

The background of the slide features a dynamic, abstract design. It consists of numerous thin, parallel lines that sweep across the frame from the top right towards the bottom left. These lines are primarily in shades of deep red and vibrant blue, creating a sense of motion and energy. The lines vary in opacity, with some appearing as bright, solid streaks and others as more translucent, layered bands. The overall effect is reminiscent of a high-speed light trail or a stylized representation of data flow.

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M&A ACADEMY

Key Considerations in Investment Management M&A Transactions

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I. Background

Sellers and Buyers

- Sellers
 - Institutional advisers
 - Mutual fund advisers
 - Wealth management firms
 - Alternative liquid (e.g., hedge fund) managers
 - Alternative illiquid (e.g., private equity, real estate, or specialty credit) managers
- Buyers
 - Institutional advisers
 - Mutual fund advisers
 - Wealth management firms
 - Alternative liquid (e.g., hedge fund) managers
 - Alternative illiquid (e.g., real estate or specialty credit) managers
 - Financial institutions: banks, insurance companies, securities firms, trust companies, and other financial services companies

I. Background (cont'd)

- Management
- Private equity firms
- Reasons sellers sell
 - Monetization
 - Diversification of net worth
 - Change in strategic direction
 - Succession planning
 - Opportunity for better distribution
 - Lack of scale/margin pressures
 - Life event (retirement, death or disability, divorce, etc.)
 - Increase product offering to clients
 - Possible changes in tax law (e.g., potential increase in capital gains tax rates)

I. Background (cont'd)

- Reasons buyers buy
 - Fill gaps in product offering
 - Fill geographic gaps
 - Improve manufacturing capabilities/acquire talent
 - Change in strategic direction
 - Economies of scale
 - Financial buyer
- Reasons to sell control vs. minority interest
 - May be more potential buyers for a change of control transaction
 - Balance taking chips off the table vs. reduced share in upside of the firm
 - Tolerance for loss of autonomy
 - Regulatory considerations
 - Investor considerations
 - Employee considerations
 - Majority sellers need to focus on liquidity with respect to minority stake

II. Forms of Transactions

- Third-party purchase of all or substantially all of the adviser's stock or assets (and, in the case of alternative advisers, the general partner or other direct or indirect equity interests in the fund)
- Third-party purchase of a minority voting and equity interest in the investment adviser (and, in the case of alternative advisers, the general partner or other direct or indirect equity interests in the fund)
- Third-party purchase of a controlling voting interest in the investment adviser (and, in the case of alternative advisers, the general partner or other direct or indirect equity interests in the fund), but a minority economic interest
- Third-party purchase of a line of business of an investment adviser
- Externalization of proprietary trading desks

II. Forms of Transactions (cont'd)

- Seeding a fund and investment in a new manager
- Management buyout of adviser
- Lift out/de novo firms (focus on access to track record/track record data)
- Joint ventures
- Acquisition of revenue share/partnership with managers
- Fund adoptions/reorganizations (mutual funds, ETFs)

III. Valuation

- Variables in determining the multiple used in valuing a target
 - Category of target (mutual fund, hedge fund, high net worth, institutional, etc.)
 - If there are performance fees, how are these weighted compared to advisory fees?
 - Historic growth rate
 - AUM
 - Geography
 - Investment style (fixed income vs. equity; small vs. large caps; etc.)

III. Valuation (cont'd)

- Valuation methodologies used to value targets
 - Discounted cash flow
 - Comparable public company
 - Comparable acquisitions
 - Other
 - Firms typically trade at a multiple of cash flow. In current market, the multiples are generally in the range of:
 - 6–8X pre-tax cash flow for alternative managers
 - 8 – 10X pre-tax cash flow for most traditional managers
 - 11 – 12X for highly sought-after traditional managers (e.g., international managers)

IV. Key Agreements

- Purchase Agreement
- Guaranty Agreement (if purchaser is not independently creditworthy)
- Employment Agreements
- Limited Liability Company/Limited Partnership Agreements for adviser and general partner (if sellers retain equity)
- Distribution Agreements (if strategic purchaser is acquiring a non-controlling interest)
- Services Agreement (transition or otherwise). If services provided by prior owner (e.g., a bank), these services must be continued or replaced

V. Purchase Agreement

- Parties
- Assets or equity sold
- Purchase price
 - Closing payment
 - Fixed amount (what if AUM changes between signing and closing?)
 - Fixed amount adjusted for client consents, market movement between base date and closing, additions and withdrawals (or redemptions from funds) between base date and closing, and working capital changes between base date and closing
 - Various mechanisms for adjusting for these factors
 - Role of escrows
 - Indemnification
 - Specified items (e.g., post-closing purchase price adjustment for client loss)

