

Buyouts

www.buyoutsnews.com

YOUR SOURCE FOR LEVERAGED AND MANAGEMENT BUYOUTS

FIRM PROFILE: GROVE STREET SCOURS GLOBE FOR VERY BEST FUNDS

By Tom Stein

If you're flying from Boston to Bangalore, don't be surprised to bump into someone from **Grove Street Advisors**.

Over the past several years, this so-called gatekeeper, which manages about \$4.5 billion on behalf of a handful of large institutional investors like the **California Public Employees Retirement System** and the **Oregon Public Employees' Retirement Fund**, has taken an increasingly global approach to buyouts.

In any given week, you can find at least one of Grove Street's 11 partners and associates trekking to India, China or Europe in quest of new opportunities. Approximately half of the \$550 million the firm will commit to buyouts and growth equity this year will go to funds based abroad, with the other half remaining in North America.

Grove Street believes in accumulating a lot of miles to better understand the world. "We are based on airplanes," said General Partner **Catherine Crockett**. "For us, this is preferable to having individual partners devoted to a particular region. We want everybody in the firm to be able to debate the merits of an investment and hold it to the same global standard."

Why the need to go global? Crockett said that the firm is trying to invest in the very best funds, period, whether they are based in New York or New Dehli. For instance, Grove Street recently made the decision to back the India Value Fund because it features a team that combines some of the best investment professionals in that country and seasoned managers with top-notch operational experience.

By investing globally, Grove Street also adds a strong dose of geographic diversification to its portfolio. "To a certain extent, GDP growth

Name: Grove Street Advisors

Location: Wellesley, Mass.

Founders: Catherine Crockett, Clint Harris, Dave Mazza

Assets Under Management: \$4.5 billion

Representative Clients: CalPERS, Oregon Public Employees' Retirement Fund, Finland's Local Government Pensions Institution

Commitments To Buyout/Growth Equity Funds This Year: \$550 Million

cycles from region to region do not always move in parallel," Crockett explained. "We see real benefit in blending regional private equity cycles with and against each other."

Fast Growth

Grove Street, founded by **Clint Harris, Dave Mazza** and Crockett, has come a long way since its formation nearly ten years ago. The firm got started in 1998 when it signed on CalPERS as its very first client. CalPERS selected Grove Street over some 16 firms to manage a \$350 million pool targeting venture capital.

"We selected Grove Street for a variety of reasons," said **Barry Gonder**, who at the time

was the senior investment officer at CalPERS. "Not only did the partners have great experience and relationships in private equity, but there was a real alignment of interest. The partners were willing to invest their own money alongside ours, and they agreed to have a proportion of their compensation tied directly to the performance of the program."

Gonder, who has since left CalPERS, is now a general partner at Grove Street. Today, the firm has eight major clients for whom it builds customized portfolios. For example, Grove Street has one program that invests \$125 million in U.S. venture firms on behalf of Finland's **Local Government Pensions Institute**. It has another \$100 million program for a family office that targets all segments of private equity.

CalPERS has been so pleased with the performance of Grove Street that it now has four separate investment programs with the firm totaling \$3.1 billion. To date, the first three Grove Street funds have returned about 1.2 times the amount invested between realizations and an estimate of unrealized value—an extraordinary track record for a venture-capital-heavy portfolio launched in the late 1990s. Starting in 2001, CalPERS expanded Grove Street's mandate beyond venture capital to include buyouts and growth equity.

Last year, Grove Street split its total investments 50/50 between venture and buyouts, but this year buyouts will account for about 60 percent of the allocation pie. "We are willing to take on capital as the market opportunities present themselves, but we don't want to take on more capital than makes sense if we can't invest with the best managers," Crockett said. "It is fair to say that we are allowing the buyouts portion

FIRM PROFILE: GROVE STREET SCOURS GLOBE FOR VERY BEST FUNDS

to grow more than we are allowing the venture segment to grow.”

Emerging Managers

Grove Street’s buyout sweet spot is not the brand-name mega-funds like **The Blackstone Group**, but smaller mid-market and emerging funds that are much harder to identify. “We need to do something for our clients that they can’t easily do themselves,” General Partner **Frank Angella** explains. “They don’t need our help finding the KKR’s of the world, which they can invest in directly.” Instead, Grove Street’s value and purpose come from directing its clients to the best smaller firms, which often requires taking hundreds of meetings and kissing “a lot of frogs” before finally finding Prince Charming.

