State of Rhode Island
Office of the General Treasurer

Riverside Micro-Cap Fund VI, L.P. - Staff Recommendation

July-2021

RECOMMENDATION: Approve a commitment of up to $50 million to Riverside Micro-Cap Fund VI, L.P. ERSRI committed $20 million to RMCF III (2013 vintage), $25 million to RMCF V (2019 vintage), and $20 million to RMCF IV B (2020 vintage). ERSRI also committed $20 million to Riverside Capital Appreciation Fund VI (2012 vintage) which is a different strategy managed by a separate team.

ASSET CLASS: Private Equity

SUB-STRATEGY: Lower middle-market buyout

ALLOCATION: The target allocation for private equity is 12.5%, and the actual allocation as of 6/30 is 11.2%. The pacing plan for private equity is $300 million per year committed to 5 - 10 primary funds per year at $20 - $60 million per primary fund.

PORTFOLIO FIT: ERSRI has emphasized deploying into lower middle-market buyout strategies with a sector focus and/or operational value-add approach. The Riverside Micro-Cap Fund (RMCF) strategy is one of nine fund families inside of The Riverside Company. The fund families are organized by strategy and geographic focus. RMCF focuses on control buyouts of North American companies generating up to $10 million in EBITDA at acquisition. This is the very lower end of the middle-market. Riverside often employs a buy and build strategy and targets companies that have been growing revenue above a 10% CAGR, with a high level of recurring revenue and little or no supplier concentration. The RMCF team formally develops target sector themes to source opportunities and then brings a number of resources to the companies to grow them organically and through add-on acquisitions. With this recommended commitment the Riverside Company will be 8.4% of the ERSRI Private Equity portfolio, and RMCF will be 7.8%.

MERITS: The RMCF strategy brings a greater level of resources to the lower middle-market than other fund managers given its shared resources with the greater Riverside organization. This includes: a 17-person Global Deal Origination team; the Riverside Toolkit which is comprised of over 50 experienced consultants in areas such as pricing, marketing, strategy, integration, HR, and digital marketing; the Riverside Information Security Office which assists companies with cybersecurity; and Sierra, a captive software development firm. RMCF is very process orientated as illustrated by its development of the RMCF Manifesto, which outlines and standardizes all major processes relevant to identifying, buying, managing, and exiting companies. RMCF continues to innovate its processes and recently added the "Revenue Acceleration System", which tracks portfolio company sales team member performance on a weekly basis using in-house software to guide changes at the companies. These resources allow the RMCF team to consistently source platform investments and a large number of add-ons for each platform that will be truly integrated and optimized. After building larger companies as described, RMCF typically sells them up market.

The RMCF strategy has a tenured and proven team with each senior partner making strong contributions to prior returns. Funds I – III have generated top quartile or decile performance across all metrics. Fund IV has underperformed due to two companies generating early losses of capital, but there is a lot of upside remaining in the active portfolio. Fund V is too early to assess.

CONCERNS: Fund VI will potentially be more than 60% larger than Fund V. Given RMCF's focus on the very lower end of the middle market this is a risk. Mitigating this risk is Riverside's allocation policy wherein the Riverside Capital

Appreciation Fund acquires companies above $10 million EBITDA and RMCF acquires platforms below $10 million EBITDA, keeping RMCF in its target market. The increased fund size will allow for more add-ons per platform which is a key to the strategy and likely a few more platforms in the fund.

The success of the RMCF team has also resulted in an organizational risk that the team could seek to become independent. Staff has reviewed this risk and feels comfortable with the organization's stability. The RMCF strategy has been effective because it leverages the resources of the larger Riverside organization as referenced above. The RMCF team highly values the support of the broader Riverside organization and acknowledges that these benefits would be difficult to replicate outside the organization.

ESG: RMCF is categorized as an **Integrator** on ESG. The firm incorporates a detailed ESG review of every company during diligence. Given the size of its portfolio companies, governance is an area that often scores low in RMCF's ESG assessment, but an improvement plan is quickly implemented. There are examples of RMCF passing on deals due to ESG concerns uncovered in later stage diligence. The firm has put an emphasis on diversity equity and inclusion at the firm and portfolio company level through hiring processes that have resulted in consistently increasing diversity at both levels. The firm has recently added team resources to the ESG effort and will continue to evaluate how to best add more tracking and reporting initiatives.

FEES: The fees are in accordance with industry standards. There is a 2% management fee during the investment period, followed by a 2% annual fee on net invested capital thereafter. Carry is 20% with an 8% preferred return.