V. Purchase Price Adjustment Mechanism

Acquisition of Rich Folks Management

A Client Name	B AUM as of 3/31/17 (in millions)	C Fee Rate as of 3/31/17	D Revenue Run Rate as of 3/31/17 (in millions)	E Net Deposits/ Withdrawals Since 3/31/17 (in millions)	F Adjusted AUM as of Closing Date (in millions) (B – E) ²	G Fee Rate as of Closing Date	H Revenue Run Rate as of Closing Date (in millions)	I Consent	J Consenting Revenues (in millions)
Chu	\$100	.75%	\$.75	0	\$100	.75%	\$.75	Y	\$.75
Johnson	\$200	.75%	\$1.50	0	\$200	.75%	\$1.50	Y	\$1.5
Jones	\$300	.65%	\$1.95	0	\$300	.75%	\$2.25	Y	\$2.25
Kim	\$400	.65%	\$2.6	\$50	\$450	.65%	\$2.925	Y	\$2.925
Smith	\$400	.65%	\$2.6	[\$25]	\$375	.65%	\$2.4375	N	\$0
Thompson ⁴	0	-	-	\$75	\$75	.75%	\$.5625	Y	\$.5625
Williams	\$500	.65%	\$3.25	0	\$500	.65%	\$3.25	Y	\$3.25
Total	\$1,900		\$12.65	\$100	\$2,000		\$13.675		\$11.2375
1) Purchase agreement signed 4/4/17 for \$75 million, based on \$6.5 million EBITDA and 12 x multiple. 2) Does not reflect any change resulting from market movement. 3) Break point on fees increased to \$500 million of AUM. 4) Account funded on April 15. 5) When added to 5% cushion equals 93.83% of contract purchase price. (On contract purchase price of \$75 million, the adjusted price is \$70.375 million, assuming a dollar-for-dollar reduction in price due to decline in revenues below the 5% cushion.									Consenting Revenue Percentage (\$11.2375 / \$12.65) is 88.83% ⁵

V. Purchase Agreement (cont'd)

- Contingent Payment
 - As a percentage of total value may be larger in alternative firms than in traditional investment manager transactions (smooth out volatility of performance fees)
 - Criteria for satisfying contingency; typically fee revenue, EBITDA, cash flow, or combination; possible separate contingencies for management fees and performance fees in alternative firms
 - Length of earn-out period. Three to seven years is customary range
 - Cliff payment vs. multiple payments over a period, with or without catch-up
 - If payment is conditioned on continued employment, the contingent payment may lose capital gains character
 - If buyer is strategic, sellers will benefit from buyer's distribution capabilities in achieving earn out
 - Governance during earn out period is often a subject of negotiation

V. Purchase Agreement (cont'd)

- Stay bonuses; not purchase price but may be required for non-owner employees
- Continuing profit participation; not purchase price but may be required where (i) there is a disparity between equity ownership and actual importance to business; or (ii) not all sellers remain with the business after closing.
- Representation and warranties of parties
 - Purpose of reps and warranties:
 - Confirm due diligence
 - Accuracy is a closing condition
 - Breach gives rise to termination right and indemnification
 - Key Reps: client AUM and fee rates; legal compliance and regulatory
 - Scope of reps re: funds highly negotiated topic
- Pre-closing covenants of parties
 - Business operated in ordinary course
 - Access to information
 - Maintenance or termination of employee benefit plans
 - Distribution of cash in excess of working capital requirement

V. Purchase Agreement (cont'd)

- Post-closing covenants
 - Restrictive covenants
 - Reasons for Restricting Sellers
 - Assets (i.e., portfolio management skills and client relationships) go up and down the elevator every day
 - “Egg on your face” if a buyer pays a hefty price only to see the sellers setting up shop across the street and soliciting the “acquired” clients
 - Together with service commitments, contingent purchase price payments or grants of equity to key personnel, rounds out the “carrot and stick” approach

V. Purchase Agreement (cont'd)

- Types of Restrictive Covenants
 - Confidential information (may include track record, strategies, client/investor information)
 - Intellectual property (may include software)
 - Non-compete
 - Scope (business sold vs. all investment management)
 - Duration (3-7 years typically for sellers)
 - Non-solicitation or non-interference
 - Clients/investors (should include no-accept)
 - Vendors/service providers
 - Employees (should include no-hire)
 - Scope/duration
- Enforceability of Restrictive Covenants in Sale of Business
 - More liberal evaluation of restrictive covenants in sale of business context than in employment context because:
 - More equal bargaining power of parties
 - Sale proceeds provide means of support
 - Premium paid by purchaser for restrictive covenant
 - Restrictive covenants necessary to protect purchased goodwill
 - CA does not enforce restrictive covenants except re: trade secrets or sale of business

