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ELEMENTS OF EXCELLENCE SERIES *REVIEW*

The Fairview Capital team was pleased to host the first web conference as part of our Elements of Excellence Series on September 23rd, 2009. The conference provided a novel platform for participants to share elements of successful private equity business practices through three unique panel discussions focusing on brand building, portfolio construction and lifecycle management, and investor communications. The event featured distinguished panelists representing funds in the Fairview portfolio, each of whom brought unique perspective to each session.



For those who were unable to attend, we would like to present a comprehensive review of each session/panel discussion. For those who were able to attend, this review will provide an opportunity to further examine the insightful and valuable information and opinions shared by the extraordinary group of panelists.

BRAND BUILDING

Creating and Sustaining a Private Equity Franchise

Moderator

Matt Schaefer
Partner



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Panelists

Brian Jacobs
General Partner



EMERGENCE
CAPITAL PARTNERS

Ron Hunt
Managing Director



NEW LEAF VENTURE
PARTNERS

Saurabh Srivastava
General Partner



ARTIMAN
VENTURES

In what can be described as a turbulent time for the private equity industry, it has become increasingly important for firms to differentiate themselves and their strategies. This differentiation is often achieved through branding – building and developing a firm’s identity and conveying it in the marketplace. In the first session of the web conference, moderated by Matt Schaefer, Partner at Fairview Capital, the panel discussed the ways in which they think about their firms’ brands, strategies they have implemented to build, extend and communicate their own unique brands, and the benefits they have derived from having done so.

Mr. Schaefer conferred the idea that “a firm’s brand is more than just an identity – it is the building block for the development of an enduring franchise in the private equity industry.” Because each brand is unique, each panelist’s firm developed their brand and built their franchise through different circumstances and experiences.

Brian Jacobs, founding general partner with Emergence Capital Partners, along with his team, decided early on in their firm’s development that it was essential to build a franchise that would provide a competitive advantage. This was particularly important as the technology-enabled services sector, in which Emergence specializes, became increasingly competitive. It was essential for Emergence to establish itself as an early leader in the category - while the sector has grown and become more competitive since Emergence started, the firm competes successfully because they spent the time to develop a franchise built on knowledge and experience.

Ron Hunt, a managing director with New Leaf Ventures, faced a rather unique branding situation. Because New Leaf Ventures was founded in 2005 as a spin-out from The Sprout Group, the challenge faced was transitioning out and creating a new brand. Many of the branding decisions that had to be made were around the elements from Sprout the new group wanted to take and those they wanted to leave behind. Another challenge was in reinforcing the notion to entrepreneurs and the venture community that New Leaf continued to be a nimble group of investors, but with new elements to the team and strategy.

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Saurabh Srivastava, general partner of Artiman Ventures, along with his team, realized the need to find a niche and a message to differentiate themselves from other venture firms early in their development. Part of this challenge was overcoming the natural inclination they be thought of as a communications firm, since he and partner Amit Shah had come out of Cisco. Over time, they defined their identity based on their area of focus: “whitespace” investing. While the term can have many meanings, to Artiman, “whitespace” investing represents areas of technology featuring large markets, emerging technologies and no initial competition.

Once established, a firm’s brand undoubtedly impacts how the firm conducts business. Branding can impact a firm’s opportunities in many ways, particularly as they relate to fundraising and investing.

Mr. Hunt made it clear that “in venture capital the brand plays an incredibly important role.” He explained that when entrepreneurs and limited partners have to make decisions and are considering a group of firms to either work with or invest in, that decision is primarily influenced by the firm’s reputation, and by extension, its brand. Having an established brand can impact a firm’s opportunities: “There are opportunities that are brewing out there that would never simply find their way to you and you would never have an opportunity to find them, if there wasn’t this brand image that was being passed around within the various communities that are important to how you do business.” Mr. Hunt surmised that a venture capital firm’s brand is “worth investing in and worth protecting.”

Mr. Jacobs agreed with the assessment that a firm’s brand is closely tied to the opportunities it sees: “We measure the strength of our franchise by how closely our deal flow matches our investment strategy,” he said. He also suggested there are additional benefits that can be derived from a firm developing a brand for itself: “It’s a very healthy process for a group of partners to sit down and think about how they want to be thought of in the marketplace.” He added that having a shared notion within a firm about its brand helps the firm operate better.

Having established a brand and realizing that it can greatly affect a firm’s opportunities, a firm must then also find effective ways to promote and communicate that brand.

