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THRIVING IN AN EVER-CHANGING INDUSTRY

CONFERENCE TRANSCRIPT

Trends in M&A for Funds

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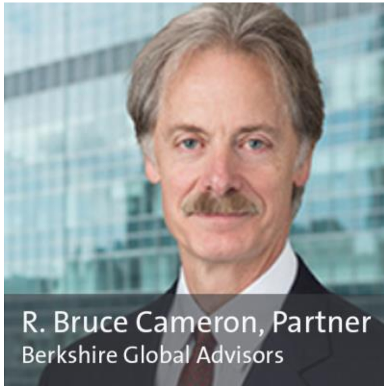

Cameron, R. Bruce

Partner, Co-founder

Berkshire Global Advisors

Bruce Cameron is the co-founder of Berkshire Global Advisors and co-leads the firm's wealth management practice. Bruce joined Mr. McEver in establishing Berkshire in 1983 as the first independent investment bank covering the investment management and securities industries. He has over 35 years of industry experience and is also a frequent speaker at industry conferences and events. During his tenure at Berkshire, Bruce has advised on a wide range of M&A transactions in the real estate, mutual fund and institutional sectors.

Recent notable transactions include CenterSquare (BNY Mellon) / Management & Lovell Minnick Partners (2017); Stockbridge Capital / CITIC Capital (2017); Allianz Global Investors / Sound Harbor (2016); Legg Mason / Clarion Partners (2016); BNY Mellon / Atherton Lane (2016).

Bruce's career includes experience with HF2 Financial, Co-Founder, Chairman and CEO; Highbury Financial Inc., Co-Founder, Chairman; PaineWebber, Associate Director, Strategic Planning Group; Prudential Insurance Company, Comptroller's Department and the Planning & Coordination Group.

Bruce attended the Harvard Business School (MBA), London School of Economics and Trinity College. He is a fellow of the Life Management Institute, past board member of the New York Society of Security Analysts, CFA charterholder and member of the CFA Institute.

Hearsh, Brad

Senior Advisor

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Brad Hearsh is a Senior Advisor in UBS Investment Bank's Global Financial Institutions Group providing advice to advice to asset management companies (including senior managements and their boards of directors), primarily in connection with mergers and acquisitions and private placements.

Brad has been with UBS Investment Bank for the last 31years, having begun his investment banking career at PaineWebber Incorporated in 1985 and then joining UBS as part of the UBS/PaineWebber merger in 2000. From 1981 to 1985, Brad was a Corporate Associate in the law firm of Willkie Farr & Gallagher in New York City.

Brad received a BA from Williams College, an MA from Lincoln College,Oxford University and a JD from the University of Virginia Law School.

Hennessy, Neil J.

CIO

Hennessy Advisors

Neil is a seasoned manager with nearly four decades of financial industry experience. He started his career as a broker in 1979, and today he serves as Portfolio Manager to six Funds and as CIO he oversees the entire family of Hennessy Funds.

Neil began his career at Paine Webber and worked there and at Hambrecht & Quist until founding his own broker/dealer firm in 1989 and founding Hennessy Funds and launching his first mutual fund in 1996.

Neil is a nationally recognized and respected asset manager, ranking among Barron's Top 100 Mutual Fund Managers for many years*, and he is a frequent guest/contributor in national financial media.

Neil received a BBA in Business Administration from the University of San Diego.

** Barron's last published a "Top 100 Mutual Fund Managers" list 8/08.*

Bellamy, Chris, CPA

Co-President, Investment Industry Services Division

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Since joining Cohen & Company in 1999, Chris has been focused on providing audit and consulting services to the investment industry. As co-president of the Investment Industry Services Division, he drives the strategic and tactical initiatives for team. Cohen & Company’s Investment Industry Services Division, representing more than 250 employees, serves a national client base including mutual funds, hedge funds, private equity, exchange traded funds, commodity pools, investment advisers, fund service providers, high net worth individuals, trusts, and foundations.

Chris is a member of the American Institute of CPAs and the Ohio Society of CPAs, and was a founding board member of the Cleveland Professional 20/30 Club. Chris's client base includes some of the firm's largest and most complex fund families, primarily in the

mutual fund and ETF sector. Chris currently serves on the Board of Directors and chair of the investment committee for the Community Foundation of Lorain County and the Finance Advisory Council for Ohio University. Chris is also active in leading the firm's recruiting efforts and is a member of the firm's leadership team.

B. Hearsh: As we get started, let's briefly touch on just a couple of things, maybe a word about valuations, current levels of transaction activity, and maybe just touch on a few transaction considerations for asset management companies. So first, maybe with respect to the valuation topic, although there's been some improvement here over the last few weeks or so, public company valuations remain relatively weak. I think investor concerns around growth and business momentum, particularly in the mutual fund businesses within the publicly-traded companies – concerns persist among investors about where the growth is going to come from. And as a result up until recently, or very recently, for a while now the PE multiples for the sector have hovered around ten times, translating into about maybe a six times EBITDA multiple, which compares quite unfavorably to the longer-term averages, particularly before the financial crisis, where the public universe was trading at something like 17 to 18 times PE and above and at ten times EBITDA or better.

I think the good news for the M&A market is that M&A valuations for the most part are generally much better, although that is I think a function of the fact that the companies that are being acquired are generally growing companies that are reasonably well-positioned, or where transactions call for synergies, particularly cost savings, where the EBITDA multiples as a result can reach low double digits, so significantly better than the public market. And I would say in situations where transactions call for the transfer of AUM or revenues without much expense it is possible for sellers to achieve what would otherwise be appropriate EBITDA multiples measured against their management fee revenue stream.

