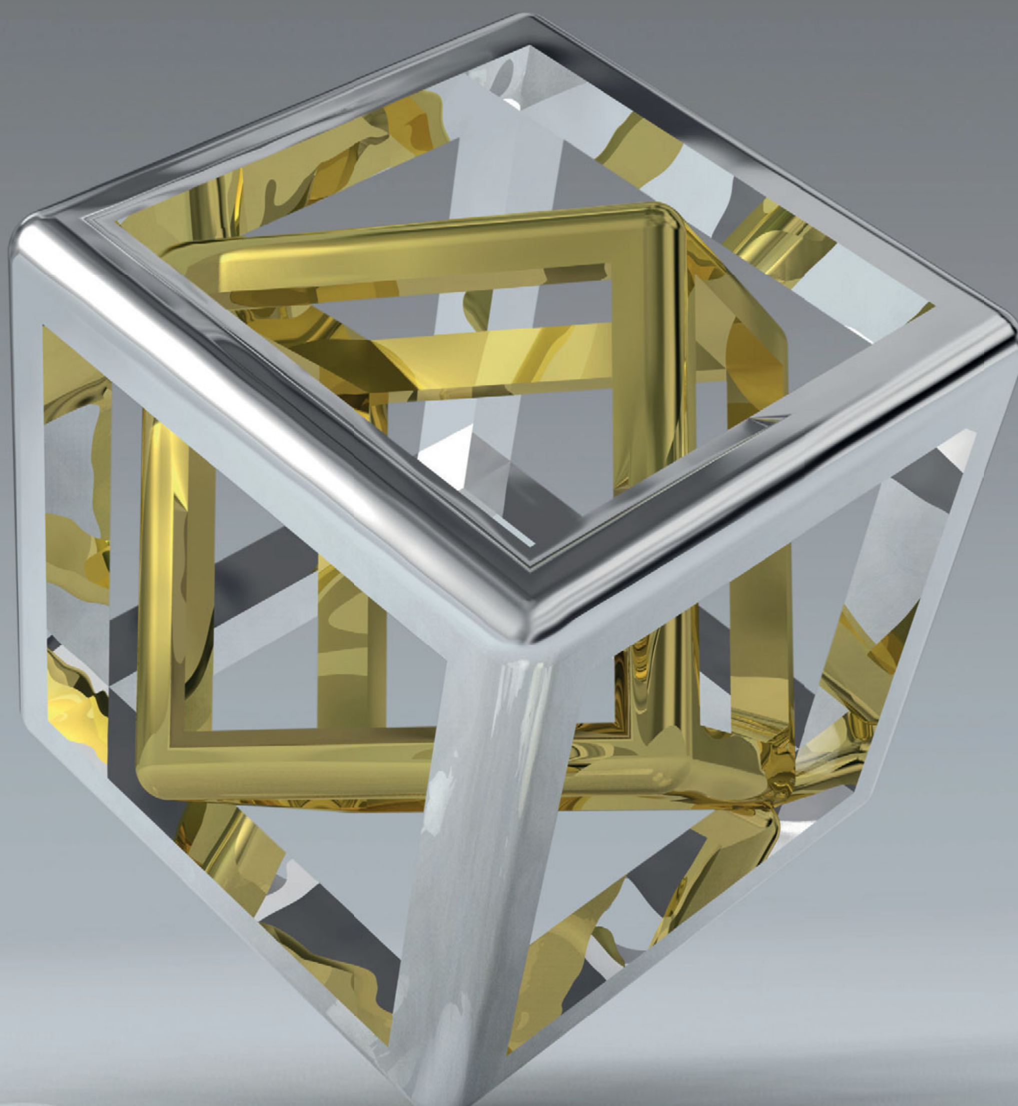
ART OF THE DEAL



EnTrust's merger with Permal at the start of last year was the latest consolidation deal in the FoHFs world. *HFM Investor Relations* checks in with CEO Gregg Hymowitz to review progress

Gregg Hymowitz is fresh off the plane when we hold our interview to mark one year since EnTrust, the FoHF he co-founded, combined with its rival, Permal Group, in one of 2016's most eye-catching deals. The previous evening he attended a charity fundraiser put on by one of EnTrustPermal's major clients in Texas.