Mr. Srivastava explained how Artiman’s branding is more targeted towards entrepreneurs: “You want them to hear about how it is that we will differentiate ourselves and that we are very serious about rolling up our sleeves and doing things that would help them in the early stages of their company.” To extend its brand out to the entrepreneur community, Artiman holds a yearly “concept conference” geared solely toward entrepreneurs. The event serves as a platform for entrepreneurs to share their experiences and ideas and to network with one another. According to Mr. Srivastava, the event has helped drive many deals to Artiman.

At Emergence, Mr. Jacobs shared that they have been tactical in their approach to branding, and have given a lot of thought as to how to effectively express their brand to the right communities. A large part of their brand is thought leadership, which they have chosen to express more through their actions than through using other mediums, such as a blog. Mr. Jacobs also added that Emergence likes to use conferences as a way to promote their brand, often through participation on panels discussing matter related to their expertise.

PORTFOLIO CONSTRUCTION AND LIFECYCLE MANAGEMENT

Successfully Navigating Funds Through Market Cycles

Moderator

Alan Mattamana
Principal



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As private equity firms prosecute their business, they are constantly faced with competing interests. These interests must be managed as firms construct their portfolios and shepherd their investments through the private equity life cycle. In the second session of the conference, moderated by Alan Mattamana, Principal at Fairview Capital, two experienced general partners, Nina Saberi, of Castile Ventures and Willie Woods, of ICV Capital Partners, shared how general partners can address the tough issues encountered during a fund’s lifecycle.

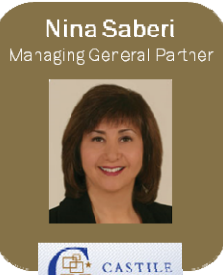
When constructing a portfolio, one challenge fund managers often encounter is selecting the appropriate syndicate partner(s) for an investment. Potential syndicate partners may have competing interests, particularly if their funds are at different lifecycle stages. Ms. Saberi pointed out that a fund’s lifecycle stage “plays a key role in the development and management of portfolio companies” for all firms. When considering syndicate partners, she explained that Castile asks the following question: “Is their role as a director and investor compatible with their role as a fund manager?” Part of analyzing a potential syndicate

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Panelists

Willie Woods
Managing Director



Nina Saberi
Managing General Partner



partner's role as a fund manager includes assessing their capital reserves as well as managing those reserves through their fund's lifecycle. Ms. Saberi also called attention to the fact that there are a number of other factors that go into selecting a syndicate partner aside from lifecycle stage, such as experience, interest and potential involvement in the development of the company.

Frequently, a firm's portfolio is impacted by factors established even before investment related decisions are made, such as the terms agreed upon at the onset of a fund. The terms first-time GPs must operate under are often different from the terms longer tenured GPs enjoy and can have serious implications on the development of a first-time GPs portfolio. Mr. Woods said he believes "there is a backwards relationship between first-time GP terms and long-established GP terms." Long-established firms are able to get better economic terms as they relate to the management fee, claw back terms, carried interest, transaction fee splits, and waterfall distribution terms. These firms typically already have an established infrastructure, and a well built-out team. First-time GPs on the other hand, as Mr. Woods pointed out, still need to build out an infrastructure and a team and yet, are often "at the mercy of LPs" when it comes to fund terms. If LPs want to ensure the success of a firm once a decision to commit has been made, they should not be looking for discounts on fund terms. Mr. Woods suggested that if LPs want to see the successful execution of a strategy, they instead look at milestones, infrastructure, and the team as a basis for negotiation, as opposed to purely looking at the economics.

Managing a fund and executing a strategy effectively also requires adequately reserving for follow-on investments. In the current environment, many GPs face the prospect of a shortfall in reserves. How does a firm avoid getting into a reserve shortfall situation in the first place? At Castile, Ms. Saberi explained they have a strategy of developing models at the onset of each fund. Not only is a detailed fund model developed, but it is modified over time taking into account a host of factors including market conditions, the progress of each portfolio company and the progress of the fund as a whole. The reserves allocated to each portfolio company are adjusted frequently according to these factors. The models also allow for proper balancing of the portfolio to meet expectations for diversification by stage and sector.

If a GP does find itself in a reserve shortfall situation, Ms. Saberi pointed out that many firms do not properly account for or take advantage of reinvestment provisions which are part of most fund agreements. These provisions typically allow for 10% to 15% of capital to be reinvested. If funds do end up facing reserve shortfall issues, Ms. Saberi suggested a number of ways in which they can be addressed, including: obtaining lines of credit, raising an annex fund, fund expansion, and crossover investing. All of these options must be evaluated taking investor suitability and expectations into account.

