Fundraising Module

Why This Case?

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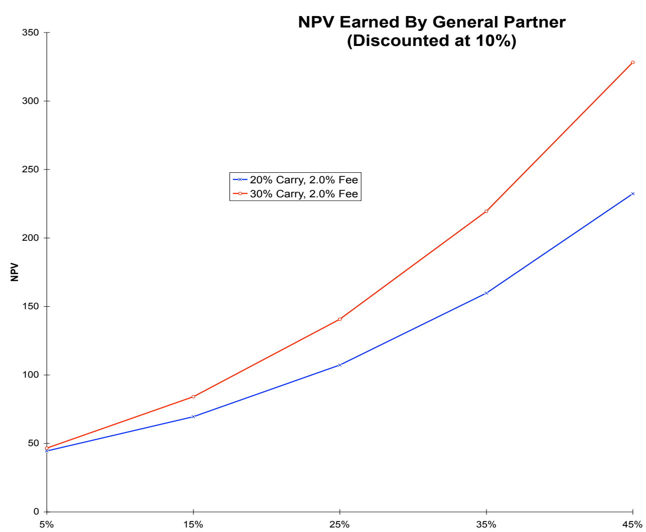
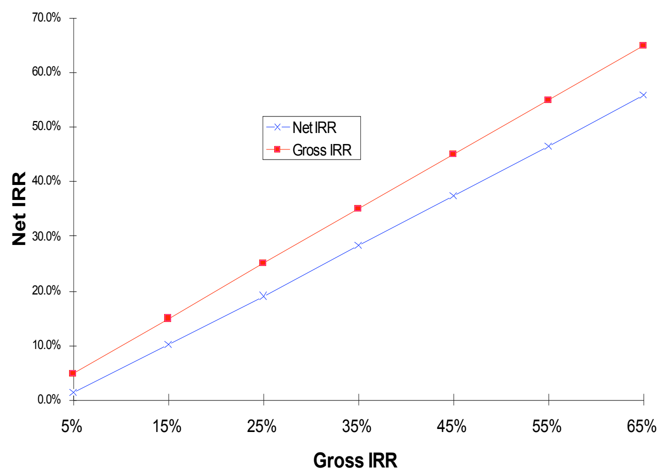
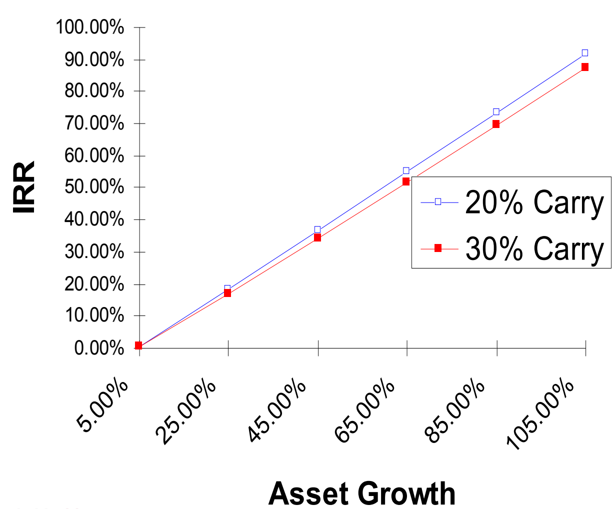
GP Economics



Net IRR to LP



IRR to LP as a function of Asset Growth



WHAT HAPPENED?

- Accel easily raised the fund -- Accel VII.

- Accel V was a $150 M fund.
  - Returned 19.6X net. 188% IRR.
  - Means that it returned about 30X gross.

- Accel VI was a $275 M fund.
  - As of Dec 11, 0.35 X capital, -11% IRR.

- Raised $1.6 billion Accel VIII in 2000.
  - Accel tried to split the $1.6 billion fund into $700 million and $900 million funds.
    - » Reduced management fee.
    - » Tried to maintain 30% carry.
    - » Rejected by LPs.

