GCM GROSVENOR

Have Your Cake and Eat it Too: Unlocking the Value of Middle Market Co-Investments

May 2023

Past performance is not necessarily indicative of future results. No assurance can be given that any investment will achieve its given objectives or avoid losses. Unless apparent from context, all statements herein represent GCM Grosvenor's opinion.

Select risks include: *macroeconomic risk, sourcing risk, investment selection, portfolio diversification, management risk, execution of value creation plan, risks related to reliance on third parties, and risks related to the sale of investments.*

INTRODUCTION

While it is no secret that market volatility and an economic downturn have created a challenging deal making environment for investors, we believe compelling opportunities continue to exist in the middle market. Not only has deal volume held up relatively well amid a general slowdown but, with ~10x the number of investible opportunities compared to large buyouts[1], the middle market often offers investors lower purchase price multiples and the ability to employ a more conservative capital structure. These smaller underlying company sizes can also offer the ability for the right sponsors to create value that will have a meaningful impact on returns versus what is possible when investing in larger companies.

Given that the middle market can present opportunities to both buy value as well as create it, the natural question is which approach is preferable? The answer, we believe, is both. We seek to target middle market co-investments that offer both attractive purchase prices and multiple value creation levers that can drive returns. Below we explore two segments of the market in which we believe there is a particular opportunity to "have your cake and eat it too" by **both** buying at an attractive entry price as well as partnering with the right sponsor to drive value creation. These two segments are **family-owned businesses** and **public-to-private transactions.**

In both family-owned businesses and public-to-private transactions, the companies at stake are usually fundamentally good businesses. But, because of the ownership dynamics, there are often cost savings opportunities to increase EBITDA margins and the ability to use cash flow to invest in future growth.

FAMILY-OWNED BUSINESSES

Family-owned companies typically allow for broad professionalization opportunities across all areas of the business, including augmenting the management team. Many of these companies have never made an acquisition before, so partnering with the right sponsor can also unlock new avenues for growth and profitability.

The below deal spotlight showcases one of our recent investments in a family-owned business that presented value creation opportunities through both margin and growth initiatives and resulted in significant return generation.

COMPANY: Non-asset based, outsourced, logistics solutions provider for chemicals and life sciences industries

Opportunity to Achieve Attractive Entry Price

The sponsor had a **focus on transportation logistics and 10+ year relationship with the company**, allowing them to buy at a compelling price outside of an auction process

Because of their industry focus and relationship with the company, the sponsor had the **expertise and resources to identify and efficiently act on multiple value creation strategies**

Opportunity to Create Value

Cost Savings Initiatives

- Reducing corporate overhead
- Facilities consolidation
- Rationalizing unprofitable contracts
- Process automation

Growth Initiatives

- Investing cash flow back into new business lines
- Pursuing acquisitions

GCM Grosvenor Position

We moved quickly to provide the sponsor with certainty of close and secured the position as the lead and largest co-investor

Result

More than doubled EBITDA in 4 years

Exited through a sale to a strategic buyer and generated returns significantly in excess of our base case

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PUBLIC-TO-PRIVATE TRANSACTIONS

Especially in the wake of broader market declines, such as what we are experiencing today, public companies or corporate carve-outs of non-core business units often offer attractive purchase prices to potential buyers. They can also provide opportunities to invest in larger scale growth initiatives when their focus is redirected away from shorter term quarterly earnings.

In this deal spotlight, we explore a recent investment that presented value creation opportunities through cost savings initiatives, management changes, and revenue expansion and resulted in margin expansion and a debt recapitalization that produced a subsequent distribution to shareholders of ~50% of invested capital.

DEAL SPOTLIGHT
TWO

COMPANY: A leading North American producer of phosphate and non-phosphate ingredients

Opportunity to Achieve Attractive Entry Price

The sponsor was a **specialist focused on industrial companies** that excels at pursuing complex transactions that often turn away other investors

Several of the sponsor's **operating executives had direct industry experience** and knew the company's assets well

The business was undersized as a public company with **less than $1bn market cap**

Prior management missteps led to a **decline in stock price**

Opportunity to Create Value

Cost Savings Initiatives
· Plant consolidation

Management Changes
· Replacing the CEO
· Upgrading other management roles

Revenue Opportunities
· Pricing actions
· Growing new business lines under the right leadership

GCM Grosvenor Position

We completed business and operational diligence on a compressed timeframe to help the sponsor close the transaction, resulting in us receiving the largest co-investment allocation and securing a board observer seat

We leveraged our proprietary sponsor and executive network to discuss future regulation of phosphates, Chinese competition on commoditized products, and phosphates' current and future role in clean label products

Result

Pricing power, cost savings related to procurement, facility footprints, and SG&A have led to margin expansion

The company was well positioned during the COVID-19 Pandemic as phosphates are essential ingredients in shelf-stable foods

In February 2021, the company completed a debt recapitalization and subsequent distribution to shareholders of ~50% of invested capital

THE IMPORTANCE OF PARTNER SELECTION

Middle market buyouts can offer compelling return potential but are more challenging to execute on your own. Pursuing middle market buyouts through a co-investment vehicle can be a cost-effective way to obtain exposure and achieve diversification. To be best positioned for success, we believe investors need access to partners with the right expertise to not only source high-quality deals, but also to effectively diligence and structure investments and portfolios that offer comprehensive diversification. They also need to work with a partner who has access to top-tier sponsors that will be best positioned to identify and take advantage of value creation opportunities and have the expertise to do so in a cost efficient and timely manner.

GCM Grosvenor has been focused on middle market investing alongside sponsors for over 23 years, and we have a nearly 20-year track record of buyout co-investing that is part of our broader ~$30 billion private equity platform.[2]

Learn more about GCM Grosvenor's private equity and co-investment platforms **here**.

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1 Source: BURGISS: Data as of March 31, 2022; downloaded August 3, 2022. U.S. MMBO: Funds less than $3 billion; U.S. Large BO: Funds over $3 billion. Analysis consists of 2000 - 2013 vintage funds.

2 Data as of December 31, 2022.

ABOUT GCM GROSVENOR

GCM Grosvenor (Nasdaq: GCMG) is a global alternative asset management solutions provider with approximately $75 billion in assets under management across private equity, infrastructure, real estate, credit, and absolute return investment strategies. The firm has specialized in alternatives for more than 50 years and is dedicated to delivering value for clients by leveraging its cross-asset class and flexible investment platform. GCM Grosvenor's experienced team of approximately 540 professionals serves a global client base of institutional and high net worth investors.

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