"I gave a very small talk there," says Hymowitz. "There must have been three or four hundred people. I said, 'listen, it's very clear what my job is. My job is to provide benefits for everyone in the audience.'" His sense of mission is a recurring theme during our 40-minute phone call.

Since he was named chairman and CEO of the newly combined firm, in which he owns a 35% stake, Hymowitz has got used to notching up the air miles. That is largely due to the international nature of Permal's investors, compared to EnTrust's mainly American allocator base. The international exposure brought by Permal has been one of the "blessings" of the deal, he says. "The negative of that is you are out a lot more on the road."

Permal is one of the FoHF industry's oldest names, with roots stretching back to the 1970s. The deal combining it with EnTrust was announced in January 2016 by Legg Mason, the Baltimore-based asset manager which purchased Permal in 2005. Legg Mason maintains a 65% stake in the combined firm.

Once the deal was announced, a key priority for Hymowitz was communicating it properly to investors. An ongoing flurry of emails, phone calls and meetings ensued in the months until the deal was completed in May. "The weekend that we announced the deal I think I sat in my living room and made 80 phone calls," says the Goldman Sachs alumnus who started EnTrust in New York with two colleagues in 1997.

He describes his approach to investor communications as straightforward. "It is not complicated. It is just about getting in front of people and explaining," he says. "I spend a fair amount of my time meeting with our investors. It is extremely important for allocators to hear from the principals of organisations."

Assets stood at $26bn when the deal was announced and have dipped to just over $25bn, reflecting the decisions of some investors to withdraw. Many others – including the University of Maine, which opted to stick rather than twist after a post-merger review – took the opposite view.

"The case to do the integration made sense to people," says Hymowitz. "You are taking two businesses with different geography focuses, different types of investors, different types of strategies," he adds, describing the general investor response to the deal as "overwhelmingly positive".

Gregg Hymowitz, CEO, EnTrustPermal

Hymowitz believes the bigger size is an advantage, and will naturally lead to lower fees. "Bigger in this industry makes a lot more sense, because you have the ability to narrow the number of managers you're using, which we've done, write bigger cheques to those managers, but negotiate better fees." He says the firm has probably negotiated a dozen new fee deals with managers since the deal happened.

Of EnTrustPermal's asset base, a quarter ($6.5bn) is tied up in direct and co-investment products, a growing area of the business which was a priority for Hymowitz at EnTrust and will remain so. The firm is in the midst of launching its fourth co-investment product.

"The last one was about $1.8bn, so I imagine this one will be larger, partly because we have the ability to speak now to all these non-US investors," says Hymowitz. The co-investing unit gives investors the opportunity to invest directly in opportunities identified by EnTrustPermal, usually for longer lock-up periods of two to three years. He dates its origins to the financial crisis.

While many FoHF investors in Europe were scarred by the Madoff experience and demanded more liquidity post-2008, Hymowitz says US investors took a different view.

FoHF deal-making continues

Consolidation has been a watchword of the FoHF industry since the financial crisis, which hit the sector particularly hard. Several big names had invested in Bernard Madoff's fraudulent hedge funds, exposing a lack of due diligence, and concerns soon mounted over fees and poor performance.

Major deals started to emerge in 2012, with long-established firm FRM swallowed up by Man Group and Permal acquiring Fauchier Partners. The trend has only intensified since then, as firms seek ways to capitalise on economies of scale and a wider and more geographically varied investor base.

In 2015 Aberdeen Asset Management bought the American FoHF Arden Asset Management, while last year began with the EnTrustPermal deal. Two more major industry names, KKR Prisma and Paamco, announced they were joining forces this year in a $30bn tie-up.

EnTrustPermal's Hymowitz thinks there will be more consolidation, but notes that many of the sector's biggest names have already done deals. "A lot of the larger players have by now done transactions," he says. "There are not a lot of guys of scale left."

