

## **Institutional Investor Profile: Rupert Montagu, Co-Founder and General Partner, Montagu Newhall**

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**Montagu on the value of identifying quality emerging management teams in their early years, on the importance of gaining vintage year diversification, on a shift in the balance of power between entrepreneurs and VCs and on the crack that is just beginning to appear in the IPO window.**

*Montagu Newhall is a venture capital fund of funds with a particular focus on early-stage investments. The firm was founded early in 2001 and its four investment professionals are based in both the UK and US. Montagu Newhall currently has approximately \$106m under management for both fund and co-investments in the US, Europe and Israel. Montagu co-founded the firm with Ashton Newhall and was previously at Altius Associates.*



### **How did Montagu Newhall come about?**

'The firm was founded by Ashton Newhall and myself at the very beginning of 2001. I had been working at Altius Associates in London and Ashton has been working at T. Rowe Price in the US. We already had a strong professional relationship because, at the time, these two organisations were planning a joint venture to create a private equity fund of funds product. So, when the project was pulled for broader strategic reasons, Ashton and I decided to leave our respective jobs and form Montagu Newhall.

'We had actually known each other, through family connections, for many years prior to this. Ashton's father founded New Enterprise Associates back in the 1970s, at about the same time my father was founding Abingworth. Abingworth and NEA have co-invested successfully over many years and I think this link gave us the encouragement that we required to launch our own venture capital fund of funds.

### **Why did you choose to focus purely on venture capital?**

We decided to focus on venture capital as opposed to later-stage private equity because that is one area where we have particularly strong relationships. As a result of our extensive network we felt that we would be able to create a highly differentiated product in this space. We were also aware that these relationships could be invaluable in helping us to gain access to the very best venture capital funds being raised.'

### **What about your particular focus on early-stage venture capital?**

'We decided to focus our investment strategy predominantly on early-stage funds because we feel that this is where the most rewarding opportunities are often to be found. If you look at the returns that have been generated historically across the venture capital industry, you will find that early-stage investments have outperformed later-stage investments to a very great extent.

'However, we do occasionally also make investments in funds that have a later-stage venture capital profile. Although this type of investment forms a relatively small piece of our overall portfolio, it is important to recognise that there are some extremely talented later-stage managers that have performed at least as well as the very best early-stage funds that we see. These funds also have the added advantage of generating liquidity at an earlier stage.'

**Beyond your emphasis on early-stage funds, what type of investments do you look for?**

'Geographically speaking, we focus predominantly on the US. In fact, just over 90 per cent of our first fund has now been deployed there, while the remainder is invested in Europe and Israel. I expect our geographic allocation to continue in a similar vein going forward.

'Within the US, we aim to gain a broad exposure across each of the main markets. We inevitably invest a great deal on the West Coast, and also on the East Coast, particularly in the Boston and MidAtlantic areas. In addition, we try to identify up and coming centres of excellence that we feel will generate good companies and good returns in the future. One example of this is a recent investment that we made in North Carolina's Research Triangle.

'In terms of sector, what we are trying to do is to provide the most diversified product that we possibly can for our investors. We focus on the three core elements of venture capital investing; information technology, communications and healthcare and life sciences, and we aim to invest fairly evenly across this spectrum.'

**Are there any areas or industries that you feel are particularly exciting at the moment?**

'We have always had a particular interest in the healthcare and life sciences sector, particularly in speciality pharmaceuticals and medical devices. We actually ended up deploying slightly more than a third of our first fund in this area. Not only do we have very good relationships with a number of extremely talented managers in this field, but we also believe that the fundamental building blocks of success are in place to take this industry from strength to strength. An aging population, combined with significant scientific development, makes for a very interesting investment proposition indeed.

'We have always tended to be a little more cautious in the communications area. Companies in this sector have experienced some very difficult times following the bursting of the internet bubble and, as a result, we have approached this market with a certain degree of caution in the first few years of our business.'

**What are your views on the venture market in general?**

'I think that things are definitely looking more positive for the venture industry as a whole. Although, with the bursting of the bubble, the quantity of deal flow fell significantly, the average quality of deal flow has risen quite dramatically.

'But while there has at no stage been a shortage of deals to invest in, the real risk in recent years has been an almost total lack of exit opportunities, particularly through IPOs. This is now starting to change. While the IPO window is certainly not wide open, there is a crack beginning to appear. This has been evident in the number of companies that have managed to go public over the last few months and is a very welcome relief for a lot of venture capital firms that have been

anxious to exit their existing portfolio companies in order to move on and make new investments.'

### **What about European venture?**

'As a European myself I get incredibly frustrated because it is clear to me that the underlying technology in Europe is at least as impressive as anything you will find in the US. But unfortunately, the less mature European venture capital industry has, as yet, failed to deliver the types of returns that investors have come to expect from the US market.

'If you look at a US venture portfolio you generally see a number of investments that have generated two or three times the capital invested. You then also see a small handful of outstanding investments that have generated ten, 20 or even 30 times the initial investment. It is these home runs that really give the overall portfolio a significant out performance. Unfortunately, in Europe, home runs are few and far between and without them it will be incredibly hard for European venture capital to compete with the US.

