



Funds in Focus 2019

Private Funds Annual Review Conference

Latest Trends in GP Stake Sales
and Asset Manager M&A

**Rob Day, Stephen Meli, Jeremy Naylor,
Steve Peck, David Tegeler**

Proskauder»

Agenda

- Market Drivers and Trends
- Control Transactions
- Minority Transactions
- Diligence Considerations

Market Drivers and Trends



Drivers



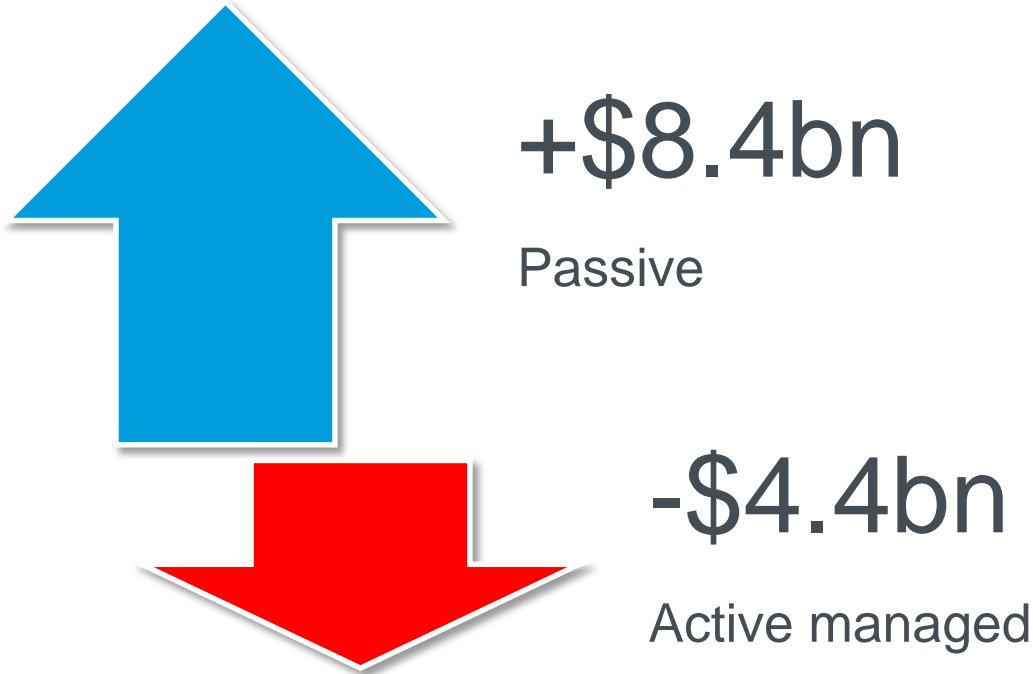
AUM +6.9%



Profit margin
-5.2%

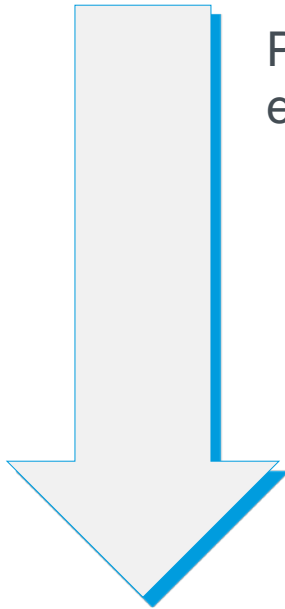
Source: Casey Quirk, 2015-18

Drivers

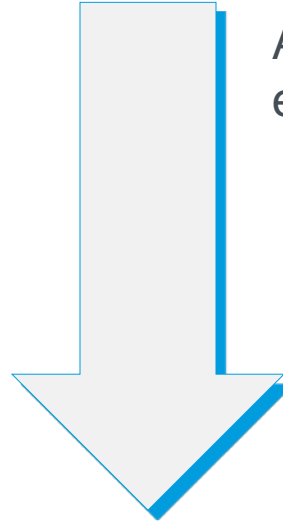


Source: Blackrock Q3 2019

Drivers



Passive – fee
erosion 3.5%



Active – fee
erosion 2.5%

Source: Casey Quirk 2015-18

January 02, 2019 12:00 AM

Money managers face reduced margins in 2019

RICK BAERT [Twitter](#) [LinkedIn](#) [Email](#)

Fee pressure slashes asset manager margins to 2009 low

Global asset managers lost \$29 billion (\$22 billion) in unrealized profits as their operating margins shrink to 20% in 2008 from a post-financial crisis high of 34% in 2015, according to Citigroup estimates.



