Transaction and Monitoring Fees: On the Rebound?

A joint investigation by Dechert and Preqin

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Transaction and Monitoring Fees: On the Rebound?

Contents

Introduction

Over the past couple years, we have found ourselves inundated with questions from our private equity clients as well as others who have read our two previous surveys (January 2003 DechertOnPoint “Transactions Monitoring Fees: Does Anything Go?”, and Summer 2008 DechertOnPoint “Transaction and Monitoring Fees: What Is Now Market?”) about the effect of the 2008 market and credit crash on the market range of transaction and monitoring fees. Given the paucity of conventional private equity investing in the aftermath of these events, our answers to these questions were, by necessity, limited to the anecdotal. Thankfully, with the relative calming of the markets and the associated resurgence of conventional private equity investing, we have been able to prepare a new survey of transaction and monitoring fees that begins to answer these questions. Our survey is based on data collected through a voluntary survey of private equity buyout firms conducted by Preqin, one of the leading providers of data and intelligence on alternative assets, combined with data collected through a random sample of publicly reported private equity acquisitions. This study presents the data from the survey in abstracted form.

While this study analyzes data over a six-year period from 2005 through 2010, we also isolate and focus on trends prevailing since the recovery from the 2008 market and credit crash. Similar to our prior two surveys noted above, we hope this survey will serve as a benchmark for private equity investors and their advisors and provide a comprehensive understanding of how the market for transaction and monitoring fees continues to evolve.

Dechert LLP
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Types of Transaction

This survey covers 143 leveraged control transactions (compared to 60 transactions in our 2008 survey) by over 40 different lead investors, including many prominent private equity firms. Unlike our prior two surveys, where the data was extracted entirely from public filings of the target companies with the Securities and Exchange Commission ("SEC"), this year we teamed with Preqin to carry out a more comprehensive survey. In addition, our survey this year provides information on other types of fees private equity sponsors receive over the course of an investment for services from deal structuring through exit.

Our sample ranges across deal sizes, industries and investors. In addition, our sample also includes transactions from various jurisdictions outside of the United States[1]. We reviewed acquisitions consummated during the previous six years (2005 through 2010). In connection with our transaction fee survey, we reviewed and analyzed data from a total of 143 transactions. We reviewed and analyzed data from 98 of those 143 transactions for the monitoring fee survey[2]. The transactions covered by the surveys were completed in the years shown in Tables 1 and 2 below.

Fig. 1: Deal Years for Transaction Fee Survey

Year	2005	2006	2007	2008	2009	2010
Number of Deals	14	17	36	24	10	42

Fig. 2: Deal Years for Monitoring Fee Survey

Year	2005	2006	2007	2008	2009	2010
Number of Deals	14	18	26	11	4	25

Deal sizes in the current survey ranged from $100 million to $30.7 billion, compared to deal sizes of $155 million to $5.5 billion in our 2008 survey. The deal size is the reported enterprise value for each transaction, being the sum of (i) the aggregate equity value established in the transaction (including any rollover) and (ii) the aggregate principal amount of new and assumed debt. The breakdown for our current survey is shown in Table 3 below.

Fig. 3: Deal Sizes for Transaction Fee Survey

Deal Size	No. of Deals	Mean (Millions)	Median (Millions)
Less than $500 Million	70	$244.9	$215.7
$500 Million to $1 Billion	31	$723.4	$552.0
More than $1 Billion	42	$3,937.4	$1,260.0
All Transactions	143	$1,433.2	$510.0

"...while the mean deal size for all transactions remained close to the average in our 2008 study, the median deal size decreased to $510 million from $872 million in our 2008 study..."

This survey includes a similar range and sample of deal sizes as were used in our 2008 study[3]. However, while deal sizes for middle-market and large-market deals generally increased, our data in this survey captures a larger number of lower middle-market deals with a value under $250 million. Consequently, while the mean deal size for all transactions remained close to the average in our 2008 study ($1.43 billion in this survey, compared to $1.38 billion in our 2008 study), the median deal size decreased to $510 million from $872 million in our 2008 study.

1. For purposes of this survey, amounts in foreign currencies were converted to U.S. dollars using the average annual exchange rate for the relevant year.
2. Certain of the 143 transactions did not produce sufficient information to analyze for purposes of the monitoring fee survey.
3. For purposes of 2005, 2006 and 2007 data, we used data from our 2008 survey and data from additional deals.