Indeed, the firm prides itself on investing early in smaller, relatively unknown funds that eventually become the hot teams that every limited partner wants a piece of. Some emerging funds identified by Grove Street that have gone on to do very well include **New Mountain Capital**, **KPS Capital Partners**, and **Lime Rock Partners**. Grove Street invested in New Mountain’s debut fund, and began investing with KPS and Lime Rock on their second funds.

There’s another reason why Grove Street prefers to back smaller buyout funds. “We think funds at the smaller end of the market can buy companies more cheaply,” Gonder said. “It’s easier to take a company with \$100 million in revenue and turn it into \$300 million, than it is to take a billion dollar company and turn it into \$3 billion.”

Creating such value is a theme you’ll hear often when speaking with Grove Street. “We

tend to like buyout funds that are focused on value creation in the enterprise and that may or may not use leverage,” Crockett said. The firm looks for groups with strong management teams that have a history of generating high returns by creating underlying value in portfolio companies, rather than leveraging them up and going for a quick flip.

However, there have been times over the past few years when Grove Street has second-guessed its approach. After all, some of the most eye-popping IRRs have been posted by funds that voraciously feed on leverage. But now that the debt markets have contracted, the partners at Grove Street feel confident their strategy has been the correct one.

So what does it take to get some of Grove Street’s money? “That’s simple,” Gonder replied. “Great returns and a strategy that will continue to make great returns.” Joking aside, he said that the firm favors teams with a niche orientation or specific strategy, but that are flexible and intelligent enough to change course during the life of the fund if circumstances require.

Are there any types of funds or specific opportunities the firm is pursuing? “Distressed is sounding pretty good,” Crockett said. Even better, Gonder adds, is turnaround distressed because Grove Street likes to focus on cash-on-cash multiple returns. “We love groups that can go in and help fix a company on an operational basis and really turn it around,” he said.

Grove Street believes there are only a limited number of groups that can do distressed equity well because it requires such a unique orientation and skill set. “But it’s a segment

we like a lot, so our eyes are always open for teams that can do it well,” Crockett said.

The firm’s most recent distressed investment is the WL Ross India Asset Recovery Fund. Grove Street has also backed **Wynnchurch**, which doesn’t really invest in distressed equity but does invest with companies requiring very significant restructuring.

Another burgeoning focus area is the smaller end of the European market, which Grove Street believes is sorely underserved. “The mega-funds in Europe have taken the lion’s share of the capital, but in each region you can still find one or two really good smaller firms,” Gonder said. Smaller European funds backed by Grove Street include **Aitor** since fund I, **Arcadia**, **Bowmark Capital**, **HIG Europe**, **i2 Capital**, **Rhone Partners** since fund II, and **Sinergia**.

The Grove Street partners are having the time of their lives, but they do admit to a few bad days. “The worst part of the job is turning down a fund manager you’ve been with for two or three funds but you just don’t think they will continue to pump out the returns, either because they have gotten too big or their strategy has changed for the worse or they have had some personnel changes,” Gonder explained. “It’s the worst part of the job but probably one of the most critical—knowing when to stop backing a fund manager who has done well for you in the past.”

And the best part? Said Crockett: “Knowing that we did some things that were contrarian and outside the mainstream, but seeing those decisions come together in a way that makes sense and delivers great returns for our clients.” ♦

Select PE Fund Winners Backed By Grove Street *

Fund	Vintage Year	Capital Committed	Cash In	Cash Out Plus Remaining Value	Net IRR	Investment Multiple
TA IX, L.P.	2000	\$61,500,000	\$59,655,000	\$113,218,734	23.8	1.90x
Quadrangle Capital Partners LP	2000	\$50,000,000	\$38,181,117	\$64,004,339	13.9	1.70x
New Mountain Partners LP	2000	\$100,025,000	\$82,952,949	\$133,546,191	19.7	1.60x
Lake Capital Partners LP	2002	\$10,000,000	\$7,896,071	\$12,725,535	30.1	1.60x
Audax Private Equity Fund LP	2000	\$100,000,000	\$99,999,999	\$153,443,179	13.9	1.50x
Rosewood Capital IV LP	2000	\$50,000,000	\$31,424,851	\$46,597,880	11.6	1.50x

* Backed as part of California Emerging Ventures program managed on behalf of California Public Employees’ Retirement System; numbers reflect estimated performance through June 30 and don’t reflect future performance

Source: California Public Employees’ Retirement System