



Capital Raising – Raising a Fund? Things You Might Want to Know

July 31, 2007

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Before the recent turmoil in the capital markets, the credit market offered attractive financing options for private equity players. As a result, private equity firms found themselves deploying more capital and depleting their latest fund’s dry powder. The effect of this was and is an overwhelmingly large number of private equity firms have entered the market to raise their latest funds.

In this article, we aim to provide some key criteria used to evaluate a fund’s worthiness.

Gross Multiple and Internal Rate of Return Percentage (“IRR%”)

The gross multiple metric is defined as follows:

- Total Returns (Realized + Unrealized Returns) / Invested Capital

(\$ Millions)

	Investment	Value Realized / Public	Value Unrealized	Value Total	Gross Multiple
Company A	\$3.50	\$60.00	\$0.00	\$60.00	17.14x
Company B	\$13.00	\$35.00	\$0.00	\$35.00	2.69x
Company C	\$19.00	\$0.00	\$62.00	\$62.00	3.26x
Company D	\$40.00	\$9.00	\$105.00	\$114.00	2.85x
Company E	\$45.00	\$185.00	\$0.00	\$185.00	4.11x
Company F	\$26.00	\$50.00	\$0.00	\$50.00	1.92x
Total	\$146.50	\$339.00	\$167.00	\$506.00	3.45x

Note: This table is for illustrative purposes only and does not represent a real fund’s information

- Working off the table above, the fund has a gross multiple of 3.45x $(\$339 + \$167) / \$146.40 = 3.45x$. This is a simple calculation that explains what the firm’s cash on cash returns are expected to be.
- Similar calculations including, Realized Gross Multiple or Unrealized Gross Multiple can be run on a fund. The difference between the two metrics is “Realized” relates to cash received from exited investments (sale and IPO)

whereas “Unrealized” relates to the value ascribed to the portfolio’s current investments.

- This metric in combination with IRR% for a fund allow potential investors to gage recent and/or historical performance.

Realizations

Important to potential limited partners (“**LPs**”) and the like are the number and relevance of portfolio realizations (portfolio company *exits* – *i.e.*, sale, IPO *etc.*). While current investors want realizations to extract a return on their investment, potential LPs use realizations as a barometer on whether or not the fund can create value. Funds coming to market with largely unrealized portfolios might find it more difficult to raise capital than their more “*liquid*” counterparts. Additionally, it is important for these realizations to be somewhat recent.

Team Issues and Attribution Analysis

In analyzing management and team strength, a key component to measure is the team’s consistency. Has there been a lot of turnover? Has the team, including mid-level professionals worked and done deals together for a significant amount of time? Have there been any high-level or significant team changes and why? Are the team’s skill-sets and/or core-competencies complimentary to one another?

In addition to team turnover analysis, LPs tend to look at attribution analysis. This part of the due diligence focuses on which of the team members were involved with which deals in the portfolio. This helps reinforce whether or not the team is strong, and whether or not those team members remaining are the true deal makers adding value to the portfolio.

Sourcing

Another critical component to look at is the company’s sourcing capabilities as well as its infrastructure related to generating deal flow. While in many cases, deal sourcing is done on an opportunistic basis (with outbound calls being lobbed into management’s voicemail) some firms have recruited industry partners to help with sourcing deal flow.

Understanding both the volume of deals evaluated and the system in place that generated those investment opportunities is an important component to understanding how the fund operates.

Conclusion

Given the myriad of requirements LPs look for, it is obvious that raising capital is a difficult endeavor. It is due to this that many successful private equity and venture capital professionals look to placement agents to assist them in their efforts. Stay tuned for upcoming articles that delve deeper in the placement agent business.