"I think [they] had a slightly different experience. What we decided to do was take advantage of the investment opportunity presented by the crisis," he says. "We went out and told investors we want to make direct investments or co-investments in opportunistic situations with our managers. Why don't you commit capital?"

He continues: "We're not going to invest the money unless we can make high-teen returns. We will only do it in dislocation ideas or where our partner needs this capital for longer." A top priority of the last year has been bringing the concept of direct co-investments to the high-net-worth world. "We just launched a co-investment fund with Morgan Stanley to bring to their financial advisors and high-net-worth investors."

Hymowitz views the fees charged on these investments as a key selling point to investors, adding that they tend not to pay the managers partnering on co-investments a management fee. "There are always exceptions, but in general we are paying no management fee and we pay a 10% performance fee."

The firm now has $700m in liquid products thanks to Permal's existing business line in this area. "Today, if an EnTrust legacy investor wanted more liquidity we have the ability to do that, where historically we did not," says Hymowitz. It is an example of the opportunities he sees "to bring the complementary strategies that the other side's investors had not seen, to them."

When discussing investment opportunities with investors, Hymowitz prefers to have money managers run the presentations. "When there are meetings with investors, no matter how big or small, to the extent that we can send investment personnel as opposed to [investor relations] people, we have always done that," he says.

Consolidation has been an ongoing theme in the FoHFs space since the financial crisis (*see box on page 11*). Hymowitz admits the EnTrust-Permal tie-up was months in the making. "It took about six months of putting it together before we actually signed the transaction," he says. "We had a really very clear view on how to execute the combination."

He continues: "It was probably most coloured by Permal's previous deal with Fauchier [Partners, the FoHF it acquired in 2012], and the lessons that were learned in that deal. I think the one big take-away from that deal was that you need to integrate and have one organisation immediately."

The priority was to ensure the individuals at the newly expanded firm started "acting, thinking, [and] being organised as just one organisation", says Hymowitz. "You have to act quickly, which we did, but you have to really act very thoughtfully." He and his lieutenants spent the first two months meeting with every single employee. "Most importantly, from my seat as the guy running the organisation, you have to be agnostic (about) which organisation the talent comes from."

There were challenges. "Everything takes longer than you'd like," says Hymowitz. "We did the integration in the context of headwinds in the industry. It is a heck of a lot easier to do an integration like this when you have big winds at your back."

In January this year, EnTrustPermal announced the hire of investment consultant Jason Zenk from Marco Consulting in Chicago. His job is to work with clients to create products that are suited to their needs, explains Hymowitz. The hire is central to the firm's plan to be a "solutions provider" rather than merely try to sell existing funds.

"I think the institutional investor, frankly, is tired of being sold funds. If you think of what's been going on in the asset management industry, you've had this explosion of asset classes," he says. "Instead of selling them a fund, the relationship with the investor should be in some ways more about 'let me understand what you actually need'." Zenk's job is to "engage the investor at a higher level" and improve the firm's portfolio construction.

For the next 12 months, Hymowitz names his three top priorities as better client engagement, a continuing focus on the direct and co-investment business and the identification of more "nichey" opportunities – like its new Blue Ocean Fund focused on direct lending to the shipping industry — to diversify the firm's offering.

He names a fourth: performance. "At the end of the day you can talk about this until you are blue in the face, but investors want you to perform." ▪

EnTrustPermal's co-investment partners*

Greywolf Capital
Cyrus Capital
Trian Partners
Gramercy
Scoggin Capital
Pershing Square
Corvex Capital

*Sample

Key quotes: Hymowitz on...

His attitude to work:

"The world is a competitive place. If you are not trying to figure out, every minute of the day, how to differentiate yourself, you're going to go the way of the dinosaur."

The challenge to remain relevant:

"If you can't figure out a way to add value in this business, you're dead. There is some passive ETF who is going to claim they can do everything you do for a fraction of the cost."

Industry woes since 2008:

"Investors in general have been underwhelmed with poor hedge fund performance."

What investors want:

"There is a lot of pain out there, and if you can figure out ways to perform in a risk-adjusted way and deliver a decent return, that's what investors are really looking for."

Will Wainewright, Contributor, *HFM Investor Relations*