Berkshire Capital

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Passives prod deals

BlackRock, whose AUM has nearly doubled to $5.1 trillion since the 2009 acquisition of Barclays Global Investors and its **iShares** exchange traded fund business, is making a shift in at least one part of its actively managed equity business that elevates computers to the pole position. In March, the New York giant announced it was "harnessing the power of 'human and machine'" to position that business "for the future of active management ... to drive sustainable alpha."

BlackRock's embrace of the quant life reflects lagging performance and years of negative outflows in its active equity portfolio, but also underlines the company's intent to simultaneously manage expenses and clip fees on active funds. Expense ratios for active equity funds in the U.S. declined steadily between 2000 and 2015 from 106 basis points to 84 basis points, according to the Investment Company Institute. One of the affected BlackRock funds, the $1.6 billion Large Cap Core, has an expense ratio of 1.24%.

The shift involves just $30 billion in assets, or 11% of BlackRock's active equity AUM, and reportedly will cost dozens of employees their jobs. But the effort is nevertheless significant given BlackRock's status as both the world's leading ETF provider and asset manager. While its active equity business has struggled, the company's iShares and institutional index businesses grew 91% in the five years through 2016 to $3.2 trillion.

In an interview with CNBC, Chairman and CEO Laurence Fink said the change involves mainly large-cap equities and emphasized that the wealth of available information has in turn driven a need for employing greater computer power. "We are not substituting machines for humans," he said. "We are reorienting some of the human jobs in terms of doing more data science and data analysis." BlackRock will group the affected products around four buckets, including "High Conviction Alpha" and "Country and Sector Specialty."

Coming off the heels of a banner year in 2016, the passive revolution pressing active managers to review their business models continued its apparently unstoppable momentum in the first seven months of 2017, when ETFs and ETPs alone garnered a record $391 billion in net inflows worldwide, according to ETGFI, surpassing the total for all of 2016. **Moody's** projects in a recent report on the U.S. market that passive funds will overtake active funds between 2021 and 2024. "We believe that the passive phenomena is more appropriately viewed as the adoption of a new technology," said Stephen Tu, Moody's vice president. "Investor adoption of passive and low-cost investment products will continue irrespective of market environments."

Although Europeans were initially slower to adopt passive investments, ETFs and index funds are growing rapidly there, too, while new regulations are likely to accelerate the trend toward lower-cost products. In 2016, European passives drew $83 billion in net inflows compared with $48 billion in net inflows for actives while

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ETFs drew neck and neck with index funds at $583 billion, according to **Morningstar**. One key distinction between the U.S. and European ETF markets remains retail acceptance, however, with U.S. individual investors accounting for roughly half the market and Europeans just 10% to 15%.

Given that data, it wasn't surprising to see yet another megadeal among two active managers in search of scale and synergies: **Standard Life**'s £3.8 billion ($4.7 billion) acquisition of **Aberdeen Asset Management**. This transaction follows a similarly ambitious merger in 2016 between **Henderson Group** of the UK and Denver's **Janus Capital Group**, which closed in May. Standard Life-Aberdeen was one of three billion-dollar-plus transactions in the first half that included **SoftBank**'s $3.3 billion acquisition of **Fortress Investment Group** and **KKR & Co.** and **Stone Point Capital**'s purchase of a combined majority stake in wealth management aggregator **Focus Financial Partners**. On the continent, **Deutsche Bank** said it will sell a minority stake in its asset management business via an initial public offering in Germany over the next two years. The German bank made the announcement in March as part of a larger reorganization and capital raising that included an €8 billion rights issue designed to bring its common equity tier 1 ratio to 14.1%

The ETF market drew two buyers in the first half, most notably **Invesco**, which acquired a high-profile London-based ETF provider, **Source**. The deal expands Invesco's presence in Europe and complements the company's **PowerShares** ETF business, which operates primarily in the U.S. In a related vein, the **London Stock Exchange** paid $685 million in cash for **Citigroup**'s fixed income indices and analytics services, following the European Commission's rejection of its merger with **Deutsche Borse**.

BlackRock continued its tack-on acquisition strategy, assuming a "significant minority equity stake" in a 3-year-old European robo advisor, **Scalable Capital**. Scalable, with €250 million ($280 million) in assets, employs BlackRock ETFs on its platform. BlackRock also bought two energy-related funds from private equity firm **First Reserve Corp.**, while **Goldman Sachs** acquired a minority stake in energy infrastructure specialist **ArcLight Capital Partners**, making the investment through its **Petershill II** vehicle. Goldman was joined by another investor, Kuwaiti state-owned **Wafra Investment Advisory Group**.

Among active managers, buyers maintained a tilt toward more specialized firms or targets that fill a void. In one of the larger U.S. deal by assets, **Touchstone Investments** acquired **Sentinel Asset Management** with an eye, in part, on the company's small-cap and international equity funds. **OppenheimerFunds** bought **SNW Asset Management**, which adds high-quality and tax-efficient bond funds to its platform. In the credit arena, **Dyal Capital Partners**, **LGT Capital Partners**, **Marble Point Credit Management** and **New York Life Insurance** all cut deals. In one of the larger ones by assets, Marble Point acquired **American Capital CLO Management**, gaining a majority holding in seven of the eight collateralized loan obligations American Capital manages.