V. Purchase Agreement (cont'd)

- Conditions to closing
 - No MAE (focus on definition, including carve-out for changes in markets)
 - Accuracy of representations and warranties
 - Performance of covenants
 - Expiration of HSR waiting period
 - Minimum AUM/consenting client revenue run rate/cap on redemptions
 - Key employees continue to be employed and have signed employment agreements
 - Third-party consents
 - For mutual funds, board and shareholder approval of new mutual fund contract and, if applicable, fund reorganization
- Indemnification
 - Survival of representations and warranties (fundamental reps vs. general business reps)
 - General vs. specific indemnification
 - Deductible/basket
 - Caps
 - De minimis claims
 - Consequential damages
 - Mitigation obligation
 - Reduction for insurance/tax benefits
 - Procedures for defending third-party claims
 - Set-off (e.g., buyer contingent payment obligation offset against seller indemnification obligation)

VI. Client Consents

- Amendment of fund documents and investor “consents”
 - Under Section 205(a) of the Investment Advisers Act, every investment advisory contract must “provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.”
 - Under Section 202(a)(1) of the Investment Advisers Act, an “assignment” includes any direct or indirect transfer of an investment advisory contract “or of a controlling block of the assignor’s outstanding voting securities by a security holder of the assignor.”
 - A “controlling block” of voting securities is not defined in the Investment Advisers Act, but in the Instructions to Form ADV a person is presumed to control (i) a corporation if it has the right to vote or sell 25% or more of a class of the corporation’s voting securities; (ii) a partnership if it has the right to receive upon dissolution, or has contributed, 25% or more of the capital of the partnership; or (iii) a limited liability company if it has the right to vote 25% or more of a class of the interests of the limited liability company, has the right to receive upon dissolution, or has contributed, 25% or more of the capital of the limited liability company, or it is a manager of the limited liability company.

VI. Client Consents (cont'd)

- Under Section 2(a)(9) of the Investment Company Act, any person who owns beneficially more than 25% of the voting securities of a company shall be presumed to control such company. Under Section 2(a)(42) of the Investment Company Act, a “voting security” means any security presently entitling the holder to vote for the election of directors of a company.
- Rule 202(a)(1)-1 under the Investment Advisers Act and Rule 2a-6 under the Investment Company Act provide that a transaction that does not result in a change of actual control or management of an investment adviser is not an assignment.
- Under the Investment Company Act, a deemed assignment of an advisory agreement results in its automatic termination.
- Client Consent Mechanics
 - Direct Accounts
 - Affirmative vs. negative consents
 - SMA/Wrap Accounts
 - Wrap sponsor
 - Underlying client
 - Collective Trusts
 - Trustee
 - Other participants

VI. Client Consents (cont'd)

- Private Funds
 - General partner or manager (typically affiliated with investment adviser)
 - Investors (negative consent, investor vote, special redemption right)
 - Implication of Rule 206(4)-8 under the Investment Advisers Act (Pooled Investment Vehicles); it is a violation of the Act for an adviser to a pooled investment vehicle to “otherwise engage in any act... that is fraudulent, deceptive or manipulative with respect to any investor...in a pooled investment vehicle”
 - Need to amend ppm and obtain consent of investors if there are any changes required to the limited partnership agreement
- Registered Funds
 - Board approval
 - Shareholder approval
 - Exemptive orders regarding subadvisers
 - Applicability of Rule 15a-4 under the Investment Company Act (permitting interim advisory/subadvisory contracts)
 - Duration of no greater than 150 days
 - Terminable upon 10 days’ written notice
 - Same material terms as previous contract
 - Escrow of fees

VI. Client Consents (cont'd)

- Section 15(f) of the Investment Company Act
 - Rosenfeld v. Black (445 F. 2d 1337)
 - 1971 case in which Second Circuit held that investment adviser to mutual fund, which realized profit in connection with appointment of new adviser upon its recommendation, violated its fiduciary duty.
 - Section 15(f) enacted in response to Rosenfeld v. Black
 - Under section 15(f), an investment adviser of a registered investment company may receive an amount or benefit in connection with the sale of securities of, or sale of any other interest in, the investment adviser that results in the assignment of an investment advisory contract if the following two conditions are met:
 - For three years after the assignment, at least 75% of the board of the investment company are not interested persons of the investment adviser or its predecessor; and
 - There is not imposed an “unfair burden” on the investment company as a result of the transaction.

