Vector Capital Funds Expansion with Sale of Minority Stake to Dyal

By

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Photo credit: Vector Capital

On the heels of closing its fifth fund at $1.4 billion, **Vector Capital** sold a non-voting minority interest to **Dyal Capital Partners**, a division of **Neuberger Berman** that acquires minority equity stakes in established alternative asset managers. Other PE firms Dyal backs include: **H.I.G., KPS Capital Partners, Silver Lake** and **Vista Equity Partners**. Vector, based in San Francisco, invests in technology sectors, including: software, Internet, digital media, communications, and industrial technology. The firm has been active with portfolio company deals of late, including recently agreeing to sell **2020 Technologies**, a developer of interior design software, to **Golden Gate Capital**. We caught up with Vector founder **Alex Slusky** to ask about the Dyal deal, the larger trend of middle-market PE firms selling minority stakes and the tech M&A landscape.

Why did Vector Capital sell a minority stake to Dyal Capital?
We chose to partner with Dyal Capital because of their reputation as a highly strategic and collaborative partner to top-tier alternative investment managers. This transaction gives Vector access to permanent capital and the ability to leverage Dyal's extensive network and value-added resources while at the same time allowing for the firm to retain full control over our strategy, investment decisions, and day-to-day operations. The proceeds from this transaction will primarily be used to strengthen our private equity business and further expand our growing credit platform. Partnering with Dyal also builds upon our 20-year relationship with Dyal's parent, Neuberger Berman.

Why are middle-market private equity firms selling minority stakes?
Every firm's situation is unique, and each is at different stages of their evolution, but broadly speaking, partnering with a firm like Dyal provides general partners with the flexibility to accelerate growth, seed new product lines, fund GP commitments and facilitate succession plans, among other things. In our case, Dyal's investment will help us fund new initiatives, particularly our continued expansion into credit investing, which we have been doing since 2008.

What's driving tech M&A in the middle market?

At Vector, we focus on identifying technology companies requiring transformational change. Currently, we are seeing growth and strong performance within the technology sector broadly and across our portfolio. At the same time, mid-size technology companies are finding it difficult to go public, or they are struggling if they are public but are not growing at high rates. These are situations we are most focused on. In our view, valuations remain high as a result of a robust credit market environment, historically low cost of capital and a continued appetite from private equity firms in the sector due to increasing amounts of capital being raised. Lastly, given venture funding cycles, we are seeing a need for consolidation within certain sectors, which will play out in the near- and medium-terms.

How do Vector's equity and credit businesses work together?

Vector was founded in 1997 as a private equity investment firm focused on special situations investments in technology companies. Our credit platform was launched in 2008 in response to the dislocation in the credit markets caused by the financial crisis. It has since grown to approximately $500 million in assets under management between our credit hedge fund, the **Vector Capital Credit Opportunity Fund**, and other investments managed by our credit team. The two businesses are complementary and share a number of strategic synergies. The credit team is able to leverage Vector’s deep domain expertise within the technology sector and our extended relationship network. Meanwhile, our credit team often serves as an early warning radar for distressed equity opportunities and has sourced some of Vector’s largest private equity investments. But most importantly, having both businesses allows Vector to serve as a true partner to founders and management teams seeking flexible capital solutions.

What's your outlook for M&A in 2018?

Most of the factors that contributed to a strong technology M&A market in 2017 remain in 2018. Private equity valuations in technology, particularly in software, remain at record highs. Until we see significant operating underperformance across the sector and/or a contraction in the availability of credit financing, we don't expect the situation to change. That said, certain semiconductor companies are beginning to announce weaker results and they tend to be the "canary in the tech coal mine" since they sit very early in the supply chain. If that trend continues, there may be further signs of operating fissures across the tech business. The last decade has been truly great for technology companies. After such a prosperous expansion, whenever the downturn finally comes, it will be severe.

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