Chinese buyers were notable among deal makers, taking part in several investments in the U.S. This occurred even as Beijing's effort to impose capital controls put a damper on the global ambitions of mainland firms, although some companies have worked around those controls by raising capital outside China. The leading buyer was the aggressive **HNA Group**, which acquired 24.95% of **Old Mutual**'s U.S. fund manager, **OM Asset Management**, and announced it was buying a stake in New York fund of hedge funds manager **SkyBridge Capital**. HNA also bought a 9.9% stake in Deutsche Bank. At the same time, China's banking regulator in June reportedly told the nation's lenders to scrutinize the risks they face from exposure to several highly leveraged serial acquirers such as HNA. A second Chinese firm, alternatives investor **CITIC Capital Holdings**, acquired a stake in an independent San Francisco-based real estate advisor, **Stockbridge Capital Group**, building off a joint venture between the two firms.

A second transpacific real estate advisory deal saw **Mitsui & Co.** acquire a minority stake in a Los Angeles-based urban real estate and infrastructure player, **CIM Group**. In other alternative areas, **KKR Prisma** cut a significant fund of hedge funds deal through the merger with **Pacific Alternative Asset Management Co.** The union creates one of the largest liquid alternatives firms with $34 billion in assets under management and advisement. **Franklin Resources** bought a small New York hedge fund, **AlphaParity**, with Franklin Chairman and CEO Eugene Johnson telling investors during an earnings call that the addition "gives us more tools to customize within our solutions group."

The UK wealth industry continued to consolidate, led by **Old Mutual Wealth**, which cut multiple deals, including the acquisition by subsidiary **Intrinsic** of **Caerus**, a national network of advisors with £4 billion in assets under advice. In May, parent **Old Mutual** said it may do "a small initial public offering" for OMW as Old Mutual proceeds to separate its businesses into four independent units. This includes OM Asset Management, which Old Mutual called "now independent." Several smaller but aggressive UK buyers joined OMW, including **AFH Financial Group**, **Mattioli Woods** and **Succession Group**, the latter of which plans to add another 20-plus firms to reach its goal of completing 50 acquisitions by 2017-2018. In the U.S., several smaller regional and community banks added to their wealth businesses via acquisition, led by **Fifth Third Bank**. The Cincinnati bank, riding a 6% year-over-year first-quarter gain in wealth and asset management revenue, acquired **Retirement Corporation of America**, with a clientele drawn from local Procter & Gamble retirees.

In securities and market structure, **B. Riley Financial** cut two deals, paying $160 million for **FBR & Co.**, a union of two complementary firms that creates an "industry-leading small-cap investment banking and brokerage firm," and agreeing to acquire full-service investment firm **Wunderlich Securities** in a transaction valued at $67 million. B. Riley's asset management unit also gained the management rights to certain hedge funds from **Dialectic Capital**. **Ameriprise** added to its capabilities by acquiring independent broker-dealer **Investment Professionals**, which specializes in the

on-site delivery of investment advice to financial institutions. Shanghai's **China Energy Co.** agreed to pay $100 million for a minority stake in **Cowen Group**, a New York broker and investment bank. In a major deal involving two firms in the increasingly challenged high frequency trading arena, **Virtu Financial** paid $1.4 billion in cash for **KCG Holdings**, creating a combination with a 20% share of U.S. equities trading.

Money Management

Building off three years of robust deal-making in the exchange traded funds sector in the U.S., buyers continued to scour the marketplace for opportunities in the first half of 2017. Meanwhile, demand for the industry's products in the U.S. remained red hot: Inflows in the first quarter hit a record $135 billion, or more than four times the year-earlier total, according to ETF.com, which described the performance as "beyond the expectations of even the most optimistic analysts."

The big three of **BlackRock**, **State Street Global Advisors** and **Vanguard** generated inflows that matched their collective 80% share of the U.S. ETF market, but smaller providers are also benefitting. ETF.com says 18 of those smaller ETF providers recorded anywhere from 100% to 7600% growth in the 12 months through mid-March 2017. A fast-growing ETF firm outside the top 18, **Efficient Market Advisors**, was scooped up in the first half by **Cantor Fitzgerald**. EMA, which provides proprietary ETF portfolio services on behalf of financial advisors, recorded a 32% gain in assets in the first quarter alone, when the deal was announced, to top the $1 billion mark. Cantor Fitzgerald CEO Shawn Matthews said the deal continues "the buildout of our asset management business, which is an important element of the overall strategic direction of our firm."

The key deal involved **Invesco**'s cross border cash acquisition of a large and established independent ETF provider, **Source**. Based on London and founded in 2009, Source has $25 billion in AUM, including $7 billion in outsourced funds (primarily managed by **Pimco**), and a large and diverse product line. Source was majority-owned by **Warburg Pincus**, which made its original investment in 2014. Invesco is the No. 4 ETF provider globally with $127 billion in AUM through its **PowerShares** brand, accounting for 15% of Invesco's total AUM. In the company's first-quarter earnings call, Invesco President and CEO Martin Flanagan said the deal expands "the depth and breadth of our factor-based strategies and ETFs" while enhancing "[our] ability to meet the needs of institutional and retail clients" in Europe. **Morningstar** projects the European ETF market could nearly double to €1 trillion ($1.1 trillion) by 2020, driven by "favourable regulatory changes, innovation, and an increasing acknowledgement of the long-term benefits of low-cost investment solutions."

In a deal involving the passive sector, the **London Stock Exchange** paid $685 million in cash for **Citigroup**'s fixed income indices and analytics services, or 14.9 times implied EV/2016 EBITDA (enterprise value/earnings before interest, tax, depreciation and amortization). In 2014, LSE paid $2.7 billion for **Russell Investments** in a bid to greatly expand its existing FTSE International indices business and last year cut a small deal for a U.S. financial data firm, **Mergent**. The Citi deal includes the bank's World Government Bond Index, a benchmark for more than $2 trillion in assets, greatly expanding LSE's fixed income exposure. The total assets tied to LSE's benchmarks will climb from $12 trillion to $15 trillion. LSE said the deal "represents a significant step for FTSE Russell to acquire a world-class fixed income analytics and index business." LSE's information services business, largely driven by the indices unit, has been generating double-digit growth in income, which reached nearly £600 million in 2016 ($750 million at the time), or 36% of total income.