VI. Client Consents (cont'd)

- An “unfair burden” includes any arrangement, during the two-year period after the transaction, whereby the investment adviser or its predecessor or successor receives any compensation (i) in connection with the purchase or sale of securities or other property to or from the investment company (other than bona fide, ordinary underwriter compensation) or (ii) from the investment company for other than bona fide investment advisory or other services.

VII. Employment Agreement

- Term
- Duties
- Compensation
 - Salary
 - Bonus
 - Possible profit participation
- Severance; definition of “cause”
- Non-compete/Non-solicit
- Reinvestment commitment into fund; amount; duration of commitment; optional reinvestments
- Liquidated damages as a means of addressing tax issue on earn out

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VIII. Limited Liability Company/Limited Partnership Agreement (if sellers retain an equity interest and in many seed transactions)

- Retained equity keeps sellers and “next generation” motivated and permits sellers to enjoy strategic benefits of transaction (e.g., buyer’s distribution capabilities)
- Classes of equity; can separate voting rights from economic interest
 - Tailor economic interests
- Capital accounts
- Allocation of profits and losses; distributions
- Governance
 - Autonomy vs. non-autonomy transaction (autonomy deals exist even without a retained equity interest)

VIII. LLC/LP Agreement - Issues in autonomy transactions

- Stages of autonomy
 - Post-closing until one or two years prior to end of initial employment term or end of earnout (Stage 1)
 - Last year or two of initial employment term or earnout period (Stage 2)
 - End of initial employment term or earnout period and beyond (Stage 3)
 - Autonomy of sellers is reduced between Stage 1 and Stage 3. But, investors may favor retained autonomy of sellers
- Issues in autonomy transactions
 - Board/operating committee composition; voting and deadlocks
 - Compensation (including allocation of profit participation and bonus pool)
 - Hiring/firing
 - Budget and expenses
 - Legal, compliance, and accounting
 - HR (e.g., impact of a discrimination suit)

VIII. LLC/LP Agreement - Issues in autonomy transactions (cont'd)

- Disposition of or structural change to the business
- Conflicts with buyer's business (impact of buyer's policies and procedures)
- Buyer vs. outside providers of services/charges by buyer to the business
- Strategic/transition plan and its implementation
- New funds - If buyer becomes involved in a competitive or similar product (including as distributor), then (i) the seller's earn out accelerates; (ii) the seller's non-compete is terminated; and (iii) in a minority investment deal, the buyer's equity is subject to call at a discounted price
- Change of control (COC) of buyer - Implications if the business has less strategic relevance to the new owner. Should COC give rise to same rights as "new funds"?
- Implications on autonomy if a seller leaves before the end of the initial term

VIII. LLC/LP Agreement - Issues in autonomy transactions (cont'd)

- Buyer's goals
 - At the end of the initial employment term, business should not be dependent on sellers. If it is, sellers can make buyer pay for the business a second time. To avoid this, an upfront concept of a "qualifying proposal" should be considered. Elements of qualifying proposal include severance/loss of severance and duration of non-compete
 - Avoid reputational harm (consider put to seller if reputational harm surfaces)
 - Be able to make changes if there is underperformance
- Minority consent rights
 - If initial transaction is a sale of a minority interest with the goal of a COC, the buyer will want minority protections until control changes at which point sellers will want minority protections

VIII. LLC/LP Agreement - Minority consent rights

- These rights may impact Investment Advisers Act's "assignment" analysis and "control" analysis for bank regulatory purposes.
- Rights
 - Admitting/removing members/issuance of additional equity
 - Hiring/firing key employees
 - Changes to investment strategy incurring indebtedness/pledging assets
 - Creating new funds/products
 - Purchasing another business
 - Sale of the fund adviser or general partner
 - Incurring expenses over a threshold
 - Changing key service providers
 - Commencing/settling litigation or administrative proceeding
 - Transactions with majority owners or their affiliates
 - Compensation/bonus pool
 - Annual budget
 - Opening new offices
 - Formation of subsidiaries or joint ventures

VIII. LLC/LP Agreement (cont'd)

- Restrictions on transfer; liquidity rights
 - Permitted transfers
 - Rights of first refusal
 - Tag/drag along
 - Puts/calls
 - Event driven
 - Change in law
 - Reputational issue
 - Time based
 - Pricing
 - Payment
 - Installments
 - Sunset
 - Look-back rights

