

Prophet Equity Management II LLC

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This Form ADV, Part 2; the “Disclosure Brochure” or “Brochure” provides information about the qualifications and business practices of Prophet Equity Management II LLC (“PEM”). If you have any questions about the contents of this brochure, please contact us at (817) 898-1500 and/or compliance@prophetequity.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (“SEC”) or by any state securities authority.

Additional information about PEM is also available on the SEC’s website at www.adviserinfo.sec.gov.

Being registered with the SEC does not imply a certain level of skill or training.

Item 2 – Material Changes

None.

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Item 4 – Advisory Business

Prophet Equity Management II LLC (“PEM”), is a Delaware limited liability company based in Southlake, Texas. PEM provides investment advisory services to Prophet Equity II LP, a Delaware limited partnership, and any parallel or alternative investment vehicles related to Prophet Equity II LP (collectively, the “Fund”). The Fund was formed in December of 2013, primarily to acquire controlling equity positions in, and seek to improve the operations of, strategically viable, asset intensive lower-middle-market companies that are underperforming their full potential. Prophet Equity GP II LP, a Delaware limited partnership (the “General Partner”) serves as the general partner of the various Fund entities.

The Fund’s investments will benefit from several unique capabilities: (1) an established and unique network of professionals (including restructuring advisors, the Fund’s network of operators and asset based lenders) from which the Fund sources significant transaction opportunities; (2) demonstrated expertise in creatively and effectively structuring and closing transactions in complex, underperforming situations (including the purchase of assets of operating businesses out of Bankruptcy Court, the carve-out of entire businesses units from larger companies, and the acquisition of stand-alone operating platforms); (3) a rigorous process for screening investment opportunities based on size, industry segment, strategic viability, detailed value creation plans, and price; and (4) the hands-on involvement of PEM executives in defining and implementing operating improvements that significantly improve cash generation and profitability in the Fund’s portfolio companies.

PEM’s principal owner is Ross Gatlin.

PEM had total assets under management of \$255,600,000 as of March 21, 2014, all of which is managed on a discretionary basis.

Description of Advisory Services.

PEM serves as investment adviser to the Fund as set forth in a Management Agreement by and among the Fund, the General Partner and PEM (the “Management Agreement”). PEM’s services include:

- examining and evaluating investment opportunities,
- structuring and negotiating acquisitions and the related financing thereof,
- monitoring and managing investments and portfolio companies of the Fund, and
- evaluating and executing divestiture opportunities for such portfolio companies.

The individual needs of the investors in the Fund are not the basis of investment decisions by PEM. Investment advice is provided directly to the Fund by PEM and not individually to the Fund’s investors..

Item 5 – Fees and Compensation:

[Please note that any summary set forth herein of the terms and conditions of an investment in the Fund is qualified in its entirety by the actual terms and conditions of such an investment contained in the offering documents of the Fund. These include, among others, the Fund's Confidential Private Placement Memorandum ("PPM"), Limited Partnership Agreement ("Partnership Agreement"), and Subscription Agreement.]

Per the Partnership Agreement and the Management Agreement, PEM is entitled to compensation for its services in the form of an annual management fee (the "Management Fee"); during the initial investment period¹, this fee is equal to 2% of total capital commitments, and after the initial investment period until the termination of the Fund this fee is equal to 2% of the total capital contributions used to make investments in portfolio companies less any distributions constituting returns of capital contributions and certain write-offs. The Management Fee is also subject to certain offsets for investment banking fees, directors' fees and other net fee income. The Management Fee is payable by the investors in the Fund semi-annually in advance pursuant to a capital call.

As set forth in Item 6 below, the General Partner is eligible to receive performance allocations. The PPM and the Partnership Agreement and Management Agreement of the Fund include further details on fees and compensation and related matters.

Additional Fees and Expenses:

In addition to the Management Fee, investors in the Fund bear all reasonable expenses made on behalf of the Fund, including:

- expenses associated with the acquisition, holding and disposition of proposed or actual investments in portfolio companies, including any incurred in connection with unconsummated transactions;
- legal, auditing, bookkeeping and accounting fees and expenses;
- expenses of meetings of the advisory board and the investors;
- insurance and indemnification expenses;
- interest expenses, investment banking, consulting, custodial, brokerage fees, finders fees, custody, transfer, registration, advisory board, commissions, discounts and other similar expenses;
- extraordinary expenses, such as litigation;
- expenses of liquidating the Fund;
- taxes, fees or other governmental charges levied against the Fund and all expenses incurred in connection with any tax audit, investigation, settlement or review of the Fund;
- subject to certain limitations, expenses incurred in connection with the organization

¹ The initial investment period is, in general, the sixth anniversary of the initial closing of the Fund.

of the Fund, the General Partner, and PEM, and the offering of the limited partnership interests in the Fund (excluding any placement fees);

- expenses incurred in connection with organization of any alternative or parallel investment vehicles.

