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2018 FINANCIAL SERVICES INDUSTRY REVIEW

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THE WORLD BULKS UP ON DEBT

As analysts last year considered how the world had changed in the 10 years since the financial crisis, one key metric stood out: everyone owes a lot more money. Global debt reached a record \$164 trillion in 2016, or 225% of global GDP, the International Monetary Fund noted in its 2018 Fiscal Monitor report. Public debt has been an important factor in that surge, the IMF writes, “with little improvement expected over the medium term.” In developed economies, the public debt-to-GDP ratio is 105% — a level last seen during World War II — but when “implicit liabilities” for pensions and healthcare are included the number rockets to 204%.

Moody's (NYSE: MCO) provides additional sobering data, saying the level of developed countries' overall debt (including corporate and households) has risen from 348% of GDP in 2007 to 382% in the 2018 first quarter, with government accounting for the lion's share of the increase. In developing countries during the same period, the level has climbed from 145% to 211%. “Countries need to build fiscal buffers now by reducing government deficits and putting debt on a steady downward path,” writes the IMF.

While sovereign debt is the major concern, it isn't the only one. Led by the U.S. and Europe, the private sector has been on a borrowing spree, too, drawn by historically low interest rates to make acquisitions and buy back shares, in addition to investing in plants, equipment and employees. **S&P Global** (NYSE: SPGI) rates 85% of the €5.8 trillion (\$6.6 trillion) in corporate debt it tracks in Europe as investment grade, but triple-B corporate bonds — the lowest investment-grade category — accounted for 32%, on par with single-A.

In the U.S., **Doubleline** notes that U.S. corporate debt outstanding had by last year reached a record 46% of GDP. According to Moody's, U.S. outstanding triple-B bonds totaled a record \$2.8 trillion by the 2018 third quarter, exceeding the \$2.6 trillion in single-A corporates and \$629 billion rated either triple- or double-A. “Thus, from the perspective of dollar amounts outstanding, the U.S. investment-grade corporate bond market is now riskier than it was prior to each recession since 1981 and possibly all prior downturns through the late 1940s,” the credit agency writes. Outstanding U.S. high-yield double- and single-B paper rose 72% and 27%, respectively, between 2007 and the 2018 third quarter, to top \$1 trillion, according to Moody's (Caa-rated bonds totaled \$179 billion). In Europe, S&P Global puts the high-yield market at €880 billion (\$1 trillion).

Investors have kept the steady buildup of debt in their peripheral vision, preferring to focus instead on a post-crisis economic rebound and revived banking system, both of which have varied in intensity globally. They have also found solace in the fact that buyers continue to soak up bonds of all shapes and sizes, and that corporate borrowers appear largely able to manage their debts. Still, concerns have lingered about the impact of higher interest rates and/or a recession on the ability of riskier corporate borrowers to service that debt.

On the sovereign side in developed countries, the borrowing binge is coinciding with an aging population to which governments have made expensive promises.

Investors in stocks, which have enjoyed a relatively smooth ride since 2009, faced their own wall of worries last year. Primarily, these involved rising U.S. interest rates and a slowdown in global growth, as well as trade and political risks. Add to that a generalized sentiment that a correction was due after a near-10-year U.S. bull market fueled recently by just a handful of powerful tech stocks and tax cuts that juiced U.S. corporate

FEWER BUT BIGGER DEALS

MERGERS & ACQUISITIONS, ALL INDUSTRIES

| Number of Announced Deals | 2018 (vs. 2017 +/-) | |
|---------------------------|---------------------|-----------|
| Worldwide | 47,585 | (- 7.5%) |
| U.S. | 12,442 | (- 7.8%) |
| Europe | 13,729 | (- 13.0%) |
| Asia-Pacific (ex-Japan) | 13,856 | (- 1.1%) |

| Value of Announced Deals (\$B) | 2018 (vs. 2017 +/-) | |
|--------------------------------|---------------------|-----------|
| Worldwide | \$4,016 | (+ 19.2%) |
| U.S. | 1,725 | (+ 32.1%) |
| Europe | 1,006 | (+ 31.7%) |
| Asia-Pacific (ex-Japan) | 898 | (- 4.3) |

Of Which (by \$value 2018, worldwide)

| | |
|-------------------------|-----|
| Cross Border | 39% |
| Mega-Deals (\$5B-plus) | 38% |
| Within Emerging Markets | 25% |
| Financials | 10% |
| Real Estate | 9% |

Source: Refinitiv

profits. By the fourth quarter, the bears' concerns prevailed, leading stock markets to give back whatever returns they had enjoyed for most of the year and end the year in the red. *The Financial Times* figured that by mid-November global stock and bond markets had lost \$5 trillion in value in 2018. By year end in the U.S., the S&P 500 had dropped 6.2% for its worst performance since 2008. Other major indexes delivered similarly depressed numbers, with the FTSE 100 off 12.5% and the Nikkei 225 down 12.1%.

For publicly traded asset managers, the year proved particularly challenging. Sparked by concerns about profits, fee

INVESTMENT MANAGEMENT TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------------|------------|------------|------------|------------|----------------|
| Majority Equity | 126 | 139 | 160 | 176 | 211 |
| Minority Equity | 14 | 21 | 22 | 32 | 51 |
| Management Buyout | 3 | 6 | 9 | 12 | 13 |
| Total | 143 | 166 | 191 | 220 | 275 |
| Total Transaction Value (\$B) | \$26.4 | \$21.2 | \$24.0 | \$28.9 | \$41.3 |
| Total AUM Changing Hands (\$B) | 1,980 | \$1,839 | \$2,443 | \$2,086 | \$2,422 |

Source: Berkshire Global Advisors LP

SECURITIES & INVESTMENT BANKING TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------------|------------|-----------|-----------|-----------|--------------|
| Majority Equity | 90 | 67 | 63 | 54 | 62 |
| Minority Equity | 20 | 12 | 6 | 15 | 14 |
| Total | 110 | 79 | 69 | 69 | 76 |
| Total Transaction Value (\$B) | \$14.2 | \$13.2 | \$14.2 | \$10.4 | \$9.9 |

Source: Berkshire Global Advisors LP

pressures and the impact going forward of volatile markets, the Dow Jones U.S. Asset Managers index was down 20% year-to-date through the third week of November, compared with a slightly negative S&P 500. A number of major public companies were also trading at significant market discounts, and few were left untouched. Having a diversified and global portfolio was no haven against the bears — **Affiliated Managers Group** (NYSE: AMG) shares were down 47% by November — nor was a large passive business: **BlackRock's** (NYSE: BLK) shares tumbled 21%. “Asset managers are being priced almost like the industry is disappearing,” **Invesco** (NYSE: IVZ) President and CEO Martin Flanagan told the *Financial Times*. “The industry is changing but it’s not going away.”

