altera

# Putting the Pieces Together

*Altera Investments' approach to underwriting sponsors and investment opportunities*

Private market investments are structurally different than public securities and don't afford investors the same breadth and depth of information to support investment decisions. There are advantages and disadvantages to these facts which warrant an appreciation and understanding of the specific nuances of private investments, like illiquidity and information asymmetry. Investors can capture these intrinsic premiums from simply being in the market, but greater return can be captured strategically through rigorous sourcing and underwriting of investment sponsors and investment opportunities. At Altera Investments, we've found that rigor, discipline, and proactiveness enable us to sort through the private market backdrop and identify high caliber opportunities.

As demonstrated by several studies by industry leaders like Cambridge Associates and Blackstone, the dispersion of, or more simply the distance between, investment outcomes is meaningfully wider in private markets, particularly so within real assets and private equity. This presents both a compelling opportunity as well as an increasing need for effective underwriting. While simply holding a private market allocation could outperform public markets, establishing a plan for sourcing, underwriting, and executing on opportunities could translate to effectively identifying sponsors or investments with a greater likelihood for outperformance. The goal of our underwriting approach is to sidestep systemic risks that can be avoided, evaluate downside scenarios and mitigants, while pursuing investment ideas that present interesting, compelling risk-adjusted return profiles.

The process through which we underwrite sponsors and opportunities is both quantitative and qualitative. It is intended to provide a framework for identifying avoidable risks and, for the opportunities that we determine are worth exploring, capturing a common set of variables attributable to asset classes or structural characteristics. The process is invariably iterative, involves several meetings with sponsors, and the collection and analysis of numerous documents and models. The successful outcome of our underwriting is where we establish a high degree of confidence in a sponsor and investment opportunity and where our Investment Team recommends investment.

The following sections will illustrate the underwriting process as a whole and unpack each of the corresponding process steps in greater detail.

## The Underwriting Process:

Altera Investments' business is centered around identifying differentiated investment opportunities within the lower middle private markets. Within that focus, we take a strategic approach to identifying asset classes and investment themes to evaluate, as well as a tactical approach to selecting investments. To deliver on this methodology, we need to evaluate investment sponsors (i.e., the team and organization behind the investment) first to determine a level of comfort with their abilities, and then the transactions themselves. Our underwriting process involves a concurrent and interrelated assessment of both.

The end-to-end process incorporates six categorical steps, including:

1. Sourcing
2. Screening
3. Opportunity Assessment
4. Comprehensive Diligence
5. Investment Committee Discussion
6. Legal/Reputation Diligence

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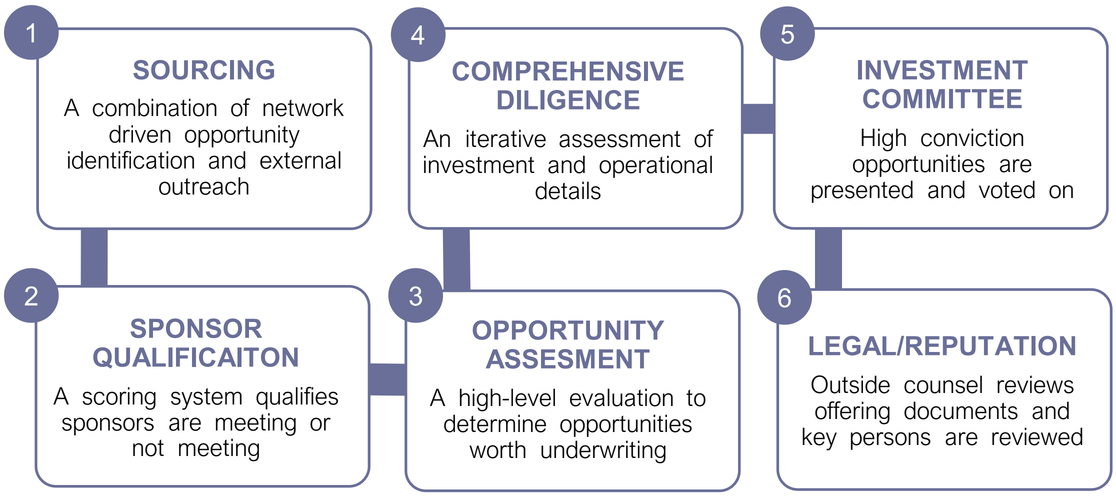
By running through this process (with two internal levels of approval), we're able to build a robust set of opportunities, circumvent many potential issues early in the process, and bring forth opportunities that we believe meet investor demand. At a high level, our process looks like the following:




In our underwriting process we seek to generate a meaningful volume of sourcing activity, such that we are establishing relationships with sponsors that fit our preferred characteristics as well as evaluating investment opportunities provided by these sponsors as they come to market. We track the segmentation of outcomes as a metric of our selectiveness, but do not ascribe to a particular rate of percentage invested from sourced investments. As we step through this narrative, we will highlight the ways in which we exhibit investment selection.