Outside the passive front, money management buyers continued to scour the landscape for specialized firms, with a number of smaller deals encompassing both equity and fixed income managers. In the U.S., several prominent players cut domestic deals, including **Alger Associates**, **Goldman Sachs Asset Management**, **OppenheimerFunds**, **T. Rowe Price** and **Touchstone Investments**.

In one of the larger such deals by assets, Touchstone acquired **Sentinel Asset Management**, adding $5.5 billion in 11 diverse mutual fund strategies to the $14 billion it already managed. Touchstone said Sentinel's retail funds and variable funds will be wrapped into existing or newly created Touchstone funds. The largest, Sentinel Common Stock (AUM: $2 billion), is a U.S. fund that focuses on companies with attractive earnings growth and strong free cash flow that manage "their capital prudently." But in an interview with MutualFundWire.com, Touchstone President Steven Graziano highlighted Sentinel's small company and international equity funds, which combined have $1.3 billion in AUM. Vermont-based Sentinel was part of **National Life Group**.

Alger acquired an established growth manager, **Weatherbie Capital** (AUM: $800 million), which pursues a bottom-up strategy targeting small- and mid-cap companies that Alger said is similar to its own. Weatherbie manages a flagship Specialized Growth institutional fund as well as two private funds for wealthy investors, including a long-short fund. Weatherbie will also wrap two smaller Alger funds into its own vehicles. Weatherbie said its clients will "benefit greatly by the scale and resources provided by [Alger's] impressive investment team and distribution network." Alger will offer Specialized Growth to financial advisors and individuals.

Two major fund managers enhanced their fixed income portfolios, with OppenheimerFunds accounting for the larger deal by acquiring **SNW Asset Management**, a 15-year-old independent firm with $2.7 billion in AUM. SNW, which serves both retail and institutional investors, said Oppenheimer's "investment boutique approach" will allow it "to maintain its independence while leveraging the resources of a larger organization." Oppenheimer said SNW's focus on high-quality and tax-efficient bonds complements its existing high-yield municipal bond platform. "It closes a big hole in our offerings for clients who want separate account capabilities and impact strategies," Ned Dane, head of

OppenheimerFunds' Private Client Group, told *Barron's*.

T. Rowe Price added $62 million in U.S. high-yield assets by acquiring **Henderson Global Investors**' Henderson High Yield Opportunities fund. The assets will be wrapped into a new fund under the T. Rowe Price name. The company said the 4-year-old load fund will complement the existing $29 billion T. Rowe Price Global High Yield fund, which has been closed to new investors since 2012. The investment team at the Henderson fund will continue to run it for T. Rowe Price, which cited "strong" demand for high-yield strategies. Nearly one-quarter of the assets in Henderson High Yield are invested in securities rated triple-C or lower. The triple-C benchmark delivered a 51% total return in the 52 weeks leading up to the deal in late February, according to Dow Jones data.

Goldman Sachs Asset Management acquired **Strategic Partnership**, one of the outsourced chief investment officer businesses of Seattle-based institutional investor consultant **Verus**. The Strategic Partnership OCIO investment team will remain with the business and become part of GSAM's outsourcing solutions business. Verus said the business absorbed an outsized amount of "operational support that wasn't core" to its mid-market institutional business. Strategic Partnership has $21 billion in assets under supervision, including from the Delta Air Lines pension plan. In 2015, GSAM acquired another OCIO provider, Pacific Global Advisors.

There were several notable cross border deals involving Chinese players on both ends of the bargaining table. In the U.S., conglomerate **HNA Group** agreed to pay $446 million in cash for a 24.95% stake in **OM Asset Management**, the U.S. fund management arm of **Old Mutual**, as part of a larger expansion into financial services outside China. HNA also announced it would buy a shareholding in New York fund of hedge funds manager **SkyBridge Capital** *(see Alternatives)*. London-based Old Mutual, which is splitting into four separate businesses, will be left with a minority stake in OMAM (AUM: $240 billion).

Canada's **IGM Financial** added to its stake in **China Asset Management** by paying $135 million for 3.9% of the company. The January deal followed on the heels of one done at the end of 2016 in which IGM paid $350 million for 10% of CAM. Mackenzie parent **Power Corporation of Canada** also acquired a 3.9% stake in January, bringing the shares held by PCC and its subsidiaries to 27.8%. PCC acquired an initial 10% stake in 2011. Founded in 1998, CAM is one of China's largest asset managers and distributors of mutual funds and other products, with $165 billion in assets, 40 million retail investors, and 400 institutional mandates. In describing the initial December 2016 deal, IGM said it provided geographical diversification and "the opportunity to participate in a rapidly growing asset management industry in the world's second-largest economy."

In a second deal, **State Street Global Advisors** and **E Fund Management** signed a memorandum of understanding to "jointly explore strategic opportunities" in China and other global markets. E Fund, based in Guangzhou, is the third-largest asset manager in China with $145 billion in AUM. SSGA said it will partner with E Fund to create multi-asset products "covering virtually every global asset class," including in its dominant passive portfolio.

Wealth Management

Focus Financial Partners, which has established itself as a leading U.S. wealth aggregator over the past 10 years, made news in the first half on the receiving end of an investment, as **KKR & Co.** and **Stone Point Capital** assumed a combined majority stake. Although ownership details were not provided, the transaction reportedly valued Focus at $2 billion. Sellers included three of the company's private equity investors. Stone Point CEO Chuck Davis said his firm plans to support Focus' expansion "with our sector expertise and deep network of relationships throughout the financial services industry." Focus' senior management team, including founder and CEO Rudy Adolph, will continue to run the business and retain "significant" equity.

