# Berkshire Capital

2018
FINANCIAL SERVICES
INDUSTRY REVIEW

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## THE BEAT GOES ON AND ON AND ON

The financial and economic stabilization that has emerged over the 10 years since the start of the global financial crisis (GFC) has been built on a foundation of trillions of dollars of stimulus by central banks. If not previously obvious, 2017 underlined the strength of the global economy as the beat of economic recovery continued to go on and on ... and on. In the U.S., the post-crisis economic expansion quickened as GDP growth topped 3% in both the second and third quarters while corporate earnings hit records.

In Europe, economic sentiment is close to a 17-year high with the possibility of solid GDP growth in excess of 2% now more a reality than a myth, although structural challenges continue to impact the region and contribute to valuation discounts in many asset classes. Seven consecutive quarters of GDP growth along with strong exports and corporate earnings have revived Japan's long-dormant economy. Following suit, emerging market earnings, currencies and optimism have improved, with Chinese stabilization and an appetite to invest abroad playing a material role (with the latter tempered somewhat by government controls). Global M&A surpassed $3 trillion for the fourth consecutive year, according to Dealogic, reflecting continued optimism in the global economy.

In U.S. markets bolstered by liquidity and the improving macroeconomic picture, confidence and low volatility reigned, with, each of the three major equity indices posting double-digit gains to reach new highs in 2017. The Dow Jones, S&P 500 and Nasdaq indices were up 24%, 18% and 27%, respectively. At the same time, the CBOE VIX index, which measures implied volatility, averaged 11 for the year, its lowest-ever level. Trading volumes in U.S. equities remained depressed, negatively impacting the earnings of capital markets firms, including the largest investment banks. While driven by improved fundamentals, market activity also reflected investor confidence that the Trump administration's focus on tax reform and regulatory relief would benefit businesses in a material way.

Equity capital markets activity rebounded from a couple of soft years, with U.S. IPOs returning to six-year average volume levels and outperforming overall equity market indices. Activity was also considerably more widespread across a broader range of industries than was evident in the two prior years. In 2017, 26 financial sector IPOs raised almost $4.7 billion, a solid increase from 2016 (13 IPOs and $4.1 billion).

A rush to refinance ahead of anticipated Federal Reserve rate increases along with strong demand from yield-hungry investors spurred corporate high-yield debt issuance. The most active year since 2014 for U.S. corporate high-yield issuance, 2017 featured 511 offerings that raised $277 billion, representing a 41% increase from 2016. Almost 70% of all high-yield proceeds raised were used for refinancing, with spreads decreasing almost 70 basis points on average.

The overarching health of the financial services industry continues to improve as seen through the prism of the global banking sector, which we view as the central nervous system of the global financial sector. The issuance of credit as reflected by overall lending volumes is robust and credit quality remains solid. Regulatory handcuffs in the U.S. have loosened, stimulating record levels of bank consolidation. In the 10 years since the start of the GFC, U.S. banks have emerged in remarkably good shape, with the 34 banks participating in the Federal Reserve's stress tests adding more than $750 billion in common equity capital since 2009 to buttress capital ratios and enjoying solid profit growth last year.

Last June, the Fed gave passing grades to all 34 banks during the latest round of tests, as well as the green light for the pent-up dividend hikes and share buybacks the banks had in their capital plans. In aggregate, **Bank of America** (NYSE: BAC), **Citigroup** (NYSE: C) and **JPMorgan Chase & Co.**

### EUROPEAN VALUE CLIMBS, U.S. DIPS

#### MERGERS & ACQUISITIONS WORLDWIDE

| **Number of Announced Deals** | **2017 (vs. 2016+/-)** |
|---|---|
| Worldwide | 49,448 (-2.5%) |
| U.S. | 13,024 (+13.5%) |
| Europe | 14,804 (-10.4%) |
| Asia-Pacific (ex-Japan) | 13,762 (+2.2%) |
| **Value of Announced Deals ($B)** | **2017 (vs. 2016+/-)** |
| Worldwide | $3,601 (+0.2%) |
| U.S. | 1,420 (-15.6%) |
| Europe | 868 (+16.9%) |
| Asia-Pacific (ex-Japan) | 954 (+14.1%) |
| **Of Which (by $value 2016, worldwide)** | |
| Acquisition by Private Equity | 18% |
| Cross Border | 36% |
| Financials | 9% |
| Real Estate | 15% |

Source: Thomson Reuters

### INVESTMENT MANAGEMENT TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Majority Equity | 129 | 126 | 139 | 160 | **176** |
| Minority Equity | 20 | 14 | 21 | 22 | **32** |
| Management Buyout | 10 | 3 | 6 | 9 | **12** |
| **Total** | **159** | **143** | **166** | **191** | **220** |
| Total Transaction Value ($B) | $14.8 | $26.4 | $21.2 | $24.0 | **$28.9** |
| Total AUM Changing Hands ($B) | $1,636 | $1,980 | $1,839 | $2,443 | **$2,086** |

Source: Berkshire Capital Securities LLC

## SECURITIES INDUSTRY & MARKET STRUCTURE TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Majority Equity | 67 | 90 | 67 | 63 | **54** |
| Minority Equity | 8 | 20 | 12 | 6 | **15** |
| **Total** | **75** | **110** | **79** | **69** | **69** |
| Total Transaction Value ($B) | $6.1 | $14.2 | $13.2 | $14.2 | **$10.4** |

Source: Berkshire Capital Securities LLC

(NYSE: JPM) pledged to buy back $52 billion in shares in the 12 months after the stress tests. Banks are also more comfortable pursuing larger transactions — while remaining leery of "transformative" mega-mergers for fear of ruffling regulatory feathers — and increasingly focused on calibrating their non-bank business portfolios.

In Europe, where banks were slower than their American counterparts to respond to the crisis, the picture is improved but mixed. Within the European Union as a whole, nonperforming loans (NPL) totaled 4.5% of all loans as of June 2017, and while that's high from a historical perspective the trend has been positive: The number stood at 5.4% in June 2016 and 6.5% in December 2014, according to the European Banking Authority. Balance sheets have also improved, with the average common equity tier one ratio for European banks at 14.3% as of June 2017. At the same time, the aggregate numbers mask wide disparities, with one-third of EU jurisdictions having NPL ratios in the double-digits, including Italy, Ireland and Portugal.

State disposals of shareholdings assumed during the financial crisis also continued. In the UK, the government sold off the remaining slice of its original 43% stake in **Lloyds Banking Group** (NYSE: LYG), in the process making a tidy profit. The Irish government floated part of the nationalized **Allied Irish Banks** (LON: AIBG), while the Netherlands and Belgium sold shares in **ABN Amro** (AMS: ABN) and **BNP Paribas** (EPA: BNP), respectively. Meanwhile, three of the continent's powerhouses — **Banco Santander** (NYSE: SAN), **Deutsche Bank** (NYSE: DB) and **UniCredit** (BIT: UCG) — raised some €28 billion ($34 billion) in new equity.

Against a strong macro environment and robust global M&A activity, the investment and wealth management industries last year saw an uptick in the number of transactions to 220 from 191 in 2016 while aggregate value increased to $28.9 billion from $24 billion. The securities industry registered 69 transactions in 2017, the same number as the previous year, with deal value reaching $10.4 billion. Within these sectors, transaction activity has been driven by the demand for scale and client relevance in a rapidly changing environment.

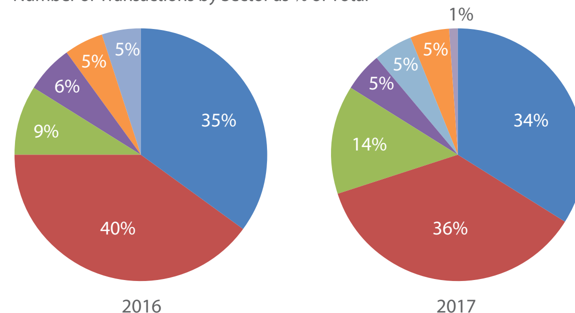
The investment management sector (including both traditional and alternative firms) has been enduring enormous changes while benefiting from strong markets that have boosted revenues and profits for the industry as a whole. The S&P Composite Asset Management and Custody Bank index was up 24.9% in 2017. However, there is great variability in future prospects for individual participants. Well-discussed pressures facing active traditional managers relating to fee levels and performance have driven assets in exchange trade funds and products from $807 billion to $4.4 trillion worldwide between 2007 and 2017, with the U.S. accounting for three-quarters, according to ETFGI. Moody's projected last year that ETFs and their passive cousins, index funds, could achieve a 50%-plus share of AUM in the U.S. within four to seven years "irrespective of market environments," up from the current 29%. On the other hand, alternative managers have benefitted immensely from investor demand for private investments and yield.

These trends have impacted M&A activity in the traditional space in two main ways: by generating multiple transactions for ETF firms for a fourth consecutive year in 2017 (including several large deals), as well as a number of mid-size to large transactions between active managers seeking to rationalize costs and diversify product capabilities in order to maintain profit margins and better serve changing client needs. Reflecting both themes, transactions in 2017 in the traditional investment management sector increased in

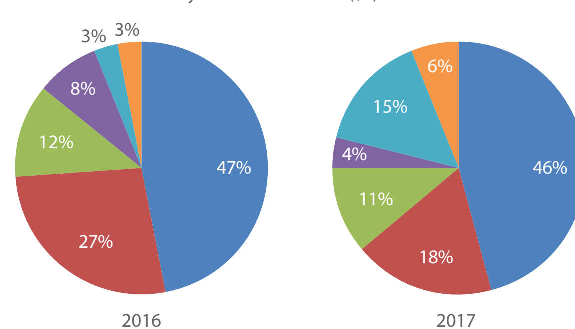
## INVESTMENT MANAGEMENT

### WHO'S SELLING

Number of Transactions by Sector as % of Total




Value of Transactions by Sector as % of total ($B)




- Traditional Investment Management
- Wealth Management
- Real Assets
- Hedge Fund / Fund of Funds
- Private Equity
- Credit
- Other

number to 74 and in aggregate value to $13.3 billion, including several $1 billion-plus acquisitions.

In the credit/yield marketplace, vigorous deal activity mirrored investor demand for investments that can deliver higher yield than traditional bonds and/or steadier long-term returns. For example, global issuance of collateralized loan obligations topped the $100 billion mark last year for the first time since 2014. Deals last year for yield-oriented strategies included targets focused on corporate credit, MLPs and real estate (private equity and debt as well as REITs). Acquirers in this space ranged from diversified investment managers (standalone alternative and traditional focused as well as insurance owned) to private equity firms in search of a growth platform. Overall transaction activity involving alternative firm sellers (real assets, credit, private equity and hedge funds) accelerated in 2017, as did aggregate transaction value, the latter driven largely by a single multi-billion-dollar transaction and an uptick in minority investments in very large alternative firms by a group of financial investors in the space.