**Sourcing:**

Whether we're pursuing a particular investment theme or tactically exploring opportunities, the process starts with sourcing. This activity involves getting to know a broad universe of investment sponsors through both inbound channels (i.e., relationship driven referrals and sponsor pitches) and external outreach. Every member of the Investment Team supports this effort. The sourcing process identifies the top layer of our underwriting funnel.

Breaking down the sourcing channels further, we find that the cross traffic of inbound versus outbound methods allows us to cover an extensive portion of the investment universe. Keeping in mind that we cover private equity (inclusive of venture capital), private credit, and real assets (inclusive of real estate and infrastructure), our team is consistently sourcing opportunities across asset classes.

The inbound channel is in some ways our analog to the proprietary, or off-market sourcing in the fund sponsor space. While this includes inbound sponsor pitches, the majority of this activity is relationship referrals or tapping into existing sponsor relationships. Our Investment Team and firm leadership have in excess of 100 years of experience in the investment management industry. Coupled with that, several key persons are well entrenched in the Southeast community of entrepreneurs, high-net-worth investors, and business services providers (e.g., accounting firms and the like), each of which serves as a channel of deal flow. The inbound channel often delivers sponsor activity that is attributed to the more differentiated investments we make, and in many instances, is where we identify direct deals and independent sponsor transactions.

The complement to the relationship driven channel is our external outreach. This is much like an inside wholesaler generating leads for a public markets fund business. In this process, our team is armed with core criteria to identify what a potential manager hired by Altera may look like, and they locate sponsors through industry databases (e.g., Pitchbook and Bloomberg) and internet queries. The goal of our external outreach is to amass a universe of sponsors which we will ultimately run through a qualification process. Between inbound and external outreach, we maintain a continuous evaluation process with a goal of qualifying at least 200 to 300 sponsors annually. As sponsors and corresponding investment opportunities are identified, our team creates an Account record in our CRM to track the details of the sponsor and an Investment Opportunity to track the investment. From there, we are able to track a sponsor relationship pipeline and an investment opportunity pipeline.

## Sponsor Qualification:

As we assemble a universe of sourced sponsors and investment opportunities, we apply our first measure of selectiveness. In the sourcing process, we know very little about the investment sponsors other than what is publicly available on their website or may be gleaned from an initial conversation. Our sponsor qualification process is tied to one goal, determining if a prospective manager resembles the qualities Altera looks for in a sponsor. The profile is rather straightforward. We look for sponsors that are of high character, consistent, aligned with their investors, have demonstrated success, and have a clear competitive advantage relative to peers.

In qualifying sponsors, we go through an exercise of objectively scoring each sponsor based on a set of eight high-level questions.

The team member that identifies the sponsor will complete the qualification and the ratings will be captured in our CRM system. Each sponsor is scored on a scale of 2 to 11, with the outcome being one of the following designations:

- Does not meet Altera requirements (2 to 6)
- Meets Altera requirements (7 to 9)
- Exceeds Altera requirements (10 to 11)

The sponsor qualification process help our underwriting process in two ways. First, when we source an investment opportunity with a sponsor we don't already know, it helps us determine if we want to work with them. Second, it helps us establish a sponsor relationship pipeline. Our sponsor relationships present long-term opportunities, and initial qualifications give us the data necessary to track when qualified sponsors may bring investments to market in the future. After we qualify sponsors and there is an actionable investment opportunity, we move on to an opportunity assessment.

## Opportunity Assessment:

This is the part of our underwriting process where we undertake a deeper evaluation of investment opportunities. Through sourcing and sponsor qualification, we determine high level characteristics (e.g., the investment is in something we don't focus on, or the sponsor seems to have a pattern of misleading investors, etc.) that may lead to us passing on an opportunity, but do not get into a review of key elements like fee structure and value creation. Similar to the sponsor qualification, we are looking at a scorecard containing key areas of interest. To complete the opportunity assessment, we will utilize a combination of documents related to the opportunity (e.g., marketing deck(s), offering documents, etc.), as well as meetings with the sponsor to acquire required information.