In a more hopeful first half of 2018, several diverse asset managers went public on both sides of the Atlantic. **Deutsche Bank** (NYSE: DB) did a partial IPO on the Frankfurt Stock Exchange of its large asset management business, rebranded **DWS Group** (FWB: DWS), while British wealth manager **Quilter** (LON: QLT), formerly Old Mutual Wealth, was spun out from parent **Old Mutual** (JSE: OMU). In the U.S., two private equity-backed firms did partial IPOs: wealth aggregator **Focus Financial Partners** (NASDAQ: FOCS) and multi-boutique asset manager **Victory Capital Holdings** (NASDAQ: VCTR).

On the transaction side, in tandem with the larger M&A universe — where a record \$3.3 trillion in deals was announced in the first three quarters before ebbing in the final three months, according to Refinitiv — the asset management industry registered a record year. Transaction value was \$41.3 billion while the total number of deals was 275. As in the broader M&A world, the dollar number was driven by several \$1 billion-plus deals, but there were also multiple ones just below that threshold. The transactions were led by the fourth major consolidation deal among traditional asset managers in the last three years: Invesco's \$5.7 billion acquisition of **OppenheimerFunds**, which created another firm with more than \$1 trillion in AUM. Invesco-Oppenheimer was the largest deal since **TIAA-CREF's** \$6.3 billion purchase of **Nuveen Investments** in 2014. “Fees matter, and if you have scale you can probably be more competitive on pricing,” **Goldman Sachs** (NYSE: GS) analyst Alexander Blostein told the *Financial Times* in reviewing the industry landscape. “I would argue that \$500 billion is a starting point [for a healthy size], but even some asset managers in that range are struggling.”

The latest data from McKinsey on the North American industry underscores the importance of scale, as the consultant writes that the “gap between the haves and have-nots ... grows ever wider, particularly when viewed through the prism of organic growth.” Through that lens, the growth gap

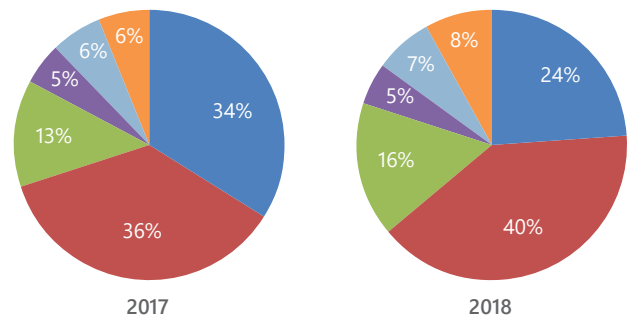
between the top- and bottom-quartile firms was 21 percentage points in 2017, a six-point increase from 2016. In Europe, the story is similar, with top-quartile firms by profit margins gobbling up 54% of net revenues vs. 21% for the bottom quartile. “The top-to-bottom profit differential has expanded considerably in recent years, and we expect the gap to widen further,” McKinsey opines about Europe.

The U.S. also accounted for the largest wealth deal, involving **Hellman & Friedman's** \$3 billion acquisition of **Financial Engines**, a retirement-focused robo advisor that H&F merged with its brick-and-mortar mass affluent provider, **Edelman Financial Services**. “Everyone’s rushing to the middle ground, and the middle ground is basically that you’re both digital and human,” **United Capital** CEO Joe Duran told *WealthManagement.com*. Canada added another chapter in its ongoing consolidation story with several major deals, the largest being **Scotiabank's** (TSX: BNS) C\$2.6 billion (\$2 billion) acquisition of **MD Financial Management**, a wealth manager serving Canadian doctors and their families. In a megadeal in Asia-Pacific, **Mitsubishi UFJ Financial** (NYSE: MUFJ) capitalized on a restructuring Australian banking industry to acquire the global asset management business of **Commonwealth Bank of Australia** (ASX: CBA) and extend its presence into Australia and elsewhere.

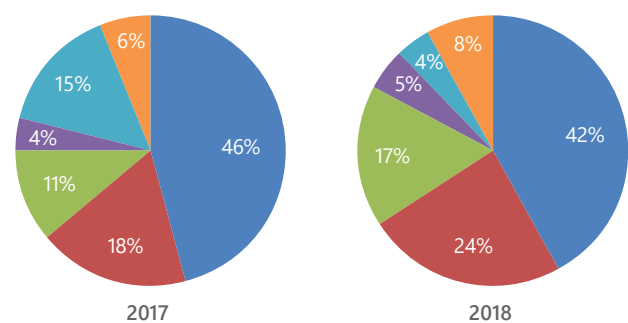
INVESTMENT MANAGEMENT

WHO'S SELLING

Number of Transactions by Sector as % of Total



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



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

Source: Berkshire Global Advisors LP

The private equity industry, sitting on some \$1 trillion in dry powder at the start of 2018 and with investors adding more capital every quarter, made its presence felt in every sector of the asset management industry, as well as the securities industry. (In the larger M&A world, private equity accounted for 19% of deal value in the first three quarters, or \$626 billion.) But the industry's greatest influence is arguably occurring within the U.S. wealth sector, where private equity-backed players have been aggressive consolidators. These include Focus Financial, which soon after its IPO made one of the largest deals in its 12-year history, paying \$235 million for **Loring Ward Holdings** of Silicon Valley, with half the price in shares. Other consolidators active last year included **HighTower Advisors**, **Mercer Advisors** and **Wealth Enhancement Group**.