Investors in the Fund are advised to review the PPM and the Partnership Agreement for a more extensive description of the fees and expenses associated with an investment in the Fund.

Item 6 – Performance-Based Fees and Side-by-Side Management

In addition, the General Partner is entitled to receive a portion of the profits of current disposition proceeds received by the Fund with respect to its portfolio companies from each limited partner of the Fund, equal to 20% of the amounts otherwise distributable to such limited partner. Such allocation of profits is only allocated to the General Partner when specific conditions are met, including the return of all capital contributed to the Fund by investors for realized investments and any writedowns on unrealized investments, as well as fees and expenses allocable to such investments and the receipt of a preferred return on such amounts.

One contractual party to the Fund – Prophet Equity (Affiliated Coinvestors) II LP – which is a coinvestment fund consisting of related persons and employees of PEM or the Fund, is not subject to the performance-based fees in connection with its investment in the Fund. This relationship is clearly disclosed to the investors in the Fund as described in the PPM.

The Fund distributes current income from an investment to its partners generally in the manner described above relating to the distribution.

The fact that the General Partner, as an affiliate of PEM, is in part compensated based on the performance of the Fund may create an incentive for PEM to make investments on behalf of investors that are riskier or more speculative than would be the case in the absence of the performance-based compensation arrangement. However, PEM manages the Fund in accordance with the investment strategy disclosed in the Fund's offering materials to help ensure that investors are aware of this investment strategy and the risks associated with this strategy. The PPM contains further details regarding the incentive allocation and risk and strategy associated with the Fund's investments.

Item 7 – Types of Clients

PEM manages the Fund, which is PEM's sole client. The Fund held its initial closing on March 21, 2014, and may hold one or more additional closings through March 21, 2015. The Fund's investors are expected to consist primarily of:

- Insurance companies
- Public and private retirement and pension plans
- Fund of funds

- Business entities other than those listed above
- Trusts and estates
- High net worth individuals

All investors are subject to applicable suitability requirements. The General Partner requires that each investor in the Fund be an “accredited investor” as defined in Regulation D under the Securities Act of 1933, a “qualified purchaser” as defined in the Investment Company Act of 1940, and a “qualified client” as defined in the Investment Advisers Act of 1940. The General Partner also generally requires a minimum investment of \$5 million, although the General Partner reserves the right to accept lesser amounts.

Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss

As noted in Item 4 above, PEM provides management services to the Fund including:

- examining and evaluating investment opportunities,
- structuring and negotiating acquisitions and the related financing thereof,
- monitoring and managing investments and portfolio companies of the Fund, and
- evaluating and executing divestiture opportunities for such portfolio companies.

Pursuant to these activities, PEM offers advice to the Fund generally to invest in equity and equity-related securities in conjunction with privately negotiated transactions. These investments are generally made in connection with acquisitions, dispositions, restructurings, workouts, management acquisitions and other similar situations and utilize some degree of leverage.

The Fund's investment strategy is to focus on strategically viable, underperforming, asset-intensive, lower-middle-market companies with between \$20 million and \$250 million in enterprise value and which PEM believes are performing well below full potential value. Target portfolio companies may have a wide array of management, financial, and operating problems and/or be subject to industry turbulence, but they must have sustainable competitive advantages across a reasonable share of their business. In order to implement operating improvement and growth plans, PEM brings to the Fund's portfolio companies extensive management tools, a unique and proven value and cash creation process, and on-site implementation capabilities.

PEM's investment professionals generally meet weekly to discuss potential and pending transactions and the current investments in the Fund's portfolio companies. At these meetings every transaction being pursued is discussed. If PEM's consideration of a transaction has advanced beyond the preliminary evaluation stage, a value creation plan and a detailed financial model is prepared and the transaction will continue to be discussed at these regular weekly meetings. If at such meetings the PEM team authorizes the transaction team to continue to pursue the transaction, the transaction team will conduct further work. If the transaction reaches the stage where the transaction team proposes to make a definitive bid to acquire or invest in the target portfolio company or business, it will prepare a detailed memorandum on the transaction and convene a meeting at which the PEM investment professionals will discuss the transaction in depth with the transaction team and decide whether to authorize such a definitive bid and what the bid should be. In

addition to an in-depth discussion of the target company or business and the investment thesis, deal tactics and potential exit strategies will usually be discussed.