Meanwhile, Focus engaged in a flurry of some 10 deals in the first half, bringing its portfolio of partner and affiliated firms to nearly 50. One month after the mid-April announcement of the KKR and Stone Capital investment, the list included the largest transaction in Focus' history for **SCS Capital Management** of Boston and New York. Founded in 2002, SCS has $16.5 billion in AUM and a focus on ultra high net worth (UHNW) clients. SCS said it had been looking for a "permanent capital partner that protects our commitment to clients and strong culture." Stone Capital has been an investor in SCS since 2012. A second deal involved a Silicon Valley UHNW firm, **Bordeaux Wealth Advisors**, with $2 billion in AUM.

Outside the U.S., Focus quickly expanded the Australian presence it established in 2016 via the then-acquisition of Melbourne's **MW Lomax Group**. In March, MW Lomax bought an established Brisbane firm, **Westwood Group**, calling it a "significant step towards driving the firm's growth plan and building its national brand."

In a continuation of recent trends, several regional and local banks added to their wealth capabilities via the acquisition of local firms, thereby enhancing the fee-based, capital-light parts of their businesses. In Cincinnati, **Fifth Third Bank** acquired **Retirement Corporation of America**, adding $460 million in AUM and a clientele drawn in part from local Procter & Gamble retirees. Fifth Third said it was drawn to RCA's retirement planning educational program, Retirement University. "Consistent with feedback we have received from clients, we are committed to providing innovative solutions to help our clients prepare for retirement," the bank said. RCA cited the opportunity to "scale our platform and reach more individuals."

In Chicago, **First Midwest Bancorp** acquired **Premier Asset Management** (AUM: $550 million), with Premier hailing the "ability to provide our clients a broader range of products" and access to its new parent's "robust network of services." First Midwest's wealth management fees have been growing at a double-digit pace in recent years and are the bank's

second-highest generator of noninterest income behind service charges on deposits. In Pennsylvania, **Meridian Bank** bought **HJ Wealth Management**, more than tripling its 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." Last year, Meridian raised nearly $14 million in a private placement to support "continued growth and expansion in the Delaware Valley." Indiana's **MainSource Bank** acquired **First Service Capital Management**, an 18-year-old wealth firm in neighboring Kentucky, one of MainSource's four markets. In referring to the First Service deal in its latest annual report, MainSource said it intends to "acquire fee-based businesses" and "hope[s] to add additional wealth practices in the next year." MainSource, which operates its wealth business through the **Raymond James Financial** network, had around $1 billion in AUM prior to the deal and registered a 12% increase in pretax wealth management income in 2016.

A transaction between two Massachusetts firms saw **Adviser Investments** add some $1 billion in assets to the $3.5 billion it already managed by acquiring **Braver Wealth Management**. Adviser Investments said the addition provides "expertise in financial planning services and tactical strategies" and allows it to "advance our mission of providing institutional-quality asset management" services. The enlarged Adviser Investments will serve 3,000 clients nationwide. Private equity firm **Rosement Investment Partners** bought a minority stake in Cleveland's **Hartland & Co.**, an established firm with $18 billion in assets under advisement for both private clients and institutions. The investment is part of a recapitalization at Hartland designed to expand employee ownership. Hartland CEO and President David Fulton, Jr., told *Crain's Cleveland Business* in 2015 he aimed to double revenues by 2018.

Bronfman E.L. Rothschild cut two deals that added a total of nearly $500 million in assets to the $4.2 billion it already held. One involved **TriCapital Advisors**, with $185 million in assets and a location that matches Bronfman's in Maryland outside Washington, D.C. "This was largely about bringing on those three [TriCapital] professionals who added to the depth of talent we have as a firm," Bronfman CEO Neal Simon told InvestmentNews. Bronfman, which made two acquisitions in 2015, said it will "keep an eye out for partners that fit well within our client service culture." A larger and more established consolidator, **HighTower**, also made multiple acquisitions that included what the firm called a "transformational" deal for **WealthTrust**. Based in Houston, WealthTrust is itself a consolidator with $6.4 billion in assets in 10 affiliates in generally smaller markets outside the coasts. The transaction brings HighTower's assets to $46 billion. HighTower said it financed the cash-only deal through a $75 million expansion of its credit facility to $245 million. HighTower cut the deal with WealthTrust owner **Lee Equity Partners**.

Alternatives

The first half of the year witnessed the initial public offering of one established alternatives firm, **Hamilton Lane**, and the acquisition of the first U.S. private equity and hedge fund firm to go public, **Fortress Investment Group**. Pennsylvania-based Hamilton Lane went public in March, raising $200 million and enjoying a 13% pop in the stock on opening day as it joined a select group of major U.S. alternative firms that have followed Fortress' 2007 lead into the public markets. Hamilton Lane also acquired a Portland, Ore.-based real assets investor, **Real Assets Portfolio Management**, with $3.8 billion in assets. Meanwhile, **SoftBank**'s $3.3 billion cash acquisition of Fortress was the second-leading transaction in the first half and capped a very active six months for alternative deals.

Although Fortress shares nearly doubled on the first day of trading 10 years ago to $35, the share price had dropped below $3 by 2008 and has languished ever since, trading under $6 prior to SoftBank's offer in mid-February. Investors in general have been cautious in valuing publicly traded alternatives firms, with the fluctuating nature of private equity businesses posing a particular challenge. In making the acquisition, SoftBank paid a 51% premium to Fortress' three-month volume-weighted average price. Fortress, with $70 billion in AUM — including a large fixed income business — will operate independently with its management team in place.