## INVESTMENT MANAGEMENT

### WHO'S BUYING

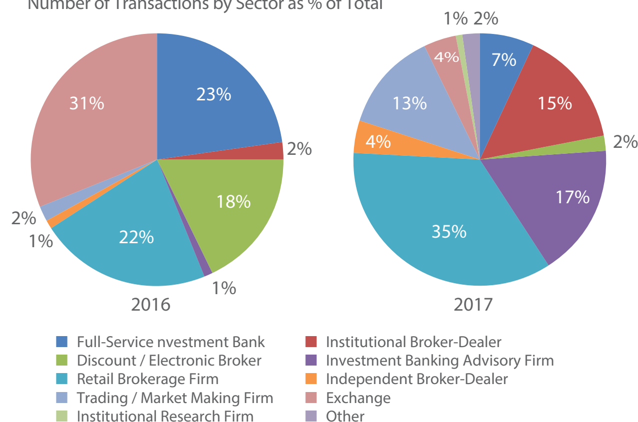
| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Traditional Investment Manager | 36 | 31 | 45 | 46 | **44** |
| Wealth Manager | 13 | 21 | 20 | 32 | **38** |
| Insurance | 9 | 16 | 13 | 20 | **27** |
| Financial Buyer | 21 | 8 | 21 | 26 | **25** |
| Bank | 24 | 17 | 19 | 19 | **22** |
| Alternatives Manager | 17 | 12 | 9 | 14 | **15** |
| Securities Firm | 9 | 14 | 16 | 6 | **15** |
| Real Asset Manager | 4 | 7 | 7 | 5 | **15** |
| Management Buyout | 10 | 3 | 6 | 9 | **10** |
| Other | 16 | 14 | 10 | 14 | **9** |
| **Total** | **159** | **143** | **166** | **191** | **220** |

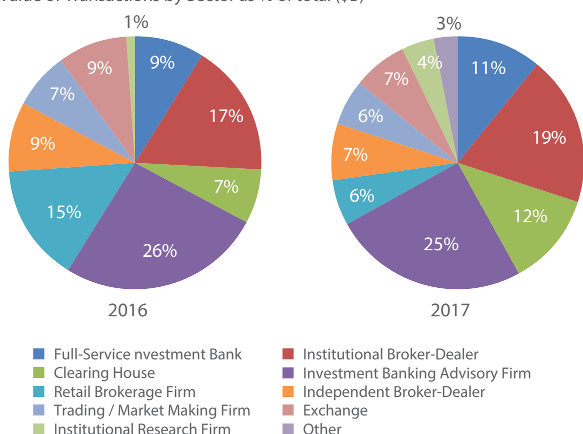
Source: Berkshire Capital Securities LLC

Wealth managers also face some of the same pressures as traditional investment managers around fees and the need to deliver differentiated, value-add offerings. Last year, the wealth management sector registered 80 transactions, in line with activity in 2015-2016, with aggregate value of $5.3 billion down from $6.5 billion in 2016. As investment management services become commoditized, wealth managers are focusing on adding more holistic solutions for clients in order to justify fee levels — solutions that can in turn pressure profit margins. As such, businesses of varying size continued to add scale through acquisitions in order to rationalize costs and share infrastructure costs across a greater base. This trend was seen among independent RIAs as well as industry aggregators that executed more bolt-on transactions with existing affiliates than ever before. Additionally, after a hiatus following the GFC, banks — primarily community/regional but including the occasional super-regional — are becoming more active acquirers.

## SECURITIES INDUSTRY & MARKET STRUCTURE

### WHO'S SELLING




A universal theme driving both operational strategy and consolidation in the securities industry and market structure sector is the ongoing quest for scale to effectively compete. Pervasive convergence of regulatory change and technological innovation over the last 20 years has had a seismic impact on the operating models of all "sell-side" participants, from the exchanges that were forced to demutualize to the full-service investment banks and mono-line executing brokerages in both the institutional and retail segments. "Go big or go home" is increasingly on the minds of executive management and resonating throughout boardrooms. Rationalization of traditional trading operations continues as each liquidity-enhancing technological innovation highlights excess capacity in the system.

On the advisory front, the emergence and proliferation of independent M&A advisory specialists further threatens

## SECURITIES INDUSTRY & MARKET STRUCTURE

### WHO'S BUYING

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Diversified Financial Services Company | 7 | 19 | 11 | 7 | **15** |
| Investment Banking Advisory Firm | 3 | 7 | 7 | 7 | **8** |
| Trading/Market Making Firm | 5 | 11 | 6 | 6 | **5** |
| Exchange | 4 | 5 | 3 | 6 | **5** |
| Private Equity Firm | 4 | 6 | 6 | 4 | **4** |
| Discount/Electronic Broker | 4 | 3 | 5 | 4 | **3** |
| Commercial Bank | 4 | 3 | 1 | 4 | **3** |
| Full-Service Investment Bank | 9 | 23 | 12 | 12 | **2** |
| Institutional Broker-Dealer | 9 | 8 | 10 | 4 | **2** |
| Independent Broker-Dealer | 4 | 1 | 0 | 2 | **2** |
| Retail Brokerage Firm | 5 | 3 | 1 | 1 | **0** |
| Institutional Research Firm | 0 | 0 | 0 | 1 | **0** |
| Insurance Company | 1 | 0 | 1 | 3 | **0** |
| Other | 16 | 21 | 16 | 8 | **20** |
| **Total** | **75** | **110** | **79** | **69** | **69** |

Source: Berkshire Capital Securities LLC

full-service investment banks that are now more dependent on advisory fees to offset the commoditization of fundamental research, diminishing trading margins and crowded IPO syndicates. In 2017, the retail brokerage sector continued to experience significant pressure due to regulation, the market's embrace of technology solutions and the ongoing march toward the fee-based model. To a certain extent, the strong equity market and the inching up of money market rates provided some much-needed relief to these firms and potentially deferred additional expected consolidation in the space.

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The asset management industry has undergone radical changes during the 10 years since the start of the financial crisis. We note in this Summary and our Traditional Investment Management section the growth of passive investments, but patient investors in search of returns have also been tapping the private markets, to the extent that the private equity industry was sitting on $1 trillion in dry powder as of last year. Some institutions have been bypassing the middlemen altogether to make direct investments.

Changes in asset allocation strategies and products are being mirrored on the technology front, where companies are scrambling to keep up with competitors and the demands of clients. Robo advisors are a prime example of tech-driven challenges to traditional managers, in particular for an emerging millennial generation that grew up online. **Charles Schwab** (NYSE: SCHW) Executive Vice President Bernie Clark, whom we reference in our Wealth section, raises the prospect of competition from the likes of Google and Amazon, telling the audience at the company's annual Impact conference last November that Schwab no longer bothers "building the fort. We're building tents so we can keep moving."

As with Schwab, the larger industry is adapting on the run as it seeks to deliver value to clients, advance growth, and ensure the sustainability of individual enterprises. For many, that involves partnering up with a like-sized or larger competitor. In a paper released last May, asset management strategy consultant Casey Quirk opined that the industry would experience "the largest competitive realignment" in its history resulting from M&A activity in the four years through 2020. The firm cited such widely quoted factors as the encroachment of passive investments and the need among sellers to gain distribution and access to technology. While markets and the global economy are swimming along at the moment, we do see the possibility that an end to the long bull market — or an economic slowdown — could lead some deal-makers to take a break from that "realignment."

Prognostications regarding M&A activity aside, the good news is the industry's pie should keep growing handsomely. By PwC's reckoning, industry assets worldwide could reach $111 trillion by 2020 (up from $85 trillion in 2016) and $145 trillion in 2025. In a 2017 report, the consultant says innovation is the key to success and warned: "But it's do or die, and there will be a 'great divide' between the few have's and the many have not's." The future, PwC suggests, will involve a smaller number of firms managing "far more assets significantly more cheaply." Active managers will remain the dominant players, with PwC projecting that such firms will enjoy an increase in AUM and still manage 60% of global assets by 2025. But that number would represent a drop of 11

## CROSS BORDER TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| **U.S. - INTERNATIONAL** | | | | | |
| Number of Deals | 27 | 21 | 26 | 20 | **32** |
| Value ($B) | $3.9 | $5.2 | $2.7 | $6.3 | **$7.9** |
| **INTERNATIONAL - INTERNATIONAL** | | | | | |
| Number of Deals | 23 | 20 | 27 | 32 | **30** |
| Value ($B) | $4.0 | $6.5 | $4.6 | $6.6 | **$3.6** |
| **TOTAL** | | | | | |
| Number of Deals | 50 | 41 | 53 | 52 | **62** |
| Value ($B) | $7.9 | $11.7 | $7.2 | $12.8 | **$11.5** |

Source: Berkshire Capital Securities LLC

## CROSS BORDER TRANSACTIONS BY DOMICILE AND TYPE

| 2017 | BUYER: SELLER: | U.S. INT'L | INT'L U.S. | INT'L INT'L | TOTAL |
|---|---|---|---|---|---|
| Wealth Management | | 2 | 2 | 7 | **11** |
| Traditional Investment Management | | 7 | 9 | 10 | **26** |
| Other | | 3 | 9 | 13 | **25** |
| **Total** | | **12** | **20** | **30** | **62** |
| **2016** | **BUYER: SELLER:** | **U.S. INT'L** | **INT'L U.S.** | **INT'L INT'L** | **TOTAL** |
| Wealth Management | | 2 | 2 | 10 | **14** |
| Traditional Investment Management | | 1 | 5 | 12 | **18** |
| Other | | 4 | 6 | 10 | **20** |
| **Total** | | **7** | **13** | **32** | **52** |

Source: Berkshire Capital Securities LLC

percentage points from 2016 while PwC projects the passive share will climb 8 points to reach 25%. PwC pegs alternatives as another winner, with AUM doubling to $21 trillion and share rising three points to 15%. "Active, passive and alternative strategies are becoming building blocks for multi-asset, outcome-based solutions," writes PwC. "In this context, demand for passive and alternative strategies will grow, but the place for active management will remain."

Having been an active participant in the industry since 1983, Berkshire Capital has itself been witness to, and has helped clients navigate, a range of changes over the decades. In the process, we have established our company as one of the industry's leading investment banks, with more completed transactions than any other firm in the investment management (traditional and alternative), wealth management and securities industries. In 2017, we were honored to add to that legacy by taking part in 13 announced transactions as well as a significant number of valuation and strategic advisory engagements. As we begin 2018, we look forward to engaging with you, our clients, on new and value-enhancing transactions, and we thank you for the continuing trust you place in us.

## TRADITIONAL INVESTMENT MANAGEMENT

Global investors continued their torrid affair with exchange traded funds last year, adding $391 billion in net new assets worldwide by July to quickly pass the previous record set during the 2016 full year, according to ETFGI. By the end of the year, net inflows in the dominant U.S. market had reached $476 billion, according to ETF.com, compared with the previous U.S. record set in 2016 of $288 billion.

The demand for these products was reflected in the impressive third-quarter results of the world's leading ETF provider, **BlackRock** (NYSE: BLK), whose AUM rose 17% from the year-earlier period to $6 trillion, with the **iShares** ETF business accounting for nearly half the increase. Noting that ETFs are "increasingly driving our flows," BlackRock Chairman and CEO Laurence Fink said during the earnings call that his firm is "creating new opportunities globally for clients to use ETFs for asset allocation and alpha generation. We're developing new products, we're spending time on ETF education ... and [we're] at the forefront of the innovation in the ETF distribution side."

Assets in smart beta ETFs, which have been the most successful extension from plain-vanilla index trackers, grew 28% in the 12 months through June 2017 to $707 billion worldwide, according to **Morningstar**, with the U.S. accounting for 88% of all assets. Fixed income ETFs are also gaining adherents, breaking the $100 billion threshold for U.S. annual inflows for the first time last October, according to FactSet.

While the ETF industry has grown rapidly — global assets doubled in the five years through September 2017 to $4.4 trillion — there doesn't appear to be a slowdown on the horizon. PwC figures robo advisors alone could boost their ETF assets more than tenfold to $800 billion over the next five years while in a recent survey from **Charles Schwab**, 63% of millennials said ETFs will be their "primary investments vehicle" in the future. In an October speech in New York, **Vanguard** founder Jack Bogle said passive investments as a whole could ultimately account for between 70% and 90% of the equity market. "As a long-term investment strategy, I don't think the index fund has any competition," he said.

Drawn by those opportunities, for a fourth year running asset managers cut multiple deals for ETF providers to either gain entry to the market or expand an existing footprint. Leading the group was **Invesco** (NYSE: IVZ), which made two deals: the $1.2 billion acquisition of **Guggenheim Investments**' ETF business (see sidebar) and the purchase of European ETF manager Source. Invesco was joined by **WisdomTree Investments** (NASDAQ: WETF), which paid $611 million in cash and shares for **ETF Securities**' European commodity, currency and short and leveraged ETFs, amounting to $17.6 billion in AUM. The deal gives New York-based WisdomTree greater scale in Europe's €600 billion ($710 billion) ETF market, making it No. 9 with a 3% share and the leader for commodity ETFs. WisdomTree said the deal would be 25% accretive to earnings per share in the first year excluding expected synergies. With the addition of ETF Securities' products, WisdomTree has $66 billion in ETF AUM.

