**GP Spinouts**

In the past quarters or even years, it has been well publicized that first-time funds are experiencing what some describe as a nuclear winter when it comes to fundraising. It makes perfect sense that if relatively more seasoned funds with some semblance of a track record are having trouble raising subsequent funds, then first-time vehicles would experience even more exaggerated difficulties. Such is the way of the world that in times of uncertainty, human beings tend to resort to familiarity. Investors are no different. Familiarity helps reduce the length of the leap investors must make when entrusting capital with investment managers/sponsors. Many investors use a tried-and-true method to take relatively more calculated risks for the potential of higher relative returns: investing with new GPs with a history of investing within established asset managers. The ubiquitous phrase that takes various forms but typically states, “We invest in new funds but not new managers or people,” is one that most GPs have heard at one time or another from various prospective LPs. This is just code for “if we are going to invest in a ‘Fund 1’, we prefer it to be a spinout”.

“Spinouts” are typically viewed as investment managers who have left an established investment firm to form their own independent entities. The term is sometimes used loosely, but in most cases, the new entity has some connection with an established predecessor firm. Dianna Raedle and Deer Isle constantly make the case for GPs (particularly newly formed ones) to thoughtfully and deliberately take advantage of Brand Transfer (positive associations or affiliations with other well-known brands with proven strong reputations and value). When the “spinout” label is used by fund managers, placement agents, or research analysts to describe an investment opportunity, it is usually a purposeful or subliminal attempt to farm as much brand transfer as possible.

Below, I have compiled some points about the various types of spinouts and how LPs typically react to and assess managers with these designations.

- **Spinouts with attribution**: Some spinouts come highly certified with deal attribution granted by their predecessor firm. This makes it easy for potential investors to verify the depth of their investment acumen and the strength of their ongoing investment thesis. Granted attribution also shows that the new GP's contributions at the predecessor firm were substantial and catalytic enough to garner complete portability. Of course, the machinery (infrastructure, networks, systems, supporting team, goodwill, etc.) of the predecessor firm has to be taken into consideration when evaluating the new entity, but the existence of full attribution bodes well as a baseline reference check. LPs will still have to investigate the likelihood of cherry-picking by speaking to the GP’s previous firm, but for the most part, past deals attributed to the new GP allow for more substantive quantitative and qualitative research.

- **Spinouts with attribution and predecessor firm investment**: Most investment firms, even the ones that emphasize a team approach above individuals, know who their superstars are. These firms do their darndest (through enhanced compensation, ownership granting, increased autonomy, etc.) to keep their best soldiers, but many know that the day will come when these folks choose to venture out on their own. These predecessor firms also know that finding ways to keep their superstars within their orbit even after they depart can be beneficial from a reputational, marketing, and economic perspective. Predecessor firms of this thinking will typically invest in the new entity. Investments could take many forms, including the predecessor firm making an anchor investment, the principals of the predecessor individually committing capital to the entity, the predecessor firm taking an ownership stake in the management company of the new GP, an arrangement to co-invest in future deals, etc. For prospective LPs, the new

GP's strong affiliation with its predecessor firm can serve as a significant signaling mechanism of the manager's quality and could ultimately be the deciding factor if other first-time funds are being considered for limited investment slots.

- **Spinouts without attribution**: Some new GPs are clear spinouts from a renowned firm but weren't granted deal attribution transportability. There are a few reasons why this could be the case, including a strict firm policy against sharing these details, a firm philosophy that views all investments as team endeavors and not individual ones, the spinout GP not holding enough sway to demand such an attribution, a view by the predecessor that the spinout GP did not substantially affect deal outcomes, etc. These types of spinouts are trickier for prospective investors to underwrite. Additionally, the general subliminal signaling around these spinouts can be slightly detrimental. If a prospective LP sees value in continuing to engage with these types of spinouts, the lift of verifying historical investment prowess is heavier. Direct reference calls with junior and senior team members from the predecessor firm and individuals at the companies or assets listed on the new GP's track record can help confirm narratives. Spinout GPs without attribution also typically have novel ways to help prospective LPs form a complete picture of their past, including putting together informal synthetic portfolios of their past deals, providing names of key people who can verify their critical involvement in the success of past deals, etc.

- **Spinouts nomine tantum**: As I mentioned earlier, sometimes the term "spinout" is used very loosely. Sometimes, the individual/s who worked at the predecessor firm with brand recognition were junior team members with no real consequential impact, worked there for a short time, parted ways on less-than-savory terms, or worked at another company somehow affiliated with the brand-name firm. In other words, these individuals worked at a brand-name firm for a period of their career and left. Mentioning an affiliation with a reputable firm may garner a new GP an instinctive look from prospective LPs, but if the initial sniff test shows any level of clever manipulation, that manager could be penalized for willful deception or added to the pile of conventional Fund 1s.

In my view, the term "spinout" is a shorthand way to imply that the new GP carries some already verified admirable traits from its predecessor institution. These traits include unconventional intelligence, rigorous attention to detail, a contrarian predisposition, high quantitative aptitude, accretive counterparty relationships, operational excellence, etc. However, all new GPs, particularly spinouts, must realize that prospective LPs will scrutinize how your chosen strategy will differ, improve upon, or continue what you have done in the past, to increase the potential for future outsized returns. Past affiliations with proven entities can help open doors, but a clear understanding of your identity and path will keep you in the room.

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