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Harvest Volatility Management, LLC, Victory Capital Holdings, Inc. - M&A Call

EVENT DATE/TIME: SEPTEMBER 24, 2018 / 2:00PM GMT

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PRESENTATION

Operator

Good morning, and welcome to Victory Capital's conference call. (Operator Instructions) Please note that today's event is being recorded.

I would now like to turn the conference over to Lisa Seballos, Director of Finance of Victory Capital. Please go ahead.

Lisa Seballos ***Victory Capital - Director of Finance***

Good morning. Before I turn the call over to David Brown, I would like to note that today's discussion may contain forward-looking statements, and as such, includes certain risks and uncertainties. Please refer to our press release and our SEC filings for more information on the specific risk factors that could cause our actual results to differ materially from the projections described in today's discussion. While a recording of this call will be made available by us on our website, any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these forward-looking statements to reflect new information or future events that occur or circumstances that exist after the date on which they were made. The press release and the slide presentation accompanying this call can be accessed on the Investor Relations portion of our website located at ir.vcm.com.

And now I would like to turn the call over to David Brown, Chairman and CEO.

David Brown ***Victory Capital - Chairman & CEO***

Good morning, and thank you for joining us as we discuss our plans to acquire Harvest Volatility Management. I'm joined today by Terry Sullivan, our Chief Financial Officer; Mike Policarpo, our Chief Operating Officer.

I'm going to spend a few minutes discussing the strategic and financial benefits of the transaction. Then I will turn it over to Terry, who will review our pro forma AUM as well as the financial impact and financing of the transaction. Following our prepared remarks, Terry, Mike and I will be available to take questions.

We'll start on Slide 4. This morning, we announced plans to acquire Harvest Volatility Management. Harvest is a leader in derivative asset management, specializing in yield enhancement overlay, risk reduction, alternative beta and absolute return strategies. We're extremely excited to be partnering with Harvest. It is a high-quality business with a differentiated product set that, we believe, will be very well received by our clients. The transaction fits squarely into our integrated multi-boutique business model, aligns with our stated acquisition strategy and is financially compelling on many levels.

Since Harvest was founded in 2008, it has been a strong and consistent organic grower. Today, it has approximately $12 billion in assets under management. The acquisition of Harvest represents a significant expansion of our Solutions Platform and provides us with an entry into alternative investments, an asset class that is in high demand with our clients.

Based on AUM as of July 31, 2018, Victory Capital would, on the closing of the transaction, have AUM of approximately $75 billion. This includes approximately $16 billion in Solutions Platform offerings or 21% of our firm-wide AUM.

Harvest will become our 10th investment franchise. As with all of our franchises, Harvest will maintain its investment autonomy and remain an independent brand. The firm's investment team and process will remain unchanged, and Harvest will continue to leverage its state-of-the-art proprietary technology platform, while benefiting from our centralized operational and well-established distribution platform.

I stated in the past that our platform is centralized, but not standardized. Our ability to enable Harvest's technology to work in coordination with our existing technology platform is a great example of this customized approach at work. Our Solutions Platform, which also includes our VictoryShares ETFs, is the fastest-growing of our focus asset classes. We believe the addition of Harvest's customizable outcome-oriented strategies will result in even stronger momentum, particularly with the support of our strong sales and marketing resources. Additionally, one of the key benefits of our integrated multi-boutique model is our ability to offer clients the opportunity to invest in strategies from multiple franchises, each with its own distinct investment approach. The Harvest strategies will expand the choices we offer to our clients and increase our ability to address multiple needs within a single portfolio.

Harvest shares our commitment to employee ownership as a means to drive alignment with clients. Harvest's senior management will be meaningful investors in Victory Capital and will continue to be significant investors in the Harvest strategies.

The $300 million purchase price will be financed through a combination of debt, equity and cash on the balance sheet. Additionally, there is an opportunity for an earn-out, subject to the achievement of meaningful revenue growth objectives over 5 years. We think the earn-out structure further aligns our objectives. Harvest is a profitable business with high margins and meaningful opportunity for future revenue generation. We expect the transaction to result in 15%-plus accretion to EPS in 2019.