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 the vast majority of the transactions covered by the study, the private equity firms collected such one-time fees in cash[4]. Table 4 below shows the range, mean and median of these transaction fees by deal size.

Fig. 4: Transaction Fees for 2005 - 2010 (One-Time Fee in Millions of Dollars)

Deal Size	Minimum	Maximum	Mean	Median
Less than $500 Million	$0.1	$10.0	$3.0	$2.5
$500 Million to $1 Billion	$1.7	$18.0	$7.4	$6.6
More than $1 Billion	$0.6	$200.0	$29.9	$15.0
All Transactions	$0.1	$200.0	$11.9	$5.1

The amount of transaction fees continues to be strongly correlated to deal size. Table 5 below expresses transaction fees as a percentage of deal size.

Fig. 5: Transaction Fees/Deal Size for 2005 - 2010 (One-Time Fee as Percentage of Deal Sizes)

Deal Size	Minimum	Maximum	Mean	Median
Less than $500 Million	0.05%	4.00%	1.25%	1.01%
$500 Million to $1 Billion	0.17%	2.00%	1.06%	1.04%
More than $1 Billion	0.03%	2.18%	0.84%	0.95%
All Transactions	0.03%	4.00%	1.09%	1.00%

The percentages are fairly consistent across deal sizes, with a small but meaningful decrease in percentage size found as deal size increases. In particular, lower middle-market deals (deals of less than $500 million) averaged approximately a 1.3% transaction fee, while the transaction fees for middle-market (deals of more than $500 million) and large-market deals (deals of more than $1 billion) were typically closer to 1.1% and 0.8%, respectively. In 94 of 143 acquisitions (approximately 65% of the deal sample), the transaction fee was within the range of 0.5% to 1.5%, i.e., within half a percentage point of the mean for all deals. Only in 27 out of the 143 deals (approximately 18.9% of the deal sample) was the transaction fee above 1.5%. The standard deviation for the entire sample is 0.62%.

Finally, we isolated the data for transaction fees in 2009 and 2010. Table 6 expresses transaction fees as a percentage of deal size.

Fig. 6: Transaction Fees/Deal Size for 2009 and 2010 (One-Time Fee as Percentage of Deal Sizes)

Deal Size	Minimum	Maximum	Mean	Median
Less than $500 Million	0.05%	4.00%	1.28%	1.13%
$500 Million to $1 Billion	0.55%	2.00%	1.24%	1.25%
More than $1 Billion	0.05%	2.18%	1.04%	0.99%

A few interesting trends are discernable in the results of this survey compared to our 2008 and 2003 surveys.

- First, average percentage transaction fees have decreased meaningfully across all deal sizes over the long term. From our 2003 study to our current study, the average percentage transaction fees for transactions less than $500 million have decreased from 1.76% to 1.25%, and the average percentage transaction fees for all deals sizes decreased from 1.35% to 1.09%. Table 7 below shows the trend of decreasing mean and median percentage transaction fees across each of our studies.

- In trying to isolate the effect of the 2008 market and credit crash on transaction fees, however, we bifurcated the data generated from this survey into 2005–2008 and 2009–2010 (as shown in Table 8). This shows a noteworthy increase in the mean and median percentage transaction fees across all deal sizes for transactions that occurred during the private equity transaction recovery period since 2009. While transaction fee activity dipped during and immediately following the market crash, we believe the opening of the credit markets and the increase of private equity buyout activity in 2010 allowed private equity firms to increase transaction fees and improve fee performance.

- While transaction fees are continuing the trend towards standardization seen in our 2008 survey, our current survey reveals an overall increase in variance across transaction fees. The standard deviation in this survey is 0.62% (compared to 0.54% in our 2008 survey), and 94 of 143 acquisitions (65%) in our current survey were within half a percentage point of the overall mean (compared to 75% in our 2008 survey). However, the variance in this survey did not rise to the level reported in our 2003 survey (where only 59% of the acquisitions were within half a percentage point of the overall mean). We suspect this increase in variance may be due to an increase in the range of fees being charged in the aftermath of the 2008 stock and credit market events.

4. In six instances, the transaction fee was paid in cash installments or pursuant to a debt instrument. In one instance, the fee was paid through an equity issuance.

"In trying to isolate the effect of the 2008 market and credit crash on transactions fees… [the data] shows a noteworthy increase in the mean and median percentage transaction fees across all deal sizes for transactions that occurred during the private equity recovery period since 2009."