Fund managers frequently find themselves having to manage investor expectations regarding investments and exits as well. Managing these situations can especially be a challenge when market environments dictate actions opposite from the expectations of an investor. For example, major challenges can arise in managing investor expectations towards the end of a fund's life when faced with a weak exit environment or managing investor expectations at the beginning of a fund's life in a weak investing environment.

Overcoming these challenges "all starts with setting the expectations of the LPs up front," according to Mr. Woods. "You ultimately have to articulate the strategy and get LPs who have decided to invest with you on the basis of that strategy." Mr. Woods explained that in his firm's first fund they made it clear they were sensitive to valuations and that there were specific types of companies in which they were looking to invest. Making their strategy clear allowed ICV to be patient, especially in 2000, when their first fund was launched and "valuations were out of control." ICV waited eighteen months to complete their first deal, and the rest of the portfolio was constructed with deals made at more reasonable valuations. "Ultimately, you've got to inspire confidence in your LPs," said Mr. Woods. "It all comes to setting investor expectations upfront and living up to those expectations – meaning, demonstrating that patience, and ultimately delivering the results that that patience provides."

INVESTOR COMMUNICATIONS

Mastering Strategies and Tools for LP Interaction

Moderator

Lesley Nettles
Principal



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The private equity landscape has experienced significant change recently which has amplified the need for strong, trusted, fruitful relationships with investors. “Maturation of the private equity industry, dramatic increase in competition, tougher fundraising environments, investors becoming more sophisticated and continuously asking for more information, transparency and communication,” are factors that have all contributed to a heightened level of importance placed on investor relations and communications, explained Lesley Nettles, Principal at Fairview Capital and moderator of the final session of the web conference focusing on the role of investor communications.

Building enduring and beneficial relationships with current and prospective investors takes continuous effort and effective management over time. An investor relations (IR) professional can institutionalize and structure an approach to create meaningful bonds between the firm and investors. Private equity and venture capital firms often find themselves contemplating whether hiring a full time IR professional is a luxury or a necessity. Firms have to determine how they need to address important communications gaps and inconsistencies and what role, if any, an IR professional will play.

Panelist

Michelle Westfall
Director of Investor Relations



21ST CENTURY
21ST CENTURY GROUP, LLC

Michelle Westfall, Director of Investor Relations at 21st Century Group, described how the need for an IR team was identified over ten years ago at preceding firm HM Capital Partners. HM Capital was early in recognizing the value of building a dedicated team focused on investor needs. The results were immediate and positive: data was disseminated on a timely basis, a consistent message was delivered to the marketplace and relationships were vested at the firm level. When HM Capital morphed into 21st Century Group, there was a seamless transition in bringing their IR team over with Ms. Westfall at the helm.

The definition of an IR professional’s role is distinct at each firm. As such, it is important for each firm to “determine their need for a particular IR professional and exactly what activities and responsibilities that person will have,” according to Ms. Westfall. The IR role generally entails activities which can be grouped into four major categories: communications, relationship management, information distribution and fundraising.

An IR professional first must assume responsibility for communication with current and prospective limited partners and consultants. They must become “the point person” for receiving requests or sending out information, said Ms. Westfall. She also noted that “limited partners are demanding a lot more information,” meaning that “it is very important there is someone there to provide timely and accurate information.”

An IR professional can add value beginning day one with a call to investors informing them that this function has been established at the firm and what the investor can expect. Calendaring meetings with each investor multiple times throughout the year, including at least one formal portfolio update, helps build constant touch points that provide current information about the investor. This gathered client data can be integrated into building a strategy to raise capital from the limited partner going forward and provide insight on how to best strengthen the tie between the firm and the limited partner.

Ms. Westfall also pointed out that IR professionals must help their firm “provide a clear, consistent message to multiple people” when distributing information. The timing and frequency of communicating information is also important: “You need to be in front of your current and prospective limited partners four to five times a year, providing them information and updates.” She stressed the importance of following up after meetings, providing updates and information while fundraising and communicating new investments and exits to the press.

Arguably, fifty percent of a private equity or venture capital firm’s business is fundraising – a critical function. The IR professional plays an important role in this process as well. They work with the firm to develop the fundraising strategy, and can be involved in producing documents such as the private placement memorandum, partnership agreements, pitchbooks and other marketing materials. The IR professional can then also help conduct meetings to uncover opportunities to raise funds from existing or prospective investors

Finally, an important part of a firm successfully implementing an IR role is supporting the role or department with adequate infrastructure. This includes a system to identify, track and maintain records of limited partners. This system, along with properly “getting plans, strategies and tools in place” are paramount for a successful IR department, explained Ms. Westfall.