A few days after the November deal with WisdomTree, ETF Securities sold its open-architecture and UCITS-compliant European ETF platform to London's **Legal & General Investment Management**. UCITS, or the Undertakings for the Collective Investment of Transferable Securities, is the harmonized regulatory structure for fund sales in the European Union. The acquisition includes $2.7 billion in AUM and 17 equity, fixed income and commodity products. For LGIM, the deal provides immediate entry into the ETF marketplace to complement its $431 billion index business. For ETF Securities, both sales mark a departure from the European market in favor of Australia and a small business in the U.S. There were

## TRADITIONAL INVESTMENT MANAGEMENT *

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 59 | 64 | 58 | 66 | **74** |
| Combined Value ($B) | $8.9 | $20.2 | $13.7 | $11.3 | **$13.3** |
| Total Seller AUM ($B) | $1,042 | $1,415 | $1,380 | $1,772 | **$1,281** |
| Average Deal Size ($M) | $151 | $316 | $235 | $172 | **$180** |
| Average Seller AUM ($B) | $17.7 | $22.1 | $23.8 | $26.8 | **$17.3** |

Source: Berkshire Capital Securities LLC

** Includes traditional institutional and mutual fund managers*

several other smaller ETF deals involving such diverse buyers as **China International Capital** (HKG: 3908), **Nikko Asset Management** (NSIT: JP) and **Turner Investment Holdings**.

A second theme in 2017 involved buyer demand for targets with yield-oriented liquid strategies, such as MLPs and REITs, with the arena drawing high-profile players like **Blackstone Group** (NYSE: BX), **Brookfield Asset Management** (NYSE: BAM) and **Lovell Minnick Partners**. For the energy-related deals that dominated, a level of opportunism was doubtless at work, as buyers jumped on a sector that was beaten down by the collapse of energy prices in 2014 but showed signs of revival last year as prices began to climb. "U.S. oil production is expected to break 10 million barrels a day [in 2018], and somebody has to transport it," a bullish Charles Lieberman, founder and chief investment officer of **Advisors Capital Management**, told *Barron's* last December. Still, over the first three quarters of 2017, the **Alerian** MLP index was off 5.6% while REITs and utilities delivered positive returns.

Blackstone's target was **Harvest Fund Advisors**, an institutional firm with more than $10 billion in AUM focused on midstream MLPs. Citing the "significant growth and opportunity in the MLP markets today, especially in the continued evolution towards broader institutional ownership," Blackstone said Harvest will "complement our extensive energy investing activities." Those investments are credit and private equity related. In the third-quarter earnings call, Chairman and CEO Stephen Schwarzman said the company plans to make Harvest products "more widely accessible to a broader range of LPs [limited partners], including retail where they really don't have a presence." He likened the strategy to the company's successful introduction in January 2017 of a non-traded REIT for retail investors.

Lovell Minnick led a group of investors in acquiring two-thirds of energy specialist **Tortoise Investments**, with employees assuming the rest of equity. Tortoise was part of asset and wealth manager **Mariner Holdings**. Tortoise manages $20 billion in income-producing active and passive investments, the majority in MLPs. In discussing the appeal of midstream MLPs with Barron's last year, Brian Kessens, Tortoise managing director and portfolio manager, said "they have high barriers to entry and earn fees based on volume, not the price of the commodity." Lovell Minnick was joined by **AlpInvest Partners**, **HarbourVest Partners** and several other limited partners. Lovell Minnick told the Wall Street Journal that Tortoise met its interest in "specialized businesses where active management has been proven to outperform as a result of the complexity of the subsector" in which the firm has expertise. Specialization also opens the door to higher fees. For example, the Tortoise MLP & Pipeline fund (AUM $3.4 billion) retail offering has a sales load of 5.75% and an expense ratio of 1.22%; it yielded 3% as of last December. Last year, Lovell Minnick also invested in real assets manager **CenterSquare Investment Management** *(see Real Assets)* and Spanish fund manager **Trea Asset Management**.

Brookfield acquired MLP investor **Center Coast Capital Holdings**, which has more than $4 billion in AUM in funds and separately managed accounts. CCC was founded in 2007 and is based in Houston. Brookfield, which made the purchase through its **Public Securities Group**, said the acquisition will diversify "its real asset public securities investment offerings" and comes "at an attractive point in the [MLP] investment cycle." As part of the deal, Brookfield will acquire **Liberty Street Advisors**, which serves as advisor to a family of subadvised income-oriented funds, including 7-year-old Center Coast MLP Focus, a midstream fund with multiple classes and total assets of $2.8 billion. Additionally, BAM will acquire certain assets from Liberty Street affiliates.

Traditional fixed income managers were also in demand, matching the strong, ongoing demand among retail and institutional investors for a variety of bonds. In the U.S., sales of investment-grade bonds passed the $1 trillion mark in the first nine months of 2017. In Europe, net sales of bond funds reached a record €93 billion ($110 billion) in the second quarter. In emerging markets, high-yield bond issues hit an annual record of $221 billion by October. Among the largest buyers of debt to emerge in recent years are cash-rich corporations such as Alphabet, Apple and Microsoft, with a Financial Times analysis showing that 30 U.S. companies hold more than $800 billion in government and corporate debt. "Not surprisingly, the corporate treasury departments of such companies have been dubbed asset managers, as just like professional investors they seek ways to generate higher returns in the era of ultra-low and negative interest rates," wrote Financial Times markets editor Michael Mackenzie last October.

There were a couple of notable domestic fixed income deals in the U.S. In the larger one, **MetLife** (NYSE: MET) paid $250 million in cash for fixed income institutional manager **Logan Circle Partners** (AUM: $34 billion), in line with its focus on "businesses with strong risk-adjusted internal rates of returns, low capital intensity and sustainable cash flows." The deal also tracks MetLife's effort to expand its third-party asset management business, focused on its core capabilities in fixed income and real estate. Third-party assets account

for one-quarter of MetLife's $560 billion in AUM. MetLife acquired Logan Circle from alternatives manager Fortress Investment Group following the latter's sale to **SoftBank** (TYO: 9984) *(see Hedge Funds/Private Equity)*.

**Raymond James Financial** (NYSE: RJF) paid $173 million in cash (subject to purchase price adjustments at closing) for Kansas City-based **Scout Investments** and its **Reams Asset Management** division, adding $27 billion in assets under management and advisement, more than 80% in Reams' diverse fixed income strategies. Scout was owned by **UMB Financial** (NASDAQ: UMBF). The companies will be wrapped into Raymond James' year-old boutique, **Carillon Tower Advisers**, which prior to the deal had three affiliates with a combined $36 billion in assets under management and advisement. Cooper Abbott, Carillon chairman and president, told Fund Action the deal enhances the company's "ability to have more of an asset allocation or an outcome-oriented focus, mixing equities and fixed income, coming up with more of a solution."

A third theme at play last year has emerged in response to the inroads made by ETFs and index funds, involving consolidation among active managers in search of synergies, greater scale and global expansion. This trend played out in the largest asset management transaction of 2017: **Standard Life's** (LON: SLA) £3.8 billion ($4.7 billion) acquisition of **Aberdeen Asset Management**. That deal followed a similar mega-deal in 2016 between Henderson Group and Janus Capital Group, now **Janus Henderson Group** (NYSE: JHG), as well as **Amundi**'s (EPA: AMUN) acquisition of active manager **Pioneer Investments**.

The combined Scottish company, rebranded **Standard Life Aberdeen**, is the largest active asset manager in the UK and the second-largest in Europe, with £581 billion in AUM, the slight majority of assets from Standard Life, and another £79 billion in assets under administration. The all-share transaction, which leaves Standard Life shareholders with two-thirds of equity, merges Standard Life's focus on fixed income, alternatives and developed markets with Aberdeen's equities and emerging markets capabilities.

The firms said the deal "reinforce(s)" their "long-standing commitment to active management, underpinned by fundamental research, with both global reach and local depth of resources." While 70% of combined AUM rests with UK clients, the merged company has offices in 50 cities worldwide and clients in some 80 countries. The deal also creates a leading manager for third-party insurance assets, with Aberdeen accounting for 72% of the combined £182 billion in that growing market.

Martin Gilbert, the prolific deal-maker who drove Aberdeen's expansion over 34 years and serves as co-CEO of the new firm, told the Financial Times the transaction was "both offensive and defensive." Underlining the pressures on active managers to scale up, Gilbert said the combination holds the potential for "two and two" to make "five" as opposed to the standalone companies declining to "one and three-quarters."

Part of that equation involves financial benefits, with the combined firm set to chop £200 million in annual costs within three years while investing in growth and innovation. Keith Skoech, the co-CEO from the Standard Life side, told analysts that clients need active managers more than ever to navigate a complex investment environment, "especially absolute return with low volatility" products. "This reinforces the need ... for product innovation."

There were two other significant deals involving domestic tie-ups. In Italy, **Anima Holding** (BIT: ANIM) paid €700 million in cash ($815 million) for **Aletti Gestielle**, the asset management business of **Banco BPM** (BIT: BAMI). The transaction, which Anima said will be immediately accretive, could approach €1 billion based on financial targets, including the transfer of certain mandates. Aletti Gistielle adds €18 billion to the €76 billion Anima already managed, making Anima the fourth-largest asset manager in Italy. Anima said the deal strengthens its position as the nation's leading independent asset manager and delivers "significant distribution potential in the retail and potentially also in the institutional segment." As part of the deal, Anima and Banco BPM extended their existing "strategic partnership" to 20 years.

Banco BPM, formed in January 2017 from the merger of Banco Popolare and Banca Popolare di Milano to create Italy's third-largest bank will retain a minority shareholding in Anima. Its economic challenges aside, Italy is one of Europe's largest asset management markets, driven in part by the propensity of citizens to save, though they are generally conservative investors. The industry's €2 trillion in assets is equivalent to 111% of GDP, according to Deloitte, while the market is dominated by five players accounting for nearly a 60% share, including 87% of insurance mandates of €685 billion.

Canada's ongoing consolidation story continued last year as **CI Financial** (TSE: CIX) paid C$780 million ($610 million) in cash and shares for **Sentry Investments Corp.** in a teaming of two large independent firms. Sentry is a retail-oriented fund manager that adds C$19 billion in assets, primarily in equities, to the C$120 billion CI Financial already managed. Sentry, which will remain a standalone brand, also adds strength in the broker channel, with CI Financial noting that the firm "opens the door to a number of new retail advisors, a strategic focus for our company in 2017." CI Financial said the deal will be "highly accretive" to earnings by 2018-2019.

In the U.S., consolidation centered around smaller fund managers, one example being **Touchstone Investments**' acquisition of $5.1 billion in a range of mutual fund assets from Vermont's **Sentinel Asset Management**. It marked the fourth and by far the largest acquisition of funds the Cincinnati fund manager has made since 2011, with AUM having doubled to $19.5 billion during that time. Touchstone, part of life insurer **Western & Southern Financial Group**, cut the deal with Sentinel parent **National Life Group**, which divested the manager due to its limited scale and competition from passive products. Touchstone was drawn to Sentinel in part by its small-cap and international equity

funds (combined AUM: $1.3 billion), areas where investors retain confidence that active managers can beat benchmarks. Touchstone, which will rebrand or merge Sentinel's funds into its own, aims to offer retail investors access to funds subadvised by "best in class" institutional managers.

The push for international expansion continues to drive transactions, including the domestic UK deal between Standard Life and Aberdeen Asset Management that also incorporates an expanded global footprint. A significant transpacific deal saw **Nippon Life Insurance** acquire a minority stake in a U.S. fixed income asset manager for the second time since 2013, as it cut a deal with **Carlyle Group** (NASDAQ: CG) for part of **TCW Group** (TSE: TCW). Nippon Life gains a near 25% share while Carlyle Group is left with 31% and management 44%.

Based in Los Angeles, TCW (AUM: $200 billion) already sells its products through Nippon's asset management unit. Although the price was not disclosed, multiple news organizations placed it around $500 million. In addition to generating income, Nippon said TCW adds U.S. fixed income capabilities that benefit its insurance investment arm and provides "expertise relating to overseas asset management business through [the] appointment of directors and sending expatriates." Nippon, which in 2015 said it could spend up to ¥1.5 trillion ($13.3 billion) on domestic and international acquisitions and investments over 10 years, also has a minority investment in U.S. high-yield and senior loan manager **Post Advisory Group**, part of **Principal Financial Group** (NASDAQ: PFG).

