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SPECIAL REPORT ON THE YEAR AHEAD

Some First-Time Funds Find Success, Despite a Difficult Market

Investors continue to selectively back first-time funds, but the capital bar remains high

By TOMIO GERON

Investors in private-equity funds are choosier than ever in doling out commitments to new managers, but a small number of firms are winning them over.

Fund investors, referred to as limited partners, generally look to first-time funds to get in early on firms they believe will be the next generation of top performers. LPs often seek options such as co-investment rights and equity in a new firm's management company to offset the risk of betting on a newcomer. Now, they also demand a strong track record at a prior firm or as an independent sponsor and an ability to build and manage a new firm.

"We're always looking for the next generation of high-quality, high-potential managers. If you start developing relationships with groups earlier, you're helping somebody start something that could go on to be a much bigger, much more institutional household name," said Sanjiv Shah, managing director at HarbourVest Partners, who focuses on emerging and diverse managers.

High interest rates and slower exit activity have made fundraising challenging, particularly for first-time funds. Just 54 first-time U.S. funds closed in 2023, making up 14% of all U.S. private-equity funds raised last year, the lowest percentage in at least a decade, according to data from PitchBook Data.

"It's probably never been harder" for first-time funds, said Joe Healey, senior client partner and private-markets practice leader at executive recruiter Korn Ferry International.

Some new managers are landing significant anchor commitments by partnering with an investor that can seed their new fund, usually in exchange for an interest in the firm's management company. Such relationships can help new firms reduce some of the risk in raising capital, according to Jason Howard, founder and managing partner at New Catalyst Strategic Partners, a new firm backing emerging and diverse managers.

New Catalyst itself received an anchor commitment for its strategy from private-markets giant Apollo Global Management, which also took a stake in the firm. Apollo has provided deal referrals, introductions for recruiting and given other strategic advice, Howard said.

"We see how instrumental Apollo's resources have been already, and we're excited about providing the same type of catalytic value creation support for our partner GPs," he added.

However, seeding can present challenges in attracting other fund investors, depending on the size and specifics of the relationship between the fund manager and the LP seeding it. Firms can mitigate these concerns through agreements to liquidate a seed investment over time.

Offering robust co-investment opportunities also remains a popular enticement for LPs, Howard said. Such investments offer fund investors a slice of certain deals without charging management fees or carried interest on profits. Co-investments also are a "critical diligence tool" for LPs to get to know GPs before investing in a fund, said Kevin Kester, partner at Siguler Guff, which actively invests in first-time funds.

Siguler Guff sometimes will finance deals for first-time fund managers, a process often referred to as warehousing, Kester said. Such arrangements provide some or all the capital for a firm to support a small number of deals while it is raising a fund. The new firm can later buy back a portion of those investments once it has raised a fund or had its first close and Siguler Guff retains the rest as a co-investment.

Co-investments, seeded portfolios and warehousing strategies offer newer firms strategies for creating a track record that is critical to winning over investors.

Stephanie Geveda (center), sits with her team inside the Coalesce Capital office

At the same time, firms winning over LP capital in this environment often offer a unique investment approach that helps them stand out.

"The biggest catalyst to generate momentum is just having a differentiated approach that encompasses sourcing, value creation, how they partner with management teams, and that encompasses sector focus," said Eric Deyle, managing director and global co-head at Eaton Partners.