IX. Transaction Timeline: A year or more to complete transaction is not that unusual, so be patient

- Engage investment banker (even if you are approached by buyer you like)
- Consult with banker on process for identifying buyer
 - Confidential discussions with a single buyer
 - Approach multiple candidates
 - Possible preparation of confidential memorandum
 - Identify buyer candidates to be invited for due diligence based on preliminary indications of interest
- Execute NDA (if not already done)
- Select counsel (if not already done)
- Organize due diligence (e.g., establish electronic data room)
 - Business

IX. Transaction Timeline

- Legal/compliance
- Financial
- Narrow group of bidders or select winning bidder
- Execute term sheet/letter of intent (typically with exclusivity agreement)
- Prepare definitive agreements while more extensive diligence continues (e.g., disclosure of investors)
- Approach selected clients prior to signing
- Execute definitive agreement
- Post-signing, pre-closing
 - Solicit client consents, including solicitation of mutual fund shareholders
 - Seek regulatory consents (including HSR if required)
 - Buyer obtains financing, if required

IX. Transaction Timeline (cont'd)

- No SEC approval required
- If buyer is a banking entity, regulatory approval of bank regulators may be required
- After HSR waiting period is terminated, focus on business integration
- Closing

QUESTIONS?

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Biography



Nathan R. Pusey

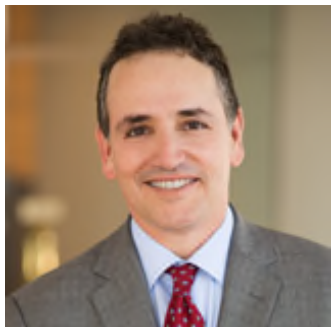
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Nathan R. Pusey advises public and private clients, primarily in the financial services industry, in mergers and acquisitions, joint ventures, and restructuring transactions. He regularly represents a variety of industry leaders in transactions involving traditional and alternative asset management firms, including acquisitions and sales of majority and minority investments, spin-outs, joint ventures, seed investments, and strategic relationships.

Biography



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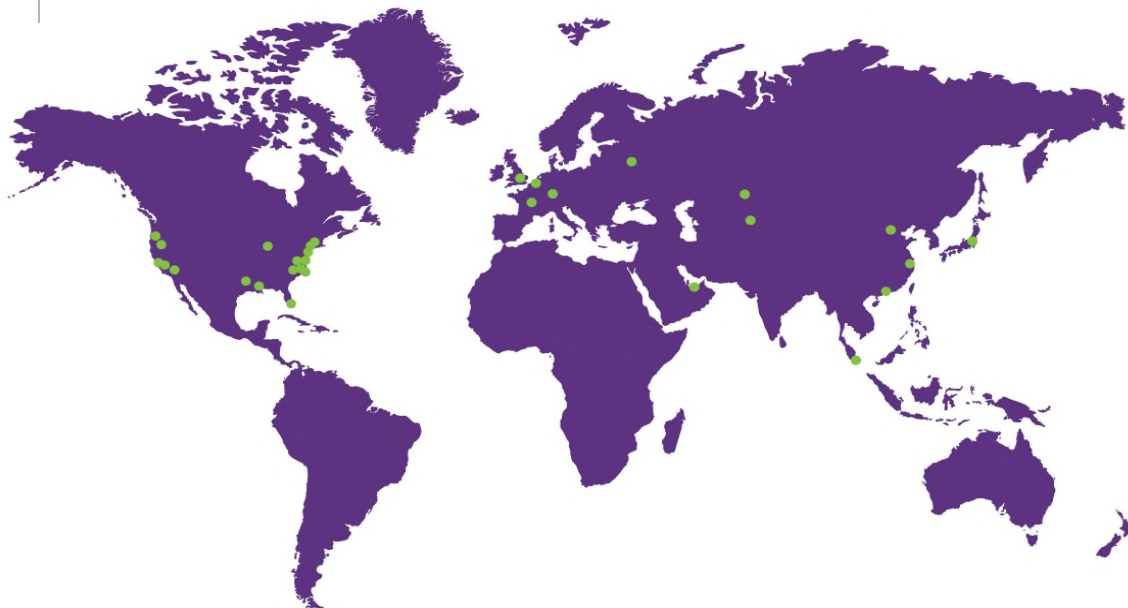
Robert D. Goldbaum serves as co-leader of Morgan Lewis's investment management transactions practice and as a consultant with Morgan Lewis Consulting. Rob regularly advises a wide variety of industry leaders in the full range of asset and wealth management transactions, including mergers and acquisitions, strategic minority investments, sales, spin-outs and lift-outs, capital markets transactions, and "seed & stake" arrangements.

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