**BlackRock** agreed to buy the Mexican asset management business of **Citigroup**, a retail-oriented unit with $31 billion in AUM that complement's BlackRock's institutional focus in that market. BlackRock also said it will enter into a distribution agreement with local subsidiary **Citibanamex** that provides a network of 1,500 branches and 20 million clients. Citigroup said the divestiture meets its strategy of "expanding access to best-in-class investment products, rather than on manufacturing proprietary asset management products." The combined business, with $62 billion in AUM, will be split evenly between retail and institutional assets, with products carrying the BlackRock name.

The Chinese global M&A activity that has been gaining steam for several years took a step back last year as Beijing imposed capital controls. In the first half of 2017, that drove a sharp drop in outbound M&A activity from the record year in 2016, though deals picked up in the third quarter, with many tied to the government's "Belt and Road" economic initiative along the historic Silk Road. Amid that clampdown, the most notable Chinese financial services buyer was privately held **HNA Group** (000616.CN), a sprawling conglomerate that came under scrutiny from Beijing, and ultimately investors, for the leverage it has employed during an overseas acquisition spree. By year-end, the company was seeking to shed assets in a bid to ease that debt burden and placate Chinese regulators.

HNA made two U.S. asset management deals last year, including the $446 million cash purchase of a near 25% stake in U.S. multi-boutique **OM Asset Management** (NYSE:

## INVESCO EXPANDS ETF BUSINESS SMARTLY

**Invesco**'s $1.2 billion cash acquisition of **Guggenheim Partners**' ETF business is the second-largest deal in that industry after **BlackRock**'s transformative 2009 purchase of Barclays Global Investors' **iShares** business. The transaction adds $37 billion in ETF assets, 60% in value-added smart beta products, and marked the second such transaction in 2017 for Atlanta-based Invesco. Five months prior to the September Guggenheim deal, the company paid cash for London-based ETF firm **Source**, with $25 billion in AUM (including $7 billion in outsourced funds). Source, majority-owned by **Warburg Pincus** and a top-10 European ETF manager, expands Invesco's footprint in that region. Based on current growth rates, **Morningstar** projects ETF assets in Europe could nearly double to €1 trillion ($1.2 trillion) by 2020.

While the two deals add an impressive $62 billion in AUM, boosting Invesco's global ETF market share by 1.5 points to 4.6%, the company's $200 billion in ETF assets leaves it in the No. 4 position, far behind No. 3 **State Street Global Advisors** (AUM: $583 billion). However, the addition of Guggenheim's business hikes Invesco's share of the more profitable U.S. smart beta segment from 13.6% to 19.9%, where it is No. 2 behind BlackRock. Guggenheim's leading ETF is 14-year-old S&P 500 Equal Weight (AUM: $14.3 billion), which weighs each stock in the index equally, rebalancing every quarter.

In discussing the transaction, Invesco President and CEO Martin Flanagan stressed that Guggenheim enhances the company's overall strategic goal of providing a "robust range of investment capabilities" in "active, passive and alternative(s)," including factor-based products. With the addition of Guggenheim and Source, Invesco's factor assets total $208 billion, or less than one-quarter of total AUM. Guggenheim's ETF unit also offers a regulatory edge in the form of SEC approval to self-index, or create products built upon homegrown indexes, as opposed to licensing indexes such as the S&P 500.

Invesco, which did not provide a price tag on the Source transaction, said it valued the Guggenheim business at 11.7 times 2018 EBITDA, noting that the business generated $108 million of run-rate gross management fees and has an estimated operating margin around 85%. The company expects the deal to produce a 25% internal rate of return.

OMAM/AUM: $240 billion). The sale by former parent **Old Mutual** (LON: OML) is part of its plan to split into four separate businesses; the company retains a minority stake in OMAM. (Toward the end of 2017, Old Mutual sold part of its UK asset management business to **TA Associates** and management.) Prior to its March investment in OMAM, HNA joined with **RON Transatlantic** to buy a majority stake in fund of hedge funds **SkyBridge Capital**, although that deal had yet to be approved by U.S. regulators as of December (see Hedge Funds/Private Equity). In Europe, HNA acquired a majority of **C-Quadrat** (FRA: C8I), an Austrian quantitative funds of funds and credit manager with €9 billion ($10.6 billion) in AUM. Additionally, the company raised its stake in **Deutsche Bank** to 9.9% and agreed to pay $475 million for New Zealand asset finance company **UDC Finance** — a deal that was ultimately blocked by regulators concerned about the lack of clarity in HNA's ownership structure.

There were several cross border deals in China, where in 2016 the industry saw AUM jump 21% on the strength of a 17% gain in net inflows, according to Boston Consulting Group. Of the 109 Chinese mutual fund companies by the consultant's tabulations, 44 involve joint ventures with foreign partners and account for 40% of AUM. While non-Chinese partners in the financial sector are capped at 49% ownership, last November Beijing pledged to raise that cap to 51% and completely remove it within three years, though some longtime China watchers remain skeptical about implementation.

Through an affiliate, **Warburg Pincus** joined the group of minority owners for a second time by acquiring a 49% stake in Beijing's **Fortune SG**, a diversified and established asset manager with $19 billion in AUM, including a leading ETF business. Warburg, which bought the stake from longtime shareholder **Societe Generale** (EPA: GLE), called the deal a "significant move ... into China's asset management industry" and said it will offer "resources and expertise" in such areas as strategic planning, product development and technology. Warburg has invested more than $8 billion in Chinese companies since 1994, including an existing stake in another major Chinese asset manager, **China Huarong** (HKG: 2799).

Canada's **IGM Financial** (TSE: IGM) and parent **Power Corporation of Canada** (TSE: POW) added nearly 8% to their collective stake in **China Asset Management**, with IGM divulging a payment of C$179 million ($140 million) for 3.9%. PCC and IGM now hold 27.8% of CAM, one of China's oldest and largest asset managers (AUM: $165 billion). Since Power Corp.'s initial investment in 2011, CAM's AUM and earnings have grown by annual average rates of 40% and 24%, respectively. In one other transaction, **State Street Global Advisors** and **E Fund Management** signed a memorandum of understanding to "explore strategic opportunities" in China and other global markets. E Fund has $164 billion in AUM, $71 billion of which is in mutual funds (primarily fixed income). SSGA said it will work with E Fund to create "multi-asset product solutions ... across passive, smart beta, active, alternatives and private equity." SSGA ended a short-lived joint venture in China in 2014.

## WEALTH MANAGEMENT

The ongoing consolidation trend in the wealth sector that continued into 2017 featured more activity by strategic buyers, including independent RIAs and banks, as well as platform companies of private equity-backed aggregators Indeed, the private equity money that continued to enter the industry mainly involved recapitalizing the largest existing aggregators to fund future growth via standalone and bolt-on acquisitions.

This trend is best exemplified through transactions involving smaller wealth managers — firms with between $200 million and $1 billion of AUM — the vast majority of which involved strategic buyers, including 13 banks over the past three years. The banks, mainly community based but including several regional institutions, have been enhancing their wealth practices in the aftermath of the financial crisis as part of the effort to expand fee-based, capital-light businesses.

For deal-makers in 2017, the wealth market they faced was a decidedly upbeat one, with strong equity markets driving portfolios to new highs following a 2016 year in which individuals with $250,000 or more in financial assets saw their wealth rise 5.3% worldwide to $167 trillion, according to the latest Boston Consulting wealth survey. Asia-Pacific ex-Japan led the world with growth of 9.5% en route to what is projected to be global wealth leadership by 2019, if Japan is included. In a positive sign on the client-relations side, the industry has enjoyed a strong rebound in sentiment after taking a hit from the financial crisis, with 79% of clients worldwide expressing "trust and confidence" in their wealth manager in the latest Capgemini wealth survey.

The asset and reputational gains of recent years aside, the industry worldwide still faces financial pressures from regulations, competition and clients shifting to lower-margin passive investments. As a result, return on assets as well as margins have been dropping since the financial crisis, with pretax margins among wealth managers declining from 33% to 22.4% since 2007, according to Boston Consulting. "Since the financial crisis of 2007-2008, [wealth managers] have been dealing with sobered investors who demand reduced fees and commissions in order to maximize returns in a low-yield world," Boston Consulting writes.

Those competitive pressures drove several notable transactions in 2017 in the U.S. involving independent RIAs focused on regional or national expansion. Take Los Angeles-based **Aspiriant** for example. An ambitious manager with $9.5 billion in AUM, Aspiriant closed a deal last year for **Stanford Investment Group**, adding $850 million in AUM and marking its third transaction in California since the fourth quarter of 2015. Although Aspiriant has an office in San Francisco and

three others in California, Stanford provides an established presence in one of the hottest wealth centers in the U.S., Silicon Valley. Stanford CEO Helen Dietz, who represents the second-generation of leadership at the 35-year-old firm, told InvestmentNews the sale involved "getting better and staying relevant. Joining Aspiriant will allow us to provide our clients with access to more services ... as well as the strength and stability that comes with being part of a nationwide firm."

## WEALTH MANAGEMENT TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 57 | 49 | 71 | 76 | **80** |
| Combined Value ($B) | $3.3 | $4.0 | $3.9 | $6.5 | **$5.3** |
| Total Seller AUM ($B) | $371 | $412 | $206 | $298 | **$334** |
| Average Deal Size ($M) | $58 | $81 | $54 | $86 | **$66** |
| Average Seller AUM ($B) | $6.5 | $8 | $3 | $4 | **$4** |

Source: Berkshire Capital Securities LLC

Aside from the search for scale, a common thread in most transactions between independents involves a desire to retain that structure combined with finding a culturally compatible partner. In many deals, the two firms enjoy a pre-existing relationship that eases the path to a successful negotiation. That was the case in **Coldstream Holdings**' acquisition of **Rainier Group**, where executives at the Seattle-area firms have known each other for years. Rainier, founded in 1988, adds $760 million in AUM and 325 clients to the $2 billion **Coldstream Wealth Management** already managed. As with Silicon Valley, Seattle is one of the hottest wealth markets in the U.S. and a center of related M&A activity.

In a Southern deal of note, Atlanta's **Brightworth** bought **McGill Advisors** of Charlotte, N.C., a transaction merging two of the region's attractive wealth markets. The addition nearly doubles Brightworth's client base to 1,200 and AUM to $3 billion while extending its presence along the Atlanta-Charlotte corridor. McGill has a niche in the dental profession and has enjoyed solid growth serving those professionals while Brightworth serves a diverse clientele. Bob Sytz, managing partner at McGill, said the deal was driven in part by succession concerns. "We wanted a transparent succession plan so our clients would be working with a fee-only, independently owned RIA firm," he told *Financial Advisor*. **Fiduciary Network**, which in 2007 acquired a minority interest in Brightworth, helped finance the deal.

Following up on its major 2016 acquisition of San Francisco Bay Area manager Presidio Capital Advisors, New York's **Tiedemann Wealth Management** extended its reach north to Seattle to acquire **Threshold Group**. A wealth advisor and family office, Threshold adds $3.4 billion in AUM, including a $1.5 billion impact investment portfolio, to the $12 billion Tiedemann has under advisement. "We saw their expertise in impact investing as being hugely additive," Chairman and CEO Michael Tiedemann told Bloomberg. Threshold's founding Russell family (of **Russell Investments**) assumed an equity stake in Tiedemann, as well as a client relationship. Although the two deals in 2016-2017 added more than $7 billion in assets, Michael Tiedemann describes himself as a skeptical buyer. "The two things that destroy all mergers are mismatches in culture and integration that doesn't go well," he told Real Assets Adviser last year, adding: "The point is to make sure that we have an institution that goes beyond our lives."

In a second bicoastal transaction, **Massey Quick & Co.** of New Jersey merged with **William E. Simon & Sons** of Los Angeles to form **Massey Quick Simon & Co.** As is the case in numerous deals, Massey Quick and William E. Simon mulled a potential tie-up for several years before sitting down in earnest. The deal combines Massey Quick's investment and financial services capabilities with William E. Simon's family office expertise. The combination has some $2.5 billion in AUM, including the Simon family wealth variously estimated between $360 million and $500 million. The company was started in 1988 by the late William Simon, a leveraged buyout investor and former U.S. treasury secretary. The sale was driven in large part by the succession concerns of brothers Bill and Peter Simon, who run their office for an extended family. For both firms, the merger creates a framework for building a multifamily office, with William E. Simon overseeing a planned West Coast expansion.