Transaction activity I think in the sector is robust. I kind of think about it in four different buckets. There's significant cross-border activity and interest on the part of non-US institutions in the US market. Much of that's directed at the larger, more

diversified firms, although a lot of non-US companies have small to midsize operations in the US and therefore are looking at a broader opportunity set to enhance their presence here in the US. Secondly, there's a lot of activity in firms that are operating in appealing asset classes such as real assets or private credit, quantitative strategies, multi-asset platforms and the like. I would say third you certainly have had a number of significant transactions that are focused very heavily on saving costs, particularly in the mutual fund space where the Oppenheimer-Invesco trade is probably the largest and most prominent and there've been a couple of others. And then fourth, there remains interest among financial buyers and private equity firms in the sector, although many financial buyers have been gravitating a little bit more toward wealth management and away from asset management here more recently.

The buyer landscape, though, is very, very broad across a lot of different types of institutions in private equity, like I mentioned. But for anybody who is in the US mutual fund business, certainly significant platforms, retail scale and leveraging distribution, will be an acquisition priority. It may not be the highest priority, but every significant mutual fund business is looking to improve scale.

I would say most transactions are driven by a combination of a desire for a monetization event or liquidity on the one hand, and a goal of addressing challenges in growth, profitability, and business momentum in the other. And so while people pursue organic growth, of course, day in and day out, there are a lot of firms that have begun to consider and I think will increasingly consider the sale of their businesses or the transfer of mutual fund contracts or what's referred to as an adoption transaction, where the seller transfers mutual funds or their company and negotiates a sub-advisory agreement to manage the assets going forward.

And then finally, just a couple of comments about transaction considerations. There are numerous criteria and valuation drivers that are important in any transaction. First and foremost, in my mind always is investment performance. Better investment performance is more attractive obviously. Flow momentum, desirable asset classes, selling agreements on important platforms can be important. I think a willingness to part with distribution and administration can be an appealing factor. And size is obviously sometimes a factor as well. Generally speaking, fund families that have $3 billion, $4 billion, $5 billion in assets under management on up are probably a little bit more appealing than firms that are very, very small.

I think in most transactions where there's a high level of integration, particularly in the retail area, buyers tend to buy 100 percent or a majority of the firms they acquire. This typically calls for obviously a payment at closing, but oftentimes there is an element of earn-out that will be based on either asset retention or asset growth. And again, I think if very little expense or few people transfer in a transaction, there's an opportunity to attract an interesting multiple of revenue that will be appealing to some. And then lastly, I think sellers can expect to be called on to sign non-competes for a period of time, and often with respect to key personnel that will be involved in the business going forward, the call for executing employment agreements.

C. Bellamy: Thanks, Brad. I think that's a great overview of what we see in the market. Bruce, I'm curious from your perspective, from your vantage point, are there differences that you'd like to point out?

B. Cameron: Brad covered a lot of it. Just briefly in terms of background, I amusingly enough also started at PaineWebber. I was a couple of years ahead of Brad and I left because probably they figured they were going to bring him on. But I set up Berkshire, originally Berkshire Capital and now Berkshire Global back in '83 with another gentleman with a focus really on the asset

management in terms of M&A, so I've been doing this for as long as Brad, I guess.

In terms of some of the perspectives about – you know, I think Brad covered a lot of the key areas. Some of the things that we're seeing is that people are more sort of responsive or more thinking about what the opportunity set is going to be, and the pressures are building up on a lot of firms. And historically we saw a lot of people who sort of felt like there was going to be a way out, that things would turn and this was – one way or another they'd make it. And we're getting more people who are conceding that maybe they won't. I suppose if all the other marketing stuff's not going to work, then you go and sell. But you know, that may or may not be true. We're the death benefit or the last resort.

There are a variety of people that are out there in the marketplace. There are certainly a number of organizations, and Neil is one of best examples of this, of – there's people like Resolute and some other organizations that are out trying to acquire funds. So there's still a pretty strong demand. We see some of the platforms in terms of – AMG did this twice. They bought a firm called the Managers Funds way back when, and then they actually bought a firm that I was involved with called Aston. But to try and provide funds, because if you think about how the industry has evolved, it's gone from being – you know, there was the institutional side, there were funds that were oriented towards individuals, and then you had sort of the wealth management side. And I find it interesting now that the world is moving more towards wealth management. That's where the money is evolving. And a lot of the institutional players need vehicles to get to those, whether it's through 401(k)s or through the RIAs.

The fund business has become more important, and some of those platforms are looking – AMG clearly has one. Old Mutual amusingly enough sold theirs at one point – I suspect they want

to get back into it – and we've seen some of the others. There is interest from a variety of different sources for this.

I think there's some international interest as well, organizations looking to come here. They're a little bit scared about how they enter the US marketplace, but funds are an attractive area for some if they've got sort of existing distributions. So there are a variety of players looking in the marketplace.

In terms of structures, Brad alluded to the sort of earn-outs and aspects about that. One thing I've noticed that is a change from 10, 15 years ago is there's more interest in mergers of equals, if you will. It's never perfect equals; there's usually one that is a buyer, but where people are looking to team up with other people. They don't want to sell or maybe there's not the opportunity to sell to a large bank, insurance company – you name the sort of traditional large acquirer – but they don't want to get out of the business per se. And so we're seeing more interest in terms of people putting their businesses together. And that is tricky in terms of the cultural aspects of making that work, and as Brad said there are obviously expense savings you're trying to accomplish. But there is also the opportunity to sort of gang up and be able to do more things, whether one brings distribution and another brings capabilities, or one brings entry into a certain channel. Some of that's pretty important. So that's an aspect that we're seeing that's different.