The alternatives marketplace remained robust for both asset managers and deal-makers, with the demand for such products reflected in virtually every area. Take the leveraged loan market, for example. It passed the \$1 trillion mark in the dominant U.S. market last year — double

INVESTMENT MANAGEMENT

WHO'S BUYING

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------------|------------|------------|------------|------------|------------|
| Wealth Manager | 21 | 20 | 32 | 38 | 58 |
| Traditional Investment Manager | 31 | 45 | 46 | 44 | 49 |
| Financial Buyer | 8 | 21 | 26 | 25 | 42 |
| Bank | 17 | 19 | 19 | 22 | 35 |
| Insurance | 16 | 13 | 20 | 27 | 23 |
| Alternatives Manager | 12 | 9 | 14 | 15 | 17 |
| Real Asset Manager | 7 | 7 | 5 | 15 | 14 |
| Management Buyout | 3 | 6 | 9 | 10 | 14 |
| Other | 14 | 10 | 14 | 9 | 13 |
| Securities Firm | 14 | 16 | 6 | 15 | 10 |
| Total | 143 | 166 | 191 | 220 | 275 |

Source: Berkshire Global Advisors LP

the level in 2010 — while reaching \$200 billion in Europe, according to the Loan Syndications and Trading Association. **Wells Fargo** (NYSE: WFC) projected that collateralized loan obligations would register a record issuance in 2018 of \$150 billion in the U.S. The demand for alternative credit also showed up among once-shunned commercial mortgage-backed securities: Spreads between the highest and lowest credit quality paper narrowed to the lowest level since before the financial crisis, according to Trepp.

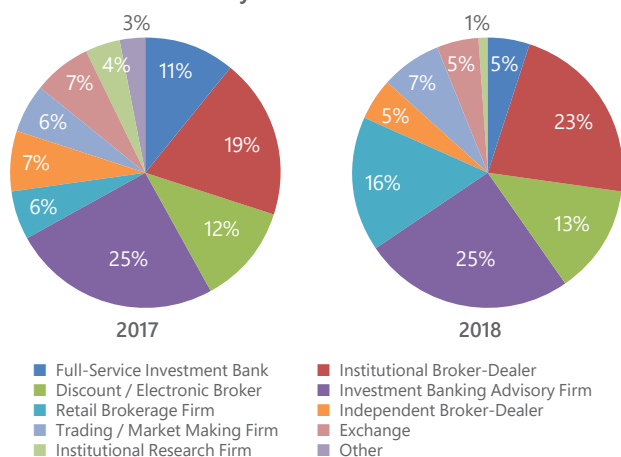
In the U.S., **Franklin Resources** (NYSE: BEN) accounted for one of the largest credit deals, paying \$683 million for a private debt/opportunistic credit and long-only liquid credit manager, **Benefit Street Partners**. In Europe, **Natixis Investment Managers** acquired one of the largest independent pan-European credit specialists, **MV Credit**, in what the French company said was “another important step” in the development of its European real assets business. A large transpacific deal saw Japan's **Orix Corp.** (NYSE: IX) acquire a U.S. middle-market loan specialist, **NXT Capital**. The investment vehicles for **Blackstone Group** (NYSE: BX), Goldman Sachs and **Neuberger Berman** were all active investors in private equity, credit and real estate firms, including a couple of joint investments. In one of those deals, Neuberger's **Dyal Capital Partners** teamed with Goldman's **Petershill** as well as **Landmark Partners** to take a minority stake in California private equity firm **Clearlake Capital Group**.

Real assets are another hot arena for investors, with real estate the dominant theme. Private equity real estate funds raised \$61 billion worldwide in the first half of 2018, according to Preqin, while dry powder in such funds reached \$290 billion. Last September, Bloomberg reported that Blackstone was aiming to raise \$18 billion for its largest-ever real estate fund. The deal-making last year was focused in the U.S. and Europe, which remained magnets for real estate investment, and featured multiple cross border transactions. A key one took place in North America, where Canada's **Colliers International Group** (TSX: CIGI) paid \$450 million for a majority of **Harrison Street Real Estate Capital**, a U.S. advisory firm focused on such demographically driven areas as student housing and healthcare. Deal-makers also targeted credit-oriented real estate asset managers, with a notable U.S. transaction seeing **Jones Lang LaSalle's** (NYSE: JLL) **LaSalle**

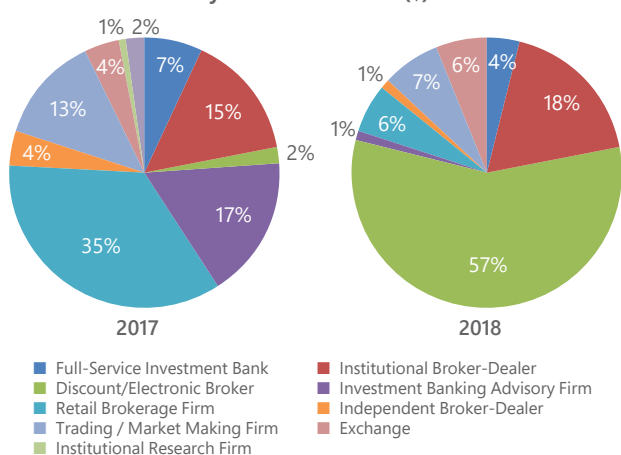
SECURITIES & INVESTMENT BANKING

WHO'S SELLING

Number of Transactions by Sector as % of Total



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



Source: Berkshire Global Advisors LP

SECURITIES INDUSTRY & MARKET STRUCTURE

WHO'S BUYING

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--|------------|-----------|-----------|-----------|-----------|
| Diversified Financial Services Company | 19 | 11 | 7 | 15 | 17 |
| Exchange | 5 | 3 | 6 | 5 | 6 |
| Independent Broker-Dealer | 1 | 0 | 2 | 2 | 6 |
| Commercial Bank | 3 | 1 | 4 | 3 | 5 |
| Discount/Electronic Broker | 3 | 5 | 4 | 3 | 5 |
| Trading/Market Making Firm | 11 | 6 | 6 | 5 | 5 |
| Full-Service Investment Bank | 23 | 12 | 12 | 2 | 4 |
| Institutional Broker-Dealer | 8 | 10 | 4 | 2 | 4 |
| Investment Banking Advisory Firm | 7 | 7 | 7 | 8 | 3 |
| Private Equity Firm | 6 | 6 | 4 | 4 | 3 |
| Insurance Company | 0 | 1 | 3 | 0 | 1 |
| Retail Brokerage Firm | 3 | 1 | 1 | 0 | 1 |
| Institutional Research Firm | 0 | 0 | 1 | 0 | 0 |
| Other | 21 | 16 | 8 | 20 | 16 |
| Total | 110 | 79 | 69 | 69 | 76 |

Source: Berkshire Global Advisors LP

Investment Management division acquire a majority of **Latitude Management Real Estate Investors**, which provides short-term, floating-rate loans for middle-market commercial real estate.

