable trend has been the rise in woman-owned firms. In 2014, woman-owned firms comprised just 18% of all woman and minority-owned firms in the market. In 2017, that figure had jumped to 34%.

Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2017

African American, Asian and Hispanic managers together tend to comprise the majority of funds being raised by ethnic minority-owned firms. Continuing a trend from 2016, we have observed a moderate increase in the proportion of Asian-owned firms in the market. There has also been an increase in the absolute number of African American and Hispanic-owned firms. These firms tend to be more concentrated in the buyout and growth equity segments. However, we see early signs of growth in the venture capital industry – in particular, there were nine African-American-owned venture capital firms in the market in 2017, a record.

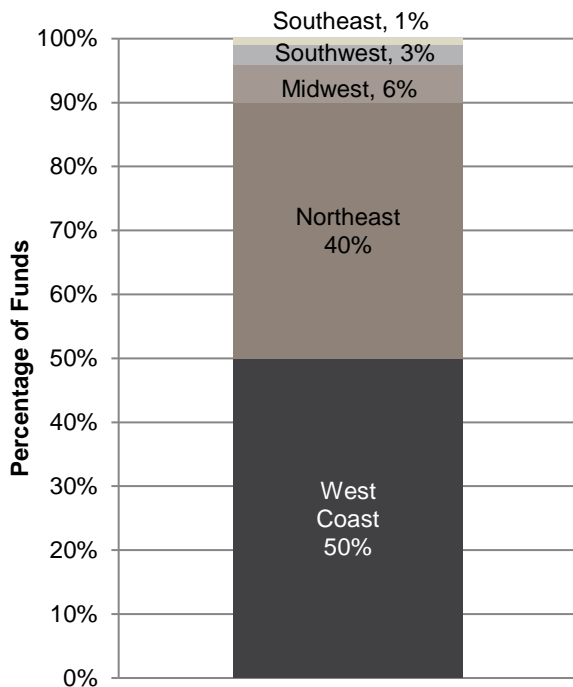
Fairview’s data reflects the primary diversity characteristic of each firm and fund. Recognizing that gender and ethnic diversity are not mutually exclusive, additional analysis shows that close to one-third of woman-owned firms feature additional ethnic diversity amongst partners. The reverse is also true – African American, Hispanic and Asian-owned firms are much more likely to feature women partners on the team.

Firm Geography

Geographically, as with the broader private equity universe, woman and minority-owned private equity firms continue to tend to be headquartered in the nation’s financial hubs. In recent years, there has been an increase in the number of woman and minority-owned firms being formed in the San Francisco Bay Area. The vast majority of these firms are pursuing venture capital investments. In the Northeast, New York is home to a large proportion woman and minority-owned firms – not a surprise given the diversity of the city itself, as well as the resources, mentorship, and accessibility to financial firms available

² Fairview Capital data and Preqin Q3 2017 Private Capital Fundraising Update

Exhibit 6: Firm Geography



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2017

to woman and minority-owned firms. New York-based firms tend to be diverse in terms of strategy, featuring a strong mix of buyout, venture, growth, and debt-focused firms. Boston and Washington, D.C. typically come in behind New York in terms of the number of women and minority-owned firms.

In the Midwest, woman and minority-owned firms tend to be based in Chicago, and most focus on buyout and buyout-related investments – in line with the competitive advantages afforded by Chicago’s financial ecosystem.

Summary

The woman and minority-owned segment of the private equity industry continued to expand at a disproportionately higher rate relative to the overall private equity market in 2017. The universe is likely to continue to expand for the foreseeable future as woman and minority managers find themselves in leadership positions at tenured 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 continue to 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 erroneously perceived to have higher levels of risk. As has been indicated in this report, there is a larger opportunity set, and many of these managers certainly do not lack experience.

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 history and the experiences of the team, Fairview is confident that opportunities to invest with high-quality woman and minority managers will continue to be plentiful and rewarding.

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