PEI PARTNER CONNECT EVENTS

OCTOBER 2019

FAMILY OFFICE CONNECT

LPs, GPs & INDEPENDENT SPONSORS

Featuring topics being discussed at Family Office Connect.

PRODUCER'S LETTER

Dear Colleague:

This Briefing Guide produced by Buyouts Magazine & PE HUB presents a snapshot of topics that will feature at **Family Office Connect**, **October 30th 2019** at **The Harvard Club** in **New York City**.

This popular conference will welcome over 300 decision making LPs, Family Offices, GPs and Independent Sponsor executives as they gather for educational sessions focused on Fundraising, co-investment programs, deal flow and to participate in our facilitated one-on-one Exec Connect private meetings program.

Articles to enjoy in the guide include:

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- Broken-Deal and Other Fees: How PE, Families Work with Independent Sponsors- Page #5
- Family Offices See Farmland as Stable Asset for Investment- Page #6
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Discussion's to augment the articles herein and to enjoy at Family Office Connect will include:

- Global Economic Trends: The Investment Environment facing Family Offices and the wider PE class
- How to set up a co-investment program that is sure to succeed
- Family Offices as fund investing LPs
- Independent Sponsors in a funded world - The deal journey into an investor. What makes for a successful partnership?
- Independent Sponsors Economics: How to maintain control
- Maximizing Quality Deals in your Pipeline – Protecting your investment whilst making an impact
- Multi Cycle Debt investing
- Early Stage Investing for HNW Individuals and Family offices
- Family Office Education 2.0 – Transferring Know How to the Next generation

This year's gathering will guarantee attendees with an opportunity to network with senior executives from Family Offices, LPs, GPs and Independent Sponsors.

See you October at Family Office Connect!

Vikash Magdani
Director, Buyouts Insider

Best,

Unlock access to the elite.

Discover how global Family Offices in a changing market environment are increasingly playing an active role in the elite private equity asset class. Network and learn how Family Offices successfully work with LPs, GPs and Independent Sponsors on deal, co-investments and potential fund investment programs. Enroll in ExecConnect where LPs, GPs, FOs and Independent Sponsors can participate in pre-arranged meetings.

FRESH CAPITAL

Family office blooms for 1-800-Flowers founder

By Justin Mitchell

- Recently added a team member to manage private investments
- Prefers funds where it knows the principals
- Funds backed include Insight Ventures, RRE Ventures and Tiger Global Management

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In the 1980s, **Jim McCann** made his fortune when he took his small floral business and branded it on a national level as **1-800-Flowers**, making it one of the first companies to integrate an 800 number into its identity.

"If we weren't out front on things and thinking two or three steps ahead, we would eventually have been left behind," he said.

After handing day-to-day operations of that company over to his brother Chris a few years ago, McCann focused on running his family office, **Clarim Holdings LLC**, as a vehicle through which to encourage more innovation. (Clarim is a combination of McCann's parents' names: Claire and Jim.)

"While Chris and I built [1-800-Flowers], we often knew about new technologies early on, and all we would do is say: 'How can we become a better floral and gift company?'" McCann recalled. "The one thing we were guilty of is not saying: 'Hey, this is a great technology; let's invest in it.'"

McCann also found himself in many conversations about how to maintain family wealth — including staffing a family office, developing the next generation of talent within a family, and how to handle philanthropy.

"We thought with Clarim we'd have two pieces, one is the investment side and the second is standing up businesses that would begin to professionalize the answers to those questions," McCann said.

On the investment side, Clarim makes direct investments and invests in funds. Initially, more money was devoted to funds, but more direct investments are on the horizon.

"We don't have the infrastructure to be very strong in direct investment, so those will be the exceptions rather than the rule."

—Jim McCann, Chairman, Clarim Holdings

"We don't have the infrastructure to be very strong in direct investment, so those will be the exceptions rather than the rule," he said.

One recent direct investment is **Skylark Travel**, which McCann said caters to "the next generation of affluent travelers that think online first."

