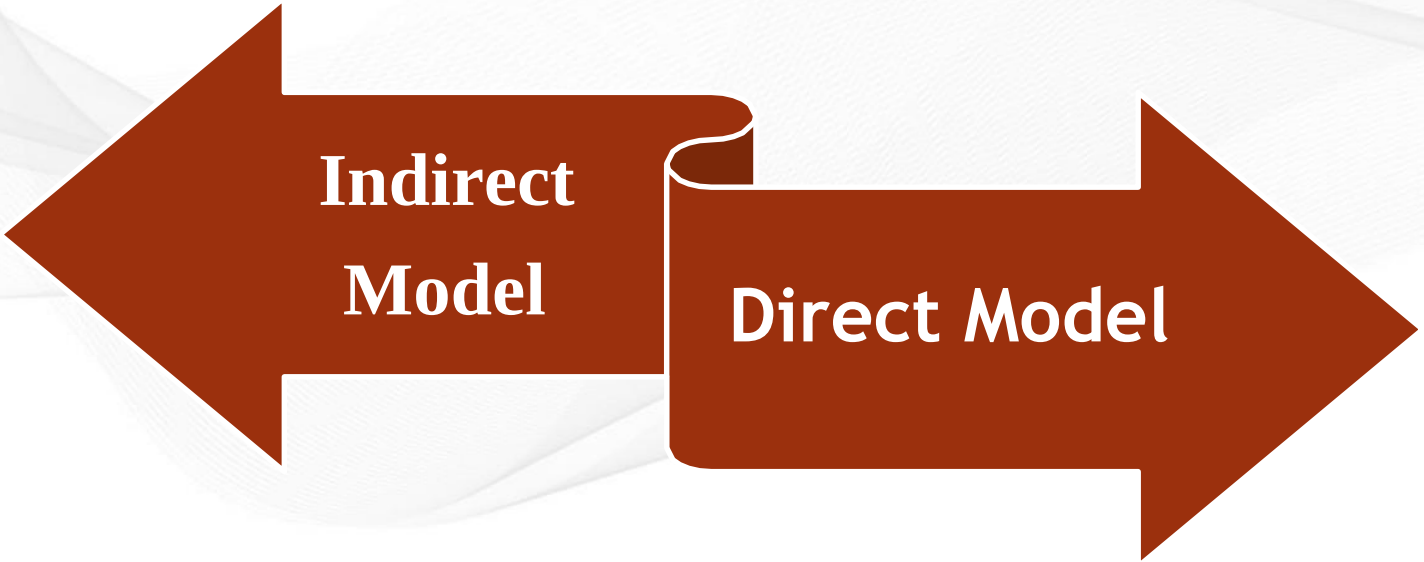
equalFi ACADEMY

AIM
CERTIFIED ALTERNATIVE INVESTMENT MANAGER®

Session 4 - Marketing and Sales Model for Alternative Investments

Capital raising distribution channels

- There are two common methods followed for raising capital:



Indirect Model

- The internal investor relations/sales team approaches a wealth manager/distributor who in turn distributes the Alternative Investment Fund (AIF) product to a wide spectrum of investors
- The primary reason for adopting an indirect model is to widen investor outreach in segments that internal teams do not have traction in
- The distributor is paid a fee on the basis of the capital contributions they secure for the fund
- Such fees may consist of two parts
  - an upfront fees
  - a running fees/trail income