Among securities firms, the twin themes of consolidation and private equity capital drove the market last year, drawing buyers such as **Advisor Group** and **Atria Wealth Solutions**, as well as **E*Trade Financial Corp.** (NASDAQ: EFTC), which made its third deal in as many years. In a major transaction that likely topped well above the \$1 billion mark, private equity firm **Genstar Capital** made a direct investment in **Cetera Financial Group**, giving it control of the second-largest network of independent broker-dealers in the U.S. **Virtu Financial** (NASDAQ: VIRT) agreed to pay nearly \$1 billion for brokerage **Investment Technology Group** (NYSE: ITG) in its second major deal in as many years. Within the exchange industry, there was one large consolidation deal involving **CME Group's** (NASDAQ: CME) \$5.4 billion acquisition of **NEX Group**, a UK firm that gives CME control of BrokerTec, the leading fixed income electronic trading platform.

Middle-market investment bankers were also in a consolidating frame of mind, with buyers targeting specialized firms in some of the deals. "The days of the local or even regional firm are over," **Capstone Headwaters** CEO John Ferrera told Axial, an online middle-market private network. "Having scale, reach, reputation and senior people with industry experience is the ante today." Ferrera's firm, **Capstone Partners**, expanded its capabilities last year with the acquisition of **Headwaters**, merging Boston- and Denver-based independents into a more formidable middle-market competitor. Two banks in the U.S., **MUFG Union Bank** and **Fifth Third Bancorp** (NASDAQ: FITB), made acquisitions. For MUFG, the addition of **Intrepid Investment Bankers**

provides an M&A team in a similar West Coast geography. Fifth Third's purchase of **Coker Capital Advisors** delivers an M&A specialty in middle-market healthcare to complement the bank's existing capabilities in that industry.

A decade after the financial crisis, total M&A activity worldwide and within the asset management and securities and investment banking industries has rebounded in stunning fashion. Worldwide M&A transaction value was a record \$3.3 trillion in the first three quarters of 2018, up 37% vs. the same period in 2017. In 2009, the total sank below \$2 trillion, or less than half the level in 2007, and then stayed around the \$2.5 trillion mark before climbing above \$3 trillion in 2014. The value of asset management deals averaged just \$12.5 billion annually between 2011 and 2013 before turning up in 2014 and reaching a post-crisis high last year.

Asset management transactions were led by Invesco-OppenheimerFunds but included several additional megadeals, while the securities and investment banking industries weighed in with a few megadeals of their own. Among privately held smaller to mid-size firms, the deal-making of recent years was somewhat predictable based on demographics alone, as aging founders prepared to monetize a lifetime of hard work. But in the decade after the financial crisis, asset managers on both sides of the negotiating table have also been pressed to take action by fast-moving trends, among them: the passive investment revolution and the related loss of faith in active management and pressure on fees; the ongoing demand for enhanced technology; and the greater regulatory burden. If the long bull market is nearing its end, you can add that to the checklist of reasons for companies to embrace.

In considering the softer stock market scenario last year, Boston Consulting Group projects industry profits could decrease to 27% to 32% of net revenues, or five to 10 percentage points below margins as of 2017. McKinsey notes

CROSS BORDER INVESTMENT MANAGEMENT TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------------------|--------|-------|--------|--------|--------|
| U.S. - INTERNATIONAL | | | | | |
| Number of Deals | 21 | 26 | 20 | 32 | 43 |
| Value (\$B) | \$5.2 | \$2.7 | \$6.3 | \$7.9 | \$8.1 |
| INTERNATIONAL - INTERNATIONAL | | | | | |
| Number of Deals | 20 | 27 | 32 | 30 | 79 |
| Value (\$B) | \$6.5 | \$4.6 | \$6.6 | \$3.6 | \$10.6 |
| TOTAL | | | | | |
| Number of Deals | 41 | 53 | 52 | 62 | 122 |
| Value (\$B) | \$11.7 | \$7.2 | \$12.8 | \$11.5 | \$18.6 |

Source: Berkshire Global Advisors LP

CROSS BORDER TRANSACTIONS BY DOMICILE AND TYPE

| 2018 | BUYER: SELLER: | U.S. INT'L | INT'L U.S. | INT'L INT'L | TOTAL |
|-----------------------------------|-------------------|---------------|---------------|----------------|------------|
| Wealth Management | | 1 | 4 | 28 | 33 |
| Traditional Investment Management | | 7 | 8 | 24 | 39 |
| Other | | 14 | 9 | 27 | 50 |
| Total | | 22 | 21 | 79 | 122 |

| 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 |

Source: Berkshire Global Advisors LP

in a 2018 report that 88% of firms with \$1 trillion or more in AUM had positive inflows in 2017, but in that particularly robust year for markets only 45% of firms between \$300 billion and \$1 trillion enjoyed similar success. Firms from \$50 billion to \$150 billion and \$150 billion to \$300 billion were in the mid-50s percentile. Interestingly, 65% of the firms below \$50 billion had net inflows, suggesting the ability of niche players to deliver performance at the same time they face the challenges of scale.

Accordingly, smaller firms “that pick their spots, find the right partners, and leverage their competencies are on a winning path,” McKinsey writes. For the largest firms, there’s a “new logic of scale” at work, involving the “ability to marshal a set of distinctive capabilities and leverage them across the entire enterprise for competitive advantage,” as opposed to simply piling on assets. This “new logic of scale” will sustain industry consolidation “and lead to a new wave of partnerships and alliances across regions and industry segments,” McKinsey says.

The various challenges notwithstanding, enormous opportunity lies ahead. In 2017, global AUM rose 12% to \$79 trillion, according to Boston Consulting, for the strongest annual growth since 2009. The increase was assisted by record net inflows equivalent to 3.1% of AUM — double the annual average for the previous five years. In 2018, the growth will clearly be more subdued, in sync with markets, but projections for the next several years place global AUM above \$100 trillion. As Berkshire Global Advisors enters its 36th year as an independent advisory firm covering multiple industries within financial services, we once again look forward to assisting you in mapping out the best route toward a profitable future.

TRADITIONAL INVESTMENT MANAGEMENT

In the 10 years through 2017, average fee rates on U.S. equity funds declined by 28 basis points (bps) to 0.59%, according to an Investment Company Institute study released last year. By comparison, in the 10 years through 2007 — prior to the eruption of the financial crisis — the drop was 13 bps. In 2017, 43% of equity funds lowered their fees while 20% posted increases.

The fee decline has been largely driven by low-cost passive funds. For example, equity index funds have seen their share of the overall fund market more than double during the 10-year period through 2017 to 17.2%. When you add in exchange traded funds, the share of passive products in both equity and bond funds climbs to 30.3%, compared with 11.6% in 2007.

