Horizon Spin-Off & Corporate Restructuring Fund

HORIZON KINETICS

February 2014

What is a spin-off?

A corporate spin-off occurs when a publicly-traded company ("the parent") separates part of its business into a second publicly-traded entity ("the spin-off") and distributes shares of the new entity to its current shareholders. The new entity takes assets, employees or existing product lines and technologies from the parent in exchange for a pre-determined amount of cash. The spin entity will take on debt to provide a distribution to the parent in exchange for those assets or loss of cash flow.

Following the transaction, shareholders own stock in two separate entities. Initially, the parent's stock and the spin-entity's stock should have a combined market capitalization similar to the parent's pre-transaction market capitalization. Shareholders are then free to sell shares of either stock. This event typically results in mispricing of one or both entities, of which, savvy investors may have the ability to benefit. Mispricing of spin-offs will be explained later.

Other forms of corporation restructuring, such as carve-outs and Reverse Morris Trust transactions, are variations of the corporate spin-off. In carve-outs (or two-stage spin-offs), the parent sells a 20% or lower stake in the spin entity through an initial public offering (IPO) and later distributes shares to the parent's existing shareholders. In the case of Reverse Morris Trust transactions, a parent spins off an entity and immediately merges it with a pre-existing publicly-traded company.

Corporate spin-offs provide certain advantages over selling a business. These transactions are usually tax free to the parent and shareholders. If the book value of the entity is extremely low, the tax consequences of selling a business can be significant. The primary disadvantage to the spin-off entity's shareholders and management is that IRS rules will typically bar a spin-off entity from being acquired by other companies for two years following the transaction.

From the point of announcement, a spin-off transaction typically requires 6 to 9 months for completion. Steps include the filing of documents with the SEC, receipt of a private-letter ruling from the IRS regarding the tax-free status of the transaction, any necessary regulatory board approval, final corporate board approval, and an effectiveness declaration from the SEC. Spin-off entities may trade for several days "when issued" between the record date and the date of share distribution. Prior to completion of the transaction, the company announces the record date (holders as of the record date are entitled to shares of the new entity) and distribution date (when shares are actually issued).

Why invest in spin-offs:

- For a variety of reasons, initial regular-way trading in spin-offs is subject to selling pressure, which may provide a more attractive point of entry.
- Initial selling pressure can be a factor of parent and spin company characteristics, including relative size and differences in industry between spin-off company and parent.
- Distribution of returns varies widely, so avoidance of bankruptcy situations and other large decliners should be a key investor focus.
- Stock selection is important: increased returns may be possible through transaction selection and strategic investment entry points.

History of spin-off transactions

Historically, spin-off transactions were viewed as opportunities for management of a large company to separate its weaker-performing businesses or assets. These divisions were in industries typically undergoing a cyclical or secular downturn and no willing buyers emerged. The parent's management would load the spin-off entity's balance sheet with debt and put the already weak entity in a very challenging overleveraged position. As a result, investors often ignored these transactions. However, occasionally, a business became overwhelmingly undervalued by Wall Street, providing an attractive entry point to investors, particularly if it was in an industry transitioning into an upturn, or it benefited from overall economic improvement.

In the 1990s, spin-offs took on new forms. During the dot-com boom, management began looking for ways to unlock value by spinning off web-based or technology-related businesses that were being undervalued as a part of a larger, industrial corporate structure. In some cases, these businesses were either spun-off or began trading as tracking stocks. Unlike spin-offs, tracking stocks were still part of the same corporation, and the transaction could be reversed at management's choosing. Tracking stocks lost favor in the early part of the millennium. Over the last decade, management has widened the scope for potential spin-offs. While weaker or underperforming businesses are still commonly separated by management for lack of a willing buyer, strong businesses that are undervalued because of the larger corporate structure are potential spin-off candidates, as well as businesses that simply no longer fit in the corporate umbrella. More recently, given the low interest rate environment, businesses with stronger, stable cash flow (such as real estate, midstream energy, or generic pharmaceuticals) have become spin-off targets, as they may be able to generate higher valuations as standalone businesses.

Heightening recent spin-off activity has been the involvement of activist investors such as Carl Icahn, Dan Loeb and William Ackman. Noting the relatively strong performance of spin-offs in any long-range study, these activists have engaged with management and aggressively pushed for the spin-off of under- or over-achieving assets that could potentially create value for pre-existing shareholders. Particularly given the lack of merger and acquisition activity in recent years, spin-offs have become an alternative way to attempt to create value in underperforming businesses.

Initial selling pressure creates opportunities to increase returns

Spin-off company stocks see a degree of selling pressure following a spin-off transaction, as the shareholder base transitions for a variety of reasons. Transactions that involve spinning off a company that is in a different sector than the parent or where there is a significant difference in market capitalization between the spin-off company and parent may result in forced selling by portfolio managers and indexes. Investors opportunistically purchasing stocks that are experiencing forced selling could begin to see increased returns, whereas parent companies generally do not experience forced selling.

Active stock selection and strategic investing entry points may prove to be valuable strategies for several reasons. First, a thorough evaluation of company and industry fundamentals allows investors to potentially avoid the largest negative outliers.

Identification of favorable transaction characteristics may increase risk/reward scenario

Several characteristics can be identified that may provide insight into the potential performance of spin-off company stocks. In general, a large company spinning off a company with a smaller market capitalization, especially one with a market cap that is under a billion dollars may result in forced selling. Investors may sell the spin-off upon distribution because of market cap or industry restrictions, while index funds may be forced to sell if the spin-off company is not a member of the same index as the parent (e.g., the S&P 500).

