2023 Brooks Case Competition

**Case Study Overview**

Principal Financial Group (Nasdaq: PFG) understands the strategic importance of Environmental Social and Governance (“ESG”) considerations for their institutional asset management business, which is ranked among the top 30 based on assets under management (AUM). The company has identified two potential acquisition targets they believe have the potential to accelerate growth through market share capture. Doing so would enable the company to enhance their reputation as an ESG asset manager committed to sustainable business practices and asset selection. Principal would also like to evaluate potential synergies from combining the business.

As CFO of the company, you and your team are responsible for vetting and recommending a path forward to Principal’s senior management and Board of Directors.

**Background:**

The acquisition targets are *Footprint* and *Quant*, for which company overviews for each are provided separately. In addition, each target is discussed in turn below with respect to several dimensions:

**General Information:**

* **Why is the business for sale?**
	+ *Footprint* – A significant percentage of the partners at Footprint are planning their retirement from the industry. The management team sees an opportunity to partner with a larger asset manager to achieve scale efficiencies that will be needed with potential fee rate compression.
	+ *Quant* – The management team is looking for a strategic partner to leverage their ESG investment fund capabilities and bring new distribution channels to grow and diversify its customer base.
* **What is the ownership structure of the business?**
	+ *Footprint*– The majority of Footprint owners are current and former employees, with less than 20% of the firm is owned by other parties. The group of current and former partners controls over 60% of the firm.
	+ *Quant*– Current and former partners of the company control over 75% of the company. The remaining share is composed of other employees and certain related parties from the company’s inception.
* **Are there any reputational, legal, or regulatory issues affecting the company?**
	+ *Footprint* – There are no outstanding reputation, legal, or regulatory issues.
	+ *Quant* – There are no outstanding reputation, legal, or regulatory issues.

**Personnel:**

* **What has the company experienced in terms of staff turnover?**
	+ *Footprint* – There has been no recent turnover in any key roles. Footprint prides itself as an industry leader for tenure of fund managers.
	+ *Quant* – In the last nine months, three fund managers left the company. One founding partner (the manager of the Large-Cap equity fund) retired, as part of a transition in leadership to an assistant fund manager with 13 years of industry experience, including 5 years with the Large Cap fund. The other two fund manager departures (relating to the International fund and Bond fund) departed without notice for similar roles at competing firms.
* **What will happen to the management team? Are there certain incentives for retention?**
	+ *Footprint* – The partners with retirement plans in sight are all open to a 2 to 3-year employment commitment as part of the acquisition agreement. Other key employees would forfeit a portion of their equity-based compensation by leaving the firm. Annual equity awards are subject to a 3-year vesting period.
	+ *Quant*– The firm has not received any notification of additional staff departures. The fund managers and other key employees have deferred compensation benefits that vest over a 3-year period.

**Financial/operational:**

* **What is the composition of customers?**
	+ *Footprint* – The firm segments customers by institutional investors (38% of AUM), retail investors (34% of AUM), small-medium businesses (17% of AUM), and high-net-worth investors (11% of AUM)
	+ *Quant* – The majority of Quant’s AUM is concentrated in institutional investors (61% of AUM) and ultra-high-net-worth investors (27% of AUM). The remaining AUM is primarily composed of retail investors.
* **Are any changes planned to the company’s fund offerings?**
	+ *Footprint* – The management team aspires to expand by creating new funds in international equity and international debt. The company is in the initial planning phase and has not made any additions to staff.
	+ *Quant* – No changes to the fund lineup are planned.
* **Are there any recent and/or anticipated outflows from the funds?**
	+ *Footprint* – Since year-end, cash flows have been positive and there have been no formal notifications of planned platform/customer withdrawals. The management team has been part of ongoing fee discussions with certain customers who have stated that if fee rate concessions are not made, they will be transitioning to another asset manager for their ESG fund offerings.
	+ *Quant*– Since year-end, they lost one key customer from their Bond fund, which had AUM of approximately $120M. The reason for the termination was the unexpected departure of the fund manager.
* **What is the outlook/pipeline of future customers/sales?**
	+ *Footprint* – Cash flows from current clients have been solid during the first quarter. However, there have been no new meaningful customers. In discussions with potential new customers, the biggest reservation is the fee rate schedule.
	+ *Quant*– The company has experienced positive cash flows since the beginning of the year,

primarily from existing customers.

**Resources**

Company overview for Footprint

Company overview for Quant

Excel File with financials and ESG metrics for Footprint and Quant

[Background on Principal](https://secure02.principal.com/publicvsupply/GetFile?fm=DD730&ty=VOP&EXT=.VOP&_gl=1*zvw7qn*_ga*MTIxMDk5NTI4My4xNjcyODc1OTcy*_ga_GP3ZP21MGH*MTY3NzYyODE0Ni41LjEuMTY3NzYyODU5NC4wLjAuMA..)

[Principal’s purpose](https://topworkplaces.com/company/the-principal-financial/desmoinesregister/)

[Principal Free Cash Flow Generation guidance](https://investors.principal.com/investor-relations/news-and-events/financial-press-releases/press-release-details/2023/Principal-Financial-Group-Announces-2023-and-Long-Term-Outlook/default.aspx).