Led by deal-making Japanese billionaire Masayoshi Son, SoftBank is a technology and telecommunications firm whose portfolio of companies includes UK microprocessor company ARM Holdings, U.S. mobile phone carrier Sprint, and Yahoo! Japan. Although Softbank was vague about the strategic rationale behind the deal, it did follow on the heels of the company's recently announced SoftBank Vision fund, which could invest as much as $100 billion in technology firms worldwide. That led some analysts to suggest the addition of Fortress provides Softbank with an in-house team to assist in identifying investment opportunities. Investors in the fund include Saudi Arabia's **Public Investment Fund**, Apple and Qualcomm. Analysts also view the deal as Softbank's bid to diversify into asset management and financial services.

The credit space continued to draw dealmakers in the U.S., reflecting both the ongoing consolidation in the sector and anticipated continuing demand among investors for instruments that can provide superior yields. In the largest U.S. transaction by assets, **Marble Point Credit Management** acquired **American Capital CLO Management**, which has $3.4 billion in eight collateralized loan obligations. Marble Point gained a majority holding in seven of those CLOs. For Marble Point, a credit boutique founded in 2016 in partnership with **Eagle Point Credit Management**, the deal "accelerates its business plans and objectives" and diversifies and "significantly expand[s]" its investor base. American Capital CLO parent **American Capital** was acquired last year by **Ares Capital Corp**.

In a second transaction, **New York Life Insurance** acquired a majority stake in **Credit Value Partners** through its asset management unit. An opportunistic, distressed and high-yield manager with more than $2 billion in AUM, Credit

Value was spun out from **Credit Suisse** in 2010 with seed capital from its former parent. **New York Life Investments** called the deal "another step in [its] commitment to offering investors a broad range of alternative investment solutions" while CVP cited the opportunity to "deepen and expand our credit investment platform and maintain our business culture." **Dyal Partners** added to its large portfolio of alternative firms by taking a minority stakes in three alternative managers, the largest being **Sound Point Capital**, a credit-oriented hedge fund with more than $11 billion in AUM. New York-based Sound Capital said the investment will be used to "fund growth." Dyal, part of **Neuberger Berman**, closed its third investment fund in the first quarter, having bumped the fund's size by $2 billion to $5.3 billion during the marketing period.

There were two deals targeting Europe's structured products market. In one, **LGT Capital Partners** of Switzerland acquired **European Capital Fund Management** (AUM: $740 million), a London- and Paris-based manager of senior debt, unitranche, subordinated debt and equity co-investments in small and mid-size European companies. LGT, which made two wealth deals last year, said the acquisition will "strengthen its investment competency in private markets." Like American Capital CLO, European Capital was an affiliate of American Capital. In the second deal, **British Columbia Investment Management** acquired a majority of **Hayfin Capital Management**, a London-based European direct credit firm with €8.2 billion ($9.4 billion) in AUM. As part of the deal, which Sky News reported was worth around £215 million ($270 million), BCIM has committed to investing "significant capital" in Hayfin funds. Hayfin, founded in 2009 by **Goldman Sachs** alumni, targets mid-sized companies. BCIM acquired the shares from several institutional owners, including private equity firm **TowerBrook Capital Partners**, which had placed Hayfin on the sale block for a while in 2014. Alternative credit has picked up in Europe, with regionally focused direct lending funds having raised more than €9 billion by June, nearly as much as was raised in 2016 as a whole, according to Preqin.

A real estate-related credit initiative saw **TIAA Global Asset Management** establish a joint venture with the **Korean Teachers' Credit Union** aiming to invest as much as $1 billion in commercial real estate loans in the U.S. The venture, done through the TIAA's **TH Real Estate** unit, builds on a three-year relationship between the two firms that has involved $950 million in commercial real estate debt investment. TH Real Estate said the deal reflected the continuing demand from investors "for yield and for defensive investments at this mature stage in the real estate cycle." KTCU, established in 1971, has $19 billion in assets.

There were two significant transpacific deals in the real estate advisory sector, the first involving **Mitsui & Co.** buying a 20% stake in **CIM Group** of Los Angeles, a North American urban real estate and infrastructure fund manager with $19 billion in AUM. Mitsui cut the deal through a newly established special purpose entity, **Sabre Investments**. The transaction represents Mitsui's entry into the U.S. real estate asset management market, which the company said "will continue to be favorable mid to long term" and particularly attractive for Japanese investors facing "lasting low interest rates." Mitsui's total investment will be $450 million to $550 million, including interests in several CIM funds. Founded in 1994, CIM invests across the real estate spectrum, from core/stabilized to debt. For example, just prior to the Mitsui deal in February, CIM added to its San Francisco property portfolio with the purchase of a 143,000-square-foot office building in the city's financial district.

In the second deal, China's **Citic Capital Holdings** acquired a stake in **Stockbridge Capital**, a San Francisco firm with $11 billion in AUM across the range of U.S. real estate investments, including core, value add and opportunistic. The two firms had previously been involved in a real estate joint venture. Based in Hong Kong and founded in 2002, Citic manages $19 billion in capital, primarily in alternative investments for a range of institutions worldwide. The company launched its first property fund in 2005 targeting China, and has subsequently introduced four additional such funds, most recently in 2016 with a London focus.

