

Private Equity

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Transaction and Monitoring Fees: Does Anything Go?

Introduction

A private equity client recently asked us for advice about the range of transaction and monitoring fees charged by leveraged buyout investors to target and portfolio companies. Requests of this kind frequently elicit answers based on anecdotal evidence that substitutes for empirical data. We took a more disciplined approach and prepared a survey of these fees based on a random sample of publicly reported acquisitions by buyout funds. This study presents the data from the survey in abstracted form. We hope that this summary can serve as a benchmark to private equity investors and their advisers.

Type of Transactions

The survey covers 32 leveraged control acquisitions by 18 different lead investors, all of which are prominent private equity firms.* The transactions were selected on a random basis, and the data were extracted from filings of the target companies with the Securities and Exchange Commission. In some cases, but not in all, we also obtained and reviewed the

agreements that set forth the transaction and monitoring fees.

Even though our sample ranges across deal sizes, industries and investors, it does not include transactions by private equity investors affiliated with financial services firm. It appears that these investors frequently abstain from charging customary deal or monitoring fees and instead direct opportunities to earn investment or commercial banking fees to affiliates. We believe that combining both categories of transactions would distort the data.

We reviewed acquisitions consummated during the last seven years. The 32 transactions covered by the study were completed in the years shown in Table 1 below.

All transactions employed a high degree of leverage, and a majority of them were recapitalizations in which the selling shareholders retained an amount of equity. Deal sizes ranged from \$163 million to \$2 billion. The deal size is the sum of (i) the aggregate equity value established in the

Table 1 Deal Years

Year	1995	1996	1997	1998	1999	2000	2001
Number of Deals	1	3	7	6	7	7	1

* They include clients of Dechert. However, none of the data presented here was derived from transactions that we worked on.

transaction (including any rollover) and (ii) the aggregate principal amount of new and assumed debt. The breakdown by deal size is shown in Table 2 below.

Transaction Fees

Transaction (or deal or success) fees are the fees charged by the private equity firm in connection with the completion of the acquisition for—typically unspecified—advisory services.

In each transaction covered by the study, the buyers collected such a one-time fee in cash. Table 3 (below) shows the range, mean and median.

As expected, transaction fees are strongly correlated to deal sizes. Table 4 (below) expresses transaction fees as a percentage of deal size.

The percentages are quite consistent across deal sizes. Despite the wide overall range (0.5%-3.39%), a large majority falls within a much smaller range. In 19 of the 32 acquisitions, the transaction fee was higher than 0.85% and lower than 1.85%, i.e., within .5% of the average. Only in nine cases was the deal fee above 1.5%. The standard deviation for the entire sample is 0.64442%.

The deal fees reflected in Tables 3 and 4 do not include advisory fees for add-on acquisitions or

Table 2 Deal Size

Deal Size	Number	Mean	Median
Less than \$500 million	10	\$347 mil	\$367 mil
\$500 million to \$1 billion	13	\$772 mil	\$790 mil
More than \$1 billion	9	\$1,550 mil	\$1,480 mil
All transactions	32	\$858 mil	\$762 mil

Table 3 Transaction Fees

Deal Size	One-Time Fee in Dollars			
	Minimum	Maximum	Mean	Median
Less than \$500 million	\$1.7 mil	\$8.3 mil	\$5.47 mil	\$5.95 mil
\$500 million to \$1 billion	\$3.5 mil	\$12.7 mil	\$8.37 mil	\$8.25 mil
More than \$1 billion	\$9.3 mil	\$40.0 mil	\$20.36 mil	\$19.40 mil
All transactions	\$1.7 mil	\$40.0 mil	\$10.77 mil	\$8.30 mil

Table 4 Transaction Fees/Deal Size

Deal Size	One-Time Fee as a Percentage of Deal Size			
	Minimum	Maximum	Mean	Median
Less than \$500 million	0.58%	3.39%	1.76%	1.58%
\$500 million to \$1 billion	0.5%	1.69%	1.11%	1.15%
More than \$1 billion	0.68%	2.17%	1.36%	1.30%
All transactions	0.5%	3.39%	1.35%	1.30%

similar post-closing transactions. Large buyout firms consistently charge deal fees for significant post-closing transactions. We did not compile data on the amount of these fees. However, we did observe that frequently post-closing deal fees are contractually locked in at the time of the acquisition. The fee is then typically calculated as a percentage of future deal size consistent with the determination of the initial transaction fee.