By **Morningstar’s** (NASDAQ: MORN) reckoning, in 2017 fees on all U.S. mutual funds and ETFs saw the largest annual drop on a percentage basis (8%, or 4 bps to 0.52%) since it began collecting data in 2000, driven by \$949 billion in flows into funds with fees ranking in the bottom 20% of their categories.

In Europe, new regulations and the increasing popularity of ETFs — assets more than doubled between 2013 and 2017 to €631 billion (\$740 billion), according to Thomson Reuters Lipper — are conspiring to squeeze fees, though they remain more robust than in the U.S. In its latest review of the global asset management industry, Boston Consulting Group says “pressure on margins (due to continued fee erosion and cost pressures) will persist, especially when the strong equity-market run eases or turns, as it eventually will.” When that downturn occurs, BCG suggests profits could drop to 27% to 32% of net revenues, or five to 10 percentage points below current margins.

According to BCG, domestic and global equity and fixed income active products represented 52% of global AUM in 2017, down from 76% in 2003, but the overall downward trend masks a more nuanced picture: While domestic large-cap and fixed income managers lost ground, “active specialties” such as small-cap and global managers held their own during that time period with a 19% share. Passive products, which more than doubled their share during the period to 20%, enjoyed a record 25% increase in AUM in 2017. Still, the consultant notes the flip side of that success: passives account for just 6% of industry revenue.

The nonstop growth in passive assets vs. those thin margins underlines the dilemma facing active managers, who must nevertheless respond to the ongoing changes in the marketplace. A notable example is **AllianceBernstein** (NYSE: AB), where active strategies account for around 90% of its \$550 billion in AUM. Last year, the company said it was considering launching a performance-based fee scale for its active funds in Europe following the introduction of six “FlexFee” funds in the U.S. in 2017. In the latest annual report, the company describes FlexFee as a “revolutionary new offering [that] could transform both AB and the entire asset management industry.” Underlining the related pressures to cut costs, the company also announced last year that it is moving headquarters from New York City to Nashville.

Last September, former AB Chairman and CEO Peter Kraus launched **Aperture Investors** with up to \$4 billion from **Assicurazioni Generali** (MI: GASI) to invest in strategies and an “ETF-like” fee schedule “which can only go higher when managers beat their benchmarks.” Managers will be paid based on performance, with “modest base compensation.” (Generali also announced it would acquire a majority stake in France’s **Sycomore Asset Management**, a specialist in environmental, social and governance investing.)

TRADITIONAL INVESTMENT MANAGEMENT *

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------|---------|---------|---------|---------|----------------|
| Number of Transactions | 64 | 58 | 66 | 74 | 66 |
| Combined Value (\$B) | \$20.2 | \$13.7 | \$11.3 | \$13.3 | \$17.2 |
| Total Seller AUM (\$B) | \$1,415 | \$1,380 | \$1,772 | \$1,281 | \$1,183 |
| Average Deal Size (\$M) | \$316 | \$235 | \$172 | \$180 | \$260 |
| Average Seller AUM (\$B) | \$22.1 | \$23.8 | \$26.8 | \$17.3 | \$17.9 |

Source: Berkshire Global Advisors LP

* Includes traditional institutional and mutual fund managers

Among the asset management giants that can afford to play the competitive game of how low can you go, **Fidelity Investments** introduced four new index funds with zero fees last year with an eye on rivals such as **BlackRock** (NYSE: BLK), whose stock dropped after the news, and **Vanguard**. “Pure-play asset managers that don’t have other revenue streams are probably feeling the pressure as greatly as they ever have on a day like today,” Morningstar analyst Ben Johnson told the *Financial Times* on the day of the announcement. Fidelity’s first two funds accumulated a combined \$1 billion in assets one month after their launch last August.

The institutions that have taken a harder line on fees with active managers since the financial crisis — while expanding their use of passives — were joined by the world’s largest pension fund last April, Japan’s **Government Pension Investment Fund**. The \$1.5 trillion fund introduced performance-based fees covering a three- to five-year period for its large roster of active managers “with the aim of strengthening alignment between GPIF and external asset managers,” as it wrote in its latest annual report. In the new arrangement, underperformers are relegated to passive-style fees, but as part of the shift GPIF eased restrictions on concentrated investments. Equities comprise 51% of GPIF’s portfolio, split evenly between domestic and international.

Fee compression and the longer-term shift toward passive products continue to be reflected in M&A activity among managers, including the fourth major consolidation deal in the last three years: **Invesco’s** (NYSE: IVZ) \$5.7 billion acquisition of **OppenheimerFunds** (see sidebar). There were two other deals that didn’t fit the major consolidation theme but were at the billion-dollar threshold: **Mitsubishi UFJ Financial’s** (NYSE: MUFJ) A\$4.1 billion (\$3 billion) purchase of the global asset management business of **Commonwealth Bank of Australia** (ASE: CBA); and **Victory Capital’s** (NASDAQ: VCTR) acquisition of **USAA Asset Management**, which could reach \$1 billion with contingent payments (see sidebar).

The ETF industry, which registered some 20 deals between 2014 and 2017, added several more last year, even as the limited universe of independent targets has narrowed. Buyers also continued to seek out specialists among active managers, including those making high-conviction bets in the quest to beat benchmarks. Cross border deal-making across all industries was robust last year— in the first three quarters \$1.3 trillion of such transactions was announced, according to Thomson Reuters — and numerous marquee asset managers joined in with tack-on deals across ETF and active platforms.

The tack-on approach among global managers included the newly branded **Standard Life Aberdeen** (LSE: SLA), which cut two such diverse deals last year following Standard Life’s £3.8 billion (\$4.7 billion) acquisition of Aberdeen Asset Management in 2017. That deal created the UK’s largest active manager. In the first, SLA acquired the U.S. business of New York’s **ETF Securities** (AUM: \$2.8 billion), broadening its product portfolio to incorporate commodity ETFs while expanding its U.S. platform.

“The needs of our clients are evolving, and we need to be able to offer the full range of solutions,” said Chris Demetriou, SLA chief executive-Americas. “For some, active solutions will be right and for others passive and smart beta options will be the solution.” SLA has about 11% of its AUM in the Americas region. Last year, **WisdomTree Investments** (NASDAQ: WETF) closed on its \$523 million acquisition of ETF Securities’ European business (AUM: \$18 billion), announced in 2017. In two other deals, SLA reached agreement with **Virgin Money** to manage the financial services firm’s £3.7 billion in AUM, which is largely held in a UK FTSE All-Share index fund, and acquired New York’s **Hark Capital**, a credit firm that provides loans to mid-life and end-of-life private equity and venture capital funds.