The last thing I'd mention is simply the interest in having upside and downside capabilities in terms of transaction. It's interesting. The fund business – and you can find exceptions to everything that you sort of generalize about, but hasn't been viewed as –
that's around the portfolio manager by and large. That probably is not true for sub-advise funds, but complexes overall – take Neil out of it; you wouldn't want to lose him. But in the context of a lot of places the fund manager is not viewed as critical. But I think in a lot of these cases people are looking to make sure that the business stays intact and that it grows. And

so if you can get upside as the business grows or downside if it doesn't, then the buyer will tend to be a little bit more aggressive about how they'll price things. So that's something that we've seen has been a bit of a change in this sector, so.

C. Bellamy: Thanks, Bruce. You know, Neil, I think you have a little bit different perspective coming from a buyer, and I'm sure you're paying those multiples that these guys mentioned and then some, right? But curious – your perspective on what you see from the Hennessy Funds world?

N. Hennessy: Well, I think the first thing is to realize a little bit of my background and what's going on. I started in business when I was 23 years old at PaineWebber. I was on the retail side as a broker –

B. Hearsh: It's a conspiracy.

N. Hennessy: While these guys were managing my life back in New York. But essentially I got the opportunity at 23 to get in the business, at 27 to become a manager at PaineWebber. At 29 I was chairman of – or 31, chairman of the NASD district business conduct committee. Then I was a divisional sales manager. So I had what I thought all the tools to start my own business in '89.

I was wrong, really wrong. But essentially, kind of long story short, in '96 I started my first mutual fund, and I realized right then and there that managing the money is the easy part. Managing the mutual fund business for the benefit of the shareholder is very difficult and becoming increasingly difficult on a daily basis. I thought right away I needed to become a student of the management business. A lot of people ask you what kind of business - you say the asset management business and everything like that. They ask me, I say I'm in the fee business, 'cause that's the business I'm in. When I look at doing transactions we've done – I did a startup fund in '96, a fund in '98, bought my first funds, O'Shaughnessy Funds in 2000, took the company public in 2002. We currently have 16 mutual

funds, a publicly traded company, and we manage this all with 19 people full time and 3 part-time. There are a lot of moving pieces, but over time we've made 10 transactions in 30 mutual funds we've bought for approximately $3 billion, and now we manage $5.2 billion.

When I look at the asset management business, we have all been faced with those two headwinds: the DOL ruling that never came out on the fiduciary side, and then passive versus active. In four months I'll be in this game for 40 years and I've seen that movie before – you know, passive versus active. And that will go back to active management. You might have seen it in the fourth quarter where we saw – people got their September 30 statement and had a million dollars. They got their December 31 statement and they've got $800,000.00 because it's just the market. Passive works in an up market; it doesn't work in a flat, down, or volatile market.

The good asset managers - as much as performance matters - it really doesn't matter, because if you look at the industry, no matter what happens you're going to lose one-third of your assets a year on the equity side. They're just going to go away. It could be divorce, could be debt, could be asset allocation – go any which way. When I look at the industry today, it's been very difficult over the last two and a half years to grow organically. I've been saying that what's going to happen is you're going to have to make a choice. You're either going to be a buyer or you're going to be a seller, and the one thing you can't do is try and play with the big boys and go to zero. And you know, when we look at the industry today I'm seeing a lot more deals, but you know, it doesn't bring tears to my eyes but at the same time I feel really bad that a lot of fund companies did the exact wrong thing in they're either waving fees or they cut their fees to such an extent you can't buy them, because when you acquire somebody the SEC is going to make sure that the shareholders' expense ratio does not go higher than where it is now.

There are three ways that we can acquire, three ways that they know how to acquire, which is you're going to do an asset purchase agreement, which is essentially when we buy the management contract and fold the assets into one of our funds. We can do it another way. We can take the assets and put it in another quantitative model that we have. The third one – what's really, really working and was alluded to here is acquiring the management contracts and sub advisors back to the people. They might have $500 million in their mutual fund out of $10 billion. They're still managing $10 billion; we just take all the back office off. You've heard about excessive fee lawsuits, about how the subadvisors do _____ _____. As soon as that hit, the first thing we did – nobody was paying attention to it – we made a list of everything we do, and then what the subadvisor does. And what was interesting – as I was talking to Joe Redwine – US Bank wanted that list. But essentially we made a list of what was going on, and we take a lot off the plate, and the manager – then gets the manager money. They get some – they got money off the table. You can ask later, you know, "What do you pay?" or whatever you want. But there's three ways to make a transaction, and they're not difficult. They really aren't. The only thing that makes a transaction difficult is portfolio managers, right? Okay, I'm not lying here. And if you don't have control of your board – those are the two big obstacles whenever you make an acquisition.

Question: You alluded to this, Brad, the distribution topic. I've lived this through a lot of the acquisitions that Neil has had. I'm curious for you to kind of probe that a little bit further. How do you evaluate that? And I recognize that it shouldn't be the top priority but it's got to be in there. What are the things that kind of stand out when examining M&A if you're thinking about the distribution opportunities?

B. Hearsh: I think it is quite common for one of the key motivations of a company considering a sale to a strategic partner to consider the distribution issue for sure. And there are lots of distribution

channels. There are certainly some products and companies that are probably a better fit with some channels versus other channels. I think clearly there is – as Bruce alluded to, I think an opportunity to consider partnering with companies that have a non-US present, and I think distribution outside the United States is viewed as an important criteria for some. Obviously products have to line up to what demand looks like in those regions.