Fig. 7: Transaction Fees/Deal Size Across Surveys (One-Time Fee as Percentage of Deal Sizes)

	2003 Survey		2008 Survey		2010 Survey	
	Mean	Median	Mean	Median	Mean	Median
Less than $500 Million	1.76%	1.58%	1.35%	1.23%	1.25%	1.01%
$500 Million to $1 Billion	1.11%	1.15%	1.16%	1.26%	1.06%	1.04%
More than $1 Billion	1.36%	1.30%	1.01%	1.02%	0.84%	0.95%
All Transactions	1.35%	1.30%	1.14%	1.07%	1.09%	1.00%

Fig. 8: Transaction Fees/Deal Size (One-Time Fee as Percentage of Deal Sizes)

	2005–2008		2009–2010	
	Mean	Median	Mean	Median
Less than $500 Million	1.21%	1.00%	1.28%	1.13%
$500 Million to $1 Billion	0.99%	1.01%	1.24%	1.25%
More than $1 Billion	0.80%	0.92%	1.04%	0.99%

Monitoring Fees

Monitoring (or management) fees are the fees charged by a private equity firm to its portfolio company for ongoing advisory and management services after the acquisition. Expenses are typically reimbursed separately. In each transaction covered by this survey, the controlling stockholder charged an annual monitoring fee in cash under an agreement entered into at the time of the acquisition. The nature of the advisory and management services is usually described in detail, but with no specific level or amount of services being required to earn the monitoring fee.

Table 9 shows the range, mean and median of the monitoring fees in nominal dollars, and Table 10 calculates monitoring fees as a percentage of EBITDA of the portfolio company. We relied on either the EBITDA reported by the survey participants or the portfolio company's publicly reported figure, in most cases in the form of Adjusted EBITDA, which eliminates transaction expenses and similar extraordinary or one-time items.

Fig. 9: Monitoring Fees for 2005 - 2010 (Annual Fee in Millions of Dollars)

	Minimum	Maximum	Mean	Median
Less than $500 Million	$0.03	$2.00	$0.78	$0.60
$500 Million to $1 Billion	$0.30	$6.55	$1.52	$1.00
More than $1 Billion	$0.85	$30.00	$5.48	$2.50
All Transactions	$0.03	$30.00	$2.75	$1.19

Fig.10: Monitoring Fee/EBITDA for 2005 - 2010 (Annual Fee as Percentage of EBITDA)

	Minimum	Maximum	Mean	Median
Less than $500 Million	0.06%	4.61%	2.23%	2.06%
$500 Million to $1 Billion	0.19%	5.00%	1.59%	1.40%
More than $1 Billion	0.20%	4.28%	1.48%	1.23%
All Transactions	0.06%	5.00%	1.78%	1.42%

"... monitoring fees have been mostly steady in middle-market deals, and steady-to-increasing in large-market deals... "

Similar to our 2008 study, monitoring fees decline as a percentage of EBITDA as deal size increases. In contrast to our prior studies, however, monitoring fees are becoming more closely correlated as a percentage of EBITDA of the target company. Despite this trend, the majority of monitoring fees fall within a commonly accepted dollar range. In 66 of 98 transactions (67%), the annual monitoring fee was within the range of $0.5 million to $2.5 million, with outliers often being the smallest and largest deals in the data set. The standard deviation from the average fee is $4.16 million, but a few outliers caused this calculation to overstate the actual variance in the data. If we remove the eight highest and lowest figures from the sample, the standard deviation on the remaining 81-deal sample is $1.08 million. The standard deviation from the average percentage of EBITDA is 1.14%.

There are some interesting longer-term trends when the data is compared to both our 2003 and 2008 studies. First, monitoring fees have decreased moderately in lower middle-market deals, both on an absolute basis (from an average annual fee of $1.33 million in our 2008 survey to $0.78 million) and on a percentage of EBITDA basis (from an annual fee percentage of 2.41% in our 2008 survey to 2.23%). Meanwhile, monitoring fees have been mostly steady in middle-market deals, and steady-to-increasing in large-market deals (although the increase in large-market deal data has been impacted by the increasing overall transaction size of the larger deals).

Table 11 below shows the average annual monitoring fees in each of our three studies.