INVESTMENT WEEK

Asset management M&A picks up as boutiques set to feel the pinch

Flurry of tie-ups expected in coming months



An estimated \$3.7tn in almost unchanged fees in the industry last year.



Julie Segal

CORNER OFFICE

Asset Management's M&A Boom Will Continue

The value of asset and wealth management deals reached the highest level since 2009, PwC says — and the party isn't over.

January 24, 2019

THE WALL STREET JOURNAL.

English Edition • October 16, 2019 • Print Edition • Video

PRO PE FUND NEWS

DeVos Family Office Affiliate to Buy Stake in Nordic Capital

Nordic Capital will use a cash injection from a unit of RDV Corp, the family office of a clan that includes Betsy and Richard DeVos to strengthen its balance sheet

HGGC Receives Strategic Minority Investment from Dyal Capital

Capital Injection to Drive Continued Growth of Successful Technology Focused Firm

HGGC

THE WALL STREET JOURNAL.

English Edition • October 16, 2019 • Print Edition • Video

Home World U.S. Politics Economy Business Tech Markets Opinion Life & Arts Real Estate WSJ Magazine Search

MARKETS

Buying Stakes in Private-Equity Firms, Not Just Their Funds, Pays Big

For investors such as Dyal Capital Partners, it means getting a direct cut of the hefty fees buyout firms charge and the profits from their deals

Bloomberg

Dyal Capital Near Deal for Stake in Infrastructure Investor I Squared

By Heather Perlberg, Gillian Tan, and Sonali Basak

10 September 2019 22:12

Defining Factors



- It's a people business



- It's a data, analytics and IT business



- It's a results business

Hedge Fund Adviser to Pay \$5 Million
for Compliance Failures Related to
Valuation of Fund Assets

- It's (increasingly heavily) regulated

Defining Factors



It's never plain vanilla

Control Transactions v. Minority Investments

- Control Acquisitions

- Large Asset Managers
- Grow AUM to offset margin contraction
- Access to new client base
- Diversify offerings
- Onboard new talent

- Minority Investments

- Sovereign wealth and other passive institutional investors
- Rise of “GP-stake Funds”
- Predictable and stable revenue stream
- Access to LP investment opportunities

Control Transactions



Some Considerations

Acquisition Transactions – Deal Structure Considerations

- Purchase Price Structure -- Buyers often structure purchase price to align interests post-closing
 - Earnouts
 - Deferred Payments
 - Rollover Equity
- Deal considerations for non-owners (“next generation” issues)
- Tax Structure – Capital gains for Sellers; Stepped-up tax basis for Buyer

Acquisition Transactions – Purchase Price Structure

- Earnouts
 - Require negotiation of control over key post-closing business matters to the extent affecting earnout metrics
 - Fundraising cycle; Buyer competing products; Target access to Buyer clients and vice versa; hiring/firing decisions; expense allocations
- Deferred Purchase Price
 - Creditworthiness of Buyer
- Rollover Equity
 - Typical minority rights

Acquisition Transactions – Non-Owner Considerations

- Buyers often seek to align interests of non-owner investment professionals (“next generation”) and may make their participation a condition to the transaction
 - Carry participation post-closing
 - Role with Target/Buyer post-closing
 - Bonus/equity incentives
 - Generational control transfers through these types of transactions can result in tension between owners and next generation professionals

Acquisition Transactions – Tax Considerations

- Generally Taxed as Asset Sale
 - Basis step up for acquired assets of Target
 - Generally capital gains to Seller (goodwill, franchise value, brand)
 - Value of so-called “Hot Assets” such as management agreements taxable to Sellers as ordinary income
 - Valuation is key – look to termination rights under contracts
- Impact of new carried interest rules
 - 3 year holding period for long-term cap gains
 - Applies to Manco interests?

Acquisition Transactions – Tax Considerations

- Ensure purchase price is not treated as compensation
 - Watch out for forfeiture of deal proceeds in event of termination of employment
- “Non-lapse” restrictions in operating agreement
 - Tax owner of interests in Manco?
 - Amend agreement to add long-term vesting?