- Accel reduced Accel VIII from $1.6 billion to $700 million.
  - Currently running at 1.3 X net / 4% IRR

- In November, 2004, raised Accel IX.
  - Only $400 million.
  - But, still got the 30% carry.
  - Includes Facebook.

WHY THIS CASE?
VC / PEP Structure & Compensation

- What is VC / PEP Structure?
- How does VC / PEP compensation work?
- How do LPs evaluate a PEP?
- What should any GP do? A first-time GP?

VC / PE investing is long-term.

- 10 to 13-year lifespan.
- Hard to get money back.
- VCs / PEPs have huge amount of discretion.
- Covenants designed to put restrictions on GPs.
- Compensation a very important piece.

Structure of Compensation:

- Management fee as a % of:
  - capital committed (initially).
  - capital employed (later).
- Carried interest / share of profits:
  - fair value method (generally).
  - after return of capital.
- GP coinvest:
  - align interests, increase downside risk.
- For typical fund:
  - 1.5% to 2.5% of capital under management.
  - 20% share of profits.
  - At least 1% coinvest.

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Analysis of compensation:

- Positive:
  - Induces effort.
  - Attracts "talented" individuals / Screens out less talented.
    - » Hard to break 20% equilibrium.
- Negative:
  - Increasing fund size means some GPs, particularly large ones, can live well on management fee.
  - Increasing fund size means that GPs invest in different deals; or
  - Increasing fund size means new, less experienced partners.

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Evaluating Performance

- Industry looks at net cash flows to LP.
- Two industry standards:
  - IRR.
  - Multiple of Invested Capital (MIC).
- Four data providers:
  - Cambridge Associates
  - Venture Economics
  - Prequin
  - Burgiss Private IQ

What do LPs look for / ask?

- Principals
  - What is current structure of firm?
  - What is investment capacity with its current structure & staff?
  - What is the decision-making process internally among the principals for: (i) internal matters; (ii) new partners; and (iii) partnership operations and management decisions? What vote level (majority, unanimous, etc.) is required for decisions?
  - How is the ownership of firm held?
  - Identify amount of time (in %) each principal will dedicate to each role.
  - Describe the firm's professional turnover in the last five years, citing reasons for each departure.
  - Provide 8 references for each person.

- Investment strategy.
  - List all of the firm's prior funds, fund commitments, investments, investment amounts, and the principals involved.
  - Describe the fund's investment strategy and objectives.
  - What is the targeted rate of return for the fund?
    - Please provide both gross and net information.
    - Why do you feel such returns are achievable?
  - How do you differentiate your fund from competitive funds?

- Investment process:
  - How many opportunities are reviewed by the firm annually?
    - Provide a current deal log.
  - Describe your due diligence process.
    - Do you use a formal checklist?
  - Describe your investment decision process.
    - What factors are highly weighted?
  - How are typical investments structured?
    - What percentage is originated or led?
  - What type of role do you play after the investment has been made by the fund? Please explain how this adds value.
  - What is the policy regarding follow-on investments?
  - What process is in place for monitoring investments and creating optimal exits?

- Track records.
  - Have to evaluate realized investments.
    - » Who originated deals?
    - » Who added value?
  - Have to evaluate unrealized investments.
    - » Are they going to be winners or losers?

What is new? ILPA Guidelines

- To better align the overall relationship between LPs and GPs in PE.
- The Principles represent a basis for dialogue between LPs and GPs and reflect an intent to benefit all PE participants over the long term.
- The Principles represent suggested best practices in three areas: Alignment of Interests, Governance and Transparency.
- Alignment of Interests
  - Provisions focus on economic terms structured to tie more closely the economic incentives and results of the GP to the returns realized by LPs.
  - Move to European waterfall, stronger clawback protection, 100% fee offsets, management fees for operations, substantial GP investment.
- Governance: More power for LPs, protection against style drift.
- Transparency: More detailed disclosure to LPs.