Information on Principal’s ESG strategy:

<https://www.principal.com/sustainability/esg-strategy>

<https://www.principalam.com/about-us/esg>

Bloomberg Terminals

Merger and acquisition articles:

<https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/how-one-approach-to-m-and-a-is-more-likely-to-create-value-than-all-others>
<https://www.chicagobooth.edu/review/forget-what-youve-read-most-mergers-create-value>

Classification: Internal Use

<https://hbr.org/1999/07/are-you-paying-too-much-for-that-acquisition>

**Recommendation**

The evaluation and recommendation to senior management and board will include three elements:

1. ESG strategy – Based on the information provided in the offering memorandum about the target companies, and publicly available information about Principal, evaluate how each target contributes to the stated objectives of the transaction. Two links to start your search are: <https://www.principal.com/sustainability/esg-strategy>

<https://www.principalam.com/about-us/esg>

* 1. Principal has made a commitment to ESG investing. Weigh the pros and cons of ESG practices in investment management as part of the recommendation on whether or not the proposed acquisition meets Principal’s strategic objectives.
	2. Evaluate the ESG metrics provided for Principal and each target company, and as part of your recommendation, opine on the contribution of each target company to enhance Principal’s reputation as an ESG manager. Consider developing a composite score for evaluating ESG that aligns with Principal’s ESG strategy.
1. Cultural fit – [Principal](https://secure02.principal.com/publicvsupply/GetFile?fm=DD730&ty=VOP&EXT=.VOP&_gl=1*zvw7qn*_ga*MTIxMDk5NTI4My4xNjcyODc1OTcy*_ga_GP3ZP21MGH*MTY3NzYyODE0Ni41LjEuMTY3NzYyODU5NC4wLjAuMA..) has a stated [purpose](https://topworkplaces.com/company/the-principal-financial/desmoinesregister/) and mission. Acquisitions have inherent risk, and it is challenging to measure success. How well does the culture and values of the target company align with Principal’s purpose, mission and values? Strong cultural fit may enable more effective integration of the company.
2. Financial – As CFO of a publicly traded company, it is your responsibility to ensure Principal is putting capital to work with realized returns in excess of the risk-adjusted expected return. Address the following elements in your recommendation:
	1. What is the fair value of the target companies? Use at least two valuation methods, one of which must be the Discounted Cash Flow Analysis. (Possibilities include Discounted Cash Flow Analysis, Valuation of Comparables, and statistical regression-based models, for example).
		1. Perform financial evaluation of past performance including looking at ratios and/or other metrics. Possible metrics to incorporate include:
			1. Return on equity and sources of ROE from the Dupont identity (profit margin, asset utilization and equity multiplier)
			2. Assets under management
			3. Growth rates of key variables
		2. As part of the analysis and forecasted cash flows, explain the rationale for the following material assumptions of each business:
3. Expected investment performance of target company funds
4. Net cash flows (fund subscriptions less redemptions)
5. Expected expense growth given growth initiatives. Consider providing a range of potential changes for key variables after acquisition.
6. Calculate WACC and explain the methodology used to do so (e.g., determining cost of equity, cost of debt, etc.)
7. The alignment of management fees charged by the targets and Principal
	1. If the recommendation is “buy”, what value do you recommend as the bid price, and why? Similarly, if the recommendation is “don’t buy”, what value do you recommend as the bid price, and why?
	2. How will Principal finance the transaction (debt, cash on hand, equity financing) and what considerations went into the financing recommendation? Weigh the pros and cons for various capital structure choices.
	3. Provide a run-rate pro-forma financial impact analysis to Principal using 2022 as the baseline reflecting earnings and cash flows of the target company, cost of financing, synergies and dis-synergies of the transaction.
		1. The impact analysis must include impact to Principal Global Investors net revenue growth., pre-tax operating earnings/margin, and free cash flow generation (free cash flow generation is after-tax cash flows divided by Net Income)
		2. Determine if the target company free cash flow generation is additive to Principal’s stated [Free Cash Flow Generation guidance](https://investors.principal.com/investor-relations/news-and-events/financial-press-releases/press-release-details/2023/Principal-Financial-Group-Announces-2023-and-Long-Term-Outlook/default.aspx).
	4. Summarize key messages to the Board of Directors and shareholders, and support your recommendations. Submit all presentation and analysis materials to “the board” (judges).

**Evaluation criteria:**

* ESG Strategy (30%), cultural (20%) financial (40%) and presentation (10%) elements will factor into the evaluation of the team’s recommendation
* Consideration will also be given to the quality of presentation material, level of engagement and responses to questions from the audience, and the team’s ability to effectively communicate to the target audience.

Offering Memorandum: Quant Impact Partners

**Company Summary**

Quant Impact Partners is a private company offering ESG mutual funds that leverage a fully quantitative investment strategy. Quant Impact was established in 2014 and has 28 employees.