Monitoring Fees

Monitoring (or management) fees are the fees charged by the private equity firm to its portfolio company after the acquisition for ongoing oversight. Expenses are typically reimbursed separately.

In each transaction covered by the study, the controlling stockholder charged an annual monitoring fee in cash under an agreement entered into at the time of the acquisition. Table 5 shows the range, mean and median.

We calculated monitoring fees as a percentage of EBITDA of the portfolio company, as shown in Table 6. We relied on the portfolio company's

publicly reported figure, in most cases in the form of Adjusted EBITDA which eliminates recapitalization expenses and similar items. We used, in order of availability, EBITDA for the fiscal year following the acquisition, the fiscal year of the acquisition, or the fiscal year preceding the acquisition.

We had expected monitoring fees to be more strongly related to the size of the portfolio company. Instead, most fees fall within a commonly accepted range regardless of deal size or EBITDA. In 19 of 32 transactions, the monitoring fee was higher than \$800,000 and lower than \$1.8 million, i.e., within \$500,000 of the average. In 23 cases, the monitoring fee was equal to or greater than \$1 million and lower than or equal to \$2 million. The standard deviation from the average fee is \$640,520, and the standard deviation from the average percentage of EBITDA is 1.15%.

A few additional observations:

- In some cases, the management agreement provided for the fee to be calculated as a percentage of actual or budgeted EBITDA or

Table 5 Monitoring Fees

Deal Size	Annual Fee in Dollars			
	Minimum	Maximum	Mean	Median
Less than \$500 million	\$0.50 mil	\$1.75 mil	\$1.06 mil	\$1 mil
\$500 million to \$1 billion	\$0.40 mil	\$3.10 mil	\$1.38 mil	\$1.2 mil
More than \$1 billion	\$.75 mil	\$2 mil	\$1.42 mil	\$1.25 mil
All transactions	\$.40 mil	\$3.10 mil	\$1.30 mil	\$1.1 mil

Table 6 Monitoring Fees/EBITDA

Deal Size	Annual Fee as a Percentage of EBITDA			
	Minimum	Maximum	Mean	Median
Less than \$500 million	0.86%	4.37%	2.63%	2.63%
\$500 million to \$1 billion	0.32%	3.42%	1.56%	1.01%
More than \$1 billion	0.24%	2.10%	0.81%	0.65%
All transactions	0.24%	4.37%	1.66%	1.15%

net sales. However, even in these cases, the fee provision included a floor (e.g., “not less than \$1 million”) or a collar (e.g., “not less than \$1 million and not more than \$1.5 million”).

- Management agreements typically continue until the expiration of a term (regularly 5-10 years) or until the buyout firm ceases to hold a specified level of equity ownership. The initial public offering is usually not a termination event, but in several cases the buyout investor terminated the agreement in connection with the offering for a significant one-time fee.
- At least one prominent buyout firm covered by our survey requires its portfolio companies to

prepay the monitoring fee at the time of the acquisition for all or a significant portion of the term of the management agreement.

Conclusion

Is there a market rate for transaction (or deal) fees and monitoring (or management) fees collected by buyout investors? We believe there is at least a market range. Transaction fees tend to converge around an average of 1.35% of deal size. Management fees tend to be flat, i.e. less related to the size of the deal or the portfolio company, and to converge around an average of \$1.3 million per annum.

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Private Equity Group

If you have questions regarding the information in this update, please contact the Dechert partner with whom you regularly work, or any of the attorneys listed below. Visit us on the web at www.dechert.com/privateequity.

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