I think obviously getting greater access to the big platforms is I think often a key objective of companies considering a sale. The big platforms are getting very expensive. Firms like UBS are working with fewer providers. It's getting harder and harder to get on them and more and more expensive to get on them, and yet obviously leveraging platforms like UBS and others like UBS I think can be a key contributor to growth.

I think interestingly, too, for a long time I think captive distribution was not viewed very favorably, partly because of what was going on with fiduciary rule and so forth at one time, and partly because I think people just got consumed by the power of the wire houses. But if you look today at financial companies like insurance companies, some of whom might have either balance sheet money to manage or be in the retirement services area which requires, as Bruce was talking about, skills and mutual funds that could be used for that purpose, it's very interesting for me to see how many people now are keenly interested to being inside an insurance company or an organization where there are multiple channels of distribution, some of which the buyer actually controls in a way that's not the case when you sell through intermediaries quite so much.

So those would be some of the channels that I think are important to the buyers. I think it's probably less of an important factors in terms of driving value to the seller. Obviously if the seller has a special position on ED Jones or some other specialized distribution channel, I think that'll be

respected by most buyers. But most of the larger mutual fund companies that are looking to either partner with or acquire other mutual fund companies are probably going to have resources directed at those channels in a way that probably make that a – for me, at least, less of a driver on value and interest, and things like performance and flows and the appealing nature of the asset class that the seller might be in, and the like.

B. Cameron: I think Brad's right on that. I think one of the things, though, that we find a lot of the acquirers are – shall we say midsized? You know, if you go to T. Rowe or UBS or something – you know, when you talk about unless they're doing something like Invesco-Oppenheimer it's just not worth the trouble – they make more money in terms of the market or their new business in a given day than a lot of these firms have. They basically look at – it's like we have three heads. If we say, "Do you want to acquire this firm with $5 billion?" it's like, why waste the time?

But for midsized firms that can be appealing, and we have seen some of them that have an interest in the fact that certain firms have particularly access to the RIA channel. A lot of the larger firms have struggled with this sort of – you heard over the last two days some of the details and the work that goes into getting to the RIA channel. It's a lot of, you know, one-off sort of relationship building. And that's not to say the large firms don't do that but that it's harder for them in a sense. I've seen some that have found that interesting, but most of the time it is the smaller firms looking to get access to broader distribution.

We did a transaction that closed I guess the beginning of this year, but it was – Tocqueville had an international fund and they ended up selling the fund to Resolute, which is the old American Beacon. And part of what the portfolio manager was looking for was simply – he had a four- or five-star fund at the time, and Tocqueville – it's a fine firm but they don't have retail distribution for mutual funds and they felt like they were missing an opportunity.

B. Hearsh: Just one last comment on the distribution point to follow onto what Bruce said – and I do think the 401(k) market, which is one of the markets that Resolute is in, is one of the channels that I think is quite desirable. I think there are other, newer channels that are desirable as well. I think the RIA market generally is a very appealing channel. The ultra-high net worth channel is in some respects the last frontier, whether it's the corner office broker at a place like UBS or the family office. So there are some emerging channels that I think will become more and more important that I think potential sellers could be looking to as appealing places to hang their shingle or transact with.

N. Hennessy: Let me just add something, because everybody keeps coming up with retail, and there is no more retail. It's the RIA market. It's very, very important to get to that RIA market by using the CRM. And the reason I say that is it took us two and a half years to build a CRM. We could've just gone to SalesForce and said, "Hey, dude, we need a CRM," or something like that. But we charged two people in my office that had no idea of technology whatsoever – one was my son – and said, "Build us a CRM." They had to talk to Matt and they have to talk to everybody involved to build it customized for us. And what's happened over the time – we might have, as Matt said – we were in front of the ball for some reason or another.

But in 2013 we dealt with 3,500 RIAs. Today we deal with 19,000 RIAs, of which 3,500 to 4,000 have two or more of our products. And it's because we did put the time and the money – and it's a long process and it's not a cheap date – to be able to get to that RIA market. And when I look at making acquisitions, and it's really, you know – I really like dealing with people, so I like to make an acquisition and then sub-advise it back. But now we've got that capability, which is very tough to do.

PR – we've been with SunStar since 2002. So you'll see – and we're a small, little firm, okay? But we look bigger than we are, simply because you see the Hennessy name once every two,

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two and a half days in either national TV, print, or radio. It's because we're always out there. And so it's important to take your marketing and your sales, the CRM and tie all this together to get to the RIA market. So when we look to acquire, I'm looking at my system. I'm not really looking at yours. But I will tell you, when we bought FBR, because of Bruce they had started that RIA program. And we looked at it and said, "Hmm, this is interesting." And that's where we've built off, and then went and did the other work that we did. So very rarely will I buy somebody that already has distribution capabilities, so you've sort of got to build that yourself, and you know, it's difficult and expensive.

Question: Our ETF business is about five years old and we've launched and are building AUM in three different funds. And the businesses are based on sub-advisory agreements. We have sleeves in a trust that's controlled by a large institution. And we wonder if that – what the – whether that is a complication for potential buyers of our company, and I wonder if you all could address that question.

