

LP PROFILE: ADAMS STREET SEES TALK AS KEY TO DUE DILIGENCE

By Nancy Gordon



Hanneke Smits

Assets Under Management: more than \$20 billion

CIO: Hanneke Smits is responsible for formulating global investment strategy. She also oversees primary and secondary investments globally.

Select Clients: Chicago Firemen's Annuity and Benefit Fund; Employees' Retirement System of the County of Milwaukee; Illinois State Universities Retirement System; Louisiana State Employees Retirement System; Montana Board of Investments; Montgomery County (Maryland) Employee Retirement Plans; Ohio Police & Fire Pension Fund; Orange County Employees Retirement System

Offices: Chicago, London, California and Singapore

Staff: Adams Street has more than 100 employees worldwide. In the United States, the firm has six professionals dedicated to selecting primary partnerships. They oversee about 70 GP relationships.

If you're sick of filling out forms in the hopes of cadging a pledge from a limited partner, perhaps you should approach funds-of-funds manager and investment adviser **Adams Street Partners**.

The firm creates a new due diligence plan every time it looks at a general partner, said CIO **Hanneke Smits**. And unlike many other firms, the Chicago-based group doesn't use checklists, RFPs or questionnaires of any kind to discover or vet a GP. Instead it considers recommendations from trusted sources; track record; best-of-breed analysis, where firms with similar strategies are compared; and organizational dynamics. And, according to Smits, GPs like it that the firm doesn't use standardized forms to vet potential relationships because more can be gained from a dialogue. Questionnaires are often so carefully written and scrutinized that the flavor of what buyout shops are trying to convey is lost, explained Smits.

Adams Street raises capital each year for its U.S. and non-U.S. programs, which include primary, secondary and direct investments. Although in December the firm closed on \$2.1 billion for its 2009 global program, Adams Street is still investing capital raised from its 2007 and 2008 global programs as well. The firm could deploy as much as \$800 million to U.S. primary funds each year, but the actual amount will depend on which managers come back to market. Of that amount, about half could go to small, mid-cap and large U.S. buyout fund managers, with the rest divided between venture capital and turnaround strategies. Of particular interest are buyout shops that pursue low-leverage growth strategies and managers with sector expertise. Adams Street's average commitment is between \$30 million and \$50 million, regardless of the size of the vehicle.

Roughly 80 percent of the firm's pledges are re-ups, said Smits, who is based in London, but the firm also pledges to first-time funds and is always on the lookout for new relationships. The firm commits to an average of one first-time fund per year. "We look at everything on its own merits, but we are more hesitant with groups that are raising

their first-time funds. The bar is pretty high, and only one or two groups each year get over it," said Smits.

As an example of how Adams Street might learn of a new group, Smits says, "You're in New York for a couple of days, and you're visiting one of your existing managers. And you ask them, which we do, 'Who is an admired competitor or are there any new groups?' Sometimes you hear a new name, and off you go and visit the new name." And after one or two meetings, Adams Street decides if it wants to keep the shop on its tracking list. Adams Street also asks placement agents, other limited partners and CEOs of portfolio companies that have worked with several private equity firms for recommendations. "It takes time, and there are no short cuts," said Smits.

Emerging Managers

One new buyout shop that ultimately received a pledge from Adams Street was **Serent Capital**. "That was one where the GPs came highly recommended to us by people we were already invested with, respected a lot and had generated great returns for our clients. And when you get a phone call from those people saying you should look at this opportunity, you take that very seriously," said Smits.

Kelly Meldrum, a partner from the California office, and **James Korczak**, a partner from the Chicago office, reviewed the opportunity with Serent Capital and met the team, whose members did not come from traditional private equity backgrounds. **David Kennedy**, former president of ServiceSource, which was backed by one of Adams Street's GPs, and **Kevin Frick**, former head of McKinsey & Co.'s West Coast private equity practice, founded the San Francisco-based firm in 2007.

"References and recommendations play an important role in conducting due diligence, and in this case, taking a first meeting based on a recommendation from someone we knew well was important," noted Smits. It took between three and six months from the time Adams Street heard about the

LP PROFILE:

shop until it committed to them. Serent Capital's \$250 million debut vehicle, Serent Capital Partners LP, which closed in April 2008, is one of the smallest funds the firm has pledged to recently. It invests in buyouts of service businesses.

Adams Street also committed to the first two funds of **Water Street Healthcare Partners**. The shop's first fund, which closed in 2005, garnered \$370 million in commitments, and its second fund closed about a year ago with \$650 million. Its location in Chicago made it easy for Adams Street to get to know the team, which had a previous history of investing together. "We were especially interested in them because first-time funds that have previous track records give us the unique opportunity to quantitatively analyze them without having to rely only on reference calls," said Korczak.