Slide 5 provides a snapshot of Harvest's business and highlights its strong track record as an organic grower. I'd like to spend a few minutes discussing the firm's history, which, I think, is a very impressive story.

Harvest was cofounded in 2008 by Rick Selvala and Curt Brockelman, 2 highly experienced professionals with a strong background in derivatives management and hedging strategies. Rick and Curt, who continue to lead the firm today, have built a highly experienced team of investment professionals with an average of 20 years in the industry and deep backgrounds in advising, structuring and managing volatility and option-related strategies.

Over the past 10 years, they built their business from 0 to approximately $12 billion in AUM, primarily by delivering their yield enhancement option strategies through the ultra-high network channels of major wire houses and independent RIAs.

Client demand for the Harvest strategies has helped drive the growth since the firm's inception in 2008. More recently, they developed a suite of alternative investments, including risk, alternative beta and absolute return strategies, and have started to build meaningful traction with institutional investors and consultants. The alternative platform today represents close to $1 billion in AUM. They've achieved all of this with an 18 person team and no formalized distribution platform.

Some of the appealing aspects of the Harvest strategies are that they are managed to be neutral to changing market conditions and are unlikely to be disintermediated by passive products. Their product set is also highly customizable, and therefore, their strategies are typically viewed as an additive to a portfolio rather than serving as a replacement for an underperforming strategy.

Additionally, Harvest has built a proprietary technology platform to support its analytic, trading and risk management functions that is robust, highly scalable and world-class in the space.

From a cultural perspective, I would describe the Harvest team as entrepreneurial, innovative and extremely client focused, which creates strong alignment between our 2 organizations and reinforces the reasons that we believe this is such a great fit.

On Page 6, I'd like to spend a few minutes discussing the strategic rationale for this acquisition in more detail. But before I do that, I'd like to revisit the key components of our acquisition strategy, which I covered on our last earnings call. As our business has evolved, we've deliberately migrated to asset classes in which we believe active management has a higher likelihood of winning. Over the years and through acquisitions, we've intentionally selected investment franchises that specialize in these asset classes, which we call our focus asset classes. These asset classes today include U.S. Small Cap, U.S. Mid Cap, Global and non-U.S. equities and our Solutions Platform. Collectively, they make up 79% of our AUM as of June 30, 2018. We intend to continue to focus our business on strategies in specialized asset classes that we currently have on our platform and in asset classes that will be new to our platform. We believe in our ability to identify and acquire the growers of the future. Our strategy is to identify franchises that fit with us culturally, put them on our platform and allow them investment autonomy, while providing the resources that they need to be successful. Once they are on our platform and perform, we'll leverage our centralized sales and marketing group to distribute their strategies across our distribution channels. The acquired franchise then will become an organic grower.

Through our acquisitions to date, we've added franchises that, we believe, can outperform the market over a full cycle and solve issues in clients' portfolios.

The acquisition of Harvest fits squarely within our stated strategy. Harvest is a highly specialized manager with strategies that will sit within our Solutions Platform. When the transaction is complete, our focused asset classes will make up approximately 82% of our AUM. The Harvest strategies are customizable, outcome-oriented and designed to address challenges in client portfolios such as the need for yield, absolute return and downside protection. They are less likely to be disintermediated by the trend towards passive products and are neutral to changing market conditions.

Harvest has a strong history of organic growth, which we believe will accelerate with the support of our strong distribution system. Victory Capital's clients will benefit from an enhanced product set with the potential to add significant value to their existing portfolios.

Harvest's clients will benefit from our ability to provide a broader set of resources, including the ability to continually reinvest in technology, operations and product development. Additionally, Harvest's investment team will be able to focus their time on managing money for their clients without the operational and administrative distractions faced by many smaller independent firms. We believe this is one of the key benefits of our integrated multi-boutique model. The transaction will increase our overall size and scale with the addition of an investment franchise that has achieved high margins and consistent growth in AUM, revenues and EBITDA since inception. Like our acquisition of CEMP in 2015, which has evolved into VictoryShares, we see this as an opportunity for future revenue growth through a highly differentiated product set.

Finally, as stated earlier, we share an entrepreneurial culture and commitment to ownership that will drive alignment between our 2 firms and with our clients.