Community banks remained players in the market for small managers, accounting for multiple deals in a continuation of a post-financial-crisis trend. A related KPMG survey several years ago showed that more community banks (32%) cited asset and wealth management as the leading driver of near-term revenue growth than any other business category. Among the examples last year was **Meridian Bank**'s (NASDAQ: MRBK) acquisition of **HJ Wealth Management** in Pennsylvania, which more than tripled Meridian's wealth management AUM to $700 million. HJ Wealth, founded in 2000, said it had been "looking for the right bank to partner with for years." In Chicago, **First Midwest Bancorp** (NASDAQ: FMBI) — whose wealth management fee income has been growing at a double-digit pace — acquired **Premier Asset Management** (AUM: $550 million). Premier touted its new parent's "ability to provide our clients a broader range of products."

There were two large bank deals involving North American buyers and U.S. targets. In a domestic U.S. deal, the **Whitney Bank** unit of **Hancock Holding Co.** (NASDAQ: HBHC) acquired the wealth operation of **Capital One** (NYSE: COF), which includes $10.3 billion in assets under management and administration in five lines of business. The business, which has eight locations, enables Mississippi-based Whitney to scale its trust and wealth management operation around the

Gulf region in particular. Capital One made the divestiture as part of an effort to focus on its core business. Whitney said the transaction "illustrates the type of largely in-market, low-risk business deals we prefer under our current M&A strategy." The addition of Capital One's business will make Whitney Bank a top-50 U.S. trust firm by revenue and gives its wealth unit $26 billion in assets under administration and $10 billion in AUM.

In the second deal, **CIBC** (NYSE: CM) acquired Chicago's **Geneva Advisors** (AUM: $8.4 billion), part of a renewed push by the Toronto bank into the U.S. in recent years. CIBC, which could pay up to $200 million in cash and shares based on performance, wrapped Geneva into its U.S. wealth business, **CIBC Atlantic Trust Private Wealth Management**, where it accounts for 17% of AUM. The deal followed the closing of CIBC's major 2016 purchase of another Chicago firm, **PrivateBancorp**, a commercial bank and wealth manager. CIBC said the addition of Geneva "will add scale in key markets where we can offer clients differentiated, high-touch service." U.S. commercial banking and wealth management accounts for 9% of CIBC's earnings.

In a transatlantic deal involving another Canadian buyer, Toronto's **Canaccord Genuity Group** (TSE: CF) acquired **Hargreave Hale** of the UK in a bid to expand its business in that market and Europe, calling the transaction "an important step in our strategy of building a leading independent global wealth management business." Hargreave Hale adds £8 billion ($10.7 billion) in private client assets under management, administration and contract to the £15 billion in assets already managed by Canaccord's UK- and European-based **Canaccord Genuity Wealth Management**. The asset total of £23 billion, including £4.7 billion in funds, makes CGWM a top-10 UK wealth manager. Canaccord's initial payment of £52 million could reach nearly £80 million based on performance, with the company saying the deal will be immediately accretive to adjusted earnings. Cannacord said Hargreave Hale strengthens its existing London office while expanding its UK footprint with regional offices. Hargreave Hale also adds capabilities in small- and mid-cap fund management.

A third strategic cross border deal saw **UBS** (NYSE: UBS) expand in Brazil by acquiring a majority stake in that nation's largest independent multifamily office, Sao Paulo-based **Consenso** (AUM: $6 billion). "We continue to believe in Brazil's long-term prospects," Alejandro Velez, head of Latin American wealth management for UBS, told Euromoney. "Consenso has a strong track record with strong historic growth. It provides access to a large number of families in the high net worth and upper high net worth space." UBS has had a roller coaster ride in Brazil in recent years, buying investment bank, asset and wealth manager **Banco Pactual** in 2006 and then selling it three years later under pressure from the financial crisis. In 2013, UBS returned to buy the nation's largest independent broker, Link Investimentos. In 2016, Brazil's high net worth population and assets grew by double digits, according to Capgemini, even as the nation struggled with negative economic growth for a second year. The market is heavily skewed toward ultra HNW individuals, who account for 87% of total HNW wealth.

The aggregators/consolidators in the U.S. remain significant participants in the reshaping of the broader industry as they transition to becoming both financial and strategic buyers. Last year, three of the key market participants were actively restructuring their own businesses in pursuit of continued growth. The largest such player, **Focus Financial Partners**, sold a majority share to **KKR & Co.** (NYSE: KKR) and **Stone Point Capital**, with Focus' three existing private equity owners cashing out. The transaction valued Focus at around $2 billion. KKR said it "look[ed] forward to supporting the firm's continued success by leveraging our global network and resources." Subsequently, Focus cut the largest-ever deal in its 11-year history with the purchase **SCS Capital Management**, an ultra HNW firm based in Boston and New York with $16.5 billion in AUM. In total, Focus and its affiliates engaged in 26 various transactions last year while its network grew to 50-plus firms.

Chicago's **HighTower** sold a "significant stake" to private equity firm **Thomas H. Lee Equity Partners** as part of a recapitalization. Lee Equity also pledged an additional $100 million in equity capital to "accelerate HighTower's next phase of growth." A half-year prior to that October investment, HighTower made its largest-ever deal by acquiring Lee Equity-owned **WealthTrust**, itself an aggregator with $6.4 billion in assets. In a cross border recapitalization, Australia's **AMP Ltd.** (ASX: AMP) acquired a minority stake in California-based **United Capital**, building off an existing relationship between the two firms. The deal transcends a financial transaction, as AMP and United Capital plan to combine their proprietary operating systems for financial advisors to create a global operating system. United Capital was also active in 2017 buying small managers in California, Colorado and Indiana.

Several transactions involved financial buyers that were simply adding to their portfolio companies or were "platform buyers" — firms laying the groundwork for additional acquisitions via an initial target. There were two examples last year in the latter category. One involved **Parthenon Capital Partners**' acquisition of a controlling interest in California's **Hanson McClain Advisors**, with more than $2 billion in assets under administration. "We found we couldn't figure out how to grow faster than 7% or 8% a year," Scott Hanson, co-founder and senior partner, told InvestmentNews. "And I'm at the stage of life where I didn't want to dip into my own piggy bank to finance the growth." Parthenon, a mid-market private equity firm, cited the opportunity for Hanson McClain to "leverage Parthenon's resources to invest in client-centric technology," as well as expansion into new markets. The Boston-based firm has identified dozens of independent firms in West Coast and Rocky Mountain states that could be added to the Hanson McClain platform.

A second example was the purchase by Connecticut hedge fund **Viking Global Investors** of a majority stake in **Rockefeller & Co.** and the subsequent formation of **Rockefeller Capital Management**. The Wall Street Journal, citing a source, placed the price in the "low nine figures." The ownership group, which includes management and a Rockefeller family trust, said it "anticipates making substantial additional capital investments."

While the push to scale up in such areas as marketing, compliance and geographic reach has been a traditional deal driver for both small and mid-size firms, in recent years those factors have been joined by another: The need to keep pace with technology upgrades across a wide range of applications. "Firms that have more scale will be able to weather the issues facing the industry.... [helping to] deal with the perceived threat of robo advisors and the regulatory environment," Aspiriant CEO Rob Francais told the Los Angeles Business Journal last June. Matt Brinker, United Capital's business development head, underlined the challenge in an interview with the Wall Street Journal last July, saying, "It's hard for smaller firms to invest enough in technology and training."

In a June 2017 webcast sponsored by PwC, technology was cited by 19% of the 1,000 wealth and asset managers attending as one of the industry's "biggest challenges," on par with changes in investor preferences for new products and strategies. A 2016 industry survey by EY showed that wealth managers considered digital firms to be the key source of competitive pressure, just ahead of lower-cost providers. EY noted that while tech spending traditionally targeted back-office efficiencies, wealth managers must now "invest in their front-office digital capabilities or run the risk of falling behind."

Four areas of tech are grabbing particular attention: mobile, social media, advanced analytics and cloud-based computing. **Fidelity Investments** tech consultant Tricia Haskins explained last year that investors aren't just comparing wealth managers to one to another, but to all providers of goods and services. "Clients are coming to expect a fully interactive experience from advisors who can deliver 24/7," she said. "So ... the wealth management business will be shaped by clients who are using technology-driven tools in every aspect of their lives."

**Charles Schwab** Executive Vice President Bernie Clark even raised the dreaded "A" and "G" words in an interview with Financial Planning at the company's annual Impact conference last November. "I personally worry about the disrupters, which could be the Googles, the Amazons," he said, telling the larger conference that tech-driven change means the company no longer bothers "building the fort. We're building tents so we can keep moving." Neesha Hathi, chief digital officer at Schwab, raised her own red flag, warning conference-goers that regulatory requirements notwithstanding, the industry is tailor-made for disruption. "This is an industry that's considered opaque. It's an industry that people really don't understand. It's an industry where everyone has pretty good profit margins."

## REAL ASSETS

As is the case with private equity, real assets are drawing patient capital in search of steady income and returns, as well as diversification. Pension funds seeking to meet liabilities for the wave of retirees have been particularly keen buyers in recent years. In the first half of 2017 in the U.S., pension funds tracked by eVestment made more new commitments to real asset strategies than any other asset class, with private equity second. "The trend is clear for these asset classes," says Graeme Faulds, eVestment's director of private markets solutions. "There is likely going to be continued flows of new money in that direction, and managers need to be ready for it."

Real estate is the dominant real assets class worldwide and remains a powerful draw for investors. In the 2017 survey of global institutions by Cornell University's real estate program and Hodes Weill & Associates, the target allocation to real estate topped 10% for the first time, up 120 basis points since 2013. Among the real estate advisory firms that manage much of that capital, deal-makers weighed in with 30 transactions last year as they sought to meet that demand, with buyers a mix of alternative and diversified asset managers.

Two notable deals crossed the Pacific, including **Mitsui & Co.'**s (TYO: 8031) entry into the U.S. market via the purchase of a 20% stake in **CIM Group** (NYSE: CIM), a North American urban real estate fund manager. Based in Los Angeles and founded in 1994, CIM has $19 billion in AUM in a broad real estate portfolio, from opportunistic and core/stabilized to debt, as well as infrastructure holdings. Tokyo-based Mitsui's total investment will be $450 million to $550 million, including interests in several CIM funds, as it called the U.S. market "favorable mid to long term" and attractive to Japanese investors mired in a low-interest-rate environment. Mitsui, a conglomerate whose asset management business focuses primarily on Japanese property, said CIM will be "positioned at the core of [our] international asset management strategy."

In the second deal, Chinese alternatives investor **Citic Capital Holdings** bought a stake in another West Coast real estate advisory firm, **Stockbridge Capital Group**. Based in San Francisco, Stockbridge has $11 billion in AUM across the range of U.S. real estate investments. The deal followed a joint venture the two firms concluded in 2016 focused on U.S. real estate. Based in Hong Kong and founded in 2002, Citic manages $22 billion in capital across 100 funds and investment products. In a December 2016 interview with the South China Morning Post, Stanley Ching, Citic managing partner for real estate, said the firm would increase real estate investment in Japan, the UK and the U.S., Beijing's efforts at capital controls notwithstanding. "Chinese investors needing to put capital overseas for diversification will continue to be a sign of the times," he said.

In domestic U.S. deals, all involving mid-size targets, buyers included **Columbia Threadneedle Investments** and **Morgan Stanley Investment Management**. In the Morgan Stanley transaction, the target was **Mesa West Capital**, which adds a commercial real estate credit platform with $5 billion in AUM to the $47 billion in real assets that Morgan Stanley already manages. The 13-year-old company, which will retain its brand and operate as a separate business, primarily originates transitional first mortgages to "strong sponsors" in core and secondary markets in the U.S. In January 2017, Mesa West closed its fourth and largest-ever fund of $900 million focused on short-terms loans. "When we launched our first fund in 2005, there weren't many institutions beyond insurance companies in this space," co-founder Jeff Friedman told Institutional Investor last year. "But we've seen more institutions, and pensions specifically, come around to the asset class."