B. Cameron: You know, you and I talked a little bit about this before. I'll try to be brief and let Brad give you his perspective, but I'll set it up so at least he can correct me. I think as long as you all have the track record, and you know, it's very hard to replace you – if you were a traditional large cap growth manager and you had 60 securities you probably wouldn't be in business anymore. But if that was the case, then they could say, "We can replace you with someone that has a similar track record," and then you're more delicate or in a dangerous position. But if you all have sort of a unique track record, sort of the expertise around that, I think that makes it pretty appealing. The risk someone will look at is can I be – can they replace you, but if that's not the case and it's an attractive product, I think someone's going to look and say, "This is an appealing capability; there's no reason it shouldn't keep growing." And I guess one of the things to look at is whether you have an exclusive relationship with your current vendor or whether they can set up something

comparable in their own channel if they have one, or whether it has to be only through that channel. There are things like that, but there's no reason you wouldn't be appealing.

B. Hearsh: Yeah, I would agree with that. I mean, think I'm – you know, the track record's good and the products are differentiated and clearly associated with what you have built. As long as someone can't replicate it, I don't see any reason why that would affect how buyers would look at the opportunity.

N. Hennessy: I think it comes down to fees.

B. Hearsh: And that, too.

N. Hennessy: Because that's what I'm looking at. I mean, we gave – in our industry we talk about all the expense ratios, you know, and that's headline news. But the reality is we only get 40 or 50 or 60 base – 70 base points to manage the money. The rest is in our cost. So that's what I have to look at, is what's the revenue stream, what am I going to pay in a sub-advisory agreement, what am I going to pay in the channels if all of it's institutional over here? So there's a lot that goes into it. It's not rocket science, but there's something to do – it really comes down to numbers. And then the real question, 'cause we're a publicly traded company – I say, "Well, do I buy a company for $10 million that's only going to add four or five cents a share to my earnings?" Probably not – I'm better off using $10 million to buy my own stock back. So there is consideration going there. But if the numbers are there, there's no problem, at least for me.

Question: Neil, you alluded to this a little bit, but for managers that are buying what you're selling, so to speak, in terms of you being a good target, what are the decision criteria managers need to be thinking about when they look at a potential partner?

N. Hennessy: Well, I'm not sure which way the question – are you talking about me acquiring somebody or somebody acquiring us or what?

Question: If they've made the decision to sell there's probably several potential suitors out there. What makes Hennessy the – what should they be considering when they look at a landing spot?

N. Hennessy: Well, there's two different ways that companies are priced. If you're private, you're going to be priced as a percentage of assets, unless somebody really wants to do the work and find out what your EBITDA is. So like Brad was saying, in the public market the going rate's probably 7 to 11, depending on how bad somebody wants it – on EBITDA, but those are audited numbers. They're auditing them every quarter, every year. You can see that. You go into a private firm, you know, there's a lot of things that run through private firms that end up in the household, you know what I mean? So it's tough – so it's a percentage of assets is what you're dealing with there, so it's just two different marketplaces.

But if you're thinking of selling and – you've just go to make up your mind. You can't say, "Well, maybe I'll sell and maybe I won't sell." I mean, at some point in time you're going to have to make up your mind. And there's nothing – I tell people, and the three of us were discussing it. There's nothing wrong with making an ingoing phone call to say to Bruce or to Brad or myself, you know, and say, "Hey, I'm thinking of selling." Oh, no kidding? 'Cause everybody thinks if you make the ingoing phone call you lose your negotiating power, and the reality is you don't 'cause you still have the word "no" in your vocabulary. So if you don't like it, it's fine. And it doesn't take that much work, as Bruce knows or Brad. They can spend 15 minutes on the phone with you and they'll tell you if it's saleable or not saleable. I can tell you that, too, 'cause it's just an envelope, and then we can figure it out from there.

B. Hearsh: I think I would just add – I just jotted down three or four things in addition to what Neil pointed out. I think obviously culture is important, to the extent that you're going to be collaborating or a part of another organization, to have spent time with the people that are going to be involved with you going forward and feeling good about that and comfortable about that. That's an important intangible for sure. I think experience in getting transactions done efficiently and smartly – someone who's an experienced acquirer like Neil, for example. I think that's an important criteria. I would say third, obviously the value-add going forward, the distribution component is an important criteria. And I think evaluating the success of a particular party in partnering with other firms, in demonstrating that they've been able to retain the people and keep them excited about the business and raise assets for the company that they buy – those to me would be among the more important criteria.

B. Cameron: I guess I would add – I'd start out and say, "Why are you thinking about it? What are you trying to accomplish?" And that might seem obvious to you, but some people are trying to do a transaction 'cause they're trying to capitalize their business and move on. They want to go play golf. They want to run a new business. They want to do something else. And this may – I'm always amazed by this. You see this when you go through transactions. Some people, it's all about me and getting the most money I can get. And there are some other places where they really care about their employees and their clients, and hopefully all the people are in the second category here. But you see both, and so you need to try to understand what's driving the sort of – what they're trying to accomplish. And if they're trying to find the right home for the business, then it's going to be about the culture, as Brad said. It's going to be about how the two businesses come together. To Neil's point, are the fee structures similar? Is the approach to the client base similar or not?

If it's about the money, then what happens is it's, you know, how much expense can I cut out, and who needs the product

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and will pay the most for that? We try not to work with the former types of structures, to be quite honest, 'cause I think those are recipes for disaster. But you know, you need to decide what it is you're trying to accomplish.

Question: Neil, what's the – over here. What's the going rate for the percent of assets basis?