Now I will turn it over to Terry, who will review our pro forma AUM as well as the financial impact and financing of the transaction.

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Thanks, Dave. Slide 7 provides a snapshot of our pro forma assets under management by investment franchise, by asset class and by investment vehicle. Harvest will become our 10th investment franchise and third largest based on July 31, 2018, AUM. At $12 billion or approximately 16% of our firm-wide AUM on a pro forma basis, it will be an important contributor to our business immediately.

The Harvest strategies will be included in our Solutions Platform. Solutions, which also includes our VictoryShares ETFs, is one of our focused asset classes and represents a high-growth, increasingly important and sizable asset class for us. The addition of Harvest will bring our Solutions Platform AUM to approximately $16 billion or 21% of our total AUM on a pro forma basis. Our focused asset classes will increase to approximately 82% of our firm-wide AUM.

In terms of investment vehicles, Harvest's distribution today is primarily through retail SMAs sold through wire houses and independent RIA platforms. Harvest also launched a mutual fund series, the Harvest Edge Funds in December 2017 that leverages its options overlay strategy and provides the outcome-oriented solutions for clients in a mutual fund format. We believe the addition of Harvest strategies and existing retail distribution footprint to Victory Capital's retail and institutional distribution capabilities will create a strong organic growth opportunity through deeper and wider channel penetration and product proliferation.

Turning to Slide 8. The acquisition of Harvest is a financial compelling transaction that we believe offers real economic value for Victory Capital shareholders. Harvest is an organically growing, high-margin, stable cash-generative business. It is well positioned for future growth in partnership with Victory Capital, particularly through expanded revenue opportunities coming from our distribution platform. It enhances our product set, increases diversification through market-neutral AUM, providing additional scale, particularly in our retail channel and expands our already strong margins.

In terms of transaction details, we'll acquire 100% of Harvest for $300 million, with potential for long-term earn-out payments that will be predicated on 30%-plus annual revenue growth for 5 years. The cash flow generative nature of Harvest's business will self-finance most, if not all, of the potential earn-out payments as these payments are made when the previously mentioned growth hurdles are achieved. We expect the transaction to result in 15%-plus accretion to EPS in 2019 and attractive high-20s IRR. We expect to achieve expense synergies of approximately $1 million in this transaction. We view expense synergies as a natural by-product of some acquisitions, but in other cases, such as in the acquisition of CEMP, the opportunity was with product expansion and organic growth. Harvest fits the latter category, with revenue expansion and organic growth being the primary opportunities.

Consistent with past acquisitions, we'll achieve a full tax step-up on the $300 million purchase price, which we expect will result in an annual tax expense savings of $5 million to $6 million over 15 years.

Let's turn to Slide 9. The transaction will be financed through a combination of debt, equity and balance sheet cash. We've received committed debt financing of up to $265 million. The Harvest cofounders and other senior management members will purchase approximately $15 million in VCTR shares at closing and additional $31 million of shares over the course of the next year issued at forward share prices. We believe the VCTR shares add an attractive component to the transaction that delivers alignment and partnership in an efficient manner. Furthermore, we believe the structure of this transaction, which leverages the capital management tools in our toolkit, is optimized to drive EPS accretion, while balancing our pro forma leverage profile and constructed to create shareholder value.

Our net debt-to-EBITDA ratio will be approximately 2.5x at closing. We would note that the expected pro forma debt-to-EBITDA ratio is below pre-IPO levels, and given the cash-generative nature of the pro forma business, we have the ability to deleverage quickly. Additionally, the relatively uncorrelated market-neutral AUM enhances our financial profile in the context of leverage.

Lastly, we are maintaining capital flexibility to reinvest in the business and to pursue future acquisitions.

Now I will turn it back to Dave to recap our discussion.

David Brown *Victory Capital - Chairman & CEO*

Thanks, Terry. I'd like to close by providing a brief recap of the key points that we discussed today, which are outlined on Slide 10.

The acquisition of Harvest is compelling for Victory Capital, both strategically and financially. It provides us with increased size and scale and diversifies our investment capabilities while reducing the correlation of our firm-wide AUM to the equity markets.

