I DID NOT KNOW A SERVICE LIKE THAT EXISTED!

MANAGEMENT ADVISORY IN PRIVATE EQUITY TRANSACTIONS – *interview with Michael Sirkin, Chairman and Managing Director of Jamieson USA*

When Michael Sirkin joined Jamieson Corporate Finance to run Jamieson USA and told people that he was joining an investment bank to do Management Advisory, the questions that he constantly received were "What is Management Advisory?", "Who needs Management Advisory services? and "How can Management Advisory be trusted in advancing the transaction process?"

So here is Michael's attempt to answer those questions and make sure everyone knows it exists in the United States because Management Advisory is an important part of private equity portfolio company transactions; one that has been common in the UK and Continental Europe and has been widely accepted in sale processes for a number of years and one that is gaining traction in the United States.

What is Management Advisory?

When we started talking to executives of US portfolio companies and explained what we do, the response was very positive, but with a capitalized ''I DID NOT KNOW A SERVICE LIKE THAT EXISTED!''

Management Advisory is the providing of advice to management teams involved in private equity company transactions on the terms of their equity incentive arrangements and other compensatory issues (together Management Incentive Plans or "MIPS"), as well as providing advice to chief executive officers and other senior executives joining existing private equity portfolio companies and restructuring of MIPS outside the M & A process.

Why Haven't I heard about Management Advisory?

Management Advisory is a practice started and professionalized in the UK in 2005 (by Jamieson) and now is standard practice in sale processes to private equity in the UK and Continental Europe, both in primary buyouts and secondary buyouts. It provides structure to the process for agreeing management terms and the service offering is built into the sale process timetable. Jamieson brought the concept to the United States several years ago in connection with international transactions and, more recently, for United States centric deals. The practice is gaining traction in the United States and, because of the "packaged" terms structure it brings to the sale process and the value it offers to management teams, we expect it will become more standard practice in the United States over time.

How does the Management Advisory process work?

The objective of Management Advisory is to ensure that the process for agreeing management terms is incorporated into the overall sales process and not left until the eve of signing or after the transaction has been signed , thus putting pressure on management and potentially risking a delay to signing. Management Advisory provides structure to the discussion and relieves much of the stress on the chief executive officer and other senior management on the economic terms for management going into a new deal and permits management to focus on running and selling the business, yet knowing they will receive a fair market deal. Management Advisory works closely with the seller side sales advisors to ensure that terms are agreed before management is required to financially commit, but at the same time doesn't disrupt or interfere with the overall sales process.

Why does management need a separate advisor to assist in the sales process?

As part of a private equity transaction, financial buyers want management teams to have "skin in the game" and to make a long-term financial commitment to the company they are running. In order to make that commitment, managers need to be comfortable with the terms they are being asked to sign up, how the terms they are offered compare to market terms and the potential future rewards? Most managers have only limited experience with what is the market amount to invest or rollover, how the management equity pool should be allocated, what should be the size of the pool, how should it vest and what should happen to their investment in a leaver situation before the private equity fund exits. It is valuable to the chief executive officer and other management to have someone independent and free from buyer / seller bias to assist them through the deal, set out what they need to know and do and represent them in negotiating their new terms with potential buyers. It is especially helpful when the advisor has a substantial data base of similar private equity transactions (many with the potential buyers in the process), and can model the projections , challenge the assumptions and analyze the risk and reward of investing or rolling over and making a long term career commitment.

Won't the seller's investment bankers be able to advise management on these points"

They may to an extent, but they have other priorities in the sale process as an investment banks primary obligation and focus, rightfully, is selling the company for the highest price and on the best terms. Management is generally fully aligned with the selling sponsors on this issue. However, management will also have issues unique to them as they are not only exiting the past investment but are staying with their company and making a new investment of money and career. Therefore, rollover equity interests or reinvestment in the next deal and new MIPS are highly important to them. Seller's investment bankers will often help with some advice on these matters to the extent they have experience or data, but they generally don't have access to the broad proprietary MIP benchmark data base that a Management Advisor such as Jamieson does and are much more concerned with the broader deal.

If management has attorneys, why is a Management Advisor needed?

I am fortunate enough to have been both being a lawyer and now a Management Advisor so I can see a sale process from both perspectives. A Management Advisor works alongside lawyers (and tax advisers) and doesn't replace them. They provide different services and are part of the managements' team, just like the seller and the buyer have lawyers and investment bankers as part of its team. The main difference is that a

Management Advisor is a commercial advisor who links the financial and legal terms together, as neither terms are effective in isolation. For example, the most watertight legal deal doesn't have much relevance if the economic terms are poor, and vice versa. Management Advisors advise on and negotiate the commercial deal terms through direct conversations with the bidders and their investment bankers and capture these terms in a condensed term sheet before the production of long form legal documents. Its not simply a case of documenting terms but rather it's about negotiating what these terms should be and how they compare to market. This advice is supported by detailed financial analysis and benchmark terms. The emphasis is on "commercial terms"; for example, what is the future dollar pool of the management equity program that is being offered, how sensitive is it to different capital structures and performance and what is the pool share of the overall value created versus the market.

Why is Management Advisory different than using a compensation consultant?

Management Advisory leverages off a proprietary data base of private equity owned portfolio company transactions. It offers extensive experience in structuring the incentive equity in private equity deals and provides management teams with the tools and analysis to help them negotiate a fair market deal. Most compensation consultants focus on public companies using the publicly available compensation data (salary and bonuses) and don't focus on or have available broad specific private equity transaction data. Many of them will only advise the private equity firms and not management and they also don't usually focus on the unique terms of the private equity transaction, such as rollover, time and performance vesting equity or management pool as a percentage of the overall equity value created, the latter being one of the main assessment factors in analyzing management equity.
In addition, Management Advisory is performed in an investment banker role exclusively for management teams with active negotiation of the transaction on behalf of management and advise on ancillary, but important issues, such as funds flow.

Will Management Advisory impact the value to the seller?

Discussion on terms for management only happens once there is visibility on price and a likelihood of a deal happening. Typically, this is during the second round of the process, for example alongside the distribution of a draft SPA to bidders, but we will liaise with the seller and their advisers on a suitable time as every process is different. Whilst there can be sensitivity around the timing for engaging in terms discussions, in my experience the issues that Management Advisory address are important to management and the knowledgeable assistance makes management more confident in going forward and working with the eventual buyer. We believe introducing Management Advisory helps permit management to help negotiate the best price and terms for the deal because it lessens distractions and also helps to permit them to continue most effectively running the company. It also structures the process for agreeing terms, which, if left unchecked, can be disruptive and delay a deal signing, thereby leading to uncertainty and put value at risk.

Walking the tight rope between not too naïve verse too greedy

Management Advisory's job is to provide management with the tools and benchmarks from which to enter into term discussions. While the goal is to obtain a deal favorable to management, at the same time it is to enter into a fair market deal, maintain the relationship with the future sponsor for management and to assure the transaction closes for everyone's benefit.

Who retains the Management Advisory Firm?

The Management Advisory Firm is retained by the company to serve as a sounding board for management for sensitive issues and negotiation of the commercial and financial management terms. The fees are paid by either the buyer or the seller depending on the negotiations. In Europe it is usually the buyer, but the custom in the United States is still developing. Management teams are very rarely asked to pay the fees.

Jamieson Corporate Finance US, LLC is a member of FINRA and SIPC.