## REAL ASSETS TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 13 | 13 | 15 | 18 | **30** |
| Combined Value ($M) | $875 | $1,458 | $1,526 | $2,892 | **$3,281** |
| Total Seller AUM ($B) | $77.9 | $93 | $90 | $151 | **$184** |
| Average Deal Size ($M) | $67 | $112 | $102 | $161 | **$109** |
| Average Seller AUM ($B) | $6.0 | $7 | $6 | $8 | **$6** |

Source: Berkshire Capital Securities LLC

**Ameriprise**-owned (NYSE: AMP) Columbia Threadneedle acquired **Lionstone Partners**, with $6 billion in real estate AUM. Lionstone employs "proprietary analytics" to invest in commercial real estate centered in cities "that are best positioned to enjoy outsized demand and rental growth." The acquisition extends Columbia Threadneedle's portfolio into U.S. real estate, which the company said "is projected to attract increasing allocations from both institutional and retail investors." Columbia Threadneedle has an existing UK real estate platform. Referring to Lionstone's analytics-driven business, Dan Dubrowski, head of capital formation, told Institutional Real Estate, "We now have a partner who has extraordinary expertise, resources and global data streams that we have never dreamed we'd have access to."

A transatlantic deal saw **Principal Financial Group** (NASDAQ: PFG) add to its formidable real estate advisory portfolio by acquiring **Internos Global Investors**, a pan-European real estate investment manager with $3.3 billion in AUM. Principal is a top-10 global real estate investment manager with $75 billion in AUM. Principal said the deal aligns with its strategy of delivering "a greater range of solutions to our clients" by adding an investment platform in Europe while also building its European client base. Founded in 2008, Internos will retain its investment and management independence, in keeping with Principal's multi-boutique structure. Last year, Internos raised €133 million ($160 million) for a hotel real estate fund backed by numerous German institutions, providing it with a war chest of twice as much including leverage. The fund, the second such vehicle for Internos, is targeting three- and four-star business hotels in city centers.

Germany's ambitious **Patrizia** (ETR: P1Z) cut three geographically diverse deals in Europe, in the process doubling its AUM to €40 billion and consolidating its position as a leading independent European real estate advisory firm. The publicly traded Patrizia, which operates in 15 European markets in both residential and commercial property, has set a goal of becoming a "global provider of European real estate investments." Accordingly, Patrizia has been more aggressive in pitching to non-European institutions, which in 2016 accounted for 18% of the €2.2 billion it attracted in new capital. The largest of the three deals last year was a domestic one involving **Triuva** (AUM: €10 billion), with press reports placing the price between €200 million and €250 million. Frankfort-based Triuva manages 40 funds and has relationships with 80 institutions. Patrizia said Triuva "enhances the stability" of its business by providing diversification and "ensuring an even greater share of our revenue comes from recurring asset management fees."

A second deal targeted an established London-based firm, **Rockspring Property Investment Managers** (AUM: €7.8 billion), whose portfolio is skewed toward Germany and the UK and retail properties. Patrizia said the addition of Rockspring provides clients of both firms with "a stronger independent platform which will offer broader access to markets and products" while strengthening its "position significantly in its core European markets." In the smallest of the three deals, Patrizia acquired Danish global real estate fund of funds manager **Sparinvest Property Investors** (AUM: €1 billion). SPI's focus on the small- and mid-cap segment complements Patrizia's strategy of expanding its portfolio.

In another all-European deal, **Edmond de Rothschild (Suisse) S.A.** (SWX: RLD) bought a majority stake in London's **Cording Real Estate Group**, with €2.3 billion in AUM and a focus on Benelux, Germany and the UK. Cording adds scale and new markets in Northern Europe to Rothschild's existing real estate platform, creating a portfolio with €7.8 billion in assets and 11 offices in Europe. Prior to the Cording transaction, Rothschild operated its real estate investment unit through two affiliates, including France's **Cleaveland**, which it acquired in 2016 when the firm had €2.5 billion in AUM. In its latest annual report, Rothschild said real assets are "imperative for an investment firm like ours and an integral component of the success our Family has enjoyed for several generations."

## CREDIT

Ten years after the start of the financial crisis, the collateralized loan obligations market is approaching pre-crisis levels. Having been tarnished by some of the dicier investment acronyms that rode the pre-crisis wave before crashing, new CLO issues collapsed along with the crowd, sinking to virtually zero in 2009 from a 2007 U.S. record of around $100 billion. Yet, the investments have proved their mettle, delivering solid returns with negligible default rates.

Issuance has rebounded since 2012, and by the first three quarters of 2017 had reached $82 billion in the dominant U.S. market, according to Thomson Reuters, **Wells Fargo** (NYSE: WFC). In Europe, €12 billion ($14 billion) in CLOs was issued in the first three quarters, within striking distance of the 2016 post-crisis high mark of €16.5 billion, though still significantly below pre-crisis levels. In total, the U.S. and Europe accounted for $543 billion in CLOs as of the third quarter, with the U.S. comprising 87%.

The leveraged loan market that CLOs draw from has also been on a tear, with volume up more than 50% in the U.S. in the first nine months of 2017 to approach $500 billion and a record year, according to Leveraged Commentary & Data. The Alternative Credit Council figures the entire private debt market could pass $1 trillion by 2020, up from $600 billion in 2016. "The industry's growth," it wrote, "underscores the increasing influence private credit is having on financing the economy at large."

### CREDIT TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 3 | 3 | 6 | 10 | **12** |
| Combined Value ($M) | $172 | $267 | $252 | $741 | **$1,702** |
| Total Seller AUM ($B) | $22 | $15 | $29 | $55 | **$96** |
| Average Deal Size ($M) | $57 | $89 | $42 | $74 | **$142** |
| Average Seller AUM ($M) | $7,373 | $4,933 | $4,867 | $5,544 | **$8,019** |

Source: Berkshire Capital Securities LLC

The demand for credit-related products has made the companies or platforms in the industry a hot item among deal-makers, who kicked off an ongoing shopping spree in 2010 led by private equity firms such as **Blackstone Group** (NYSE: BX), **Carlyle Group** (NASDAQ: CG) and **Fortress Investment Group**. At Blackstone, for example, AUM in the credit business nearly doubled to $100 billion (including dry powder) between the third quarters of 2012 and 2017, with the firm having launched 11 CLOs totaling $6.3 billion in the 12 months through September 2017.

Last year, deal making in the credit space remained robust, drawing a range of investment firms. For credit firms weighing sales, there's been an additional push of late in the form of the Dodd-Frank Act Risk Retention Rule covering asset-backed securities, which commenced in 2016. This rule, mandating that firms sponsoring such products hold a minimum 5% stake, has created a stress on capital for some manufacturers but opportunity for acquirers. In a busy 2017, **Marble Point Credit Management** was first out of the blocks with the January acquisition of **American Capital CLO Management**, which manages $3.4 billion in assets across eight CLOs. Marble Point and its affiliates gained a majority holding in seven of those CLOs. Marble Point was established in 2016 with a focus on senior secured loans, in partnership with 5-year-old CLO investor **Eagle Point Credit Management** and including **Sumitomo Mitsui Trust Bank** as an investor. The company said the deal "accelerates its business plans" and diversifies and expands its investor base.

**Neuberger Berman**'s alternatives investment arm, **Dyal Capital Partners**, took minority stakes in four credit managers, with the final one in 2017 involving **Cerberus Business Finance**, which manages $14 billion of capital through an established middle-market lending platform. CBF is owned by **Cerberus Capital Management**. The Wall Street Journal cited sources that placed the valuation of CBF at "about $2 billion." Dyal also invested in fast-growing **Sound Point Capital**, a diversified credit-oriented hedge fund with $14 billion in AUM, double the level in 2015. The capital will be used to fund growth, including an investment in the Sound Point CLO fund, launched in 2015 to address the Dodd-Frank rule. Sound Point called the investment "a significant event" that provides "access to Dyal's global resources and permanent capital." Dyal's two other transactions were with **Atalaya Capital Management**, a New York private credit and special opportunities firm, and San Francisco's TSSP, a global credit investor.

There was a series of transactions involving two publicly traded middle-market credit managers, Boston's **NewStar Financial** (NASDAQ:NEWS) and Connecticut's **Fifth Street Asset Management** (OTCMKTS: FSAM). The deals began between the two firms, with NewStar paying $16 million, net $13 million of assumed debt, for Fifth Street's CLO business (AUM: $726 million). Fifth Street said it lacked the scale to continue the business. Subsequently, **Oaktree Capital Group** (NYSE: OAK) paid $320 million in cash to acquire the investment management contracts for two Fifth Street-sponsored business development companies. Oaktree called BDC management "a clear strategic fit" that creates "a BDC platform with scale that leverages our deep credit expertise."

Following that, New York's **First Eagle Investment Management** acquired NewStar, an internally managed BDC, for around $515 million (based on NewStar's float as of the third quarter). First Eagle, a privately held diversified

asset manager with $116 billion in AUM, gains $7.3 billion in AUM across multiple credit funds, though NewStar agreed to sell a $2.4 billion loan portfolio to Blackstone's **GSO Capital Partners** credit unit. NewStar and GSO plan to maintain a collaborative relationship. NewStar said the sale is in line with its strategy of transforming "from a balance-sheet-driven commercial finance company into an investment manager of third-party assets." In 2015, Blackstone Group and **Corsair Capital** teamed up to buy a majority stake in First Eagle.

**New York Life Insurance** continued its steady acquisition strategy by assuming a majority stake in **Credit Value Partners**, an opportunistic, distressed and high-yield manager. The firm's AUM has climbed more than threefold since 2013 to $2.5 billion, including CLOs. New York Life, which made the acquisition through its asset management unit, said the deal adds another alternative platform for its clients and "align(s) with the income generation needs and total return profile of our investor base." Credit Value said the connection to its new parent will "enhance [its] access to capital and investment opportunities." Credit Value was created by **Credit Suisse** before being spun out in 2010 with seed capital from its former parent. Two other U.S. deals with CLO-focused targets saw **Pretium Partners** acquire **Valcour Capital Management** (AUM: $1 billion) and **Pine Brook** buy **Triumph Capital Advisors** (AUM: $1.5 billion).

In Europe, **LGT Capital Partners** of Switzerland acquired **European Capital Fund Management**, a London- and Paris-based manager with $740 million in AUM. European Capital manages senior debt, unitranche, subordinated debt and equity co-investments in small and mid-size European companies. The combined **LGT European Capital** defines its investment style as placing "a strong emphasis on capital preservation" while seeking to generate "attractive" risk-adjusted returns. As one example of European Capital's portfolio, in 2015 the company established the €474 million ($550 million) European Capital Private Debt fund focused on middle-market companies in Western and Northern Europe, with an investment target of from €5 million to €100 million. European Capital was briefly part of **Ares Capital Corp.** (NASDAQ: ARCC) after that company's 2016 acquisition of its parent, **American Capital** (NASDAQ: ACSF). LGT's deal follows two wealth acquisitions it made in 2016.

In a transatlantic deal with a European target, **British Columbia Investment Management** acquired a majority of London's **Hayfin Capital Management**, a European direct credit firm for mid-sized companies (AUM: €8.2 billion). BCIM, which concluded the deal with Hayfin's institutional shareholders, has also committed to investing "significant capital" in Hayfin funds. Hayfin said the link to BCIM will "provide the access to capital" that will allow it to become "Europe's leading credit platform." In its latest fundraising for a special opportunities fund, completed last July, Hayfin attracted commitments of €2.2 billion. The fund will invest in illiquid, undervalued hard assets and corporate debt across a range of sectors and asset profiles such as rescue financings.

## HEDGE FUNDS / PRIVATE EQUITY

One of the more unusual buyers in the recent history of asset management M&A surfaced last year to cut one of the largest deals: **SoftBank Group** (TYO: 9984), which paid $3.3 billion in cash for hedge fund and alternatives manager **Fortress Investment Group**. Led by brash billionaire Masayoshi Son, SoftBank is a Tokyo-based technology and telecommunications firm with holdings such as Sprint and Yahoo! Japan. Why would such a firm suddenly buy an alternatives manager?