With funds, Clarim prefers those where it knows the principals. Previous investments include **Compound VC, Insight Ventures**, **RRE Ventures** and **Tiger Global Management**.

Clarim also operates as a holding company. On its website, it bills itself as "a family of companies serving today's leaders." Its operating companies include *Worth* magazine, now called **Worth Media**, which focuses on affluent people throughout the world; **Techonomy**, a technology conference company; and **Copperfield Advisory**, a marketing firm.

Earlier this year, Clarim added to its team. **Steve Roberts**, a managing partner at **SR Capital Advisers**, joined in January to manage Clarim's private investments. The other key team member is **Paul Stamoulis**, senior managing director and head of Clarim Holdings.

McCann expressed interest in co-investing with other family offices. "It's more and more becoming apparent to us that those opportunities are real and distinct," he said.

ACTION ITEM

Jim McCann can be reached at jmccann@1800flowers.com; Paul Stamoulis is at paul.stamoulis@clarim.com.

FAMILY OFFICE & INDEPENDENT SPONSORS

Broken-deal and other fees: How PE, families work with independent sponsors

By Chris Witkowsky

- Independent sponsor fees vary across managers
- Firms say fees depend on independent sponsor's skill set
- Family offices usually won't pay broken-deal fees

When family offices and private equity firms work with independent sponsors, one question that arises is who pays broken-deal fees.

The answer seems to be — not family offices, according to a panel discussion at **Buyouts Insider**'s **Family Office Connect** conference in New York on May 21.

While FOs are not likely to pay dead-deal fees, PE firms are, said **David Acharya**, partner at **AGI Partners**.

"If you go to a family office, there's virtually zero chance of them covering dead-deal costs. If you go to a pure-play private equity fund, it's the other way around: They're more than happy to cover dead-deal costs," Acharya said.

There are contributing factors, of course. Equity and mezzanine shops generally will agree to pay broken-deal costs, depending on how much they like the deal and how interested they are in maintaining a relationship with the independent sponsor, Acharya said.

"It comes down to which capital partner you go to. ... If broken-deal costs keep you up at night, going to a pure-play private equity fund is probably your best choice," he said.

Broken-deal costs were part of a broader discussion about terms like fees that independent sponsors charge investors on deals.

Independent sponsors generally are managers that invest without traditional, commingled, blind-pool funds. Such managers work in a variety of ways, including sourcing deals and then reaching out to investors for funding.

These sponsors vary in what they charge investors. In some cases they may charge a traditional management fee of 2 percent and performance fee of 20 percent of profits. In other cases fees are lower, or fees are only for ongoing monitoring of the investments and deal-related charges.

Bob Levine, managing partner at L2 Capital Partners, says an independent sponsor who proposes a deal with L2 will share in the fees. Photo of Bob Levine courtesy of L2 Capital Partners.

A continuous, active role in a portfolio company warrants an annual management fee, said **Noah Kroloff**, managing director at independent sponsor **Black Granite Capital**.

The firm structures carried interest in various ways, including tiered carry, Kroloff said. Tiered carried interest ramps up depending on performance.

"We try to customize ... depending on which group we're talking to ... to be flexible and find something that works with capital partners we're working with," Kroloff said.

> **"Bringing a deal is worth something. Beyond that, it's a blank slate as to what it's worth and how fees are shared."**
>
> —Bob Levine, Managing Partner, L2 Capital Partners

Firms that fund deals with independent sponsors tend to view fees as dependent on the level of the sponsor's expertise and participation in the portfolio company.

Bob Levine, managing partner at **L2 Capital Partners**, which works with independent sponsors on deals, said a sponsor who proposes a deal with L2 will be sharing fees.

"Bringing a deal is worth something. Beyond that, it's a blank slate as to what it's worth and how fees are shared," he said. Other factors include the sponsor's skillsets and whether they bring industry expertise relevant to the specific deal, the strength of the firm's relationship with the sponsor and whether the deal was truly proprietary or one that was orchestrated by a banker.

Brad Batten, a partner with **Zwick Partners**, agreed that fee sharing depends on the sponsor's involvement in the deal, pre- and post-close. "The more value-add you bring pre- and post-close, the more willing we are to pay fees," Batten said.