The transaction significantly expands our Solutions Platform and further solidifies our organic growth profile with a historically strong organic grower. It also provides us with an entry into alternatives, an asset class that our clients are demanding.

The addition of Harvest to our platform will increase our ability to deliver strategies that solve problems in client portfolios both today and in the future. It will also expand the choices we offer to our clients and increase our ability to address multiple needs within a single portfolio. We intend to leverage our strong distribution system to accelerate the significant sales momentum that Harvest has achieved over the past 10 years as a means to drive continued strong organic growth.

The acquisition of Harvest is financially compelling and is expected to be accretive to EPS in 2019. We've structured the financing of the transaction through a combination of the tools available to us, including debt, equity and cash on the balance sheet.

Harvest is a profitable business that has achieved high margins and consistent growth in AUM, revenues and EBITDA since inception. It represents a meaningful opportunity for future revenue and asset growth.

Finally, Harvest shares our entrepreneurial culture and commitment to employee ownership, which ensures that our interests are aligned with those of our clients. We look forward to welcoming Harvest as our 10th investment franchise.

This concludes our prepared remarks. We'd like now to turn it -- the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) David Brown, Terry Sullivan and Mike Policarpo will be joined by Mannik Dhillon, President of VictoryShares and Solutions for the question-and-answer session. (Operator Instructions) And our first question comes from Ken Worthington of JPMorgan.

Kenneth Worthington ***JP Morgan - Analyst***

Maybe first, what is the fee rate that Harvest is generating on the assets?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Good morning, Ken. It's Terry Sullivan. What we would say about the fee rates is it's predominantly management fee-driven and it's in the broad range of where our fee rates lock up today, so call it 30 to 60 basis points.

Kenneth Worthington ***JP Morgan - Analyst***

Okay. Okay. And then on the earn-outs, how big can the earn-outs be if they sort of max out the path that you set out for them?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Yes. Well, let's talk a little bit about the earn-out. It really -- as we said in our opening comments, it's really a function of revenue growth. And so a couple of attributes just to round out people's understanding of the earn-outs. So first of all, it's revenue-driven, which we think is particularly important for us as we think about the Harvest team plugging into our integrated model. They will be primarily focused on driving organic growth and revenue growth in the business. Secondly, those growth rates are set at 30%-plus CAGR. So they are long term, and we think that at that level, sustainability is going to be key. And we're looking at earn-out payments that if they happen and manifest would be in years 3, 4, 5. I'd also point out that at today's level of revenue, they're out of the money. So they have to grow just to be in the conversation. Next, I'd point out that these are effectively self-financing. So if they're hitting these targets, what we'd be looking at is cash flow that would effectively take care of those earn-out payments. We'd also say that they're very much driven to create alignment for growth and will be accretive if they're paid out. So that -- those are the key attributes. And again, just given all the calibration of the earn-out, I would say that it really depends on if they are able to achieve these growth rates.

Kenneth Worthington ***JP Morgan - Analyst***

Okay. Great. And then last one, in February, we saw a big spike in volatility. Did customers take any losses on the Harvest strategies, and generally, how did the Harvest strategies hold up in February?

Mannik Dhillon ***Victory Capital - President of VictoryShares and Solutions***

Good morning, Ken. This is Mannik Dhillon. So when you look at the volatility spike that happened in the market in February and March, what's interesting is the way their strategy is constructed, it has a very narrow range of outcomes. So while there were a couple of negative months for clients, not as significant as it would have been, either unmanaged or kind of in a non-active way. What's interesting about their approach is that following periods like that, it actually turns out to be a good performance period for their clients.

Operator

And our next question comes from Chris Shutler of William Blair.

