

Fund Economics

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LP Expectations from Venture Capital



LP Expectations from Venture Capital

- Industry Benchmarks
 - Cambridge
 - Prequin
 - Thomson Reuters
- PME
- DPI, RVPI, TVPI
- Current sentiment

Effect of Different Terms On Net IRRs

Assumptions:

Fund Size: \$1B; Life Cycle: 10 Years + 2 year ext.; LP Investment: 99%
 Contributions: Straight-line Years 1-4
 Other fund expenses offset by misc. income
 Distributions (multiple on invested capital)
 Return of capital: Straight-line Years 1-7
 Distributions in Excess of Capital:
 70%: Straight-line Years 8-10
 30%: Straight-line Years 11-12
 125% Test for Standard Model Distributions Made
 (assuming no fee reimbursement):
 1.5x: 91/9 2.0x: 87/13 3.0x: 83/17

<u>Model</u>	<u>Terms</u>	<u>LP Return on \$ Invested</u>		
		<u>1.5x</u>	<u>2.0x</u>	<u>3.0x</u>
LP Friendly Model	70/30 / 1.25% Fee Reimbursed	8.5%	15.7%	24.2%
	Return of Capital			
Standard Model	75/25 / 2.0% No Reimbursement	<u>2.2%</u>	<u>10.0%</u>	<u>18.2%</u>
	125% Test			
Difference		6.3%	5.7%	6.0%

Summary of factors impacting IRR to limited partners

For 2X return on dollars invested:			Change in
<u>Business Points</u>	<u>Static Assumptions</u>	<u>Return</u>	<u>%</u>
(A) Fee Reimbursement -vs- No Fee Reimbursement	25% Carry, 2.0% Fee, Return of capital	2.0%	35%
(B) 30% Carry -vs- 25% Carry	2.0% Fee, Return of Capital Fee reimbursement	(1.1%)	(19%)
(C) 1.25% Fee -vs- 2.0% Fee	25% Carry, Return of Capital Fee Reimbursement	3.0%	53%
(D) Return of Capital -vs- 125% Test	25% Carry, 2.0% Fee Fee Reimbursement	<u>1.8%</u> 5.7%	<u>32%</u> 100%

- The impact of management fees over 12 years (1.25% vs. 2.0%) has the most impact on returns to LPs; a 5% difference in carried interest has the least
- Not reimbursing fees and return of capital (full recovery) also have a significantly greater impact to LPs on their returns than the 5% difference in carry
- Difference between 75/25 & 70/30 likely not the determining factor of Quartile status
- Any use of leverage/recycling by either model assumed to be the same – therefore, no difference to change in return

Other terms that LPs care about

- Key Person
- Clawback
- Valuation Methodology for Distributed Securities
- Fees, particularly during extension periods
- Carry and how it's allocated to team
- Vesting

Incentives for GP & the Team

- Compensation
- Carry
- Spot or Incentive Carry
- More success + more responsibility = more carry

Career Path for Investment Professionals

Apprentice Model



Associate (Research/Project Flow) – generally 2 year stint
Sr. Associate (Research/Project Flow)
VP/Principal (Investing)
Partner (Investing) – 3 to 7+ years
General Partner

Thrown to the Wolves Model



Generally, senior operating execs brought in as Partners or General Partners – given checkbook and assume they have or will quickly get investment judgment; also given meaningful carry

Career Path Considerations



- Venture Capital is not like a tech start-up
- It's hard (although it does happen) to accelerate the timing of carry
- Critical to make the bet on the right firm for you