N. Hennessy: Well, that depends, but just ballpark you're going to be somewhere – I've paid as little as 87 basis points. That was one deal, but that was a special situation. I've paid as much as two and three quarters percent, but that was a special situation, and that was only a $35 million fund. But the going rate is going to be somewhere between – depending on the cost or what's happening, and if you're sub-advising or merging, but it's going to be one, one and a half, two, two and a quarter, something like that. Normally they'll probably – they were talking about an earn-out when you're a smaller firm or something like that, especially if you're going to sub-advice. We want to make sure that you're on our program, that you understand it. It's very important to keep those assets. And so we use a – you know, a two-sided transaction, which essentially is – let's say it's two percent. We give you one percent on closing of the assets and we'll give you the other one percent on what assets are left at the end of one year. So it could be – because of our marketing, whatever, the assets could double and you'd just make that much more money. But it's important to have that person there and their team to get, number one, the shareholder vote, and number two is to make sure that you can save the assets as best as possible.

But that's the range. Like I say, publicly traded they're going to go off of EBITDA, 'cause it's a different ballgame.

C. Bellamy: You know, a couple things to add, and to draw on a couple comments that were made. So, Bruce, you talked about the merger of equal concept becoming more prevalent. You talked about the reason why someone is looking to merge. What I see

at my client base of 500-plus investment advisors – they all want to have a discussion, but 99.9 percent of them all want to be the acquirer, you know, in all scenarios. And you know, I think those that really work hard on their business and they're always thinking about this, their head's on the swivel to say, "You know what? I see something interesting." Maybe I met somebody at a conference that has a complementary skill set – those are kind of all drivers that I think are important. So one thing I want to ask, you know, the panel – you've seen plenty of deals fall apart. You know, what are some of the things that have caused those things to fall apart as they've gotten to the finish line that maybe you can offer some advice to the crowd with respect to things they should be thinking about on an ongoing basis as they entertain the concept of going to market?

B. Hearsh: I mean, I guess – and I think Neil and Bruce have sort of alluded to this, Chris. Obviously in terms of getting deals closed – in other words, sort of preventing deals from getting interrupted along the way – and then there's another set of questions about what happens after a deal closes. But in terms of getting deals closed, I think it's a lot about making sure that you've got the support of the fund boards and the shareholder vote sort of well-grounded. And I think that means having a good messaging frankly to those types of constituents about why the transaction is taking place and why the shareholders of the funds involved are going to be as happy or happier after the deal closes. So I think, you know, spending time as you get down the road and are getting close to inking a deal, to making sure that there's a commonality of vision number one going forward, and that you've got a good story to tell those that have a fiduciary obligation to sign off on the deal – to me those are the kind of key things to making sure that a deal actually closes.

B. Cameron: I think that's fair. There's a reason that you end up having to put up with investment bankers and lawyers through these processes, as much as you probably would prefer not to. And

there are lots of nits and gnats, whether it's indemnification provisions or how much working capital is going to be available. I've seen deals blow up over the fact that, you know, they've priced the deal at $100 million but then someone's got to leave $1 million of working capital on and you think, "God, does it really matter?" But at the eleventh hour they're all fixated on their money and that extra million dollars kills it. You know, so you try to make sure you've thought that stuff through and made it clear. So a lot of it's – I think the fundamentals, as Brad said, are where you want to start with, but you just need to make sure you have people that are working with you going through to get the details done correctly as well.

N. Hennessy: I think the transaction from the beginning has to work for all four sides. If one side doesn't work it's not going to work. So it has to work for the mutual fund's shareholders on the sell side. It has to work for the shareholders or partners of the firm that's selling. It has to work for our shareholders in the mutual funds or product lineup. And it has to work for Hennessy Advisors' shareholders. If it doesn't work, if one of those pieces doesn't work it's not a good deal so it's not worth going forward. Luckily, and I don't want to break my luck, we've never had not a transaction go through. But those are the steps that you take first and make sure, and as much as it pains me to say, but really in the mutual fund industry, and I think these gentlemen would back me up, very few people know how to acquire. Very few people know what to look at. Very few people don't understand maybe you can squeeze more revenue out of something; you don't have to necessarily cut costs. So when I look at the industry today, I mean, there's going to be a lot more consolidation. And you're hoping that you get with a good firm that you can still enjoy the business and have a good time. But, you know, there's a – we're a publicly traded company. I have to be completely honest. If somebody comes in and they want to buy and people come to the door and they go, "Well, what do you want to do?" I say, "Well, I don't have much of a choice. If you're going to write the check you're

going to tell me what to do. You don't want me or the people or something – I can't do anything about it. It's a publicly traded company." As a private company you can do that a little bit more. You can do that and try and protect your people as much as possible, little more difficult in the public arena.

Question: Neil, just a quick question for you is what size of a – just a quick question on funded options. How small is too small to be worth the effort?

N. Hennessy: Well, you know, like I said, we bought a $35 million fund that doesn't make a whole lot of sense, but what it did do was give me the seed capital for another quantitative fund that we had sitting on the sideline, so that's it. For us to move the needle now, and I hate to say this, you know, it has to be $100 million, $200 million, $300 million, $500 million, $1 billion to move the needle, so it has to be somewhat unique. But I think what's happened – and they know better than me, but I think all the big deals have pretty much been done. Janus and Henderson were the last really big deal. To a great extent there's not big ones out there. So I think if you're going to continue the build and you're wanting to buy $100 billion or $200 billion, you're going to have to piecemeal them together. You're gonna have buy fives, tens, twenty-fives, thirties, and stuff, and these guys are going to make fortunes 'cause the lower the price the more they charge, okay? [Laughter] But essentially that's what's – so –

B. Hearsh: What's wrong with that?

N. Hennessy: No, I didn't see nothing wrong with it, as long as the other side pays. [Laughter] But essentially that's what I think is going to happen, that you're going to have to piecemeal. So for instance, at $250 billion, you know, buying $3 billion, that's not going to do anything unless it fits in somehow, some way, or you can buy and if you got the distribution and you can grow it – for instance, Schwab bought – oh, years ago – God, I'm forgetting the name, but they were like $1.5 billion; within two years they were $15 billion. They just had a little problem with

their quantitative model that didn't work out too well. But yeah, the end of the game is I think you're going to see a lot more consolidation. You just – it's the way the business is going.