Acquisition Transactions – Other Considerations

- Gap period issues
 - Client/AUM loss or increase and impact on Purchase Price
 - Nature and timing of client/regulatory approvals
- Indemnification obligations – set off against earnout/deferred purchase price and impact on alignment of interests
- Control over existing fund GPs (as opposed to management company) and Buyer involvement in carry grants, forfeitures and dilution
- Marketing of funds/closings during pendency of transaction

Acquisition Transactions – Fund Matters

- Obtaining client consent
 - Advisers Act anti-assignment and change of control rules
 - Who is the “client”
 - Fund, managed account, fund-of-one
 - LPs v. LPAC
 - Customary closing condition
 - When and how to seek
- Other contractual consents (e.g., side letter)
- Fund LPA amendments

Acquisition Transactions – GP Matters

- Buyers often seek to take control of each GP entity
 - Regardless of whether carry is changing hands
 - Tension between Buyer securing control over Seller's fund structures . . . and Seller group maintaining control over the vesting, forfeiture and dilution of their own carry
 - Buyer may not stipulate control until after term sheet stage
 - “Splitting the difference”

Minority Transactions



Some Considerations

Minority Transactions – Nature of Investment

- Percentage ownership interest aligned with managers versus preferred equity
 - Debt vs. Preferred Equity – Tax Considerations
- Investor rights/obligations for carry and capital contributions
- Growth/balance sheet capital versus liquidity for owners
- Passive investor with minority protections versus more active investor with governance rights
 - Board or IC participation
 - Compensation and incentive equity limiters
 - Key business changes

Minority Transactions – Investor Protections

- No competing business -- All management fees captured through Target entity
- Protections against economic dilution -- limits on compensation to investment professionals, affiliate transactions, etc.
- Transfer rights, tag and drag-along rights, preemptive rights, put/call rights
- Information and access rights
- Rights and obligations regarding fund LP commitments

Minority Transactions – Investor Contributions

- Minority fund investors often market themselves to Targets as bringing value to the enterprise
 - Investor introductions
 - Distribution and sales
 - Access to capital
 - Secondary liquidity
 - Compliance/back-office assistance
 - Strategic advice

Diligence Considerations



Diligence – Key Topics

- People
 - Current ownership
 - Current incentivisation
 - Incentive allocation method
 - Protective covenants
 - Track record usage
 - Departures and disputes
- AUM
 - Fund structures
 - Contractual withdrawal rights
 - Statutory withdrawal rights
 - Client consent/notification requirements
 - Key man
 - Side letter/MFN
 - Possible impact into acquiring group
 - Client intentions
 - Clawback risk
 - GP/Executive investment requirements

Diligence – Key Topics

- Risk and regulation

- Litigation, claims and disputes
- Regulatory correspondence (and investigations)
- Risk and compliance policies
- Governance
- Regulatory approval requirements

- IT

- Proprietary software and systems
- Change of control impact
- Alternative provision

- IP

- Proprietary algorithms and models
- Business processes
- Proprietary data

Diligence – Complicating Factors

- Separation from financial institution
 - IT separation
 - Data separation
 - Secrecy laws
 - Distribution model
 - Central risk function
 - Central regulatory capital
- Succession at the same time
 - People and client attrition risk
 - Allocation of current and future consideration
 - Control and compliance risks
 - Possible cultural mismatch

Diligence – Traps for Unwary

- Seller's Corner

- Structure, ownership
 - Governing agreements in sync with how you plan to share proceeds?
 - Recently equitized “partners”
- Corporate hygiene
- Regulatory approvals
- Contractual approvals
- Fiduciary duties among selling individuals

- Buyer's Corner

- Acquisition Deals
 - Gaps between Seller's and Buyer's compliance programs (e.g., political contributions)
- Minority Deals
 - Avoiding “affiliate” status
 - Federal securities law presumes at 25%

Contacts



Rob Day
+44.20.7280.2040
rday@proskauer.com



Stephen Meli
+1.617.526.9745
smeli@proskauer.com



Jeremy Naylor
+1.617.526.9441
jnaylor@proskauer.com



Steve Peck
+1.617.526.9890
speck@proskauer.com



David Tegeler
+1.617.526.9795
dtegeler@proskauer.com

Proskauer's Global Presence





The information provided in this slide presentation is not intended to be, and shall not be construed to be, either the provision of legal advice or an offer to provide legal services, nor does it necessarily reflect the opinions of the firm, our lawyers or our clients. No client-lawyer relationship between you and the firm is or may be created by your access to or use of this presentation or any information contained on them. Rather, the content is intended as a general overview of the subject matter covered. Proskauer Rose LLP (Proskauer) is not obligated to provide updates on the information presented herein. Those viewing this presentation are encouraged to seek direct counsel on legal questions. © Proskauer Rose LLP. All Rights Reserved.