

Proskauer» Built to Serve Asset Managers

Asset Manager M&A Considerations

Legal & Business
Insights for Asset Managers
The Bottom Line

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Agenda

- Market overview and trends
- Minority/GP stake investments
- “Joint venture” launches
- Acquiring control
- Preparing for an Asset Manager M&A transaction

Market Overview & Trends

Outlook – What is Driving M&A Activity?

Despite global uncertainty brought on by COVID-19, we believe M&A activity is likely to continue at a robust pace

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Need for Scale

- Medium and smaller-sized businesses without adequate scale or sufficient differentiation (product niches or investment performance) are finding it harder to compete
- Brand and access to diversified global distribution is becoming increasingly important
- Investors consolidating stables of managers drive need to offer multiple products to retain existing and attract new relationships
- Private markets businesses seeking to access capital (GP and seed capital)

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Demand for Private Markets

- Appetite for private markets strategies will continue given strong investor demand
- Managers are assembling private markets platforms across private equity, private debt, real estate and infrastructure
- Traditional managers are diversifying from long-only active businesses facing strong headwinds from passive providers

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Global Presence

- Diversified asset managers have continued to show an interest in quality investment management opportunities globally
- US and larger European groups are looking to build out global presence while Asian groups are looking to partner with firms to expand access to investment capabilities
 - Private markets strategies generally require on-the-ground resources given active value creation

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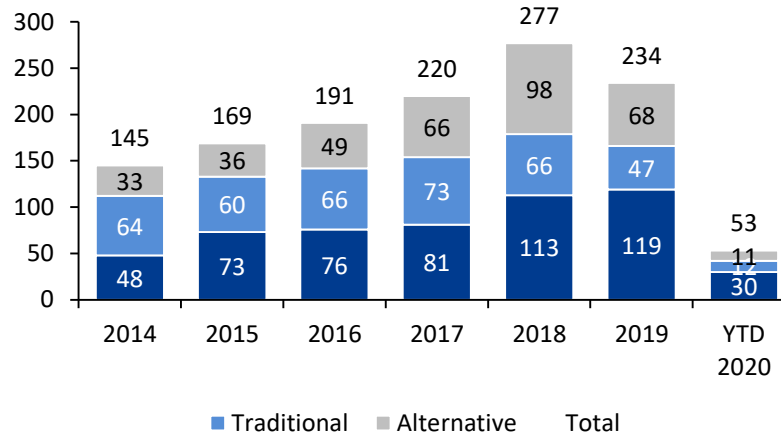
Regulatory Impact

- Operating costs going up given regulatory impacts
- Regulatory developments continue to shape the market and impact the strategic outlook for bank- and insurance-owned asset managers
- Volcker rule, Basel III and CRD IV limit a banks ability to provide seed capital and pay market-based compensation
- MiFID II in Europe could reshape how banks and other distributors operate in the market place

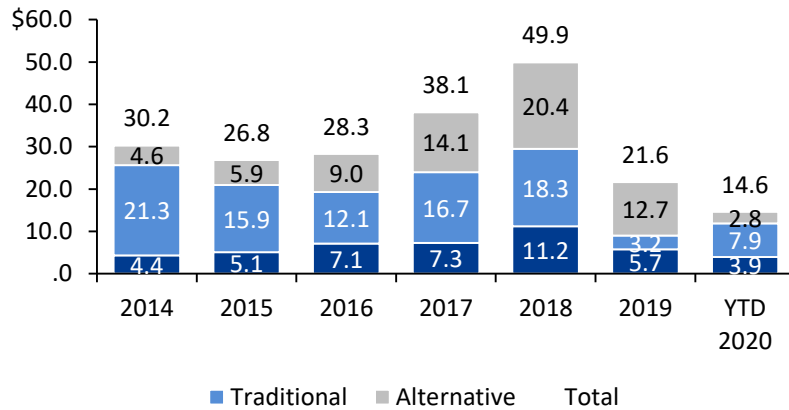
Global Investment Management M&A Trends

Global investment manager M&A has become increasingly active since 2013 while valuations have generally increased over the same period, although activity in 2020 has slowed as a result of COVID-19