Cases of companies that are spun off into a differing industry will likely create a gap in research coverage, because general dissemination of company knowledge and insight is limited as the analyst coverage base enters a period of transition. When these two elements combine, initial performance figures may be skewed. Sector-specific investors, including indexed Exchange Traded Funds (ETFs), portfolio managers, and retail investors, could be forced to sell shares, which may cause the new company to trail the benchmark. There is a fair degree of subjectivity in industry classification in most transactions; however, in general, transactions that will result in a transition of analyst coverage could present opportunities.

An attractive scenario can also occur when large diversified companies, such as holding companies, spin-off a company whose performance may be obscured in the larger corporate structure. These spin-off entities can be smaller in size, which may offer additional favorable transaction characteristics.

Challenges to valuation analysis can cause some investors to fail to do the necessary homework, and thereby provide another type of opportunity for stock selection and investment entry point strategies. Examples include idiosyncratic company attributes such as Hawaiian real estate or a vacation time share business in a cyclical (not secular) downturn.

Lastly, identifying cyclical versus secular industry trends is crucial to attaining competitive returns. Industry cycles can play a key role in a company's decisions to spin-off assets. A conglomerate with a subsidiary whose performance is being obscured through an increasingly bullish cycle could be spun out to unlock value. Alternatively, in a cyclical downturn (or a secular downturn, for that matter) a company may wish to consider a spin-off of assets if they are viewed as a drag on the parent's valuation.

For industries in a cyclical downturn, using a variety of valuation techniques may prove to be essential in that positions can be initiated following the potential initial selling pressure. This scenario may require more investor patience as the company works through the cycle, and thus may play more into the strategy of value-oriented investors.

Indexation

One of the outcomes of rules and ETF-based investing is that a greater variety of undervalued businesses are being made available. A focus of indexation is to provide portfolio exposure to very specific criteria, such as an asset class, an industry sub-sector, a growth metric, a stock market capitalization band, and so forth. Companies that can fulfill those needs may be rewarded by inclusion or a greater weight in a successful index, with the attendant demand for their shares and a higher stock price, which would equate to a lower cost of capital. Managements have become sensitive to these constituencies, and they will make capital allocation decisions to accommodate them.

For instance, large corporations have become much more active in spinning off or otherwise divesting subsidiaries that do not closely match the parent's primary business line, or that have a lower return on capital, slower growth profile, are more capital intensive, etc. A hypothetical example would be a large chemical company with, say, $40 billion in sales that divests a division that also makes chemicals, but a different type that doesn't have much production or sales synergy with the parent's main products and which has, in any case, only $1 billion in sales. Now there's nothing wrong with a company with $1 billion in sales that are profitable. The parent presents this as a streamlining move, which makes the parent more of a 'pure play' and improves its financial metrics. This example is attractive from the perspective of index operators. However, unlike the historical norm for corporate spin-offs and divestment, which were typically troubled or underperforming operations, nowadays there is often nothing wrong with the discarded division other than the new fashion for 'purity' among large public companies. Thus, the spin-off realm provides Horizon with more fundamentally attractive opportunities.

Horizon Asset Management LLC (Horizon), a wholly owned subsidiary of Horizon Kinetics LLC, is the Fund's Sub-Advisor. Liberty Street Advisors, Inc. is the Fund's Advisor.

Before investing you should carefully consider the Horizon Spin-Off and Corporate Restructuring Fund's ("Fund") investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling 1-800-207-7108. Please read the prospectus carefully before you invest.

As of 2/11/2014, the Fund changed its name from Liberty Street Horizon Fund, and its investment strategy. The Fund's investment objective, to seek long-term growth of capital, has remained unchanged.

RISKS AND OTHER DISCLOSURES

There is no guarantee the Fund will achieve the investment objective. The Fund is non-diversified and may focus its investments in the securities of a comparatively small number of issuers. Investment in securities of a limited number of issuers exposes the Fund to greater market risk and potential monetary losses than if its assets were diversified among the securities of a greater number of issuers. The Fund may invest in small- and medium- sized companies, which involves greater risks than investing in larger, more established companies such as increased volatility of earnings and prospects, higher failure rates, and limited markets, product lines or financial resources. The Fund may invest in foreign and emerging markets securities, which involve special risks, including the volatility of currency exchange rates and, in some cases limited geographic focus, political and economic instability, and relatively illiquid markets. The Fund may purchase IPOs and distressed securities. IPOs have special risks as there may be a limited number of shares available, unseasoned trading, lack of investor knowledge of the company and a limited operating history. Distressed securities involve considerable risk and can result in substantial or even total loss on the Fund's investment. These companies are more likely to become worthless than securities of more financially stable companies. The Fund may invest in preferred stock. The market value of this stock is subject to company-specific and market risks applicable generally to equity securities and is also sensitive to changes in the company's creditworthiness, the ability of the company to make payments on the preferred stock, and changes in interest rates, typically declining in value if interest rates rise. The Fund may invest in convertible securities, which are subject to market and interest rate risk and credit risk and are typically issued by smaller capitalized companies with stock prices that may be more volatile than those of other companies. The fund may invest in Warrants, which may lack a liquid secondary market for resale. The prices of warrants may fluctuate as a result of speculation or other factors.Warrants can provide a greater potential for profit or loss than an equivalent investment in the underlying security.

Foreside Fund Services, LLC, Distributor.

Liberty Street Advisors, Inc. is the advisor to the Fund. The Fund is part of the Liberty Street family of funds within the series of Investment Managers Series Trust.

LIBERTY STREET ADVISORS

www.libertystreetfunds.com