The usually extroverted Son wasn't providing many clues, but analysts searching for the deal's logic looked to the introduction of SoftBank's $100 billion Vision fund, a tech-focused investment vehicle that has drawn significant funding from Saudi Arabia's **Public Investment Fund**, among others. Son, they deduced, was seeking to build an asset management arm that can offer wide-ranging expertise for the Vision fund while also drawing capital from the institutions he engages with. A half year after the February deal, Bloomberg added more intelligence, saying "people familiar with the matter" were reporting that SoftBank was considering additional acquisitions of financial firms and was seeking to build an asset management unit with $300 billion in AUM, including the Vision fund.

SoftBank paid a 51% premium to Fortress' three-month volume-weighted average price to gain $70 billion in AUM built on a diversified alternatives business and the **Logan Circle Partners** fixed income unit (AUM: $34 billion), which it divested soon after (see Traditional Investment Management). As Fortress left the public markets, its 10-year experience was a decidedly disappointing one: The stock suffered a steady decline following an initial pop, and management became frustrated by what it viewed as an undervalued share price. Fortress' three principals agreed to continue leading the firm and committed to investing 50% of their after-tax transaction proceeds in Fortress funds and vehicles.

Two other notable deals in the sector took place in an ever-consolidating fund of hedge funds arena that has faced considerable headwinds since the financial crisis, with overall assets in these firms having dropped by more than half between 2008 and the third quarter of 2017 to $310 billion, according to BarclayHedge. The leading transaction was the merger between **KKR & Co.** (NYSE: KKR) unit **KKR Prisma** and **Pacific Alternative Asset Management Co.** with the subsequent creation of PAAMCO Prisma Holdings. Employees hold the majority

## HEDGE FUND / HEDGE FUND OF FUNDS TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 19 | 7 | 10 | 11 | **10** |
| Combined Value ($M) | $755 | $76 | $986 | $1,874 | **$1,011** |
| Total Seller AUM ($B) | $71.1 | $7 | $98 | $89 | **$71** |
| Average Deal Size ($M) | $40 | $11 | $99 | $170 | **$101** |
| Average Seller AUM ($M) | $3,743 | $1,000 | $9,818 | $8,108 | **$7,115** |

Source: Berkshire Capital Securities LLC

of equity in the new firm while KKR has a minority share "as a long-term strategic partner." PAAMCO Prisma has $34 billion in liquid alternative assets under management and advisement, two-thirds from PAAMCO. The two firms will maintain their brands and offices while collaborating on new investments. "This is about bringing together two strong players with complementary capabilities and products to become a top-five player in the liquid alternatives space," Scott Nuttall, co-president and co-chief operating office at KKR, told *Pensions & Investments*.

In the second fund of funds deal, China's aggressive and controversial **HNA Group** (000616.CN) and Washington, D.C.-based **RON Transatlantic** announced the acquisition of a majority stake in New York's **SkyBridge Capital**, with $12 billion in assets under management and advisement for institutional and retail clients. The Wall Street Journal reported that SkyBridge was valued at $200 million. SkyBridge founder Anthony Scaramucci divested the stake ahead of joining the Trump administration, but his tenure there proved to be short-lived. Meanwhile, as the White House scrutinized Chinese investment in U.S. companies, the deal had yet to be approved by last December — 11 months after the announcement. HNA, a conglomerate that made multiple investments in non-Chinese financial firms last year, said the link to SkyBridge "is an important step in [our] strategy to build a global asset management business."

In smaller deals, **Neuberger Berman** acquired Toronto's **Breton Hill Capital** (AUM: $2 billion) in a bid to enhance its quantitative investment capabilities, saying "few have the research and investment platform, technology and creativity to navigate markets as they [Breton Hill] do." Breton Hill said Neuberger will provide "the deep resources of a large, global investment firm" along with a private ownership structure that "promotes stability and long-term success." Breton Hill was launched in 2011 with $100 million in funding from the **California Public Employees' Retirement System**, which three years later began divesting its hedge fund portfolio. **White Oak Equity Partners**, a private equity firm that targets minority investments in hedge funds, acquired an interest in **ROW Asset Management**, a systematic quant global macro fund with $800 million in AUM. White Oak, based in New York, focuses on firms with less than $2 billion in AUM and seeks to assist them with global distribution. **Franklin Resources** (NYSE: BEN) acquired macro-focused quant fund **AlphaParity**, which has $500 million in AUM in custom portfolios for institutions, family offices and other alternative managers. For Franklin, the deal tracks its strategy of acquiring "small, yet highly experienced asset management teams that complement [our] global offerings."

The private equity industry continued to benefit from an influx of capital in search of long-term returns, with $731 billion having been raised from fund closures between 2016 and the 2017 third quarter and dry powder reaching a record $954 billion by last September, or $100 billion more than at the start of the year, according to Preqin. In the first three quarters, private equity firms accounted for $212 billion in deals, or about one-tenth of global M&A, according to Thomson Reuters.

Among firms targeting private equity companies, two high-profile buyers acquired minority shares through dedicated investment funds. One was **Goldman Sachs**, which was joined by Kuwaiti social security fund **Wafra Investment Advisory Group** in buying a stake in an established energy infrastructure specialist, **ArcLight Capital Partners**. Goldman cut the deal through its $1.5 billion Petershill II fund, which invests in mid-market hedge fund and private equity managers. Based in Boston, ArcLight has invested $19 billion in more than 100 transactions since its founding in 2001. Last September, for example, an ArcLight affiliate acquired a 30% interest in the company that owns the 400-mile Olympic Pipeline running through Washington and Oregon. Wafra also acquired a minority stake in San Francisco-based private equity firm **TSG Consumer Partners**.

In the second such deal, **Blackstone Group** acquired a minority stake in **Leonard Green & Partners** of Los Angeles through the $3.3 billion Blackstone Strategic Capital Holdings, which takes minority shares in alternative managers. Leonard Green, founded in 1989, primarily invests in companies providing services to the consumer, business and health care industries, as well as retail. A 2016 retail investment involved Signet Jewelers, the world's largest retailer of

## PRIVATE EQUITY FUND TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 8 | 7 | 6 | 10 | **12** |
| Combined Value ($M) | $789 | $354 | $910 | $638 | **$4,193** |
| Total Seller AUM ($B) | $52 | $39 | $36 | $78 | **$116** |
| Average Deal Size ($M) | $99 | $51 | $152 | $64 | **$349** |
| Average Seller AUM ($M) | $6,478 | $5,533 | $5,973 | $7,825 | **$9,679** |

Source: Berkshire Capital Securities LLC

diamond jewelry. That same year, the company closed the Green Equity Investors VII fund with $9.6 billion in committed capital.

In Europe, **Schroders** (LON: SDR) acquired **Adveq Holdings**, a Swiss-based private equity manager with more than $7 billion in client commitments, primarily from Swiss and German investors. Adveq specializes in the buyout of small and medium-sized enterprises. Schroders said the addition, which brings its private assets business to $20 billion in AUM, complements its existing alternative capabilities in real estate and infrastructure finance. Schroders views private assets as one of its key opportunities, particularly in Europe where institutional demand is strong. At an investor meeting last October, John Troiano, global head of distribution at Schroders, referred to the Adveq deal and told the group "we see quite a few opportunities to acquire capabilities within Europe."

## SECURITIES INDUSTRY & MARKET STRUCTURE

Set against a backdrop of impending MiFID II (Markets in Financial Instruments Directive), the Trump administration's long-awaited legislative agenda including tax reform, and a continuation of one of the longest bull markets and lowest volatility periods on record, the operating environment for securities industry and market structure ("SIMS") participants in 2017 was generally characterized by muted trading volumes, a light but rebounding U.S. IPO calendar, and another robust year for global M&A activity. Consolidation activity within the SIMS segment remained consistent with 69 announced transactions in both years while aggregate deal value decreased to $10.4 billion in 2017 from $14.2 billion in 2016.

Several secular themes drove consolidation activity in 2017, including the ongoing quest for scale among full-service mid-size investment banks, including a higher percentage of total revenues coming from advisory services; the quest for cross border capital markets, advisory, trading and research capabilities; and an increased interest in non-fundamental proprietary research, including macro and systematic offerings. Achievement of scale economies remained an almost universal objective among boutique and mid-size firms as the cost of doing business appeared to continue to outpace organically generated top-line growth.

Among acquirers, regional banks and insurance companies were largely absent due largely to a continued focus on core competencies and compliance with stricter capital and regulatory requirements. Selective super-regional banks sought specialized bolt-on capabilities within their wholesale and corporate banking operations while steering clear of transformative transactions beyond their core banking footprint. Specialized advisory firms selectively tinkered with diversification opportunities within areas such as capital markets and asset and wealth management. Exchanges continued to focus on expanding data and analytics offerings, while institutional trading firms tended to prioritize asset class expansion and selective investment banking offerings. Generally speaking, we expect these themes to continue to drive consolidation dialog and transaction activity for the foreseeable future.

One of the more notable combinations of 2017 involved the acquisition by Los Angeles-based **B. Riley Financial** (Nasdaq: RILY) of **FBR & Co.** (Nasdaq: FBRC), an Arlington, Va.-based full services investment bank with a long and storied history in the private placement and Rule 144A marketplace. In recent years, B. Riley built impressively on its small and mid-cap investment banking roots through prudent and selective opportunistic acquisitions, including its 2014 combination with **Great American Group**. Through that transaction, B. Riley added a specialized and uncommon retail inventory and alternative asset liquidation advisory capability while utilizing a reverse merger transaction structure to go public. With highly regarded capital markets capabilities, including a leading book-running manager of U.S. IPOs for small-cap issuers, FBR added significantly to B. Riley's portfolio of research, distribution, trading and investment banking businesses.

The transaction followed a months-long strategic review by FBR's board and resulted in approximately $160 million of value to FBR shareholders inclusive of the common shares issued by B. Riley and special dividend to the FBR shareholders. At the time of the announcement, B. Riley stated that the combination creates a "clear leader" in the small-cap investment banking and brokerage segment, with an expanded footprint and little overlap. On a combined basis, B. Riley has approximately 600 companies under coverage (notably, there were only 17 overlapping names) and remains focused on small and mid-cap corporate clients along with institutional investors active in this segment. The combined firm had pro forma 2016 revenue of $325 million, and a strong presence on both coasts. Praising the "great strategic and cultural fit," B. Riley Chairman and CEO Bryant Riley said his firm "will enjoy an increased capital base as well as meaningful revenue and expense synergies."

Shortly after the FBR transaction, B. Riley executed a definitive agreement to acquire Memphis-based **Wunderlich Securities** for $67 million. Wunderlich was formed in 1996 by Chairman and CEO Gary Wunderlich and sold a minority interest to private equity firm **Altamont Capital Partners** in 2013, supported by an aggressive growth and

### SECURITIES INDUSTRY & MARKET STRUCTURE TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 75 | 110 | 79 | 69 | **69** |
| Combined Value ($B) | $6.1 | $14.1 | $13.2 | $14.2 | **$10.4** |
| Average Deal Size ($M) | $175.5 | $257.5 | $357.8 | $568.0 | **$346.1** |

Source: Berkshire Capital Securities LLC

## INVESTMENT BANKING ADVISORY FIRM TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 9 | 14 | 17 | 18 | **17** |
| Combined Value ($M) | $4 | $957 | $3,916 | $202 | **$1,828** |
| Average Deal Size ($M) | $3.6 | $191.3 | $559.4 | $40.4 | **$609.4** |

Source: Berkshire Capital Securities LLC

expansion plan. Wunderlich added an attractive retail and institutional brokerage business, including 200 retail advisors, while strengthening B. Riley's small-cap research capabilities with approximately 200 companies under coverage in complementary industry sectors. Through its wealth management and advisory business, Wunderlich added 37,000 client accounts and approximately $10 billion of assets under administration. At the time of the announcement, B. Riley noted Wunderlich's "stable, steady cash flow" as a source of balance for its existing "high-margin, episodic liquidations and capital markets businesses." For the 12-month period through March 2017, Wunderlich generated revenues of $117 million.