Each opportunity will be scored across the following topics:

- Management Team
- Investment Strategy
- Value Creation
- Sourcing Capabilities
- Portfolio Management
- Risk/Return Profile
- Deal Economics
- Sponsor Alignment
- Fundraising Capabilities
- Operations

The outcome of this process is a numeric score that tracks to a category:

- Under 25: Do no pursue
- 25 to 36: Worth pursuing
- 36+: Attractive opportunity

At the opportunity level, we are looking to assess if the strategy is logical and differentiated from peers. There are hundreds of strategies in each sub-asset class, and we are trying to identify those that are both successful and have developed a competitive advantage. Further, we want to make sure the economics of the investment make sense relative to its risk and complexity, and that the sponsor is effectively managing the operational aspects of offering an investment.

Ideally, each opportunity that progresses past this point is scored as an Attractive Opportunity. However, there are scenarios in which an opportunity scored as Worth Pursuing will go through further underwriting. As is the case in most underwriting, the facts and circumstances behind a score may warrant additional discussion, through which a different outcome may be reached. Beyond this, we would mark the Do Not Pursue opportunities as Passed in our CRM. Opportunities scored as Worth Pursuing or Attractive Opportunity would then be moved to comprehensive diligence.

**Comprehensive Diligence:**

Due diligence is a time and resource-intensive process. To optimize the use of our resources, an opportunity should go through an assessment and score favorably prior to commissioning comprehensive diligence. Our goal with this stage of the process is to deepen our sense of optimism around an investment sponsor and strategy, such that we have high conviction. This requires a deeper understanding of the investment opportunity, and while we are optimistic in that we like an opportunity enough to underwrite it, we take a skeptical approach and utilize multiple validation methods to further evaluate the sponsor. We deploy significant resources on underwriting each prospective investment opportunity, including, but not limited to our outside legal counsel, professional background investigation firms, and our internal investment professionals.

At a high level, we delve deeper into whether a sponsor has been lucky, opportunistic, or is legitimately skilled. We ask if a manager can sustain any success they've achieved, whether they are set up operationally to support the complexity of their business and scale, and whether they have reputational baggage that may lead to negative media, distraction from the strategy, or criminal charges (in the worst case).

We look at the investment and operational components in isolation, but also in relation to one another.

As we transition from the opportunity assessment phase, we are digging deeper into the details of the opportunity and requesting a series of documents from the sponsor, including but not limited to:

- The private placement memorandum (PPM)
- The limited partnership agreement (LPA or equivalent)
- Audited financials (as available)
- Performance history and holdings from predecessor investment(s)
- Due Diligence Questionnaire (DDQ) (as available)
- Compliance Manual (as available)

- Code of Ethics (as available)
- Valuation and Accounting Policies (as available)
- Operational Controls Assessment (as available)
- Business Continuity and Disaster Recovery Plan (as available)
- Information Security Policy (as available)
- Policy on Diversity and Inclusion (as available)
- Responsible Investing Policy (as available)

We then evaluate investments through our proprietary diligence questionnaire. Some of the significant factors we focus on include, but are not limited include:

### Investment Due Diligence

| Investment Strategy | Investment Process | Team Structure & Tenure |
|---|---|---|
| ▪ What types of transactions(s) are anticipated?<br>▪ Are there parameters around deal size and hold periods?<br>▪ What sources of return are there? How is the downside protected?<br>▪ How might the market have evolved since their last investment? | ▪ How are the investments sourced and how is that process staffed?<br>▪ Are there distinct origination and underwriting functions?<br>▪ What is the process for portfolio management?<br>▪ What is the investment decision-making process?<br>▪ How are the investments valued?<br>▪ What exit scenarios are likely? | ▪ How long has the core team worked together?<br>▪ What is the approach to employee retention and what is the culture?<br>▪ What is the team hierarchy?<br>▪ Does the sponsor retain leadership of non-investment functions (e.g., Finance and Compliance)? |

### Operational Due Diligence

| Key Terms | Legal/Regulatory/Accounting | Third Party Vendors |
|---|---|---|
| ▪ Do the fees, GP terms, and rights/protections make sense?<br>▪ Is the internal documentation prepared correctly and to the standard set in the market?<br>▪ Is there demonstrated alignment of interest as shown by both the GP investment commitment and fee structure? | ▪ How are conflicts of interest handled?<br>▪ Are there any legal or regulatory matters outstanding?<br>▪ What is the manager's approach to risk management?<br>▪ How are key operational items handled? | ▪ Does the sponsor provide regular investor reporting and conduct an audit?<br>If so:<br>▪ What firm does the manager use for audit purposes and tax accounting?<br>▪ What firm does the manager use for legal counsel?<br>▪ What firm handles the fund administration? |

The breadth of operational diligence will vary depending on if we are underwriting a fund and its sponsor versus a co-investment or independent sponsor transaction. Many of those structures may not incorporate administration as an example or may not have audit financials provided. We acknowledge there are some differences and for things like audit/valuation will utilize a third-party valuation agent to substantiate the data we receive from the sponsor

Other key elements integrated into the process include:

**Review of past holdings and/or case studies:** The goal of this exercise is to understand behavior around how the investment manager underwrites deals, do they get attractive pricing (e.g., at what multiples do they acquire companies or what cap rates do they acquire properties), how comfortable is the manager with leverage, etc.