Christopher Shutler ***William Blair - Analyst***

Terry, I think that you gave some of the transaction details around the breakout of debt, equity and cash, but can you just revisit that. I think, I missed it. And then to get to the 15%-plus accretion, what -- I guess, what share price are you assuming? What interest rate on the debt are you assuming? And what closing date are you assuming?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Sure. Yes, maybe it makes sense to just walk through the sources and uses for the transaction. And basically, if you start at the $300 million, the closing date will have some impact on our -- the cash utilized in the transaction. We'll assess cash utilization. But if you assume a closing at the end of the first quarter, we would probably be looking at about $40 million of cash, debt of about $215 million and then the balance in equity. And so that commitment of up to $265 million is just to give us some protection or certainty, if you will. I'd say that if you think about then the accretion math, we expect to finance the debt at our current levels, which are currently LIBOR plus 275. And the equity component, there's 2 components, there is the upfront piece, which we're looking at on a 20-day VWOP pricing. And then what we've done here, and we think this is actually pretty structurally innovative, is looked at a forward pricing metric where we'll be -- the Harvest principals will effectively be buying Victory stock at forward prices over the next year at about $7.5 million a quarter.

Christopher Shutler ***William Blair - Analyst***

Okay. Got you. Okay. And then maybe just on competition in this space. Dave, could you just talk about how competitive the overlay space is? Who the large players are? How Harvest differentiates itself from the rest of the guys?

David Brown ***Victory Capital - Chairman & CEO***

Yes. I would say that this space is not that competitive. There clearly are other competitors in the space. And it really depends on the channel that it's being sold in. We view this as less competitive than a traditional active equity strategy. And then as far as to name competitors, really hard to go and name who are their direct competitors because they have a unique approach, and I would just categorize their approach as very conservative. They really have a band of upside and downside that they work with and that's somewhat unique in this space.

Christopher Shutler ***William Blair - Analyst***

Okay. And lastly, is there any client concentration to speak of? I'm guessing no given the retail client base, but any detail there?

David Brown ***Victory Capital - Chairman & CEO***

They're on a number of the larger platforms. They have no direct client concentration, but they are larger on some platforms and really smaller on other ones. The real opportunity here is they really haven't had a formalized distribution effort, and we think the real opportunity with this transaction is really to take their products and really plug them into our distribution system both on the institutional side and on the retail side.

Operator

Our next question comes from Michael Carrier of Bank of America Merrill Lynch.

Michael Carrier ***BofA Merrill Lynch - Analyst***

First question, just on the growth for Harvest. So if we look at some of the details that you guys provided, there were years when the organic growth was strong versus relatively weak, just wanted to get some sense when you look at the outlook, was any of that driven by performance or environmental, and then when we look at sort of the products that are currently run by Harvest versus anything in the pipeline, is there anything like new or that's upcoming? And then I think you guys just went through distribution, but where do you see some of the potential opportunities to drive the growth going forward?

David Brown ***Victory Capital - Chairman & CEO***

So I'll start with -- it's Dave. I'll start with the performance and kind of the environmental piece. If you look at the history of the firm, they've grown pretty consistently over the last 10 years. They've had periods where they've grown stronger. Then they've had periods where they've not grown as much, but they've still grown. I would just remind you that this was -- is a small organization, didn't have a formalized distribution effort. There were points in times in their life span that they made the decision not to focus on marketing as much and you can see some of the up and down. Their performance has been consistent over the last 10 years. Of the last 10 years, they've had 8 of the last 10 years have been positive, and they've really focused on, at all times, their investment performance. And then during certain time periods, they would focus on distribution, and other times, they wouldn't. As far as the products, there's really 3 platforms. The majority of the assets are in their one platform, but there are other platforms that really have not been marketed yet, and we plan on marketing those to our channels. And I would say the immediate opportunity for us is to continue doing what they're doing in the retail channel, but we see great opportunity with a few of their products in the institutional channel and really see great opportunity in expanding out the retail channel with some of their other products.

Michael Carrier ***BofA Merrill Lynch - Analyst***

Okay. That's helpful. And then Terry, maybe a quick one. I don't think you went through like the 15% accretion. I mean, looks like down the expense side, it's relatively minor, and the tax benefit is more significant. And then anything else that we should be thinking about in terms of how to get to the 15%?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

No. I -- look, I think it's predominantly driven by the sources and uses that I outlined. And again, it can -- the plug, if you will, will be just the timing of the transaction and the cash accumulation that we can drive, but we feel pretty confident in the base case that we've outlined, and if there is a plus and minus margin to it, it's pretty minimal. I think that we've talked a lot about the flexibility of our capital structure. We're obviously using a number of the tools in our toolkit, cash, debt, equity and structure. And I think on the debt side, the fact that we're a seasoned creditor in the Term Loan B market here and we've used that market effectively over the years gives us confidence that we can finance this transaction at what we think are relatively attractive terms, which are basically our current levels. We'd also point out again the equity part and the forward pricing construct, which we think creates a lot of alignment and also gives us the opportunity to reduce our cost of equity given some expectations we think about the growth of this business and how it translates to shareholder value.