Fig. 11: Average Monitoring Fees Across Surveys (Annual Fee in Millions of Dollars)

	2003 Survey	2008 Survey	2010 Survey
Less than $500 Million	$1.06	$1.33	$0.78
$500 Million to $1 Billion	$1.38	$1.39	$1.52
More than $1 Billion	$1.42	$3.74	$4.80
All Transactions	$1.30	$2.44	$2.47

Monitoring fees on a percentage of EBITDA basis in our current study range from 2.23% for the lower middle-market deals to 1.48% for the large-market deals, while in our 2008 study percentage fees ranged from 2.41% for the lower middle-market deals to 1.48% for the large-market deals. In our 2003 study, percentage fees ranged from 2.63% for the smallest deals to 0.81% for the largest deals. Table 12 shows the mean and median annual monitoring fees as a percentage of EBITDA in each of our three studies.

Fig. 12: Monitoring Fee/EBITDA Across Surveys (Annual Fee as Percentage of EBITDA)

	2003 Survey		2008 Survey		2010 Survey	
	Mean	Median	Mean	Median	Mean	Median
Less than $500 Million	2.63%	2.63%	2.41%	2.00%	2.23%	2.06%
$500 Million to $1 Billion	1.56%	1.01%	1.59%	1.40%	1.59%	1.40%
More than $1 Billion	0.81%	0.65%	1.48%	1.08%	1.48%	1.23%
All Transactions	1.66%	1.15%	1.73%	1.40%	1.78%	1.42%

The results of our current study show that the trends we highlighted in our 2008 study have generally continued. Monitoring fees as a percentage of EBITDA continued to decrease for lower middle-market deals and stayed steady around 1.6% for middle-market deals and 1.5% for large-market deals, resulting in a decrease in variance across the board of monitoring fees on a percentage of EBITDA basis.

In order to focus on the most recent trends in response to market events, we isolated the data for monitoring fees in 2009 and 2010. Table 13 below expresses monitoring fees as a percentage of EBITDA.

Fig. 13: Monitoring Fee/EBITDA for 2009 and 2010 (Annual Fee as Percentage of EBITDA)

Deal Size	Minimum	Maximum	Mean	Median
Less than $500 Million	0.06%	4.61%	2.53%	2.93%
$500 Million to $1 Billion	1.25%	3.00%	1.79%	1.59%
More than $1 Billion	0.71%	2.50%	1.50%	1.23%

We also bifurcated the data generated from this survey into 2005–2008 and 2009–2010. Similar to transaction fees, the mean and median percentage monitoring fees across all deal sizes have increased since 2009, particularly for lower middle-market and middle-market deals.

Fig. 14: Monitoring Fees/EBITDA (Monitoring Fee as Percentage of EBITDA)

	2005-2008		2009-2010	
	Mean	Median	Mean	Median
Less than $500 Million	1.92%	2.00%	2.53%	2.93%
$500 Million to $1 Billion	1.54%	1.24%	1.79%	1.59%
More than $1 Billion	1.48%	1.18%	1.50%	1.23%

A few additional observations:

- As in both our 2003 and 2008 studies, in some cases the agreements provided for the monitoring fee to be calculated as a percentage of actual or budgeted EBITDA. In certain of these situations, the fee provision included a floor (e.g., “the greater of $1 million or 2% of EBITDA”), which allows for much greater potential fees as EBITDA rises (subject to any restrictions on payment set forth in the portfolio company’s credit facilities). However, unlike our 2008 study, some of the agreements contained a cap or collar (e.g., “1% of EBITDA but not more than $2 million”), which limit the fees recoverable if the portfolio company’s EBITDA significantly improves.

- Management agreements typically continue until the expiration of a term (regularly 5–10 years) or until the buyout firms cease to hold a specified level or 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. This is consistent with our prior studies.

- Private equity firms typically require their portfolio companies to pay monitoring fees on a quarterly basis, payable in advance or in arrears. However, at least three buyout firms covered by our survey require their portfolio companies to prepay monitoring fees at the time of the acquisition for all or a significant portion of the term of the management agreement.

“Similar to transaction fees, the mean and median percentage monitoring fees across all deal sizes have increased since 2009…”

Additional Transaction Fees

In addition to the annual monitoring fee, private equity firms frequently charge additional deal fees (or have the contractual right to do so) for significant post-closing transactions such as add-on acquisitions, debt refinancings or exit transactions. The right to charge these post-closing special deal fees is frequently locked in contractually at the time of the acquisition in the management/transaction services agreement.