ACTION ITEM

Read more about the conference here: https://bit.ly/2JTcQyF

INVESTMENT

Family offices see farmland as stable asset for investment

By Justin Mitchell

- "Farmland always has a rent": LandFund MD
- FOs, wealthy investors see stability in farmland
- Pricing in I states up a bit this year

Harrison Freeland, senior associate, and Eric Sarff, vice president, at Murray Wise.
Photos courtesy of the firm.

For family offices, where maintaining wealth is often a top priority, investing in farmland has made good sense for the past few years.

"Farmland always has a rent," said **Chris Morris**, co-founder and managing director of **LandFund Partners**, a Nashville investment firm that buys land primarily in Mississippi and Arkansas. "Farmland is a productive asset; things actually grow out of the ground, so a farmer can always make some sort of revenue."

Less vulnerable

Farmland is also less vulnerable to market ebbs and flows such as the 2008 financial crisis and its aftermath. "Farmland was still producing positive returns [post-2008] because it's not financialized, it's not as connected to the Wall Street system," Morris told *Active LPs*.

"It's a stable investment," said **Eric Sarff**, vice president of Champaign, Illinois-based **Murray Wise Associates**, a large global farmland asset manager. "The year-to-year returns aren't sexy, but as long as you're in it for the long game, it's a pretty attractive investment."

Both LandFund and Murray Wise said they do a lot of work with family offices and other high-net-worth investors.

Sarff and **Harrison Freeland**, a Murray Wise senior associate, said they saw interest in farmland investments among FOs and wealthy investors spike around 2012. Freeland said most of that was concentrated in Illinois, Iowa and Indiana, the so-called I states.

"It's considered a very stable investment-grade-asset farmland in those areas," he said. "In terms of the farms we're adding to our portfolio, it's almost a hundred percent these high-net-worths and family offices."

Freeland said that in total, wealthy investors and FOs had bought 15,200 acres of farmland for $158 million in Illinois since Jan. 1, 2018. Murray Wise declined to share how much of that was the firm's deals. It said those numbers came from public records.

"There have been at least three or four big guys buying farmland in this region, so it's certainly been an active region," Freeland said.

Morris estimated that half of the $30 million in LandFund's fourth and most recent fund comes from family offices or funds of funds and the rest from other high-net-worth investors. After recently saying it would buy $10 million of farmland in Q2 2019, LandFund's Fund IV now holds about $17 million of what he expects to eventually be $50 million in holdings. (LandFund uses some debt for each of its purchases.)

LandFund controls about 25,000 acres of farmland in the South for about $125 million in AUM, Morris said.

Neither LandFund nor Murray Wise would identify the family offices they work with. Morris did say that most of LandFund's families had at least $100 million in assets, usually investing 5 percent of that in farmland. He said their families also tended to already understand real estate.

Gates and Soros

Some of the world's wealthiest people have invested in farmland. *Land Report* reported last September that **Microsoft** Founder **Bill Gates** paid $171 million for farmland in Washington state. *Agri Investor* reported that Gates appeared to be the buyer of $520 million of U.S. farmland from a Canadian pension fund in 2017. In 2011, the *Washington Post* reported that the billionaire investor **George Soros** controlled farmland in South America.

Farmland prices rose for a few years after the 2008 crash but prices have flattened overall in recent years, according to the **U.S. Department of Agriculture**.

Mykel Taylor, an associate professor of agricultural economics at **Kansas State University**, confirmed that was also the story in the Midwest.

The year "2014 or 2015, depending on what state you're in and what commodities you have, was kind of the peak," she told *Active LPs*, "And then the next year we started to see commodity prices fall off and we started to see some profitability fall. And land values have since started to soften in most areas around the Midwest and the Great Plains."

Freeland said land prices in the I states were slightly up this year, and he saw them holding firm in years to come. "This does not really affect family offices investing in farmland greatly, as to them it is a long-term investment typically measured in decades, not years," he said in an email.