**Reference checks with service providers and LPs:** Ideally, we speak with the fund administrator and at least one LP from a prior fund.

**Interviews with the investment team:** This can be multiple meetings with different individuals, or a single occurrence with the broader investment team. The goal is to speak with individuals at different levels, get a walkthrough of process, and feel for the culture.

There is a distinction in our process depending on if we are looking at an investment in a fund, a co-investment, or an independent sponsor transaction. In the case of the former, there is an extensive assessment of the sponsor and their prior track record, but many times we will be investing either in a fully blind pool or a portfolio that is only partially identified when we invest. These situations require a more acute focus on the sponsor and a determination of if we feel confident they can continue to implement their portfolio strategy. When we invest in a co-investment or independent sponsor deal there is an identified asset(s) which we can evaluate. Our team will still assess the capabilities of the sponsor generally but will perform a more detailed evaluation of the target asset. This evaluation often includes building or replicating financial models, market research on the particular industry of focus, as well as validating sponsor assumptions.

After we conduct all our analysis, meetings, interviews, and reference/checks, we prepare an investment memo on the opportunity for the Investment Committee. The investment memo contains the recommended course of action and a suggested allocation amount. It includes a comprehensive assessment of the opportunity, the broader investment opportunity in that sub-asset class, the sponsor, their investment process and strategy, the track record, and an assessment of the operational diligence.

## Investment Committee:

Our next step is our Investment Committee process, in which a decision is made on whether a prospective investment is approved or rejected. On a weekly basis[1], we convene our Investment Committee to discuss the merits of each investment opportunity that has made it through an opportunity assessment or that have completed comprehensive diligence.

The Committee consists of the full Altera Investment Team. The team member who led the diligence ("Deal Lead") will present the merits of the opportunity and the Committee will determine whether the profile of the opportunity aligns with Altera's core investment criteria. Decisions are made through a majority vote, with the CEO retaining the right to veto any opportunity. In practice, we seek to ensure

*[1]In certain instances, the timing of an investment opportunity may be abbreviated, from identification to Investment Committee discussion. Under these circumstances, the Committee may meet off-cycle to assess an opportunity.*

all parties around the table are comfortable with the proposed investment and have consensus in moving forward, following which opportunity is considered to be “conditionally approved.” Opportunities that are conditionally approved will then go through legal/reputational diligence.

### Legal/Reputational Diligence:

As we go through our underwriting process, the Investment Team evaluates each sponsor and investment opportunity through a critical lens. We are validating and verifying what sponsors communicate as their value creation strategy, their level of alignment, their differentiation from peers, the sustainability of their business

operations, and their performance. Our internal process gives us high conviction on an investment and associated operations. To solidify our views, we enlist the services of our outside counsel, Seyfarth Shaw, as well as other outside parties as necessary. Seyfarth reviews key terms and identify instances where there may be a disadvantage to investors or include terms that are not consistent with the industry. In many cases, there are items identified as worth following up with the sponsor or recommendations for potentially improving the terms. The Investment Team will follow up with the sponsor as necessary, evaluate their responses, and assess the risks that may be presented by less favorable terms.

Along with the legal review, we engage background checks of the sponsors we work with. This process may look different depending on the firm we are considering (e.g., a firm that is registered with the SEC versus a small real estate operator). Effectively, we are looking to either a professional third party or a collection of resources in our network to determine the background and character of our potential investment manager. Similar to the legal review, there may be items uncovered in this process as well. The team will review issues with the sponsor to determine our level of comfort and whether that changes the decision to invest.

If an investment opportunity comes through Legal/Reputational Diligence favorably, the opportunity will progress to final approval and be investable.

## Conclusion

As demonstrated, our process for sourcing and underwriting is a meticulous and labor-intensive process. We endeavor to make the process both comprehensive and efficient, and always strive to identify best-in-class investment opportunities for our investors. We see tremendous value in the results of effective underwriting – it can represent the difference between allocating to a top quartile investment and a third quartile one.

## About Altera

We are a private asset investment firm focused on investing in the lower middle market. We back experienced fund managers and independent sponsors across private equity (buyout, growth equity and venture capital), real assets (real estate and infrastructure) and private credit (senior, junior and opportunistic). We aim to deliver attractive investment opportunities to family offices, high net worth individuals and registered investment advisors.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