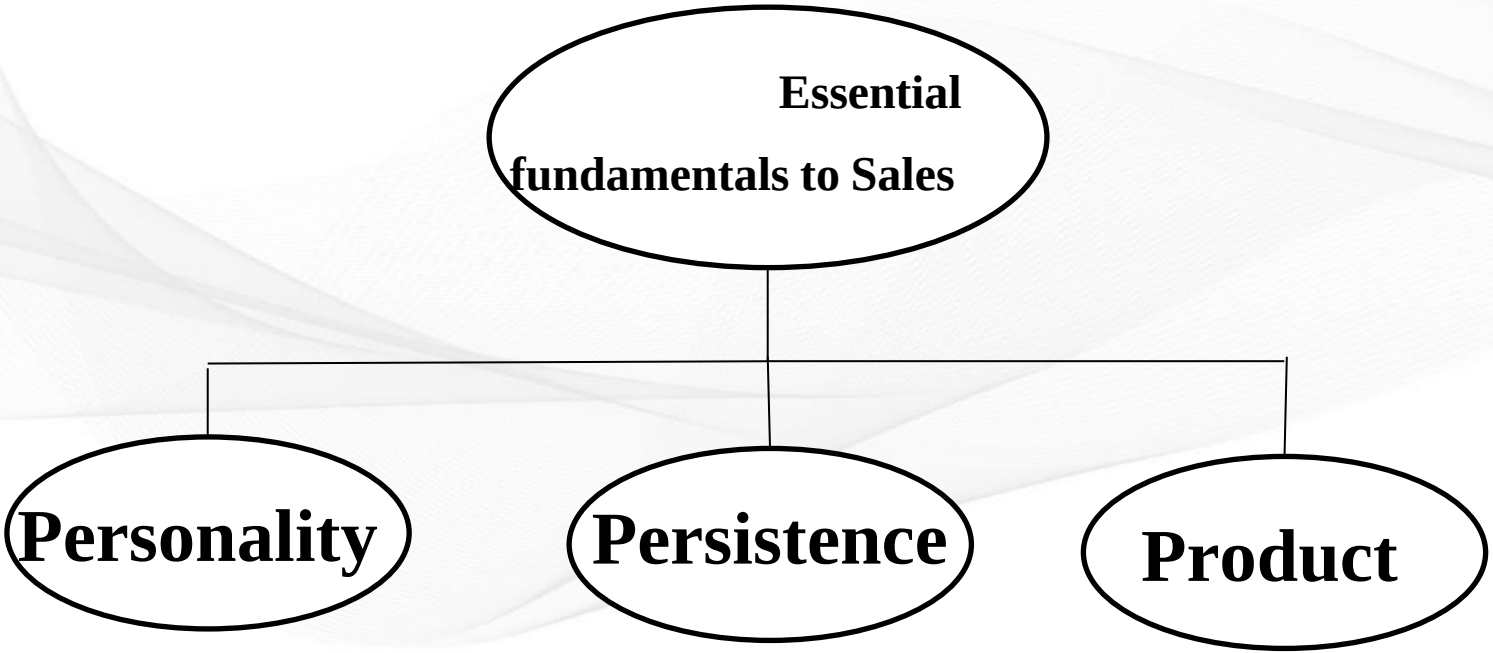
- In some cases upfront fees may be fixed at a higher cost without any trail on a periodic frequency.
- Some funds recover the distribution cost from investors in addition to the management fees charged by the investment manager while other management companies take it as an expense in their own balance sheet without this impacting investor yields.
- The parties involved in this model are:
  - Internal team of the Investment Manager
  - External team i.e. the distributor

Direct Model

- An internal sales/marketing team directly connects with the investment team of an investor

- The ability to build connections with prospective investors is the primary element that determines the success of the direct model

- At the early stages of starting a fund management business, there might be a lack of investor base and the market might not know the fund either. Thus while marketing the product, the real impact that the fund can create at this time is by building interpersonal relationships by connecting to investors through various mediums


Essential
fundamentals to Sales
Personality
Persistence
Product

Techniques used in building investor relations

Meeting with Investors regularly

Sharing useful snippets

Organizing knowledge sharing sessions or events

Distinct Investor Services

Being prompt

Putting Ethics First

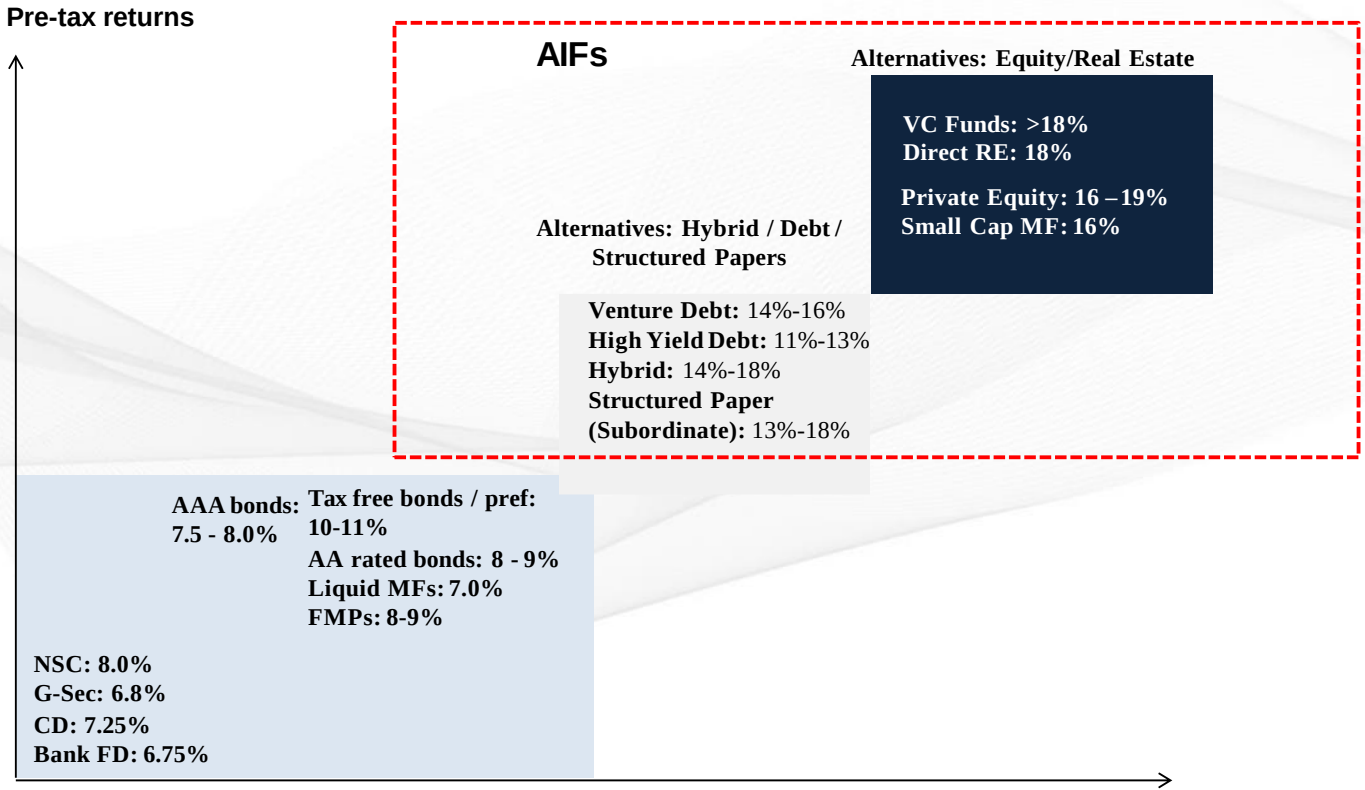
- Ethical conduct is another equally important aspect.
- It is important to remember that any investor who raises capital should continue to stay an investor in the long run.