Risk of Loss:

An investment in the Fund entails a significant degree of risk and therefore should be undertaken only by investors capable of evaluating the risks of the Fund and bearing the risks such investment represents. Set forth below is a non-exhaustive list of such risks:

- No assurance of investment returns; past performance is not a guarantee of Fund performance
- Dependence on PEM's key personnel
- Difficulty locating suitable investments
- Financial market fluctuations
- Illiquidity of investments by the Fund
- Illiquidity of investment in the Fund
- Use of leverage
- No operating history of the Fund
- Competition for investments
- Risks associated with foreign investments
- Risks associated with acquiring material, non-public information
- Risks associated with minority investments
- Risks associated with a limited number of investments
- Risks associated with legal, fiscal, and regulatory regimes and subsequent changes thereto
- Risks associated with bridge financings
- Dependence on portfolio company management
- Obligation to indemnify PEM, the General Partner and their owners, employees and agents
- No right of investors to control the Fund's operations
- Potential conflicts of interest
- Failure of another investor to make its capital contributions
- Tax considerations

As well, stock markets and bond markets fluctuate substantially over time. As recent global and domestic economic events have indicated, performance of any investment is not guaranteed. As a result, there is a risk of loss of the Fund's assets that may be out of PEM's control. PEM cannot guarantee any level of performance or that investors in the Fund will not experience a loss of their investment. There is no assurance that the Fund will be able to generate returns or that the returns will be commensurate with the risks inherent in their investment strategy. The marketability and value of any such investment will depend upon many factors beyond the control of the Fund. Therefore, an investor should only invest in the Fund if the investor can withstand a total loss of its investment. The past investment performance of the personnel of PEM cannot be taken to guarantee future results of the Fund or any investment in the Fund.

Item 9 – Disciplinary Information

Neither PEM nor the Fund have any legal or disciplinary events to report.

Item 10 – Other Financial Industry Activities and Affiliations

Neither PEM nor any member of the management of PEM is registered, or has an application pending to register, as a broker-dealer, commodity pool operator, futures commission merchant, commodity trading advisor, and there are no relationships material to the management of the Fund with any of the following:

- broker-dealer, municipal securities dealer, or government securities dealer or broker
- investment company or other pooled investment vehicle (including a mutual fund, closed-end investment company, unit investment trust, private investment company or “hedge fund,” and offshore fund)
- other investment adviser or financial planner
- futures commission merchant, commodity pool operator, or commodity trading advisor
- banking or thrift institution
- accountant or accounting firm
- lawyer or law firm
- insurance company or agency
- pension consultant
- real estate broker or dealer
- sponsor or syndicator of limited partnerships

PEM has entered into “side letters” with investors in the Fund, which allow for certain additional rights with respect to the Fund. These “side letters” are presented to all investors in the Fund and each investor is allowed to elect to receive the rights and benefits of each such “side letter.”

Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

PEM has adopted a code of ethics (“Code”) for all of its employees describing PEM’s standard of business conduct, and duty to its clients. The Code includes provisions relating to the prohibition of insider trading and personal securities trading procedures, among other things. All employees must acknowledge the terms of the Code, as amended, annually.

A copy of the Code is available to any investor in the Fund upon request by calling (817) 898-1500 or emailing compliance@prophetequity.com.

An affiliate of PEM's coinvests with the investors through the Fund as a contractual partner in all of the Fund's investments on a pro rata basis (based upon the relative commitments of such affiliate and the investors in the Fund as measured on the date of each investment by the Fund).

Item 12 – Brokerage Practices

It is expected that all securities held by the Fund will be acquired directly through private transactions, and that no intermediary will serve as a broker for any subscription for, or serve as a broker for any redemption of, any interests in the Fund.

Item 13 – Review of Accounts

The Fund will furnish quarterly unaudited and annual audited financial statements of the Fund to all investors in the Fund.

Item 14 – Client Referrals and Other Compensation

No broker or finder is or has been compensated for placement of interests in the Fund with the investors.

Item 15 – Custody

The Fund holds all of the investors' funds and all securities acquired with respect to any investments by the Fund; the Fund does not use a qualified custodian for either of these functions. The Fund furnishes quarterly unaudited and annual audited financial statements of the Fund to all investors in the Fund. The Fund advises investors to carefully review such financial statements.

Item 16 – Investment Discretion

PEM accepts discretionary authority to manage the Fund and its assets, pursuant to the Management Agreement and the Partnership Agreement. PEM maintains the authority to manage the Fund on a discretionary basis, subject to the overall supervision of the General Partner, in accordance with the investment guidelines, limitations, other provisions and terms set forth in the Partnership Agreement and the Management Agreement. In all cases, PEM exercises its discretion in a manner consistent with the stated investment objectives for the Fund.

Item 17 – Voting Client Securities

This item is not applicable to PEM.

Item 18 – Financial Information

PEM has discretionary authority over the Fund's assets. There are no current financial conditions that are reasonably likely to impair PEM's ability to meet its contractual commitments to the Fund.

Item 19 – Requirements for State-Registered Adviser

This item is not applicable to PEM.