SLA was joined by several other ETF buyers in a global industry whose dominance by three companies presses the scores of other ETF players to consolidate as they compete for the remaining 20% of the market. As was the case with SLA-ETF Securities, two of the key deals crossed borders while also involving buyers expanding existing ETF platforms. These included **VanEck Associates’** acquisition of a majority stake in an established Dutch firm, **Think ETF Asset Management**, with management retaining a “minor” share. New York-based VanEck (AUM: \$46 billion) was a top-10 U.S. ETF provider before the deal with some 60 products, but the addition of Think (AUM: €1.5 billion/\$1.9 billion) enhances the company’s European presence. Following the acquisition, Think founder and Managing Director Martijn Rozemuller was named European chief, saying his goal is to “significantly expand the European business over the next few years.”

In an all-European cross border deal, **Societe Generale** (PA: SOGN) acquired €9 billion in ETF assets and more than 100 related products through the purchase of the equity markets and commodities businesses of a retrenching **Commerzbank** (DE: CBKG). SocGen’s **Lyxor** asset management unit is a top-three player in the European ETF market, with €64 billion in AUM prior to the deal, or nearly half of total assets under management and advice.

In a similar-sized deal that crossed the Pacific, South Korea’s **Mirae Asset Global Investments** acquired a New York ETF provider, **Global X Management**; the Korean business press placed the price at \$488 million. Global X manages niche products such as Robotics & Artificial Intelligence and Lithium & Battery Tech, and saw its assets more than double in 2017 to \$10 billion. Mirae had \$20 billion in ETF assets in Asia-Pacific and Canada prior to the deal. Taeyong Lee, global head of ETFs for Mirae, told Fund Selector Asia that the addition of a platform in the U.S. puts his company in position to “become a true global

ETF player.” But, in a nod to Global X’s products, he added: “We are not positioning ourselves to compete against BlackRock, Vanguard or State Street. Having a ‘me too’ product doesn’t really work in this competitive and crowded business. We are building an ETF business that can compete in niche markets.”

Although multiple emerging markets experienced turmoil last year, two major Western asset managers and insurers extended their presence in the most attractive such region, Asia. As is the case with many emerging market deals, established Western firms deliver expertise in investment products while a local partner, often a bank, offers distribution and local know-how. That was the case with **Prudential Plc** (LSE: PRU), which entered the Thai fund market by acquiring a 65% stake in fast-growing **TMB Asset Management**, the fifth-largest domestic asset manager (AUM: £10 billion). Prudential, which had an existing Thai life insurance business, cut the deal through its Asian asset management arm, **Eastspring Investments** (AUM: £139 billion). TMBAM was owned by Thailand’s seventh-largest bank, **TMB Bank Public Co.** (SET: TMB), which has 400 branches and six million customers and will serve as distribution partner.

For **Principal Financial Group** (NASDAQ: PFG), with offices in 19 countries, the two deals it cemented last year boosted ownership stakes it already held in longstanding ventures. In Malaysia, the company paid about \$117 million to assume majority shares of 60% in two joint ventures it holds with local banking giant **CIMB Group Holdings** (KLSE: CIMB). With CIMB as a minority owner, the two ventures face fewer banking-related regulatory restraints. Malaysian fund market assets rose by 12% in 2017 to nearly \$200 billion, according to the nation’s securities regulator. In India, Principal bought out the 21% stake of partner **Punjab National Bank** in **Principal Pnb Asset Management**. PNB will remain a distribution partner. In 2017, Prudential launched 50 new funds in emerging markets to meet demand “for multi-asset and income-generating solutions.”

In Europe’s emerging markets, where M&A activity has been limited recently, Assicurazioni Generali acquired Poland’s **Union Investment TFI**, the sixth-largest asset manager in that market with €3.3 billion in AUM for a mix of retail and institutional investors. Generali cut the deal with Germany’s **Union Investment Group**, where Poland accounted for just 1% of AUM. Generali, which has operated in Poland since 1998 as an insurance provider, said it is “pressing forward with the development of joint activities that combine insurance and asset management” in emerging Europe. The Polish asset management market had about \$70 billion in assets as of mid-2017, mostly invested domestically, while registering average annual growth of 15% in the five years through June 2017, according to Inteliace Research.

In established markets, European and U.S. active manager buyers sought tack-on deals involving specialized firms, a continuation of a recent trend that has left broad-based large-cap managers on the sidelines. Buyers also focused on global expansion in a number of the deals. Among them was **Franklin Resources** (NYSE: BEN), which acquired Scotland’s **Edinburgh Partners** (AUM: \$10 billion), a global and value manager. Although value has taken a backseat to growth since the financial crisis, value adherents believe the pendulum will ultimately swing back, with Franklin Chairman and CEO Gregory Johnson telling analysts that “it’s a good

time to add to our portfolio of value.” The deal has a human element, bringing Edinburgh CEO Sandy Nairn back to his former employer, where he was named head of the global equity group at **Templeton**. Edinburgh also adds distribution in the UK and a subadvisory presence in the U.S. (*Franklin also acquired a major credit manager; see Private Equity/Credit.*)

In a second cross border deal targeting a value manager, **Macquarie Investment Management** (ASX:MQG) acquired **ValueInvest Asset Management** of Luxembourg (AUM:€4 billion), an established global and Japanese equities manager. ValueInvest joins Macquarie’s multi-boutique platform. Calling ValueInvest “an excellent complement to our existing high-conviction equity strategies,” Macquarie said, “Investors today need skilled active managers across a diverse range of asset classes.” ValueInvest says its strategy creates “fairly concentrated long-only equity portfolios that are not tied to any benchmark.” For example, the company’s Lux Global fund, with 38% of its €800 million in AUM in U.S. equities, and 15% in Japan, has nearly half of assets in its top-10 holdings.