B. Hearsh: I mean, I would agree with that, but obviously if there's something special about the small fund, either in terms of its track record or the asset class that it's operating in, whereas Neil points out there's a distribution opportunity because of the characteristics, that I think would be the exception. But it can be difficult to get people's attention to focus on a small fund versus a larger family of funds.

N. Hennessy: I also meant to add that there's share classes, too. So, you know, if I'm going to buy an A share or something, most likely if it's at a smaller broker-dealer, an Edward Jones or something like that and they go, "Well, who's Hennessy?" most likely we're going to lose that shareholder, and depending on how long they've held it, buy another five and a half percent mutual fund. C Share – most likely going to go away because they're not getting the one percent anymore. So you've got to be very conscious, and what I do see is – and I think it's a mistake but it's just my perception – is these fund companies are coming up with just trillions of different share classes. I mean, I look at the company and it has seven mutual funds but it's 63 share classes. And I go, "You can't do anything with that." You can't – I mean, so I've always said just keep it simple. You know, you've got a retail and an institution. I'm really seriously thinking about just forgetting the retail because all the sales and everything is going through the institution anyway.

N. Hennessy: So why even have two share classes? Because they get shareholder servicing fees. That's why. [Laughter]

C. Bellamy: Yeah, to follow up on that question I would say I think that $100 million threshold is probably the right place to look when you look at legal fees and proxy costs and things of that nature. But to Brad's point, there's lots of examples where – you know,

I've had multiple five-star funds with $100 million to $200 million where the portfolio manager said, "You know what? I'm done, throwing in the towel. I don't even want to talk to anyone about potential partners; I just want to liquidate." And that's just such a shame. And I've also seen transactions where, you know, you'd have small funds, but a larger shop sees a product that they want. Maybe it's first to market, maybe it has good performance, and we've seen cases where, you know, a $100 million fund becomes a $1 billion fund overnight because of the product type. So, you know, I try to caution our clients to pause before they liquidate a fund, to stop and think if there's someone out there. And really know your competition and have that network. It doesn't hurt to pick up the phone and make a half dozen phone calls. Maybe it gets you nothing but maybe it allows the fund to survive, and you know, you put a few bucks in your pocket along the way as well.

Question: So I'm curious – when you acquire a fund company, what's the time commitment? So how long do you want the owners to remain, 'cause obviously they want to exit, right? And the partnering sounds great, but I'm just curious. You know, are you going to let them stay? I mean, ten years sounds great, but what if you've got baby boomers who are really wanting to retire and want to spend more time? So how short is that timeframe? I'm just curious. And then about baby boomers, I'm wondering is this a larger cycle? Like you've got a lot of baby boomers who have been very successful in the business and you just have a lot more people who are wanting to sell. And this is kind of probably a sweet spot for this kind of a topic, so that one. And then there's a lot of managers blowing up right now. I mean, last year you had some superstar money managers who are just blowing up as far as performance goes, and I'm wondering are you seeing those types of – I'm not going to name them, but are they ready – well, I'm kind of done with this; I'm going to sell – too? So just curious about those points.

B. Hearsh: Yeah, maybe to address the first point first, you're absolutely right. The great thing about the business – all three of us having been in it now for some time – is that it really is an evergreen industry. And for every transaction that gets announced there's another group of guys who break way from a bank or an insurance company and start a business and ten years later they're running $5 billion or something. So there is this natural turnover. I think the baby boomer aspect of it may make this period oncoming even more prevalent in terms of the need for monetization and liquidity.

I think the answer to your question about the commitments going forward and the flexibility to structure what you'd like as the seller – I think it largely depends on the situation. I mean, obviously there are some companies that have spent a lot of time planning for succession and where the key people who might be involved in portfolio management or other key positions in the firm, the founders of the business or the people running the business that own most of the equity have provided for identifying those people. If that's the case, then I think many buyers will feel comfortable allowing individuals who might want to retire to do so relatively rapidly. And I think we've all seen situations where people depart almost immediately after a transaction, and yet there are a lot of people, particularly in the investment management part of the business, who love picking securities and want to do so until their health prevents them from doing so. And I think if they're doing a good job, then buyers are going to allow for that, too.

I think you can always count, regardless of how long a principle might want to be around, being asked to sign up for non-competes. And I would say generally speaking that can range, you know, wildly, but I think you need to be thinking at least sort of five years and maybe a couple of years after retirement if you're with the business as a seller beyond the five years. So the non-compete is always going to be there, and as I said before, often employment agreements for key personnel as well. But I do think people who are looking to move on should

be able to accomplish that as long as they can demonstrate that there will be continuity in the business going forward.

B. Cameron: I used to worry that I was going to work myself out of a job, and but you all are the examples of why that's not the case. You keep creating new funds, so thank you. But in terms of – I think Brad's point is fair. I think there's probably a wellspring of activity now because a lot of firms were started 20, 30 years ago, and so a lot of those are now thinking about doing things. In the context of somebody who's had really bad performance, it's really hard to sell a product that has had really weak performance. Everybody just assumes it's going to go to zero unless there's some unique characteristic around it. So you're almost better in that circumstance working with and trying to get it at least turned around, in Morningstar parlance, at least get back to a three, you know, in some way, shape, or form get yourself so you're not being the focus of everybody trying to get out. Trying to sell when you're at the bottom is just a recipe for disaster.