Although all the managers Adams Street looks at must have track records of some kind, that does not mean they must be a spin-out team from a buyout shop or have invested via a prior fund, said Smits. They could be firms founded by entrepreneurs with a history of building businesses, for example, but Adams Street would not move forward with a firm that has had no exits. And in examining the track record, Smits would want to know more than just a firm's investment multiple. For example, two mid-market buyout funds might both have scored a multiple of 2x, but one firm might have posted a 15 percent loss rate in the process, and another firm may have a 35 percent loss rate. The firm that lost 35 percent of its investments might have taken on too much risk and only have gotten a couple of big wins because they were lucky. On the other hand, the firm may have a perfectly good rationale for the loss rate, which can be reasonably explained. So looking at the track record closely is a way to help eluci-

date how the GP thinks about risk/return, said Smits. The dialogue with the fund manager that follows then helps determine if Adams Street wants to go forward with the group.

After analyzing a firm's track record, Adams Street also spends a lot of time on what it calls "best of breed analysis," benchmarking a manager against its peer group, both quantitatively and qualitatively, making comparisons using a sizeable proprietary database that has been created and refined over the years. For example, a fund specializing in the retail sector would be compared to others in that sector. Adams Street also examines how the firm differentiates its strategy, and how its strategy might enable the manager to outperform in different economic environments.

Adams Street investigates organizational dynamics for signs of a cohesive team that does not completely depend on one person for its success. The firm has backed fund managers where there is key-person risk, but only if a succession plan is in place. Adams Street wants to understand how the group makes decisions, so the firm spends a lot of time looking at what level of debate occurs among the team with respect to its investment selections. The firm also looks for diverse experience in teams.

"It's good to have a common culture in a firm, but that doesn't mean that every person there has to look the same as the next person," said Smits. They can come from different backgrounds, such as private equity, the industrial sector, banking or consulting, depending on the focus and strategy of the fund. "In this industry, you meet a lot of very confident people, but we do watch for overconfidence, which can be an issue. We see this time and time again, where the next fund becomes way too large because the prior

fund posted great results. As a result of which, perhaps the GP is at risk of thinking they walk on water and will do it again with a fund that's three times the size," said Smits. She prefers GPs who recognize that increasing fund size could change how they operate, such as in the size of the checks they write or their internal processes.

The partners at Adams Street spend most of their due diligence time getting to know the people. "Ultimately it is about feeling you can entrust them with your clients' capital," said Smits. Most of the groups the firm has backed have been in its portfolio for years. Groups backed more recently, such as Serent Capital, tend to come very highly recommended by GPs or other LPs that Adams Street knows well. "When they're not fundraising, it's nice to drop into someone's office and have coffee and find out what they're working on," said Smits. It might be an existing portfolio company, a deal in the pipeline or a focus on recruiting. This process allows the partners to build a picture over time of the team as they react to changes in the marketplace. "You see how people act in different environments, and you see how sensible they were in a more frothy environment and what they're doing today to focus on portfolio companies that face challenges," explained Smits.

Korczak, who spends most of his time on small buyouts, energy and distressed debt, added that the firm is looking at a mid-market U.S. buyout firm right now that could lead to a potential new commitment. Although Adams Street passed on the shop's previous fund, the firm really liked the particular strategy and thought highly of the firm's founder, but hadn't seen evidence of him succeeding on his own yet. Plus, he had a fairly young team that had not worked together in the same organization before, and the founder planned to grow his firm to attract people that would be a good fit for the strategy.

Korczak wanted to see how it all worked out, so over the last few years, he sat down with the founder a couple times a year. When the firm actually raised a fund this year, "We weren't starting from scratch," said Korczak. "We knew the strategy, the companies and the investors," many of whom he had already spoken to regarding their experiences as LPs with this firm or its predecessor. "That was helpful to do before getting a PPM or a phone call saying 'Hey, we're going to raise a fund,'" said Korczak. Adams Street hasn't yet pulled the trigger on a pledge, but "we're working through it," Korczak said. ♦

Funds Raised By Adams Street Partners

Fund	Size (\$ Mil)	Vintage
Adams Street Partners Global Opportunities Secondary Fund II	734	2009
Adams Street Partnership Fund Program - 2009	2,305.00	2008
Adams Street Partnership Fund Program - 2008	2,195.00	2007
Adams Street Partnership Fund Program - 2007	2,150.80	2007
Adams Street Co-Investment Fund, L.P.	250.7	2006
Adams Street Partnership Fund Program - 2006	1,552.40	2006
Adams Street Partnership Fund Program - 2005	1,337.20	2005
Adams Street Global Opportunities Secondary Fund, L.P.	210.5	2004

Source: Thomson Reuters