LandFund's Morris told *Active LPs* that land prices have gone up in the South, even as they have fallen slightly or plateaued in the Midwest. Overall, he is optimistic.

"We've definitely seen a pickup in investor interest," he said.

CAZ Investments eyes coming transformation of car-rental market

By Justin Mitchell

- CAZ: "Transport revolution ... a generational change"
- Sees rental-car industry ripe for disruption
- PEs, VCs, bankers, hedge funds going in on transport

"If I was managing any of the car-rental companies right now, I would feel like there is literally a hurricane-force wind in my face," says Christopher Zook, chairman and CIO of CAZ Investments.

woraput/E+/Getty Images

When **Christopher Zook**, chairman and CIO of **CAZ Investments**, recently told *Buyouts* his firm was betting on **Uber** stock after its disappointing IPO, he was highlighting one of CAZ's most prominent themes: transportation.

"We love the space," Zook told *Buyouts*. "We believe the transport revolution, with rideshare being the most actionable, is a generational change."

Zook said CAZ is especially eyeing the rental-car industry, which he called ripe for disruption. He compared rental giants like **Hertz**, **Avis** and **Enterprise** to **Blockbuster Video**, the once-mighty but now-defunct video-rental chain that failed to get out ahead of the streaming revolution.

"If I was managing any of the car-rental companies right now, I would feel like there is literally a hurricane-force wind in my face," he said.

"There will be a time — and it's already there in some cities — where you will not rent a car in the traditional way. … There will be cars along the street that with your app you can have drive to pick you up, take you wherever you want to go … that will completely revolutionize and take over the car rental market."

Neil Abrams, an expert on the car-rental field and owner of **Abrams Consulting Group**, told *Buyouts* that CAZ is far from the only player paying attention.

"We do a lot of adviser calls with PEs, VCs, investment bankers, hedge funds," he said. "How could they not be interested? You're talking about an enormous shift in how transportation will work."

The rental companies are doing fine for now. According to *Auto Rental News*, the industry's revenues hit a record last year, passing $30 billion for the first time. Hertz and Avis, which are public companies, both posted revenue growth in 2018.

Certify, which tracks corporate expenses, reported after Q1 2018 that use of ride-hailing services by business travelers spiked 63 percent from 2014-2018, while rental cars decreased 32 percent. *Bloomberg* later pointed out that Certify's data counts only the number of spending filings, not actual spending, and when calculated for that, the numbers show a change but a "less than stunning" one.

Nevertheless, Abrams said the major car-rental companies are facing an almost unheard-of situation that they must address: competition from other industries for the same customers, with car makers and tech companies working to cater to the demand for what Abrams called "personal mobility."

"It's really a social and cultural revolution that's part of this transition. … They have to face those challenges," Abrams said. "They're not going out of business… but the handwriting is on the wall and they are going to be forced to transition."

Even while reporting the record revenues, *Auto Rental News* shared the view that "transportation is changing," and recommended rental companies start finding ways to create more personalized experiences for customers, creating a "to-do list" for the industry that included creating app-based experience for customers and partnering with "autonomous tech players."

Abrams and Zook agree that competition from more tech-oriented companies like **Lyft**, **Uber**, **Google** and **Apple** are making things interesting.

"Their ability to actually adjust and adapt is going to be tough, and so it wouldn't surprise me if we saw consolidation in the industry," Zook said.

Rental companies are trying new things. Avis has owned **Zipcar** since 2013, Enterprise has operated a car-sharing service since 2008 and Hertz began renting cars in its fleet to rideshare drivers.

Abrams told *Buyouts* that autonomous vehicles are the future, which customers will be able to rent automatically — and that vehicle manufacturers, tech companies and rideshare companies will all be investing in this technology.

That, along with peer-to-peer vehicle loan services like **GetAround**, will pressure the rental companies and everyone else to come up with a workable solution.

"Right now, it is a horse race," Abrams said. "If I was an M&A company, if I was a PE, you know, I'd be looking at possibilities for a combination of companies that all bring something to the table. … Rental companies have collectively hundreds of millions of customers and they've got millions of vehicles that can be optimized in many different ways."