N. Hennessy: For us, I mean, if you look at it, if we merge it in, we don't need anybody, so that's gone. If we merge it in, we want a non-compete, you know, normally three, five years, and normally that's only because the person's 70, 75. I don't think they're going to really want, at least a startup. But on the sub-advisory what we try and do is give the manager a three-year contract with one-thirty-sixth going away a month, and the reason we do that is I can't say you all get to manage the money for the next three years, 'cause the board can fire you. So you know, you can't put an agreement like that. So what we try and do is come to some agreement with the manager that's going to sub-advisor and say, "Okay, you've got a contract for 36 months; one-thirty-sixth goes away." So if the assets are $200 million one year later and you get fired, you're getting 24 payments right now of whatever our sub-advisory agreement is, one check. So it protects the manager that way.

You know, and what's really happening out there, at least what I'm seeing, and I'm not sure what they're seeing – is the asset – the separately managed account business has really grown, and that's what they're dealing with a lot more because you have more control over those clients. You talk to them daily or weekly or quarterly. Mutual fund assets, as I said, you're going to lose them, so they could be here; they could be there. So it's a little more difficult, so the asset management business is growing that way. And so that's where I think the opportunity for smaller funds that have $500 million, $1 billion, $2 billion or whatever – if they have that separately managed account business or institutional business, they can really start to grow that, especially a separately managed account business, with the cash they get out and they're still managing the mutual fund. So they're still building equity and net worth in their company, and that's what we try and do, is everybody – it's a four-sided transaction. Everybody has to come out ahead, but you really want your sub-advisor – at least we do – to do really well, 'cause the more assets that come in, the more I make. And it's like I tell me employees, the harder they work, the more I make. [Laughter] It's work.

C. Bellamy: I think we have time for one more question. Okay, I have one for the panel. So the prevalence of private equity ownership in the asset management space is continuing to grow. Do you have any perspective of the positives and negatives, whether it's a minority slug of capital or 100 percent acquisition that the advisor should think about?

B. Hearsh: Sure. Look, I think most people think about the plusses and minuses of private equity in a couple of ways. I think on the plus side I think private equity is viewed as enabling the manager to remain independent. Private equity firms do not try to interfere generally in the operations, certainly the investment side of an asset management company. So I think the primary interest in private equity is one, flexibility in terms of minority versus majority because private equity often is willing to do either, but it's really in the independence. And to the extent

that the private equity firm can sit on the board and be a sounding board, that's great. There could be some value added there, but it's really primarily about autonomy and independence and achieving a level of liquidity obviously in selling a stake to private equity.

I think the biggest drawbacks are the requirement for the private equity firm to exit the investment. And so you have typically built into a private equity acquisition or investment some kind of mechanism that will enable the private equity firm to exit in five to seven years. And many organizations don't want that looming out there in the future as yet another transaction that they have to think about. There are organizations out there that have obtained capital that is more permanent, so it is now possible to transact with financial private equity-like buyers and not face the sort of five- to seven-year requirement for an exit because some organizations have found some very long-term money and so are not really part of the traditional private equity fund structure where assets have to be sold and liquefied and the like. But for me those would be – that's really the biggest positive weighed against maybe the biggest negative.

B. Cameron: I have to meet Brad's private equity groups. They're clearly better than mine. [Laughter] They don't tend to get involved in managing the investment process. Most of the ones that I see do insist on being on the board and they have opinions. And there are some that are actually pretty good and they understand the industry well, and so I think they're generally additive. I've had experienced in the past where you get private equity groups that don't really understand the nuances of this industry and that can be frustrating. But, you know, if you're trying to take out a partner, if you're trying to make an acquisition to add onto your business, most investment firms don't keep a lot of capital around. That's kind of a truism in this industry. And so if you're trying to buy a competitor, for instance, or build out your business, private equity can be a

useful tool in terms of facilitating that. And so we work with them often on that sort of thing.

I think, as Brad alluded, some of these groups – and they tend to be focused on the largest transactions, so Dyal and Petershill and Blackstone, have got funds that are basically permanent funds, and so you don't have to find liquidity. But there are actually now some family offices as well that are interested in this, and that – again you referenced that before, that that may be one of the next avenues. I think some of the family offices like this industry, and so we see some of them as being willing to put money into these businesses. And just to get the income stream it's generally a profitable business. So that's something we're trying to develop. We'll see how it plays out, but I think that's an avenue that may sort of help supplement what goes on in private equity.

N. Hennessy: Quickly my experience with private equity firms is they act like investment bankers, [laughter] with absolutely no help from the standpoint that they just want to buy you cheap.

N. Hennessy: And – yeah. I mean, you guys are trying to get – depending on what side, you're trying to get a good deal done. But the PE firms really want to get in, get out, but they want to buy you cheap. And there's a – you'll spend a lot of money in my opinion – I mean, you can do what you want, but by the time you get through just the attorneys and you're going through all the money you spend, if they want to do something, just make them pay all the bills because you'll find at the end that, you know, what started isn't where it's going to finish, unless you happen to meet one or two that I know on the Street that are very, very good. But they're run, like Bruce just said, more like a family office. They're there for the long term. They're buying an apartment building essentially.

C. Bellamy: Well, with that I believe we're out of time, so please join me in thinking your panelists.