In connection with our survey with Preqin, private equity firms were asked to disclose whether they have charged transaction fees in connection with add-on acquisitions, debt refinancings, sales or similar transactions completed by portfolio companies, and if so the average percentage fee charged. As summarized below, for firms that charge transaction fees in these types of transactions, the fee charged generally ranges from approximately 0.8% to 1.4% of the applicable transaction. Table 15 shows the percentage of firms that charge fees in connection with such transactions and the average transaction fee related with each type of transaction.

"The fee charged generally ranges from approximately 0.8% to 1.4% of the applicable transaction..."

Fig.15: Transaction Fees Charged in Transactions by Portfolio Companies

	Percentage of Firms that Have Charged Fees	Average Transaction Fee Size (Represented as a % of Transaction Value)
Add-on Acquisitions	70.3%	1.4%
Sale of a Portfolio Company	46.4%	1.3%
Third-Party Debt Financing	36.0%	1.2%
Sale of a Subsidiary or Division	26.1%	1.2%
Sale of New Equity or an Initial Public Offering	19.0%	1.4%
Affiliate Debt Financing	19.0%	0.8%

Allocation of Fees

Transaction and monitoring fees may be allocated entirely to the general partner and/or an affiliated advisory entity of the private equity firm, or otherwise divided between the other partners of the private equity fund. Our survey with Preqin requested that private equity firms indicate how such fees are allocated. Of the 72 firms that responded, approximately 36.6% of the private equity firms provided that all or a significant portion of the fees are divided between all of the limited partners of a private equity fund. Approximately 43.7% of the private equity firms split the fees evenly between the general partner and/or an affiliated advisory entity and the limited partners. The remaining 19.7% of the firms provide that all or a significant portion of the fees are paid to the general partner of the private equity firm. There was no discernable difference in the method of the allocation by the firms between transaction fees and monitoring fees.

"36.6% of the private equity firms provided that all or a significant portion of the fees are divided between all of the limited partners of a private equity fund"

Minority Transactions

Our survey with Preqin also inquired whether private equity firms have been successful in obtaining a monitoring or transaction fee in connection with a minority investment. Of the 75 firms that responded, 28 (37.3%) of these firms reported that they had been able to secure such fees in minority investment transactions.

Conclusion

Our study has shown some possibly significant trends in the private equity transaction recovery that has followed the stock market and credit crash of 2008. While fee activity dropped during and immediately following the financial crisis, the continued recovery of the credit market and an increase in private equity buyout activity in 2010 has resulted in an increase in the average transaction fees and monitoring fees across all deal sizes since 2009, in many cases to levels above those that prevailed in the era prior to the financial crisis. Time will tell if this matures into a permanent trend.

Transaction fees in our current study tended to converge around an average of 1.3% of deal size for deals under $500 million, 1.1% for deals between $500 million and $1 billion, and 0.8% for deals over $1 billion. However, more recently, transaction fees for middle-market and large-market deals have rebounded since 2009 to approximately 1.2% and 1.0%, respectively.

Monitoring fees in our current study averaged 2.2% of deal size for lower middle-market deals under $500 million, and averaged close to 1.5% for deals over $500 million (both with respect to middle-market and large-market deals). Similar to transaction fees however, monitoring fees have been increasing since 2009, with lower-middle market deals averaging over 2.5% of deal size and middle-market deals averaging close to 1.8% of deal size. The survey results also showed that monitoring fees are becoming more closely correlated as a percentage of EBITDA of the target company (as opposed to being paid on a flat fee-based paradigm).

We have also now observed that when private equity firms charge fees for special types of transactions after acquisition (such as add-on acquisitions, debt financings, sales of equity and exit transactions), the fees tend to range from 0.8% to 1.4% of transaction size.

"...the continued recovery of the credit market and an increase in private equity buyout activity in 2010 has resulted in an increase of the average transactions fees and monitoring fees across all deal sizes since 2009..."

About Dechert

Dechert LLP is an international law firm with fully integrated offices throughout the United States, Europe and Asia. Our private equity team, numbering approximately 200 lawyers worldwide, provides creative solutions to the most complex issues in structuring, negotiating and consummating private equity transactions at every phase of the investment life cycle. We structure funds for market terms and tax efficiency, investments that maximize value, transactions that enhance portfolio companies and exits that optimize returns.

Dechert LLP is ranked among the leading law firms for private equity by prominent league tables, such as Preqin, mergermarket, and The American Lawyer's "Corporate Scorecard." We are also recommended for private equity by The Legal 500, Chambers and JUVE.

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