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Dallas Shop Buys Out from CalPERS Program

by Scott Johnson

Emerging manager Smith Group Asset Management has struck an innovative financing deal to buy itself back from its minority owner, the California Public Employees' Retirement System (CalPERS). In exchange for capital, the Dallas-based growth equity shop will share revenue with Asset Management Finance (AMF) for a limited time while holding on to 100% equity.

The deal is AMF's third in three months and helps lend the New York-based firm legitimacy with small managers that would otherwise look to large strategic partners or private equity to broaden their resource base. In turn, the arrangement allows Smith Group to become completely employee-owned. The firm bought back a separate stake from Wells Fargo last summer.

Smith Group, founded by CEO Stephen Smith in 1995, became part of a CalPERS emerging managers program four years ago. CalPERS has more than \$2 billion invested in emerging managers and has taken a stake in several shops in addition to awarding assets.

The arrangement has been beneficial for Smith Group. Since partnering with CalPERS and Strategic Investment Group, which oversees the manager development program, the firm's assets have grown from about \$1 billion under management to just less than \$6 billion.

"CalPERS was a very cooperative partner, and we still manage a significant relationship with their pension account, which we expect to stay with us going forward," says Smith.

Smith Group managed less than \$300 million for the pension across large-cap and small-cap domestic equity strategies as of Dec. 31, 2007, according to a CalPERS spokesman.

Still, the firm held an "independence day" celebration in early April to mark the deal with AMF, which Smith says has been well-received by both clients and investors.

"[The response] has been overwhelmingly positive, both from the clients and also from the investment professionals we have here that now see a greater ability to be owners of our company and participate in the long-term growth that we're experiencing," says Smith.

Prior to founding his own shop, Smith held various senior investment roles at Wachovia and Bank of America. He began his career at NASA, however, where he was an engineer in the lunar landing program in the late 1960s.

Smith Group employs a staff of 25, including 12 investment professionals. With an eye to growth, the firm is looking to bring on additional investment expertise and expand its moderate risk large-cap and small-cap growth product set.

AMF has signed similar deals with 11 investment firms that range in size from \$1 billion in assets under

management to \$15 billion. The terms of the Smith Group deal have not been made public, but most arrangements under AMF's revenue share interest (RSI) investment structure will expire in seven to 20 years. So far, the firm has committed more than \$260 million.

Most of those deals have involved institutional managers, but AMF has made forays into the wealth management space, inking a capital deal with PHH Investments in early April that allowed the Dallas-based registered investment advisor to purchase another firm, RAA Wealth Management.

AMF, founded by president and CEO Norton Reamer, is the evolution of an earlier Reamer brainchild, United Asset Management, which more than a decade ago invested in small managers but took equity stakes on top of revenue shares.

"Here we've almost turned the model on its head," says Reamer. "We're using revenue sharing, but we're using it in a way that helps the independence of the firm. We are not owners at all."

Reamer believes that structure is an improvement over competing models, such as acquisitions by large strategic buyers or private equity managers. AMF's approach differs both in the fixed expiration date for the arrangement and the lack of an equity purchase

"Basically we're providing capital for them to get some liquidity for the senior principals, transfer equity ownership to the next generation, buy themselves out from another company," he says. "All of it is really geared toward increasing their control, increasing their independence, while still making liquidity available to them for the purposes they have in mind."

Elizabeth Bloomer Nesvold, managing partner of Silver Lane Advisors, a New York-based investment bank, says the AMF model is particularly attractive to fiercely independent managers that are nevertheless struggling with growing pains. Nesvold worked with AMF in a November 2007 deal that supplied capital to Chicago-based Gresham Partners.

"I think that they are establishing a very good name for themselves as a pure financial solution – 'we're not equity, we're not debt, we're somewhere in between,'" she says. "I think it's a wonderful option for firms to have because there are no requirements on what you use the proceeds for."

The arrangement appears to go beyond a dollar exchange. Steve Smith says AMF will act as a "sounding board" for ideas already on the table at Smith Group while offering its expertise on risk management and growth strategies.