France’s **Natixis Investment Managers** factored into both the cross border and high conviction model by investing in **WCM Investment Management** (AUM: \$29 billion), a California manager focused on global growth stocks. But Natixis did depart from its usual approach, which involves owning affiliates either wholly or via majority shares, by assuming a minority stake in WCM. As part of the deal, Natixis, with a strong presence on both sides of the Atlantic, becomes the exclusive third-party distributor for WCM products. Natixis said the connection provides its clients with another “high-conviction, high-active share investment manager with a distinctive investment culture and process.” Natixis also acquired a credit manager (*see Private Equity/Credit*). WCM acts as a subadvisor to another multi-boutique firm, **Virtus Investment Partners** (NASDAQ: VRTS), which tapped a high-conviction U.S. and global growth manager in an all-U.S. deal. Virtus paid \$130 million for 70% of Connecticut-based **Sustainable Growth Advisers** (AUM: \$11.6 billion), a fast-growing manager that typically holds only 25 to 35 positions in each of its four primary portfolios. SGA also expands Virtus’ institutional client base from 23% to 31% of AUM.

Two key developed markets outside the U.S. and Europe played host to multiple domestic deals. One was Australia, where the total asset management market reached a record high of A\$3.7 (\$2.6 trillion) in the first quarter of 2018, up 14% over the same period in 2017. The nation’s superannuation (pension) system accounts for close to half the total, and the government projects the total market could reach A\$12 trillion by 2037, representing average annual growth of 7%. Those numbers have generated consistent M&A activity from both domestic and international players.

In one of the domestic deals last year, **Pinnacle Investment Management** (ASX: PNI) added to its roster of boutiques by acquiring a 40% stake in **Omega Global Investors**. Omega, founded in 2008, has A\$4.2 billion in AUM and a diverse smart beta portfolio that matches “Pinnacle’s strategy to gain exposure to [the] ETF market.” Omega cited Pinnacle’s “proven distribution teams” that can provide “a strong boost to Omega’s market profile and penetration.” Pinnacle also acquired a stake in an Australian credit manager, **Metric Credit Partners**, bringing the number of its affiliates to 11, all via minority shareholdings.

Canada's ongoing consolidation story continued with two major all-domestic deals involving independent targets, led by **Scotiabank's** (TSX: BNS) C\$950 million (\$740 million) stock-and-cash acquisition of **Jarislowsky Fraser**. An additional share-based earnout of C\$56 million could be made based on performance. Jarislowsky, founded in 1955, adds C\$40 billion in AUM to the C\$126 billion Scotiabank already managed to

make the Toronto bank the third-largest active manager in the market. Jarislowsky also adds a coveted institutional base, comprising three-quarters of AUM, compared with just 11% at retail-focused Scotiabank.

TD Bank Group (TSX: TD) joined its competitor by paying C\$792 million in cash and shares for **Greystone Capital**

"WE ARE IN A ONCE IN A GENERATIONAL CHANGE"

Invesco's (NYSE: IVZ) \$5.7 billion acquisition of **OppenheimerFunds** marked the third year running that a consolidation deal between fund managers topped the asset management M&A tables. The deal adds \$250 billion in AUM, primarily retail, to make Invesco the 13th-largest asset manager in the world with \$1.2 trillion and the sixth-largest retail manager in the U.S. (\$680 billion). Invesco said the addition will drive 18% and 27% increases in earnings per share for three quarters of 2019 and all of 2020, respectively, including \$1 billion in incremental EBITDA by 2020 with projected run-rate synergies of \$475 million. Oppenheimer has net annual revenues of \$1.4 billion and operating margins of 40%.

Oppenheimer parent **Massachusetts Mutual Life Insurance** will receive \$4 billion in 21-year noncall preferred shares carrying a fixed 5.9% coupon as well as common shares that will make it Invesco's largest shareholder with 15.5%. The two firms said they will "explore future strategic collaboration opportunities."

"We are in a once in a generational change, and it's happening at a faster pace than I ever imagined," Invesco President and CEO Martin Flanagan told *Barron's* after the deal. "Every single day the strong are getting stronger and the weak are getting weaker. Scale matters more than ever. I wouldn't have said that four years ago." For Invesco, getting stronger involves incorporating Oppenheimer's complementary active strategies, 85% of which by AUM are in categories where passive funds comprise less than 10% of the market, according to the company. Invesco also has a large active business, but nearly one-quarter of its \$980 billion in AUM is in exchange traded funds.

The majority of Oppenheimer's assets are in international, emerging market and U.S. equities, but the company also has a significant presence in alternative income products such as loans. The company's largest fund — and the largest in its category — is 22-year-old Oppenheimer Developing Markets with \$38 billion in AUM, four of its top five country holdings in Asia, and a 38% concentration in its top-10 holdings. "When the world is looking at the headlines, we look at the companies we own or want to invest in," Justin Leverenz, who has managed the fund since 2007, told CNBC last August, "So when there is trouble in the world, we tend to do well because we can find good companies" at a more reasonable price.

Another element in the deal for Invesco involves potentially capitalizing on MassMutual's 9,000 advisors

nationwide to drive sales. In reference to that network, Flanagan told analysts, "That's going to be an obvious focus area for us." The Oppenheimer transaction comes on top of Invesco's busy 2017, when it paid \$1.2 billion for the ETF business in the U.S. of **Guggenheim Partners** and an undisclosed amount for Source, a European ETF provider. The two deals added \$62 billion in ETF assets.

While the two other megadeals last year did not fit the consolidation narrative defined in recent years by the major players, they significantly expanded the capabilities and reach of the buyers. In the U.S., **Victory Capital Holdings'** (NASDAQ: VCTR) \$850 million acquisition of **USAA Asset Management** came just nine months after its initial public offering and could reach \$1 billion with contingent payments over four years. The company, which valued the deal at 6.9 times 2018 EBITDA (3.8 times with expected synergies), will pay through a combination of debt and cash. USAA adds \$69 billion in AUM to Victory Capital's existing \$76 billion, including \$12 billion from its acquisition of New York hedge fund **Harvest Volatility Capital** just prior to the USAA transaction. Victory Capital said USAA "represents a substantial expansion and diversification of [its] investment platform." USAA has 60% of its AUM in fixed income and solutions products, split evenly, with money markets another 15%. USAA also delivers a clientele that's large (12.7 million customers) and targeted (the military community, including families); it will become the 11th company in Victory Capital's multi-boutique structure.