Operator

Our next question comes from Alex Blostein of Goldman Sachs.

Alexander Blostein ***Goldman Sachs - Analyst***

Just a couple more, I guess. So I guess, on the financials of Harvest, 30 to 60 bps is a pretty wide range, so maybe just help us with the current revenue run rate of the business and maybe EBITDA margin?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Sorry, the EBITDA margin, Alex?

Alexander Blostein ***Goldman Sachs - Analyst***

Well, I heard the answer to Ken's question about the fee rate, 30 to 60 bps, understanding that's a pretty wide range, so help us with the revenue run rate of the business and what the EBITDA margin is currently?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Yes. I would say, we gave you a range and it probably centers in the middle of that range. When you apply that to AUM, and I would say that the margins, this business has actually scaled quite well and it had some good growth. And what you see in businesses of that nature is that you're going to see high margins. So this transaction is actually accretive to our EBITDA margins, and we think about where our EBITDA margins are today among industry leaders, that's a pretty powerful statement. So it implies that the margins here will be higher than that. I think, the other question that you may ask is sustainability. Is the business growing and can it sustain those margins? Well, we believe it can. And that actually, we think, is a real differentiator and unique element of our model because we can take a business like this, partner with them and plug them into our integrated multi-boutique model, give them all the business and support functions that they would probably otherwise need to maintain this pace, give them the distribution that they would need to continue this pace. And we can do that because we already have that capability. So if you think about it almost on an incremental margin basis, we think the sustainability is there just because of the uniqueness of their capabilities in partnership with our integrated model.

Alexander Blostein ***Goldman Sachs - Analyst***

Got you. And then on the accretion 15-plus for 2019, do you guys assume -- what are you guys assuming for revenue growth, I guess?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

What we would say is that it's -- we do expect growth if we look at the quality of this franchise, we look backwards at the organic growth they've been able to build up on their own and then what we expect them to do in partnership with us pretty quickly and immediately. We do think that they will sort of move in the money so to speak into the earn-out calculation.

Alexander Blostein ***Goldman Sachs - Analyst***

Got you. And then just a last question, a little bigger picture around performance. I haven't seen anything in the deck really that talks about their performance and my understanding is that these are largely kind of systematic vol-selling strategy. So maybe talk a little bit about what year-to-date results for them look like given slightly different regime in volatility? And then as -- if we are in more of a upwardly biased vol environment, how are these strategies expected to perform?

Mannik Dhillon ***Victory Capital - President of VictoryShares and Solutions***

Hi, Alex. This is Mannik. I'll take this question. So in terms of their performance, if we look back over time, they've had 70-plus months that have been positive. And if you think about the strategy that they're driving for their clients is to add an incremental yield or enhance the outcome for that investor's portfolio. So targeting roughly 150 basis points of an outcome. And like I mentioned earlier, what we see is, this year, we saw a spike in market volatility that they responded to as expected and actually controlled the relative loss for the client in that period only to then be able to add even more value in the subsequent months. If you think about being 8 out of the last 10 years positive, that's a function of the main strategy that they drive, which is being able to structure a very narrow outcome for the client that adds incremental value to their portfolio in a very uncorrelated way. I think that's very important too because what their outcome is dependent upon has nothing really to do with the levels of volatility in the market. It's about harvesting the premium that exists between implied volatility being far greater than realized volatility in the options market. And that's the phenomenon that needs to persist and has persisted and is well documented for decades in the market. But it does not require specific level of volatility.

Alexander Blostein ***Goldman Sachs - Analyst***

Got it. And then just the year-to-date results, if possible?

David Brown ***Victory Capital - Chairman & CEO***

I think, as of today, they're probably down 30 or 40 basis points on their flagship product.

