David Conrod
Founder,
FocusPoint Private
Capital Group

The Case for *First-Time* Funds

A veteran placement agent explains why the smartest LPs seek to back new "teams and themes"

David Conrod, the founder of placement agent FocusPoint Private Capital Group, says private equity LPs are hungry for new teams to back, because the best of these can often produce significant returns. And yet determining which teams are likely to succeed is tricky, he says.

Privcap: What does the market look like for first-time private equity funds?

David Conrod, FocusPoint: A significant number of new management teams are being formed out of successful, high-quality private equity firms. When firms are successful, we see an acceleration of spin-outs and new firms launched. Whereas when times are not as buoyant, teams tend to stay together, which is somewhat contra-cyclical. The types of investors that gravitate to new funds are typically endowments, foundations, family offices, and recently some large institutional investors, particularly insurance companies. Additionally, investors having the confidence and judgment to support new managers with capital look to previous accomplishments. One can always have experience, but in some cases 10 years of experience may really only be the same single year of experience 10 times.

How do these investors get comfortable with a new team, albeit an accomplished one?

Conrod: They spend a substantial amount of time not only with the team but also confirming the investment thesis. We refer to it as "team and theme." These investors spend a great deal of time making reference calls as they look to connect the dots as to who they know that knows the talent under consideration. For our own due diligence, we seek to complete a minimum of 40 reference calls. In these calls, we also learn valuable information about the management team, and the value proposition becomes a thread that can be woven throughout their story.

Does it help for a new team to have one or two deals under its belt?

Conrod: A transaction provides visibility into a portfolio and will also compress the fundraising time frame.

With all the risks, why would an investor spend time vetting a first-time fund?

Conrod: One of the largest not-for-profit investors in the U.S. experienced a great deal of success with smaller first-time funds, which usually led to oversubscribed successor funds. It was quite apparent that these management teams are more motivated by carried interest, are operating within a larger deal opportunity set, and generally have smaller teams, enabling crisper decision-making with greater ability to influence outcomes. If the typical life cycle of a general partner is 15 to 20 years, with this evidence it may make sense to commit to a general partner in the first 10 years of its life.

There are also other advantages to being the first money in—investors can better drive economic terms. Supporting high-performing newly formed teams will also maintain a position of leadership in the industry, as many successful first-time funds become oversubscribed in fund two. The tricky part is having the judgment to back the right teams—that is what separates the cream from the milk. ■