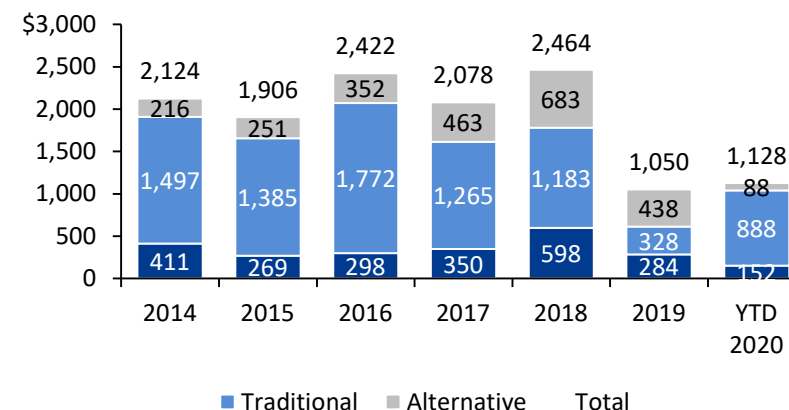
Historical Number of Transactions (#)



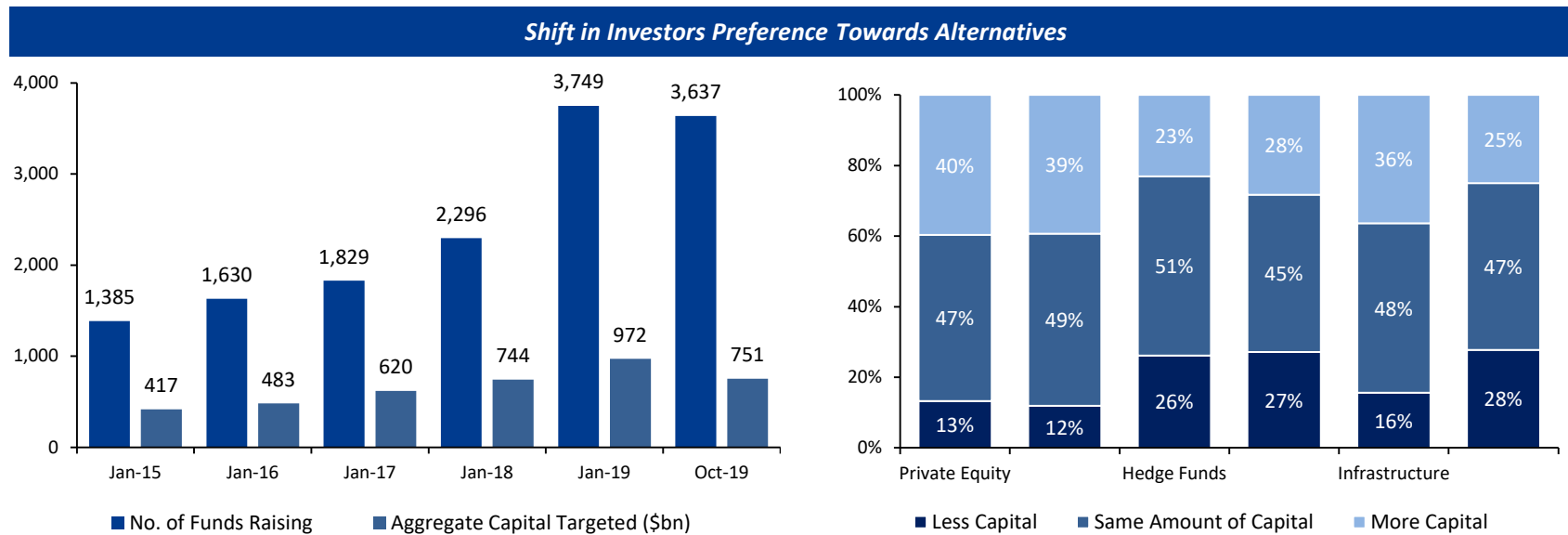
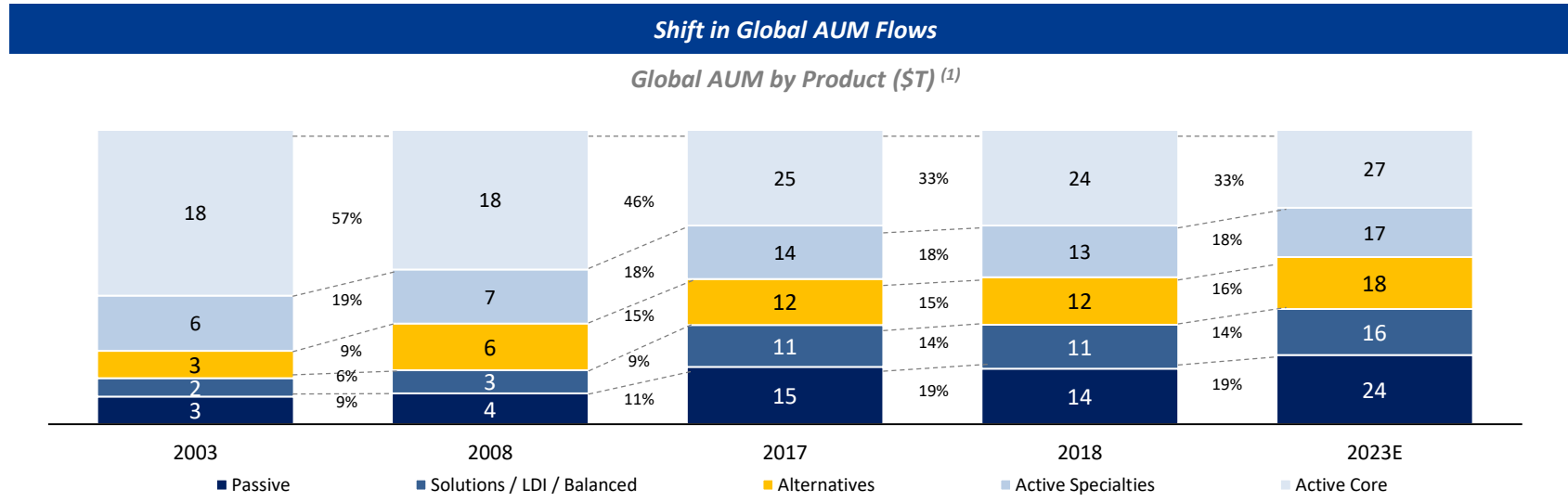
Historical Transaction Value (\$B)⁽²⁾