Operator

(Operator Instructions) Our next question comes from Robert Lee of KBW.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

Maybe just following up, if I understood it correctly, it seems to suggest even though they have 7 or 8 different strategies, there is -- it's really kind of very weighted towards one. Could you -- I don't think I heard it upfront. Could you remind us which strategy that is and maybe what proportion of the current asset base that may be?

David Brown ***Victory Capital - Chairman & CEO***

So their largest strategy is the collateralized yield strategy and that's about 80% of their assets today. The other 20% really sit on a few platforms, primarily sold through the institutional channel, liquid alternative, absolute return type strategies.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

Okay. Great. And going back maybe to the earn-out. I'm -- would it be -- will it be correct in assuming that in your adjusted earnings going forward that you'll be excluding any mark-to-market volatility each quarter that may flow through on a GAAP basis as you have to mark that?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

Yes, it would be -- rather it would be marked as a contingent liability is the way we'll think about it. But again, the important thing here is that it's only earned or recognized in the event that they're growing at the levels we've talked about.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

All right. And is that payable all at the end of 5 years? Or is there a kind of in terms?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

It's going to be tranched over several years.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

And is there like a clawback provisions as well?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

There are mechanisms that will, I guess, I'd say, align the economics with the performance of business, which is what you typically see in these earn-outs.

Operator

Our next question comes from Kenneth Lee of RBC Capital Markets.

Kenneth Lee ***RBC Capital Markets - Analyst***

I just have 1 question. You mentioned that Victory still retains the potential financial capacity for further acquisitions. Just wondering if you could give us any details on that?

David Brown ***Victory Capital - Chairman & CEO***

It's Dave. I would first say that the structure that we've used has really used all of the tools that we've spoken about over the last few months. We still have those tools kind of in our tool bag, debt, cash, equity issuance. I'd also say that, as I said on our last earnings call, our deal pipeline is extremely full, and we're moving up -- still moving opportunities through it, and we think we've positioned ourselves to continue to execute on acquisitions with the structure that we have today in this transaction.

Kenneth Lee ***RBC Capital Markets - Analyst***

Okay, great. Actually, one more question, if I can. Wondering if you could -- I think you mentioned that the absolute return strategy is still a growth area. Wondering if you could expand upon that, potential demand there and whether it's just a variation of the yield enhancement strategies?

Mannik Dhillon ***Victory Capital - President of VictoryShares and Solutions***

Hi, this is Mannik. Well, first of all, I'll answer the second part of the question. There are not necessarily extensions directly of the collateralized yield enhancement strategy. They do use derivatives that are predominantly options-based to drive specific alternative, absolute return-oriented outcomes for institutions. One of the things that we like about it from a growth perspective is the way that they deliver these are generally transparent and well based in academic theory around options and volatility premiums. So compared to some of the more lack of transparency or illiquid alternative products that are out there, we think there's going to be tremendous demand going forward in addition to what they've already done on their own.

Operator

Our next question comes from Robert Lee of KBW.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

Just had a follow-up. In terms of selling shareholders, is it all insiders and founders, or just curious, if there was any type of third-party seller who originally kind of help finance the start-up who was exiting?

Terry Sullivan ***Victory Capital - CFO & Head of Strategy***

So it -- it's a 100% acquisition. So yes, it's 100% sellers. It's predominantly owned by the founders. They do have a passive investor that will also monetize, but it's majority by founders and employees.

Operator

(Operator Instructions) Our next question comes from Michael Cyprys of Morgan Stanley.

Michael Cyprys ***Morgan Stanley - Analyst***

Congratulations on your first deal announcement as a public company. Apologies in advance for any background noise. Question is around the platform that they have. You had mentioned that they have their own technology platform. Just curious, how are you thinking about integrating them within the broader Victory platform that you have in the past? Have you been able to extract meaningful synergies by putting other companies on your platform? Maybe it's a little bit different here, just if you could talk a little bit about how you're approaching that?