**Baird Financial Group**'s acquisition of macroeconomic research firm **Strategas Research Partners** was particularly notable given both the immense potential represented by this strategic tie-up and the very timing of the transaction in the face of MIFID II. With a history dating back to 1919, Baird is proudly independent and entirely employee-owned with a significant number of its 3,400 employees on the ownership roster. Since its 2004 acquisition of a majority interest of its own shares from the **Northwestern Mutual Life Insurance Company**, Baird has grown through a responsible combination of solid organic growth and well-timed, opportunistic acquisitions. Now an international asset and wealth management, investment banking and capital markets firm with offices in the U.S., Europe and Asia, Baird serves the needs of individual, corporate, institutional and municipal government clients with more than $170 billion of client assets under management or administration. Strategas's award-winning proprietary content, high-caliber sales team and approximately 600 institutional clients were viewed by Baird to be highly complementary of its own fundamental research and distribution platform.

## INSTITUTIONAL BROKER-DEALER TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 26 | 34 | 26 | 12 | **13** |
| Combined Value ($M) | $2,754 | $3,770 | $4,205 | $286 | **$1,543** |
| Average Deal Size ($M) | $196.7 | $198.4 | $382.3 | $95.4 | **$171.4** |

Source: Berkshire Capital Securities LLC

**PNC Financial Services Group**'s (NYSE: PNC) recent announcement of its intent to acquire specialized investor relations and corporate communications advisory firm **The Trout Group** illustrated PNC's continued prioritization of value-added corporate advice to supplement the capabilities of both **Harris Williams & Co.** (middle market M&A advisory services) and **Solebury Capital** (IPO advisory services), two highly successful acquisitions.

**KeyCorp** (NYSE: KEY), the 29th largest U.S bank holding company with approximately $140 billion of total assets as of June 30, 2017, had previously acquired TMT specialist Pacific Crest Securities in 2014 to bolster its technology research, distribution and investment banking capabilities. In announcing the acquisition of closely-held New York-based **Cain Brothers**, Key will significantly enhance its healthcare advisory and capital markets capabilities. Cain Brothers' long-running expertise in healthcare public finance has been augmented in recent years by an emerging M&A advisory practice. Having completed the integration of its $4.1 billion **First Niagara Financial Group** acquisition in early 2017, Key appeared to refocus its efforts once again on bolstering the investment banking capabilities of its Key Capital Markets operations.

In cross-border action, Japan's **Daiwa Securities Group** acquired two U.S.-based advisory specialists as part of a consolidation and expansion initiative. Following the closing of the transactions, both **Sagent Advisors** and **Signal Hill Holdings** will be combined with the existing U.S.-based operations of Daiwa and rebranded **DCS Advisory** as a "growth economy" focused global investment bank. Prior to the transactions, Daiwa held a minority equity interest in Sagent. Sagent's clients include emerging and middle-market companies in a range of industries while Signal Hill specializes in technology and telecommunications M&A advisory services. On a consolidated basis, DCS will have a team of 100 investment bankers. "Cross border M&A involving Japanese corporations has grown significantly over the past 10 years, and we believe that this transaction is an excellent opportunity to bolster our global advisory capabilities," said Seiji Nakata, president and CEO of Daiwa Securities. According to **JPMorgan Chase & Co.**, outbound cross border deals amounted to 57% of Japanese total M&A ($198 billion) in 2016, up 12 points since 2011. But in a reference to the market opportunity, Daiwa noted that annual cross border M&A volume between Japanese and U.S. corporations is less than one-tenth of Europe/U.S. volume. In reference to the market opportunity, Daiwa noted that annual cross border M&A volume between Japanese and U.S. corporations is currently less than one-tenth of Europe/U.S. volume.

## FULL-SERVICE INVESTMENT BANK TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 4 | 13 | 5 | 6 | **8** |
| Combined Value ($B) | $30 | $1,072 | $1,760 | $3,315 | **$698** |
| Average Deal Size ($M) | $14.9 | $153.1 | $440.0 | $1657.4 | **$116.4** |

Source: Berkshire Capital Securities LLC

Among other 2017 transactions, there were three interesting niche transactions involving specialized advisory boutiques. The acquisition by Los Angeles-based investment bank **Houlihan Lokey, Inc.** (NYSE: HLI) of **Black Stone IP, LLC**, a boutique specializing in valuing and trading patent and other intellectual property assets, reflected the degree to which mainstream investment banks and larger specialized advisory firms will search for unique specialized advisory capabilities in order to fill capability gaps, engineer a differentiated range of capabilities, and protect and grow market share. Since its founding in 2013, Black Stone IP has executed more than 100 transaction and advisory projects for clients worldwide. Houlihan Lokey said intellectual property "is increasingly regarded as an asset class deserving the attention of boards and investors across many industry sectors, and companies are recognizing that significant value exists in these assets." Houlihan Lokey's largest business unit is corporate finance, incorporating mid-cap company M&A, capital markets advisory services, and illiquid financial assets solutions. In the first six months of its fiscal 2018 year, corporate finance accounted for 59% of the company's $460 million of revenues.

Consistent with this theme, Chicago investment bank **Stout Risius Ross** acquired the assets and certain liabilities of **FMV Opinions**, an established valuation advisory firm focused on the trust and estate community. Stout said the deal "solidifies" its estate and gift tax practice in the U.S. as "the market-leading" valuation provider for wealthy individuals. In addition, two investment banks and consultants with five decades of experience in the community bank market teamed up in a strategic merger when Louisville's **Professional Bank Services** and **Austin Associates** of Toledo, Ohio, agreed to combine. "The depth of experience of our professional team along with the complementary services of our respective firms creates an unmatched resource for community banks," Austin said. In the nine months after the completion of the merger in January 2017, the combined firm acted as advisor in nine community bank deals in states such as Montana, Tennessee and West Virginia.

In the independent broker-dealer sector, three notable acquisitions included **LPL Financial**'s (NYSE: LPL) purchase of **Prudential**'s U.S. independent broker-dealer network; **Ameriprise Financial**'s (NYSE: AMP) acquisition of **Investment Professionals**; and **Lee Equity Partners**-backed **Atria Wealth Solutions**' acquisition of **CUSO Financial Services** and its sister company, **Sorrento Pacific Financial**. In the former, the UK insurer said the sale reflected a focus in North America on retirement products. LPL paid an upfront price of $325 million that could climb to as much as $448 million depending on the percentage of advisor production transferred. LPL estimates the transaction may generate $75 million to $100 million of incremental run-rate EBITDA. The Prudential network comprises four entities with a total of 3,200 advisors, 1.5 million accounts and $124 billion of client assets. LPL said the transaction adds scale that it can leverage to provide its existing and acquired advisors "with the capabilities they need, and the service they expect, at a compelling price."

In acquiring Investment Professionals, Ameriprise Financial gains a San Antonio-based independent broker-dealer specializing in the on-site delivery of investment advice to financial institutions, including banks and credit unions. IP has 200 advisors, $8 billion of client assets and operates in 29 states. The company said pairing its "community bank culture" with Ameriprise's resources and products "will open the door to extensive opportunities in the financial institution investment business." For Ameriprise, the transaction meets a strategic initiative of adding new advisors while creating a new business channel. The deal by Lee Equity Partners-backed Atria Wealth Solutions was notable for its implication for private equity interest in consolidation opportunities within the broker-dealer channel. Atria, a wealth management solutions holding company founded in 2017, gains two established San Diego-based firms with approximately $30 billion of client assets with its acquisition of CUSO Financial Services and Sorrento Pacific Financial.

## DISCOUNT / ELECTRONIC BROKER TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 7 | 7 | 9 | 5 | **8** |
| Combined Value ($M) | $267 | $257 | $66 | $2,522 | **$244** |
| Average Deal Size ($M) | $89.1 | $85.8 | $22.0 | $1,261.0 | **$81.2** |

Source: Berkshire Capital Securities LLC

M&A in the electronic market-making and high frequency trading ("HFT") sector remained active, as an industry beset by sharply falling revenues, slim margins and expensive technology continues to consolidate. **Deutsche Bank** (NYSE: DB)

## RETAIL BROKERAGE FIRM TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 12 | 16 | 7 | 10 | **4** |
| Combined Value ($B) | $1.5 | $5.6 | $1.1 | $3.1 | **$3.6** |
| Average Deal Size ($M) | $245.7 | $704.5 | $562.8 | $511.8 | **$1,799.5** |

Source: Berkshire Capital Securities LLC

estimated in a 2016 report that revenues from U.S. equities trading among HFT firms dropped from $7.2 billion to $1.3 billion between 2009 and 2014, hammered by competition and lower volatility. By 2017, the Tabb Group figured revenues had declined to $850 million. There were several HFT-related transactions last year with the most notable involving two publicly traded companies: **Virtu Financial**'s (Nasdaq: VIRT) $1.4 billion cash acquisition of **KCG Holdings**. The transaction was facilitated by a $750 million equity investment from several major institutions.

KCG added a strong position in wholesale market-making and independent agency execution to Virtu's liquidity and order-routing capabilities and placed Virtu within striking distance of market leader **Citadel Securities** for U.S. equities trading volume, with a 20% share. Virtu said it expects to migrate trading for the combined company on to one platform. The combination is also expected to generate significant economies, amounting to $208 million in net pre-tax expense savings and $440 million in capital synergies within two years. Virtu CEO Douglas Cifu emphasized that the transaction was taking place "at an opportune time ... given historically low points in global realized volatility, which [is] naturally cyclical." Virtu said the combination will generate 25% accretion in its earnings per share, including projected synergies.

## INDEPENDENT BROKER-DEALER TRANSACTIONS

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Number of Transactions | 4 | 8 | 3 | 6 | **5** |
| Combined Value ($M) | $147 | $1,245 | $25 | $103 | **$376** |
| Average Deal Size ($M) | $147.0 | $311.3 | $25.0 | $34.2 | **$375.6** |

Source: Berkshire Capital Securities LLC

In a smaller but high-profile deal, **DRW Holdings** acquired **RGM Advisors**, a pairing of two established, privately held and complementary firms. DRW said the combination will add strength in equities trading, research and technology infrastructure and "bolster liquidity and innovation." In 2015, DRW acquired another small HFT competitor, **Chopper Trading**. DRW founder and CEO Don Wilson worked as a trader on the Chicago Mercantile Exchange before launching DRW in 1992.

Finally, a 2017 theme made notable by relatively low level activity was that of private equity's involvement (or lack thereof) in the SIMS segment — in sharp contrast to private equity involvement in the asset and wealth management sectors, and similarly contrasting to the relatively active role played by private equity in the SIMS segment as recently as five to seven years ago. The $1.75 billion announced acquisition by a **Permira**-led consortium of premier advisory specialist **Duff & Phelps** stood out as a notable exception. The New York-based global valuation, M&A advisory and corporate finance firm offered a scaled platform with global brand recognition and a business model producing a higher percentage of recurring revenues, lower overall earnings volatility and lower capital requirements than a traditional investment banking firm. Duff & Phelps' high-profile assignments have included roles as the valuation advisor in the Lehman Brothers bankruptcy and advisor to the U.S. government's Troubled Asset Relief Program.

Duff & Phelps has been in and out of the public markets and bought and sold multiple times since 1989, with the most recent deal prior to last year involving Carlyle Group and other investors taking the company private in late 2012. This time around, investors opted for a sale on the secondary market rather than another IPO. Permira said Duff & Phelps has the scale, brand strength and "full suite of advisory and consulting services" to provide "sound, objective and independent counsel" for a range of clients facing heightened regulatory oversight, new accounting standards, and the need for "fair value and third-party valuation assessments." Permira was joined by Stone Point Capital and other investors. Duff & Phelps management retains a "significant equity stake."

# ABOUT BERKSHIRE CAPITAL

Berkshire Capital is an independent employee-owned investment bank specializing in M&A in the financial services sector. With more completed transactions in the asset management and securities space than any other investment bank, we help clients find successful, long-lasting partnerships.

Founded in 1983, Berkshire Capital is headquartered in New York with partners located in London, Sydney, San Francisco, Denver and Philadelphia. Our partners have been with the firm an average of 14 years. We are recognized as a leading expert in the asset management, wealth management, alternatives, real estate and broker/dealer industries. We believe our success as a firm is determined by the success of our clients and the durability of the partnership we help them to structure.

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