Poor Ethical Conduct

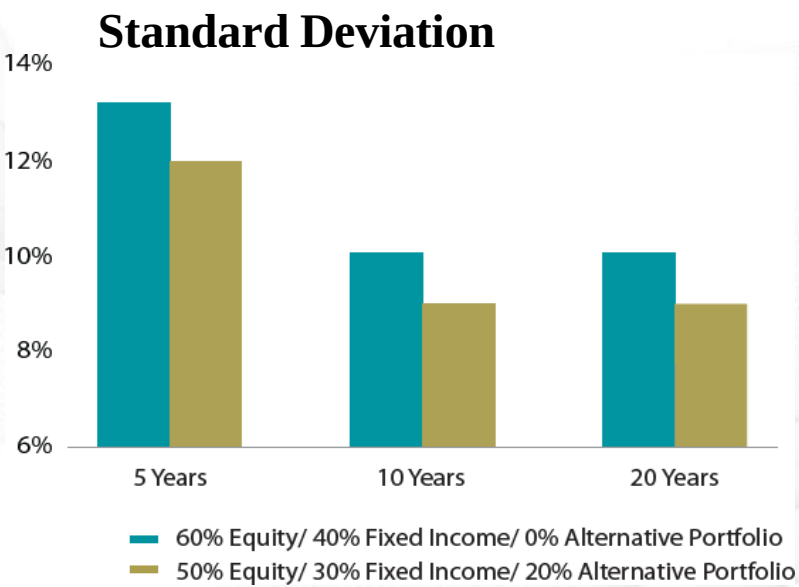
Common Questions

- What are Alternative Investment Funds?
- How does investing into an AIF benefit us?
- How do they differ from Mutual Funds?
- How does your product differ from other AIFs in the market?
- What are the underlying sectors and instruments that you invest in?
- What are the key risks and how are they mitigated?
- What is the expected return and how will distribution be made?
- How will investments be valued and benchmarked?
- What is the track record of earlier funds?
- What is the tax treatment for this product?
- Can there be early exits or redemptions? How does the liquidity look like?

Positioning is Critical



Diversification Benefit of Alternatives



Traditional Investments
Domestic Equity
International Equity
Taxable Fixed Income
Tax-Exempt Fixed Income
Cash

Alternative Investments
Private Equity
Hedge Funds
Managed Futures
Alternative Mutual Funds

Source: The Role of Alternative Investments in a Diversified Investment Portfolio, Baird Private Wealth Management, 2012 Proxy indices used for various asset classes-
Equity: S&P 500 Index. Fixed Income: Barclays Capital US Aggregate Bond Index. Alternative Mutual Funds: Style-specific universe of mutual funds categorized by Morningstar. Private Equity: Cambridge Associates Private Equity Index. Hedge Funds: HFRI Funds Weighted Composite Index. Managed Futures: Barclays CTA Index

Features of a good AIF

- Clear investment objective
- Low expense ratio
- Distribution fees charged to the Investment Manager
- Going beyond regulatory requirements
- No side letters
- Reasonable Representation and Warranties
- Sharing of information and opinions
- Rating of the Investment Manager and the Fund

