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Och-Ziff Files For $2 Billion IPO

By Emma Trincal, Senior Financial Correspondent
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NEW YORK (HedgeWorld.com)—Och-Ziff Capital Management, a $26.8 billion hedge fund and private equity manager, plans to raise up to $2 billion in an initial public offering, according to an S-1 form filed today [July 2] with the Securities and Exchange Commission. The floated shares, to be listed on the New York Stock Exchange under the symbol OZM, would represent 7.5% of the total assets under management. The partners would reinvest all the proceeds into the fund, according to the filing, with their money tied in for a five-year period following the offering.

If completed, this IPO would be the third U.S.-based IPO of an alternative investment manager this year, after Fortress Investment Group LLC in February Previous HedgeWorld Story and The Blackstone Group LP last month Previous HedgeWorld Story.

Och-Ziff was founded 14 years ago by Daniel Och, with funds from the Ziff family. Since inception, the firm's flagship Master Fund Ltd., which accounts for 65% of the total assets under management, has earned a net 17% annualized return, versus 11.6% for the Standard & Poor's 500 stock index during the same period, according to the filing. The firm has also grown at a fast pace. According to the offering document, assets grew at a 42% compounded annual rate from $5.8 billion in December 2002 to $26.8 billion in April 2007. The firm had earned a profit of $85.2 million as this March, an 86% increase from the $45.9 million profit posted the year before.

Och-Ziff's timing may surprise some, since the IPO is being announced just as Congress is considering several new laws aimed at raising taxes for alternative investment firms. Only a few days prior to Blackstone' s IPO last month, Senate Finance Committee Chairman Max Baucus (D-Mont.) and ranking member Chuck Grassley (R-Iowa) introduced a bill that would tax publicly traded partnerships as corporations, raising their tax rate to 35% from 15%. Shortly after that, 14 Democrats in the House of Representatives introduced a bill proposing to raise taxes on "carried interest" compensation Previous Reuters Story. Since Och-Ziff plans to organize as a partnership, any such tax changes would hurt the shares' value.

Despite those tax hurdles, the market is ripe for profitable hedge fund or private equity IPOs, as those firms have gotten generous valuations from the market.

"Smart people don't sell when prices are low," said Steven Kaplan, professor of finance at the University of Chicago. "It's true again and it's not a surprise. They think people are paying a high value for what they have and they're trying to sell."

Several private equity firms are rumored to be preparing their own IPOs in order to reap the benefits of those high multiples. Blackstone priced at $31 per share, about 12.6 times its 2006 profit.

Because Och-Ziff is mostly a hedge fund rather than a private equity firm, the effect of being taxed at a corporation rate versus the 15% partnership rate may not be as hurtful as it would be for a Blackstone, reasoned Mr. Kaplan. "Taxing has much less of an impact for hedge funds because they're paying ordinary income on their management fee and most of their trades are held less than a year, and so they are already taxed at a 35% short-term capital gain rate," he said.

Yet Och-Ziff is aware of the potential negative effect of a new tax law. In its SEC filing, the firm listed that possibility as being among the risks it identified. As a result, the firm has announced that it may not go public should the legislative environment become too adverse.

"We may determine not to proceed with this offering if our ability to qualify as a partnership for U.S. federal income tax purposes remains uncertain, or if any other legislative or executive branch action occurs which would materially affect our ability to move ahead with this offering," according to the S-1 form.

In its SEC form, Och-Ziff did not give any information as to when the deal will hit the market, but it typically takes anywhere from two to three months for an IPO to take place after the initial filing. During the next couple of months, Och-Ziff is expected to get comments from the SEC and to make adjustments. "By filing now they're preserving the possibility of a September deal," said Robert Lustrin, a partner at New York law firm Seward & Kissel LLP. Since market conditions are ideal right now, the best timing seems to be now or never. "With IPOS, you have to strike while the iron is hot," said Mr. Lustrin.

Another possible factor that could lead to a good valuation for Och-Ziff is its diversification. Alternative investment firms gather most of their revenues from fees generated by performance. Since performance is unpredictable, the more diversified a firm is, the greater its assessed value.

Och-Ziff runs private equity, hedge funds and real estate strategies, though the filing does not give a breakdown of the allocation to those three different asset classes. Some of its most illiquid strategies are buyouts, equity restructurings, distressed credit and real estate. Its main hedge fund strategies are merger arbitrage and convertible arbitrage. From a geographical standpoint, Och Ziff is well diversified, with 50% of its invested assets in the United States and 50% abroad.

Compared with the Blackstone IPO last month, Och-Ziff's offering contains some structural differences. Unlike Blackstone, Och-Ziff will be issuing shares with a voting right, entitling each owner to one vote per share.

Och-Ziff's use of the proceeds is also distinctive from Blackstone. Partners in Och-Ziff will reinvest their proceeds into the business. "By reinvesting the proceeds in the fund, the partners [at Och-Ziff] are presenting a positive marketing tool to demonstrate that they're aligning themselves with the interests of the public shareholders as opposed to taking cash out of the business," said Mr. Lustrin.

Indeed, the objective of aligning partners' interests with those of the investors is cited in the registration document as one of the main reasons for going public. Other reasons include the need to grow the business and also to attract and retain talented staff. The firm expects to grant its Class A shares to all of its employees with a four-year vesting period. The firm has 125 investment professionals in several offices worldwide including New York, London, Tokyo, Hong Kong and Bangalore.

Over the past year, hedge funds have grown bigger and have been eager to raise money from the capital markets. Going public has been one of the ways to do that. Other firms such as Oaktree Capital Management LLC have sold stakes of themselves in the private markets Previous HedgeWorld Story, while others such as Citadel Investment have issued bonds Previous HedgeWorld Story.

After the Och-Ziff IPO, the firm will form a partner management committee, and Mr. Och will serve as its chairman. Its four other members will be David Windreich, Joel Frank, Michael Cohen and Zoltan Varga.

A spokeswoman for Och-Ziff declined to comment, invoking the SEC-mandated "quiet period," which prohibits advertising and public statements prior to an IPO.

The underwriters for the IPO are Goldman Sachs and Lehman Brothers.

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