Historical AUM Transferred (\$B)



Shift in Investor Appetite and Business Models



Transaction Motivations for Private Markets GPs

Managers have recognized the value of strategic partners to capitalize on growth prospects

Strategic Motivations

- **Succession Planning:** Achieve liquidity for founders and partners and put into place mechanisms for ongoing stability of the firm
 - Potential reorganization of legacy/seed investors
- **Capital Needs:** Raise capital via enhanced distribution and assistance with GP capital obligations
 - Raise new / larger fund(s)
 - New product development (LP/GP commitments)
 - Synergistic product expansion via acquisitions of new business lines/teams
 - Helps fund GP commitments by junior investment professionals
- **Operational Synergies:** Migrate back office / shared functions and instead focus on investing
 - Back office synergies (IT, human resources, financial reporting, etc.)
 - Ability to leverage international offices for fundraising / new product development
- **Talent Retention:** Proceeds from transaction and institutional ownership enhance talent retention
 - Extend non-competes
 - Broaden firm ownership
 - Establish new incentive programs

Components of Value: Private Markets Manager Transactions

Majority Acquirers

- Management Fee EBITDA: Acquire up to 100% of EBITDA
- Carried Interest: Typically acquire an interest in carried interest for vehicles launched post-transaction
- Balance Sheet: Typically leave existing GP commitments behind and provide capital support for new GP commitments

GP Stake Acquirers

- Management Fee EBITDA: Acquire <25.0% of EBITDA
- Carried Interest: Acquire a stake in all carried interest (existing and new funds)
- Balance Sheet: Acquire an interest in existing GP commitments and provide capital support for new GP commitments

1	Management Fee EBITDA	<ul style="list-style-type: none"> • Private Markets Manager's net management fee profits
2	Carried Interest	<ul style="list-style-type: none"> • GP's carried interest proceeds
3	Balance Sheet	<ul style="list-style-type: none"> • GP's balance sheet returns

Buyers of Minority Interests in Alternative Managers

In recent years, a new group of investors in the form of 'permanent capital vehicles' has emerged. These groups, originally formed to take passive stakes in hedge fund managers, have been increasingly active in purchasing minority stakes in private capital businesses