'Having said that we have deployed approximately ten per cent of our first fund in Europe and Israel and that is because we want to take advantage of the technology that is being created there. There are definitely some funds that really are worth investing in, and that we think will produce very comparable returns to the top tier US funds.'

### **How many investments do you typically make in a year?**

'We typically aim to make six or seven fund commitments in a year, with the objective of having around 20 to 25 underlying fund commitments in a fund portfolio. We are more opportunistic with our co-investment strategy and we generally go at the speed at which good opportunities present themselves. We have ended up on average completing between three and five co-investment deals per year and would expect to continue at a similar rate going forward.'

### **What size of investment do you typically make?**

'Our bite size can vary considerably. If we are making a commitment to a long established firm, we will typically commit around \$5m or \$6m. We also reserve a portion of our capital for emerging managers and we would generally invest between \$1m and \$4m in a newer fund. Our co-investments usually fall in the \$500,000 to \$2m range.'

### **Why have you chosen to reserve capital for emerging managers?**

'There are a number of emerging managers that we believe will generate returns that are at least as good as the top tier long established managers. We decided to reserve some capital for these types of managers because we believe they represent the future of the industry and we want to reserve our seat at the table.

'But it is important to point out that for us, an emerging manager is rarely a team that is raising its first or even second fund, although we may look at such opportunities under special circumstances. Our emerging managers are typically teams that are raising their third, fourth or even sometimes their fifth fund. You have to consider this in the context of the US venture market where a lot of the long established managers are now raising their tenth or perhaps eleventh fund.'

### **How do you find out about good investment opportunities?**

'We know a lot of the long established managers extremely well already and we make sure that we stay as close to them as possible in order to ensure that we gain access to their new funds. If you read about a top tier firm that is looking to raise a fund, the chances are that by the time you have dialled their number it will be too late. It is essential to be proactive.'

### **What do you look for in a good fund manager?**

'One of our key concerns when assessing an investment proposition is whether or not a firm has adequately taken care of the succession issue. We have turned down a number of funds for that very reason. We need to feel confident about who will be running the firm going forward.'

'There are a number of other attributes that we look for in a good manager. We like to see a team with broad venture capital and operational experience, as well as healthy team dynamics. We also like to see a consistent track record that has not been sustained by one or two big hits, but that has a convincing breadth and depth across all previous funds.'

'In addition, we look for a firm with a consistent investment strategy. We have seen a lot of venture firms that have swung wildly from one investment strategy to the next and we have tended to avoid those and have focused instead on teams that have maintained the same strategy over multiple funds. And finally, we look to find managers that have generated a lot of respect in the LP community, GP community, and most importantly in the entrepreneurial community.'

### **How do you go about conducting your due diligence?**

'In any one year there are hundreds of venture capital funds raised and what we do initially is to screen those funds to see whether they will fit into our portfolio. In order to fit into our portfolio a fund should be targeting at least \$100m, have a pure venture capital profile, as well as being focused on the right sectors and the right geographies.'

'We then complete a detailed questionnaire to ensure that all the 'i's are dotted and all the 't's are crossed. We spend a great deal of time talking to other LPs, other venture capital firms and also to portfolio companies, in order to gain a wide range of perspectives on whether that fund is likely to continue to generate good returns in the future.'

'We also hold extensive talks with our advisory board members, a number of whom are founding partners of leading venture capital firms in both US and Europe. This is, of course, incredibly valuable when it comes to assessing investment opportunities.'

### **What advice would you give a new investor in private equity?**

'First and foremost, I would advise a new investor in private equity to ensure that they achieve good vintage year diversification. Like wine, it is rather hard to know at the beginning how a particular year is going to turn out. It is therefore very important to continue to make commitments annually to the asset class. If you do so, theoretically speaking at least, you will be able to use your distributions from the good years to meet drawdowns and ultimately, your investment strategy will become self-perpetuating.'

'It is also essential to make commitments to funds that are being raised by experienced and proven teams. In the late 1990s and early 2000, a lot of firms were able to raise venture capital funds that perhaps should not have been able to do so. The consequences of those years have provided investors with a sharp reminder of the importance of investing with the best.

'The only problem of course, is that it is extremely difficult to access these top-performing funds. There are very few new investors that would be considered by the most established firms. In addition, most venture capital firms are raising much smaller funds than was previously the case, which is further exacerbating the problem. As a result, I would say that the majority of new investors would be well advised to use a fund of funds for diversification, expertise and access.

'Ultimately, if you cannot gain access to the top performing funds, either directly or through a fund of funds, then I genuinely don't think that it is worth getting into the asset class at all.'

### **How do you expect the market to evolve going forward?**

'During the bubble period entrepreneurs were very much in the driving seat. But immediately after the bubble burst roles were reversed and venture capitalists were in control and dictating the terms under which deals were done. I think we are now gravitating toward a situation where there will be a much better balance between the venture capital firms and start-up companies in structuring deals. And I think this will be absolutely critical to producing good returns long term.'

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