



Deep Pockets: Repeatability, Consistency Analysis

June 2, 2006

By: James Bachman

One of the many ways that prospective investors attempt to analyze past performance of a fund sponsor is by investigating the *realization multiples* (“RM”) and/or *investment multiples* (“IM”) of the sponsor’s previous portfolio companies. These multiples (as defined below) are very simple metrics (no time weightings) that help to shine some light on the sponsor’s track record.

$$RM = \frac{\text{Distributions}}{\text{Contributions}}$$

$$IM = \frac{\text{Distributions} + \text{Valuation}}{\text{Contributions}}$$

In short, when these multiples exceed 1, the portfolio company was a profitable investment. The RM is typically used for fully exited companies, while the IM is used for companies still held in one of the sponsor’s funds.

During the due diligence phase, it is likely the investor will look at the distribution of these multiples. This helps to answer questions like the following:

- Did one “homerun” portfolio company carry the performance of a basket of underperforming (multiples < 1) portfolio companies?
- What is the average (median, minimum, maximum) multiple?
- Was more capital invested in the highly successful deals as opposed to the negative performers?
- What is the ratio of winners to losers?

Although every investor wants to be a part of the wildly successful deals, most would prefer a fund sponsor that has proven to be a consistent performer. Basically, repeatability (as gauged by the multiple) proves that the fund sponsor has more skill than another fund sponsor who has relied exclusively on homerun deals to carry performance.

Let’s not forget that many of the deals that the media publicize are only one of many in a particular fund. Thus, a portfolio company with a RM exceeding 100 may not actually impact the bottom line as much as expected. Moreover, a well diversified limited partner will feel that homerun even less because its money is spread between many funds.

It is worth noting that many of the longstanding venture capital firms have had their fair share of homerun invested over the years. The aforementioned discussion is not to discredit those investments, rather it is to highlight that an investor may be skeptical of the homerun being attributable to skill if it were one of the only profitable (multiple > 1) portfolio companies in the fund(s).