There were two deals of note in the consolidating fund of hedge funds sector, including a major one involving the merger of **KKR Prisma** and **Pacific Alternative Asset Management Co.** The resulting independent company, **PAAMCO Prisma Holdings**, "will be one of the largest firms in the liquid alternatives industry," with $34 billion in assets under management and advisement, two-thirds from PAAMCO. Employees from both firms will hold a 60.1% stake while KKR Prisma parent **KKR & Co.** retains the rest. In an interview with Bloomberg, KKR Prisma co-founder Girish Reddy said clients are "looking for broader solutions than currently exist ... beyond fund of funds, such as how we can combine products and bring the fees down. That's where we see the puck going." The fund of funds sector has been losing assets since the financial crisis, as investors balk at paying an additional layer of fees to access hedge fund managers.

A second fund of hedge funds deal saw China's **HNA Group** and Washington, D.C.-based **RON Transatlantic** acquire a majority stake in **SkyBridge Capital** of New York. SkyBridge, with $12 billion in assets under management and advisement, enjoys a high profile from its annual SALT Conference, which draws a luminous crowd from the financial industry; the conference will be spun off as part of the deal. The *Wall Street Journal* reported that SkyBridge was valued at $200 million. The deal incorporated a certain amount of irony as seller and SkyBridge founder Anthony Scaramucci divested the stake in preparation for a role in the Trump administration, which has taken a strong stand against China's trade policy.

Both HNA and RON are diversified conglomerates with financial arms. HNA called the deal "an important step" in its effort to "build a global asset management business." Just prior to the January deal for SkyBridge, HNA paid $475 million for New Zealand's **UDC**, an asset finance firm that was part of **ANZ Banking Group**. HNA also assumed a minority shareholding in an independent Austrian-based alternative manager, **C-Quadrat**, with £9 billion in

AUM ($10 billion). Founded in 1991 in the living room of Alexander Schutz, chief executive, C-Quadrat took 15 years to reach €1 billion in assets. The multi-boutique has since expanded via acquisition.

Franklin Resources added a small hedge fund to its portfolio with the acquisition of **AlphaParity**, a 5-year-old New York firm founded by two alumni of **Tudor Investment**. AlphaParity pursues a risk premia strategy and manages $500 million in assets in custom portfolios for institutions, family offices and other alternative managers. In 2015, for example, the firm launched a Negative Correlation fund designed to provide downside protection in rising markets. Alpha Parity said the deal offers access to Franklin's "strong product development teams, well-established global distribution networks and deep institutional relationships." Franklin said the transaction continues a policy of "strategic investments in small, yet highly experienced asset management teams that complement [its] global offerings." In a small deal between two London firms, fund manager **Dalton Strategic Partnership** (AUM: $1.8 billion) added $230 million in AUM by acquiring long-short global equity manager **MSK Capital Partners**.

In private equity, **Goldman Sachs** acquired a minority stake in energy infrastructure specialist **ArcLight Capital Partners** via its **Petershill II** alternative investment vehicle. Goldman was joined by **Wafra Investment Advisory Group**, owned by the Kuwaiti social security fund. Since its founding in 2001, Boston-based ArcLight has invested $17 billion in more than 100 transactions, including the 2016 purchase of TransCanada's New England hydroelectric power portfolio. In 2016, the $1.5 billion Petershill II fund made four investments in alternative firms. **Dyal Capital Partners**, the alternative investment arm of **Neuberger Berman**, acquired minority stakes in three credit specialists in the first half of 2017: **Atalaya Capital Management** (AUM: $2.5 billion); **Sand Point Capital** (AUM: $11.5 billion); and **TSSP** (AUM: $20 billion).

BlackRock added to its infrastructure capabilities by acquiring two energy-related funds from **First Reserve**, a private equity energy specialist based in Connecticut. The funds, with $3.7 billion in AUM, invest in pipelines, power plants and wind farms worldwide. The deal brings total assets in BlackRock's infrastructure platform to $14 billion. BlackRock said the transaction allows clients to invest in "energy infrastructure projects that can provide income generation, diversification and inflation protection." The two firms have collaborated before, including buying a 45% interest in Mexican natural gas pipelines in 2015. The deal continues a string of alternative acquisitions BlackRock has made in recent years, including the 2012 purchase of **Swiss Re**'s European private equity and infrastructure fund of funds business.

In a deal between two Swiss firms, **Unigestion** acquired **Akina** to create a global small- and mid-cap private equity specialist with $6 billion in AUM. Unigestion manages another $17 billion in equities, multi-asset and other alternatives. Founded in 1998, Akina (AUM: $2.6 billion) complements Unigetion's global focus with a narrower lens on European opportunities while adding a U.S. clientele. Akina's flagship Euro Choice funds comprise primary, secondary and direct co-investments in Europe "driven by strong macro convictions." In the UK, **Royal County of Berkshire Pension Fund** agreed to take up to a 20% stake in alternatives firm **Gresham House**; it could pay £8.3 million ($10.1 million), or a 7% premium, for the newly issued shares. Gresham (AUM: £360 million), which trades on the London Stock Exchange, manages UK timber assets and invests in smaller British and European companies. Royal County will also be a cornerstone investor in a new Gresham fund targeted at £300 million and focused on innovation, housing and infrastructure. Royal County has some £1.7 billion in assets, 36% invested in alternatives.

Europe

Following a 2016 year in which European firms factored into the two largest asset management deals, the region registered the largest deal in the first half of 2017. As was the case with the deals last year — **Amundi**'s €3.6 billion ($3.8 billion) acquisition of **Pioneer Investments** and **Henderson Group**'s "merger of equals" with **Janus Capital Group** — **Standard Life**'s £3.8 billion ($4.7 billion) acquisition of **Aberdeen Asset Management** in March involved two traditional active managers.

