

Replacing vs. Buying Out Carried Interest

Evaluating Different Alternatives and Best Practices

Buyouts often necessary for external hires / recruiting

Illustrative example of individual forfeiting \$2M in dollars-at-work to join new firm:

Option A: Trade Carry for Carry *Common Practice*

Outstanding carry exchanged dollar-for-dollar in new fund

\$2,000,000 new dollars-at-work

Dollars-at-work between similar funds often have similar projected future payouts

Common Practice

Easiest option when carry available in existing / new funds

Variable Payout

\$0 to \$2,000,000+

Potential for significant upside and downside around projected value

≅ 5 to 8 Year Vesting / Payout Schedule

Typical period before carry distributions

Option B: Cash / Equity Buyout *Minority Practice*

Carry "bought out" at risk-adjusted fair market value (see attached white paper for more details)

≅ \$600,000 risk-adjusted FMV

Accounts for performance risk, timeframes, hurdle rates, liquidity premium, and tax treatment

Selective Use Cases / One-Off Situations

No carry program, insufficient reserves, no upcoming fundraise, current program underwater

Stable Payout

+/- \$500,000 to \$700,000

Often paid lump sum or on schedule over 3 years in cash or restricted stock

≅ 3 Year Vesting / Payout Schedule

Shorter, predictable payout schedule

Philosophical Summary

Option A Summary

Longer timeframe / no short-term liquidity
Uncapped upside but potential for no payout
Highly linked to investment results
Avoids valuation negotiations with candidates

Option B Summary

Shorter timeframe / near-term liquidity
+/- stable payout (minor variation if stock)
Less alignment to investment performance
Defensible methodology but may receive pushback

Bryan Liou
Managing Director
bliou@jaiconsulting.com

Michael Perniciaro
Principal
mperniciaro@jaiconsulting.com

JOHNSON ASSOCIATES, INC.