Michael Policarpo ***Victory Capital - COO***

Sure, Mike, good morning. It's Mike Policarpo. Yes, so this transaction is a bit unique. They are, in the complexity range, very simple from a business perspective: 18 people, 1 location. They have built their own trading and technology platform, that's really consistent and world-class with respect to their assets that they trade. We will look to keep that, and it's part of our centralization, but standard -- not standardized. We will allow them to keep that. It'll plug into the rest of our technology infrastructure, our corporate functions, and obviously, the biggest piece will be the distribution and marketing that they'll plug into with Victory. So we will look to have them maintain their platform, and we'll enrich that with kind of the plug around. And overall, the risk associated to this integration is quite low. As I mentioned, pretty simple, low complexity. We'll be able to integrate pretty quickly, both from a distribution and an operating perspective.

David Brown ***Victory Capital - Chairman & CEO***

And I would add one thing. This is Dave. I would say, this is very similar to our CEMP acquisition we did, where it was a smaller-type company. And it was an acquisition where we were able to integrate in a way that was low risk, was fast and was less complicated than some of our other transactions.

Michael Cyprys ***Morgan Stanley - Analyst***

Great. And come to an interesting point. Apology, if I have missed this earlier. But maybe you could talk a little bit about how you think about helping this company scale to be perhaps larger in size than they could maybe on a stand-alone basis, what sort of demand within your existing clients do you see for this sort of product set?

David Brown ***Victory Capital - Chairman & CEO***

Yes. So when we compare to CEMP, we really think that it's very similar in a sense that these products will plug into our retail and our institutional distribution channels quite quickly. We see lots of demand, continued demand from the current type of retail clients that we have access to that they've been selling to. So we think we're just going to do more of what they're doing today and introduce them to a lot of the relationships that we have. We also think that they've been very successful in the institutional side with a limited sales effort. And when we put our sales effort on top of really the products they offer, we think that, that has a real ability to grow as well. This transaction for us, we really think it enlarges our Solutions Platform, and also really will be additive to our organic growth profile. As Terry said in his prepared remarks, some of the transactions that we look at will be heavier on the expense side in synergies and will have a different field than this. This is very much like the CEMP transaction, which has evolved into our VictoryShares platform, which has seen really nice growth over the last few years. Lastly, I would add that this transaction will -- as Mike said, will integrate very quickly into not only our operational platform but into our distribution platform.

Michael Cyprys ***Morgan Stanley - Analyst***

Great. And just last question here, if I could. It sounds like this product set could resonate well into your retail separate account sort of platform. Can you just remind us where you are today in terms of retail separate account platform? If there's any sort of expense build or investment that would be necessary to kind of get this up and running for that sort of distribution?

David Brown ***Victory Capital - Chairman & CEO***

There would not be.

Operator

We have a follow-up question from Robert Lee of KBW.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

I guess, I just wanted to clarify the nature of the existing shareholder base. So when I look at Slide 7, it suggests that most of the assets are on retail separate accounts, yet I think you've kind of suggested their success in the institutional market. So I mean, could you maybe help me kind of square those 2 things?

David Brown ***Victory Capital - Chairman & CEO***

Sure. They have close to $1 billion from institutional investors, and a lot of their client base is ultra-high net worth type investors. And a lot of those ultra-high net worth investors are coming from the largest retail platforms and a lot of them are through the retail separate accounts.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

Okay. And would I be correct in assuming that this is positioned in a lot of these SMA platforms as kind of a liquid alternatives product?

Mannik Dhillon ***Victory Capital - President of VictoryShares and Solutions***

Yes. This is Mannik. Because it's an overlay strategy designed to provide additional income or enhance the return, it fits more in as an overlay because it's not in and of itself designed to lower risk or drive an absolute return outcome. I'm talking about their flagship strategy platform.

Robert Lee ***Keefe, Bruyette, & Woods - Analyst***

So usually, they would -- someone would purchase this if they -- it's again, overlay their existing equity SMA portfolio if that is what they could view one way or the other?

Mannik Dhillon ***Victory Capital - President of VictoryShares and Solutions***

Exactly. The way this strategy works -- the overlay would work, first of all, it doesn't require the client to actually displace their existing portfolio and it can be applied to the entire portfolio value.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to David Brown for closing remarks.

David Brown ***Victory Capital - Chairman & CEO***

Thank you for taking the time today to participate in our investor call. If you have any additional questions, please don't hesitate to contact us. And we look forward to sharing our progress on this planned acquisition with you in the future. Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.