As with the Henderson-Janus deal, the Standard Life-Aberdeen transaction also represents a response in part by two large, publicly traded firms to the challenges posed by passive funds. For Standard Life, the deal also fast forwards its transition from insurance to a "capital light" asset management and fee-based business. The all-share deal, under which Aberdeen shareholders will own one-third of the combined group, creates the UK's largest independent fund manager — and the second-largest in Europe — with £581 billion in AUM (Aberdeen AUM: £303) and another £79 billion in assets under administration. The two Scottish firms said the combination will generate £200 million in annual pretax run-rate cost synergies within three years.

The two firms run complementary businesses, with Aberdeen's expertise in emerging markets and tilting toward equities while Standard Life's portfolio is heavier on developed markets and fixed income, as well as alternatives. On the client side, 83% of Standard Life's AUM hails from the UK while Aberdeen has 42% of its AUM outside the UK, with continental Europe and the Americas the predominant non-UK markets. On a combined basis, 70% of AUM will be based among UK clients, but the company will have clients in more than 80 countries as well as 50 unique distribution locations.

The two firms also hope to expand their third-party insurance mandates, which account for £182 billion of pro forma AUM, with two-thirds from Aberdeen. The companies said the deal "creates a diversified asset manager with complementary investment skills and capabilities across all asset classes" that will "have a compelling and comprehensive product offering for clients and will be a leader in active investing."

While the Standard Life-Aberdeen deal grabbed the headlines, the UK wealth sector was the center of activity,

as firms of varying sizes continued to strike deals, with many targets well below the £1 billion threshold in assets and based outside London. **Old Mutual Wealth** was the biggest player, as it cut three deals, including two through subsidiaries. In the larger indirect one, **Intrinsic** acquired **Caerus**, a network of 300 advisors with £4 billion in assets under advice. In the second, **Quilter Cheviot** bought **Attivo Investment Management**, a South West England firm with £300 million ($375 million) in AUM. Quilter said the acquisition facilitated its business expansion in Southern England and was a "statement of our confidence in the UK's economy." In October 2014, Old Mutual paid £585 million for fast-growing Quilter, whose AUM has climbed by 25% since then to £20 billion. Old Mutual also added £170 million in assets via the direct purchase of **Premier Planning** and **Premier Wealth**, an established Birmingham-area advisor. The deal expands Old Mutual Wealth's network to five regional offices across England. Parent Old Mutual plans to spin off Old Mutual Wealth into a UK-focused wealth business.

While Intrinsic and Quilter Cheviot are part of a large firm, the primary UK deals occurred between small firms intent on bulking up. In a survey of wealth managers last year by **Investec Wealth & Investment**, 55% of respondents said they expected M&A activity to increase among smaller firms, with the primary drivers involving generational sales by baby boomers, technology requirements, and regulations. One such deal involving two small offshore UK firms saw **MitonOptimal International** acquire **Blythe Financial**, the second transaction MitonOptimal has done since 2016, when it acquired **Coram Asset Management**, an advisor to one of its funds. MitonOptimal said the addition of Isle of Man-based Blythe will allow it to "further focus on the many opportunities" within "discretionary management" in that market. Established in 2002, MitonOptimal has $700 million in AUM.

Several small but acquisitive British wealth managers continued to add to their growing portfolios in the first half. West Midlands-based **AFH Financial Group** cut 10 deals, including the addition in February of a London presence with the purchase of **Taylor Frost Wealth Management**. Taylor added £45 million in AUM to the £2 billion AFH already managed at the time. Publicly traded AFH announced in March it would seek to raise as much as £10 million for acquisitions and general corporate purposes via an offering of new shares. The company has set a goal of accruing some £5 billion in assets within the next three to five years.

Another growing and aggressive publicly traded firm, **Mattioli Woods**, took a 49% stake in an Edinburgh-based fund manager, **Amati Global Investors**, with the option to buy the remaining equity over two years. A small- and mid-size company specialist, Amati adds £120 million in AUM to the £1.4 billion Mattioli already managed. Based in East Midlands, Mattioli is a wealth management and employee benefits firm that has made acquisitions "a core part" of its growth strategy. Toward that end, the firm has amassed £22 million in cash. Consolidator **Succession Group** continued its aggressive expansion, cutting deals for both **Chambers Group** and **Plan4Wealth** that valued the businesses at more £10 million. The transactions added £200 million in AUM to the £4.5 billion Succession already managed (Succession's affiliated members manage another £8 billion). Based in the south west coastal city of Plymouth and founded in 2009, Succession secured an investment of £25 million from **HSBC** and related shareholders last year to "accelerate its growth strategy" of completing 50 acquisitions by 2017-2018. The company, which ultimately plans to do an initial public offering, is more than halfway toward that goal.

Lovell Minnick Partners acquired a "significant growth investment" in **Trea Asset Management**, an independent Spanish fund manager with €2.8 billion ($3.0 billion) across equities, fixed income and fund of funds. The private equity firm said the investment will support Trea's growth, including the purchase of **Banco Madrid Asset Management** (AUM: €1.3 billion). Trea distributes its products primarily through exclusive partnerships with banks. Lovell Minnick said it was drawn to Trea's partnerships and ability to develop "unique products to meet the growing demand from retail customers for higher yielding investment options."

Securities & Market Structure

One of the financial services industry's headline deals of 2016 — the proposed merger of **Deutsche Borse** and the **London Stock Exchange** — was vetoed by the European Commission in March. The EC cited competitive concerns in areas such as the clearing of fixed income instruments and single-stock equity derivatives, but the merger was complicated by the UK's Brexit vote in June of last year, which occurred three months after the deal announcement. In the wake of the EC's decision, the two exchanges focused on their futures as standalone entities while analysts pondered the potential for other exchanges to weigh bids. LSE rebounded from the Deutsche Borse parting by paying $685 million in cash for **Citigroup**'s fixed income indices and analytics services *(see Money Management)*.