**Management Discussion & Analysis**

Quant inc. believes 3 additional basis points of revenue could be squeezed from the small cap space due to the less sophisticated nature of their high-net-worth investors, and absent a sale intended to raise expenses on new contributions to the fund.

**Product Summary**

Quant Impact’s seven ESG-focused mutual fund accounts represent over $10 billion in assets under management. Each fund relies on internal modeling that tracks thousands of trading signals. Unlike other quant funds, QI models also consider environmental, social, and governance data points to drive investment decisions. QI also employs a “Fossil Fuel Free” investment policy, restricting investments in coal/oil/gas industries, including exploration, production, refining, storage, distribution, and power generation. QI’s funds are heavily concentrated in a small number of ultra-high net worth and institutional customers.

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| --- | --- | --- | --- |
| **Fund** | **Assets***(12/31/22)* | **Expense Ratio (%)** | **Performance vs. Benchmark (%)** |
| *1-yr* | *3-yr* | *5-year* | *10-year* |
| QI International | $596M | 0.89% | -1.03 | -0.90 | -0.02 | +0.87 |
| QI Large Cap | $4,244M | 0.69% | -3.27 | -1.08 | +0.09 | +1.56 |
| QI Mid Cap | $1,820M | 0.69% | -2.08 | -1.79 | -0.16 | +1.19 |
| QI Small Cap | $882M | 0.69% | -3.39 | -1.29 | +0.68 | +2.01 |
| QI Balanced | $1,027M | 0.59% | -0.57 | +0.90 | +1.32 | +1.70 |
| QI Bond | $1,279M | 0.49% | +0.23 | +0.43 | +0.09 | -0.27 |
| QI Income | $345M | 0.49% | +0.03 | +0.10 | -0.22 | -0.19 |

**Risk Factors**

Since its founding in 2014, Quant Impact Partners has experienced high turnover of key employees. This trend accelerated in 2022, with the departure of two equity fund portfolio managers and one debt fund portfolio manager.

**Acquisition Summary**

* Minimum Bid Accepted: $416M USD
* Synergies Assumed:
	+ 10% Compensation Synergy
	+ 30% General and Administrative Synergy
	+ 75% capture of expected synergy benefits
	+ 5% Shock Lapse to Management and Advisory Fees upon announcement of deal (Negative Synergy)

Offering Memorandum: Footprint Asset Management

**Company Summary**

Footprint Asset Management is a privately held firm specializing in actively managed mutual funds with a fully integrated environmental, social, and governance (ESG) research process. Footprint was founded in 1992 and today has 72 employees.

**Management Discussion & Analysis**

Footprint Asset Management is dedicated to investing for good. The management team believes global adoption of green fuels and modern technology will not only provide investing tail winds, but also adoption will produce better stewardship of the planet. As of late the portfolio performance has seen higher than average expense ratios. Footprint believes effective go-forward expense management and a long investor time horizon will net significant returns and benefits for ESG efforts globally.

**Product Summary**

Footprint offers five ESG-focused mutual funds with a combined asset value of approximately $10 billion as of 12/31/2022. The team’s investment approach excludes all companies generating more than 5% of their revenues from sources on their restricted operations list (fossil fuels, tobacco, alcohol, firearms, gambling, and adult entertainment). They also implement an extensive ESG analysis into their valuation process. All investments are required to achieve thresholds for environmental, social, and governance based on an internal scoring methodology. Ultimately, this has created a portfolio of companies with 60% less greenhouse gas emissions, 10% higher human capital development scores, and 5% more diverse board of director composition than industry peers. Footprint’s fund clients are a diverse mixture of institutional investors, retail investors, small-medium businesses, and high-net-worth individuals.

|  |  |  |  |
| --- | --- | --- | --- |
| **Fund** | **Assets***(12/31/22)* | **Expense Ratio (%)** | **Performance vs. Benchmark (%)** |
| *1-yr* | *3-yr* | *5-year* | *10-year* |
| Footprint Growth | $4,929M | 0.85% | -0.12 | +0.39 | +0.80 | +0.73 |
| Footprint Value | $1,351M | 0.90% | -3.29 | +4.81 | +3.09 | +2.47 |
| Footprint Mid Cap | $2,453M | 0.95% | -2.56 | -1.39 | -2.27 | -0.23 |
| Footprint Fixed | $1,078M | 0.75% | -1.07 | -0.44 | -0.19 | -0.30 |
| Footprint Real Estate | $295M | 1.35% | -0.55 | +0.17 | +0.62 | +0.80 |

**Risk Factors**

While Footprint has a solid track record of performance, they recently lost multiple platform positions that represented a material share of their distribution. The platforms cited an above-market expense structure in their decisions. Thus, after accumulating strong net deposits in 2017-2021, Footprint experienced net outflows of over $700 million during 2022.

**Acquisition Summary**

* Minimum Bid Accepted: $337M USD
* Synergies Assumed:
	+ 10% Compensation Synergy
	+ 30% General and Administrative Synergy
	+ 75% capture of expected synergy benefits
	+ 5% Shock Lapse to Management and Advisory Fees upon announcement of deal (Negative Synergy)