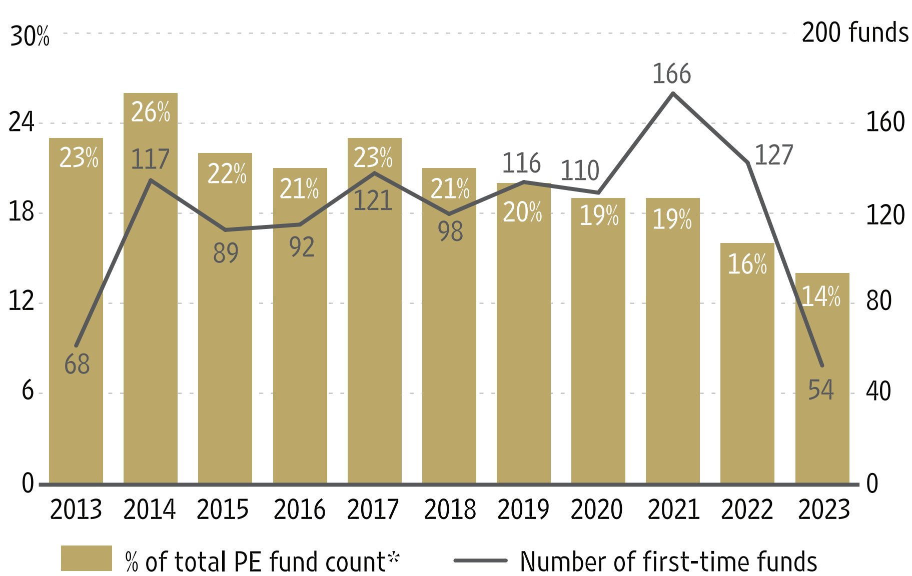
That includes domain expertise. "Particularly in the lower midmarket, we've seen increased appetite for specialization and domain expertise," Deyle said.

A firm that targets investments in human capital and technology-enabled business services deals, Coalesce Capital, rounded up some $900 million for its debut offering. The midmarket firm is founded by Warburg Pincus alum Stephanie Geveda. She has built experience focusing on such deals at Warburg, which backed her new firm's fund, alongside individual commitments from some senior executives at the firm.

"They wrote checks and they wrote checks early in the fundraising cycle, which is a strong reference point," Geveda said.

Market Share of U.S. First-Time Funds Falls

In 2023, first-time private-equity funds accounted for the lowest percentage of total U.S. funds raised in at least a decade



Note: *Percentages rounded to the nearest whole percent
Source: PitchBook Data

Investors Vary in Embracing First-Time Funds

Among fund-of-funds managers surveyed by Preqin, 81% said they would back a first-time private-equity fund

Firm type	Private equity and venture capital	Private debt	Hedge funds	Real estate	Infrastructure
Fund-of-funds manager	81%	80%	89%	67%	65%
Government agency	64%	60%	17%	30%	53%
Corporate investor	62%	43%	52%	23%	35%
Asset manager	57%	52%	58%	46%	47%
Sovereign wealth fund	53%	59%	40%	18%	63%
Endowment plan	52%	55%	44%	47%	52%
Family offices	51%	48%	57%	44%	48%
Fund-of-hedge-funds manager	—	—	80%	—	—
Bank	49%	45%	38%	26%	33%
Wealth manager	49%	49%	44%	47%	46%
Foundation	47%	41%	29%	30%	39%
Public pension fund	45%	44%	32%	30%	49%
Private sector pension fund	41%	37%	34%	21%	34%
Insurance company	38%	39%	32%	29%	32%
Superannuation scheme	34%	29%	50%	28%	38%

Source: Preqin

TPG Next, a unit of the private-markets firm that seeds funds for emerging and diverse managers, backed Visualize Group, which targets a combination of private and public investments, including take-private deals, said Pamela Pavkov, a TPG partner and head of TPG Next.

Visualize Group's founder C. C. Melvin Ike, previously a managing director at Blackstone, has a "unique background professionally (that) really equipped him with the insights necessary to build this specific type of firm that we think is really attractive in today's environment where there is such a disconnect between public- and private-market activity," Pavkov said.

Although the fundraising environment may be challenging for first-time fund managers, investors and placement agents alike say that those willing to back them will find more talent available, lower valuations and GPs who are very committed to their new firms.

"People have to be extraordinarily committed to their strategies to have the confidence to launch in this type of environment, which I think is another positive," New Catalyst's Howard said. ■

—Laura Kreutzer contributed to this article