Investor Landscape and considerations

Domestic

- Minimum ticket size – INR 1 crore
- AIFs have seen participation from HNIs/ UHNIs / Single & Multi Family offices
- Investors have found this attractive from a diversification standpoint
- Taxation – less attractive than Mutual Funds due to indexation benefit (for debt funds)
- Liquidity, cash-flow considerations,
- Effectively captures the 'missing middle' segment

International

- Minimum ticket size – INR 1 crore
- Foreign investors (non-FPIs) permitted to participate in all categories of AIFs. FPIs can invest in CAT III AIFs only
- Applicability of DTAA benefits makes AIFs attractive for offshore investors
- Rather than have a feeder vehicle offshore which increases costs, regulation permits direct investments by non-residents in India-based AIFs
- Concern among non-resident investors could be to apply for a PAN in India and come under the purview of Indian IT Act

AIF Sales: Industry Best Practices

•**Deemed Consents –** None of the legal documents should have a deemed consent clause for any provision

series of

•**Standard Contribution Agreement –** A standard Contribution Agreement signed with all investors speaks highly of transparency at the Investment Manager level. Avoid side letters with specific investors bestowing special privileges

•**Compensatory Payments between investors** – New investor should compensate old investors for income accruing prior to their investment. Best practice is to have an independent valuer value the fund assets for arriving at such payments.

•**Seat in the Investment Committee –** Investors can arrive at a consensus and nominate a member/observer to the Investment Committee

Questions to Expect in AIF Sales

Rights of Investors / Documentation related:

Contributor Giveback Provisions: Are contributors under any obligation to return back distributions from the fund post the fund closure? If so, is this capped / limited to a certain period?

Indemnity: Check for capping of indemnity and number of years post which the indemnity obligation will expire

Representations & Warranties – Check for Reps & Warranties of Contributors in comparison to the Reps & Warranties of Trustee and IM

Side letters – Do some investors get special privileges via a side letter which bypasses the Contribution Agreement?

Investment Manager – Can the Investment Manager be removed by the Contributors for a cause and post a cure period?

Removal of Trustee/Investment Manager – Can investors change Trustee/IM for a defined "cause" post a cure period based on voting crossing a defined threshold?

Questions to Expect in AIF Sales

Restrictions in Secondary Trading – Has the Trustee/IM put any restriction on secondary market trades by investors?

Costs and Expenses

All expenses should be fairly allocated (this usually means equally) between different investors, irrespective of whether the investor is the Sponsor/Manager

Equitable mechanism has to be put in place for allocation of set up expenses between all investors, particularly investors who come in the fund during different closes. Best way to do this is to amortize set up cost over the life of the fund.

Check for hidden costs, especially inclusion of marketing expenses in operating expenses. Do direct investors bear the brunt of any distribution expenses paid to wealth distributors?

The 4 Quadrant Approach

- Most investor queries can be bucketed in one of the four quadrants

- As long as the sales team has analysed their product through the lens of each of these quadrants, they should be able to address investor concerns and queries

Case Study

- **Objective:** Fund Raising for a high yield debt AIF targeting pre-tax IRR (net of all expenses) of ~ 14-15%
- **Fund features:** Close-ended 3-4 years, semi-annual coupon payments, bullet principal redemption. Rating profile of mostly BBB
- **Target Investor Base:** Private Wealth/HNIs
- Expected pushbacks and how to approach them
  - Comparison with credit mutual funds – what is the alpha?
  - What is the liquidity as compared to open ended credit mutual funds
  - No indexation benefit available for AIFs
  - Comparison with Real Estate AIFs/Venture Debt AIFs
  - Limited upside/unlimited downside
  - Pre tax IRR of ~14-15% translates to post-tax IRR of ~ 9-10%. Is it worth the risk?
  - Why invest here when equity can give me average 9-10% return over 3-4 years
  - Lack of sector understanding/knowledge on investee companies

Case Study

Investor pitch – Anticipating each question, bucketing it into a relevant head, and having preparatory material for answers

- Investment Strategy
  - Comparison with credit mutual funds – what is the alpha?
  - Comparison with Real Estate AIFs/Venture Debt AIFs
  - Limited upside/unlimited downside
  - Why invest here when equity can give me average 9-10% return over 3-4 years
  - Pre tax IRR of ~14-15% translates to post-tax IRR of ~ 9-10%. Is it worth the risk?
- Liquidity
  - What is the liquidity as compared to open ended credit mutual funds
- Taxation
  - No indexation benefit available for AIFs, but the high yield permits for higher absolute post-tax yields
- Fees
  - How much is the fixed fee and how much is the variable fee

Thank You