FRESH CAPITAL

Investors strive to get the balance right on deals in opportunity zones

By Justin Mitchell

- OZ benefits include 10-pct tax break for investment carried five years, another 5 percent if held seven years.
- OZ deals must make sense as regular investments: investors
- Factor in possible recession to any OZ deal: investors

AlSimonov/iStock/Getty Images Plus

Despite the buzz around opportunity zones, some investment professionals remain cautious about OZ deals.

"We have looked at a lot of opportunity zone funds, and we haven't been compelled by most of them," said **Kevin Philip**, a managing director at **Bel Air Investment Advisers**.

Philip said his firm has identified "a couple" OZ investments that seemed useful for clients, but "it's very selective." "They will from time-to-time have a role to play, but on the edges of an investment plan, not as the central thesis," he said.

The concern comes down to whether an OZ investment would make sense on its own, even without the tax benefits that are part of the program.

"To do something that generates a subpar investment return, simply to have a delay in taxes — it's a simple math calculation and it just doesn't make a whole lot of sense," Philip said.

Philip sought out more predictable real estate investments in established locations and added more risky investments in up-and-coming areas to enhance the overall return. Opportunity zones are, by definition, less developed, and therefore more risky.

"A lot of people believe we're going to face a recession sometime in the next five years, so if you're investing in a property in a location that you believe is gentrifying, that gentrification might get stalled and recessed if we have a recession three or four years from now," Philip said.

He added: "I have a feeling the real estate people specifically love opportunity-zone funds because it's helping them raise more money for projects they otherwise would have a problem raising funds for. The outcomes sometimes don't matter as much to them as long as they've raised a fund they can charge fees on."

Opportunity zones were created as part of the 2017 Tax Cuts and Jobs Act, and were spearheaded in congress by South Carolina Republican Senator **Tim Scott**. They provide a series of tax breaks to investors who roll their capital gains into a qualified opportunity-zone fund for investment in one of 8,700 designated census tracts.

Benefits include a 10-percent tax break for an investment carried for five years and an additional 5 percent if it is held for seven years. That part of the program sunsets in 2026, meaning investors had until June 29 to apply their 2018 capital gains to a qualified OZ to get the seven-year carry. They have until the end of this year to apply that carry to their 2019 capital gains.

Profit or impact

Fund managers and real estate investors focusing on OZs generally agree with Philip that OZ investments need to be able to stand on their own.

Avy Stein, chairman and co-founder of **Cresset Capital**, which is making a big OZ push, said his firm does not expect clients to invest only in OZs. "I would never tell anybody to put all their eggs in any one basket," he said. "I absolutely agree that this has a role in a portfolio. It is not a portfolio [on its own]."

Like Philip, Stein said Cresset is taking a possible recession into account. "I don't think anybody does a set of numbers on a real-estate deal without pricing in a recession."

"If you buy and/or build quality real estate in quality locations, it stands the test of time," **Craig Bernstein** of **OPZ Bernstein** said via email. (OPZ Bernstein is a qualified-OZ fund that is part of **Bernstein Cos**.)

"If you can find attractive investments, and they also happen to be located in opportunity zones, we view that as a win-win opportunity for us," said **Frank McGrew** of **McNally Capital**.

Some investors do not even see OZ investments as being primarily about profit. **Kamil Homsi**, founder and CEO of **Global Realty Capital**, the onshore arm of a Dubai-based family office, said it is "all about impact."

"You're not going to make more money than you're going to make in regular investments," Homsi said. With that in mind, investors need to work closely with communities, he said.

Kunal Merchant, president and co-founder of **CalOZ**, a nonprofit trade organization that seeks to facilitate OZ investments in California, said he hoped family offices would look beyond the "low-hanging fruit" of easy profits.

"I ask them to try to push a little bit out of their comfort zone for the benefit of the state and the country and all of the people in these opportunity zones that are counting on us to help them," he said.

FAMILY OFFICE CONNECT

LPs, GPs & INDEPENDENT SPONSORS

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