Shared Attributes

- Targeting passive minority interests (10% - 25%), with some flexibility
 - Light touch governance model
 - Minority protections aimed at preserving economics rather than exercising control
- Vehicles targeting cash-on-cash yields in the teens
 - Buying into existing carry is often important to achieve near-term yield targets
 - Participation in all cash flow streams for alignment purposes
- Preference to invest on balance sheet to fund GP co-investment obligations and platform growth (vs. secondary liquidity)
- Investments often create cleaner capital structure, provide equity value mark, help to extend non-competes and secure proceeds in funds for several years
- Capital is permanent – no intention or requirement to sell the investment at a future date

Differing Attributes

- Level of value-add (distribution/LP introductions, product development, etc.) varies across the group
- Some have more of an ability to make independent LP commitments
- Market perception
- Cultural compatibility

Minority/GP stake investments

Minority/GP Stake Transactions

- Size of interest
 - “controller” or affiliate, or below threshold?
- Use of funds
 - GP stake funding
 - Balance sheet capital
 - Expansion capital
 - Founder/partner liquidity
- Debt vs equity
- Profit vs revenue share structures

Minority/GP Stake Transactions

- Long term capital or defined term capital
- Liquidity protections
- Rights and/or obligations as regards future funds
- Carry entitlement
- Fund-level due diligence
- Client consent considerations
 - Anti-assignment and change of control rules
 - Identifying the “client”
 - Regulatory requirements vs investor relations

Investor Protections

- Profit share structures:
 - Cost control guidelines
 - Profit share add backs
 - Dividend/distribution policy
- All income to flow to investment entity
- Dilution protections
- Information and access rights
- Liquidity protections (tag, pre-emption, ROFO/ROFR)

Investor 'Value Add'

- Distribution, sales and introductions
- Secondary liquidity
- Compliance and regulatory assistance
- Back office assistance
- Strategic advice

Joint Venture/Launch Transactions

Joint venture/New Launch

- GP/Management level arrangements
 - Working capital
 - Interest in GP/management vehicle
 - Equity contribution or debt/preferred equity
 - Carry entitlement
 - Future fund commitment
 - Exit/liquidity rights
 - Governance rights (board and IC)
 - Investor reserved matters
 - Distribution and reserved capital policy
- Fund level arrangements
 - Cornerstone commitment
 - Preferential fee treatment
 - MFN
 - Syndication/introduction rights
 - Co-investment rights
 - GP removal rights

Team Protections

- Remedies for breach of commitments
- Failure to maintain cornerstone commitments
- Step down of entitlements for failure to follow on
- Entitlement to launch additional fund products
- Profit share only where investment into the fund is made
- Approvals for launch and hire of team
- Ability to build up balance sheet to meet GP commitments and regulatory capital requirements
- Call option

Investor Protections

- All activity and fee income to route to management vehicle
- Time commitment to core activity
- Key man/leaver provisions
- Restrictive covenants
- Investor reserved matters
- Governance involvement
- Dilution protections/new equity or points issues
- Partner transfer restrictions
- Liquidity rights (tag, ROFO, ROFR)
- Compulsory transfer situations
- Information and access rights

Control Transactions

Control Transactions

- Purchase price protections
 - Earnouts and deferred
 - Rollover of value
 - AUM/fee income adjusters
- Rollover equity
 - Minority protections
 - Leaver provisions
 - Phased liquidity rights
- Tax considerations
- Carry allocation post acquisition
- Bonus and equity incentives
- Succession planning arrangements

Control Transactions – Gap Period Issues

- Time to obtain regulatory clearances
- AUM termination/withdrawals
- Fund LPA amendments
- Client consents
 - IMA/Advisors Act
 - LPAC vs LP consent
 - Contractual commitments, including side letters
- Key man protections
- Management/advisory agreement termination
- Impact on expected fund raising activity
- Revaluation of carry

Preparing for an Asset Manager M&A transaction

Preparing for an Asset Manager M&A transaction

- Gather and review relevant agreements for Buyer diligence (Side letters and other material agreements in addition to fund, GP and advisory agreements)
- Consider rationale for a transaction (i.e., liquidity vs capital needs; strategic needs)
- Prepare a consent checklist to understand client and third party consent requirements
- Consider any internal restructuring to aggregate management fees or otherwise facilitate a transaction
- Consider intra-partner matters
 - Who would participate in liquidity
 - Differing waterfall participation
 - Differing holding periods
 - Approval rights
 - Succession

Questions

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The Bottom Line

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