That dramatic EC news aside, M&A activity in the securities and broader capital markets structure sectors was generally characterized by small and mid-size deals. In the U.S., B. Riley Financial made multiple deals, including a cash-and-shares transaction valued at $160 million to acquire **FBR & Co.**, creating an "industry-leading small-cap investment banking and brokerage firm." The combined firm will have 600 companies under coverage with limited overlap of clients, coverage and capital-raising activities, as well as expanded geographic distribution reach. FBR also adds a robust initial public offering practice: it is the leading bookrunner for IPOs involving issuers with market capitalizations of less than $1.5 billion.

The two publicly traded firms, with pro forma 2016 revenue of approximately $325 million (one-third from FBR), will have particular strength on the East and West coasts, with B. Riley based in Los Angeles and FBR in a Virginia suburb of Washington, D.C. "FBR's leadership in investment banking and its sector coverage, combined with minimal overlap on our existing brokerage business, make this a very powerful combination for our clients," said Bryant

Riley, chairman and CEO of B. Riley. Subsequently, B. Riley announced it will acquire Memphis-based full-service investment firm **Wunderlich Securities** in another cash-and-shares deal valued at $67 million. B. Riley said Wunderlich broadens its institutional and retail client base (37,000 active wealth management accounts; $10 billion in assets under administration); extends its footprint with more than 200 new financial advisors; and "creates the leading small-cap equity research platform." B. Riley said Wunderlich, with a "stable, steady cash flow business," should be accretive to 2017 earnings per share.

In a third deal, **Dialectic Capital** assigned the management rights to certain hedge funds to B. Riley's asset management unit. Dialectic Managing Director John Fichthorn was also named head of alternative investments for **B. Riley Asset Management**. Bryant Riley called the acquisition "consistent with our strategy of expanding our capital management business," which has around $1 billion in AUM. The two firms have worked with one another over the years.

Ameriprise acquired a San Antonio-based independent broker-dealer, **Investment Professionals**, with 200 advisors and $8 billion in assets. IP specializes in the on-site delivery of investment advice for 140 financial institutions, including banks and credit unions, in 29 states. Ameriprise said the firm would operate as a new advisor channel serving financial institutions. In June 2016, for example, IP partnered with New Jersey community bank **Sussex Bank** to provide investment services to the bank's newly branded retail brokerage division.

There were several U.S. deals of note involving electronic trading platforms, including high frequency traders (HFTs). In the major one, **Virtu Financial** paid $1.4 billion in cash for **KCG Holdings**. The transaction merges two HFTs that will have a combined 20% share of U.S. equities trading, about even with market leader **Citadel Securities**. KCG also adds strength in the retail wholesaler area, where it is No. 2 in market share. At the same time, the deal underlines the pressures on HFTs from lower pricing, higher costs and lower market volatility. In a 2016 report, **Deutsche Bank** estimated that U.S. revenues among HFT firms dropped sharply between 2009 and 2014 from $7.2 billion to $1.3 billion. Accordingly, Virtu noted that within two years it expects to realize $208 million in net pretax expense synergies and another $440 million in capital synergies. Publicly traded Virtu paid for the deal in part via the sale of new equity to several institutions, including Singapore's **Temasek** and **GIC**.

In the second HFT deal, **Quantlab Financial** acquired "certain technology and intellectual property assets" from **Teza Group**, as Teza quit proprietary HFT to focus on its hedge fund business. As part of the deal, Quantlab said it will create a new group charged with developing and deploying "quantitative trading strategies for global futures markets." In a deal involving corporate bond electronic trading platforms, **Trumid** acquired **Electronifie**. The combined "all-to-all" platform will serve 350 institutions, including 80% of the top-25 asset managers and 60 broker-dealers. Trumid said the acquisition "will enhance" the platform's liquidity, "increase the size and diversity of the Trumid user network and strengthen Trumid's team and technology offering." Both firms were founded in 2014, with Trumid backed by investors George Soros and Peter Thiel.

A cross border deal saw Shanghai conglomerate **China Energy Co.** agree to pay $100 million for newly issued shares amounting to a 19.9% holding in New York-based broker, investment bank and alternatives manager **Cowen Group**. Privately held China Energy also agreed to provide Cowen with $175 million in debt financing as part of the deal. Cowen, which emphasized the "long-term strategic" nature of the relationship, said it will use the proceeds to repay high-interest senior notes and to fund growth, including acquisitions. China Energy, whose financial services unit generates around one-quarter of revenues, said the deal will promote "deepened cooperation in a number of areas within the U.S. and global capital markets." Subsequently, Cowen agreed to pay $116 million for New York broker Convergex Group in a deal with private equity owner **GTCR** and **Bank of Mellon**, among other investors. Convergex is a global, agency-focused firm serving 3,000 clients. Cowen said the deal will position it as "the leading independent trading platform in equities."

In a small UK deal involving the purchase by a high-profile former banking chief of a venerable UK institutional broker and investment bank, **Atlas Merchant Capital** agreed to pay £15.5 million ($19.2 million) for **Panmure Gordon**. Atlas is a New York private equity firm targeting the financial services industry that was co-founded in 2013 by former **Barclays** head Bob Diamond. Atlas made the bid in conjunction with Qatari investment firm **QInvest**, which held a large minority shareholding in publicly traded Panmure. In discussing the sale, Panmure cited the challenges posed by a consolidating industry that also faces "an increasingly burdensome regulatory environment." Atlas said it would apply "our operational skills and financial services expertise to enhance Panmure Gordon's strong reputation and build a larger, successful boutique investment bank." ▲