Q&A With Marlin Equity On the Fundraise of the Year

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Marlin Equity Partners

Marlin Equity Partners recently announced the wildly oversubscribed close of its third fund, raising $650 million in just under four months. As we reported earlier, this was the hottest fundraise to occur within one of the iciest fundraising years in memory.

Marlin entered the market in September with placement agent Probitas Partners, seeking $450 million (a slight jump from its prior $350 million vehicle). With private equity fundraising at its lowest levels since 2004, the firm expected to have a difficult run.

They couldn't have been more wrong. For Marlin Equity, gathering commitments was the easy part! The firm received $1 billion worth of interest from LPs, creating the challenge of capping the fund at an appropriate level without excluding any LPs.

I spoke with Marlin Equity Founder and Managing Partner David McGovern about the firm's track record, possible new hires and the difficulties with increasing its fund size and cutting LP commitment**s.**

peHUB: Congrats, how many months were you in the market?

Peter Spasov: We formally kicked off fundraising after Labor Day and received our final subscription documents on November **20.**

This was a first and only close, meaning you haven't deployed any of the capital yet.

No, it's a 2010 vintage that we'll turn on sometime in the first quarter of **2010.**

Anything in the pipeline?

We're still investing out of fund two. We have deals in the pipeline for it; we always have around 50 to 60 opportunities we're looking at at any giv**en time.**

How deployed is fund two?

It's 80% **committed.**

How did you increase the fund size by so much: Did your existing LPs increase their commitments or did you bring in a ton of new investors?

It was a mixture of things. It helped that our fund two fundraise was very successful. Similar to this fund, we launched that after Labor Day in 2007 and had a first and final close at the hard cap right before Thanksgiving. We were well oversubscribed and had to cut all existing investors back substantially.

When we got started with this fund, we were warned about the (difficult) marketplace and about firms not getting to where they needed to get to, so we were prepared for the worst. We were expecting that existing LPs would want to scale back from the amount they had invested in prior funds, given the marketplace, so we were pleasantly surprised that a fair amount of LPs increased their commitments. We also more than doubled our LP base in terms of the number of investors. All of that taken together led to more demand than we could have reasonably expected in such **a short time.**

How many investors did you end up with?

We had a little more than 40 dist**inct entities.**

Did LPs like your fund because of the strategy or because of the track record?

We had a few things going for us. Our historical track record was strong. People were surprised that we had no pain in our portfolio companies; the companies we acquired were all performing according to our plan, which was a direct result of the operational improvements we made to the companies. On top of that, the strategy is timely because we view ourselves as guys who invest across market cycles. We do distressed investments, debt-for-control deals, and also buy underperforming growth equity businesses and make operational improvements. So we have a lot of different types of deals we can do. People like that we can play a**cross the cycle.**

I think I read the track record was something like a 260% IRR on fund one, a 2005 vintage with $65 million in commitments, and a 32% IRR on your $300 million second fund from 2007. Is that ri**ght?**

That's right.

Have you exited anything fro**m fund two?**

Not yet.

I heard some LPs were upset that you guys cut their commitments to accommodate for new investors, even after they approved a $75 million increase to the hard cap. What's your response to that?

When you find yourself in a severely oversubscribed situation, it's very difficult to balance all the interests involved. With fund two we couldn't take all the investors that wanted in. Cutting people out of the fund entirely is not a good idea, so we wanted to change that this time around. We tried to accommodate the interest of anyone who made our deadline (of November 20). There were cutbacks (in commitment size) across the board, and it was difficult to balance the interest of squeezing everyone into a fund and giving them the allocation that they wanted. But at the same time, it created a more diverse LP base. There wasn't any way to do it without having people be disappointed. But overall I think people felt we handled it professionally and did the best we could. If we gave everybody their allocation we would have had a supremely upsized fund and people would have b**e angry about that too.**

How upsized would it have been?

We had over $1 billion in commitment letters that had been submitted. We turned off diligence and meetings for people that couldn't make it by **the November 20 deadline.**

By how much did you cut commitment sizes?

Some people were cut by more than 50%. When you have a smaller fund and people are asking for big posi**tions, you have to do that.**

You mentioned diversifying your LP makeup. Who are you investors?
We had a lot of endowments and foundations in fund two. We closed out that fund so quickly that we never made it out to Europe, so we didn't have any international LPs. So we added (European investors) this go-around and added some exposure to the public **and corporate pension plans.**

The jump in fund size will obviously mean more deals or bigger deals. How do you plan to handle that?

We plan to continue to do what we did on fund two but also capture deals we couldn't do on our own. The nature of our (distressed) strategy requires speed and certainty for sellers, so it's difficult to partner on deals. A larger fund size allows us to get true middle market opportunities. The $10 million to $50 million equity check was the sweet spot, but now we can go up to $65 million or so before we start feeling **concerned about concentration.**

Do you plan to increase your headcount?

We may hire at the junior level and potentially at mid-level. We run four deal teams, with 14 investment pros and 20 full time operational partners. So from that perspective we're staffed right for what we currently do.

Previously:
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Marlin Equity Raising Third Fund
Update: An earlier version of this story mistakenly identified the interviewee as Marlin Equity Partners Principal Peter Spasov, who was on the call but did not give the above responses; they came from Founder and Managing Partner David McGovern.