Mitsubishi UFJ Financial (NYSE: MUFJ) paid A\$4.1 billion (\$3 billion) for the global asset management business of **Commonwealth Bank of Australia** (ASX: CBA), capitalizing on the ongoing restructuring of Australia's banking industry. CBA's **Colonial First State Global Asset Management**, the third-largest asset manager in Asia-Pacific ex-Japan, adds a diverse business with A\$210 billion in AUM to the give Mitsubishi a total of \$730 billion in AUM and a more global presence. Mitsubishi said the deal, which it valued at 12.4 times 2018 EBITDA, will make it the leading asset manager in Asia-Pacific and a top-15 manager worldwide. While the deal will still leave Japan as Mitsubishi's dominant market (74% of pro forma AUM), the company will gain a significant presence in Australia (12% of AUM), which is the fourth-largest pension market in the world. Last year, Mitsubishi also acquired Los Angeles investment bank **Intrepid Investment Bank** (see *Securities & Investment Banking*).

Management, the parent of **Greystone Managed Investments**. TD Bank said the deal vaults it one place to No. 1 among asset managers, ahead of **Royal Bank of Canada** (TSX: RY), with Greystone's C\$36 billion in institutional AUM giving TD Bank a total of C\$393 billion. More than half of Greystone's assets are in alternatives, with the rest split about evenly between fixed income and equities. "Greystone's leadership in alternative investments is a perfect complement to [TD Bank's] traditional investment products," TD Bank said.

PRIVATE EQUITY/CREDIT

Formed in 2011 to acquire minority stakes in established alternatives firms, **Dyal Capital Partners** in the years since has made more than 30 investments worldwide in firms with aggregate AUM of \$500 billion. The assertive tack by the **Neuberger Berman** division has mirrored the sharp growth of the alternatives industry. Private equity AUM alone grew by \$600 billion to \$3 trillion in just the two years through 2017, according to Preqin.

For private equity and other alternatives firms, the link to an investor such as Dyal provides a source of permanent capital as they seek financing for new and often larger funds (see sidebar). Commenting on this trend in its latest annual report, Neuberger Berman said that industry demand for capital "to facilitate platform development, generational transfer, new product launches and other strategic initiatives continues to grow." That statement followed the closing in 2017 of Dyal's third fund, with committed capital of \$5.3 billion.

Dyal isn't alone in the capital-for-equity exchange, which provides buyers with a share of their targets' earnings and potential gains on an exit. Other major players include **Blackstone Group's** (NYSE: BX) Strategic Capital Holdings fund and **Goldman Sachs'** (NYSE: GS) **Petershill**, both of which were active last year. In one deal, Dyal and Petershill teamed with **Landmark Partners** to assume a minority stake in **Clearlake Capital Group**, a California-based private equity firm specializing in such sectors as industrials, energy and technology. The deal is part of a nascent team approach to investment in private equity firms, with Landmark having previously provided financing for the firm.

In an interview with *Pensions & Investments*, Clearlake co-founder and Managing Partner Jose Feliciano noted that each investor brings "different strengths" to the table, with Dyal providing business services acumen and Petershill credit experience. In a statement, Feliciano said "the strategic partnership ... will help accelerate Clearlake's growth as a leading franchise with a proven strategy." Formed in 2006, Clearlake has managed \$7 billion of capital since its founding and closed its largest fund to date in the first quarter of 2018, of \$3.6 billion.

Dyal cut several other deals for private equity firms, including for **Bridgepoint**, a European middle-market investor with £18 billion (\$20.5 billion) in AUM. *The Wall Street Journal* reported that the deal, involving an equity stake of between 15% and 20%, placed a "multibillion-dollar valua-

tion" on Bridgepoint, with the proceeds aimed at expansion outside Europe. The firm invests in such sectors as consumer goods, financial services, and technology and media. In Bridgepoint's 2017 annual report, Managing Partner William Jackson noted that in "a highly priced market" the firm has been "selectively" paying higher multiples for "higher growth companies, but we've made sure that we have also made some great value purchases." Dyal also acquired a minority stake in **Vector Capital**, a San Francisco technology investor with \$3.8 billion in AUM. Vector, formed in 1997, has had a relationship with Neuberger Berman during most of that time.

Blackstone and Goldman teamed up in a second deal, acquiring a minority stake in **Francisco Partners** of San Francisco, a technology specialist that has raised more than \$14 billion and invested in 200 tech companies during its 18-year history. "Long term, we want to be one of the preeminent brands in our industry, and having preeminent partners will continue to help us get there," Francisco CEO Dipanjan Deb told Bloomberg. Francisco said it will use the capital to develop its platform and increase commitments to its own funds, "strengthening alignment with limited partners." Blackstone made two other investments in established firms through its Strategic Capital Holdings fund: U.S. middle-market private equity firm **Kohlberg & Co.**; and Hong Kong's **PAG**, an Asian-focused firm with \$20 billion in AUM in private equity, absolute return and real estate.

The credit marketplace continued to benefit from the institutional search for yield in a world where \$9.7 trillion in sovereign debt still carried negative interest rates as 2018 approached, according to Fitch. The outstanding leveraged loan market in the U.S. passed \$1 trillion last year, according to the Loan Syndications and Trading Association, double the level in 2010, with another \$200 billion in Europe. Within that market, collateralized loan obligations loom large, and **Wells Fargo** (NYSE: WFC) predicted a record 2018 issuance

CREDIT TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------|-------|-------|-------|---------|---------|
| Number of Transactions | 3 | 6 | 10 | 13 | 22 |
| Combined Value (\$M) | \$267 | \$252 | \$741 | \$1,727 | \$3,396 |
| Total Seller AUM (\$B) | \$15 | \$29 | \$55 | \$98 | \$228 |
| Average Deal Size (\$M) | \$89 | \$42 | \$74 | \$133 | \$154 |
| Average Seller AUM (\$B) | \$5.0 | \$4.9 | \$5.5 | \$7.5 | \$10.4 |

Source: Berkshire Global Advisors LP

of \$150 billion in the dominant U.S. market. Not surprisingly, that robust demand has led to a weakening of covenants on some products as borrowers flex their muscles. "It's pretty difficult to find good credits," Buffalo High Yield manager Paul Dlugosch told the *Financial Times* last May in reference to the credit market. "Covenants are definitely getting looser, and the pricing [for investors] is not as good."

The willingness to take on more risk in return for yield was also reflected in the U.S. commercial mortgage-backed securities market, where spreads between the highest and lowest credit quality paper had by last summer narrowed to

the lowest level since before the financial crisis, according to Trepp. At the same time, Fitch expects the delinquency rate for CMBS will have dropped to between 2.25% and 2.75% by year end 2018, owing to strong new issuance and the continued resolution of distressed legacy securities, though the rating agency warns of potential risks ahead. This compares with the peak delinquency rate of 9% reached in July 2011. In the first half of 2018, CMBS issuance was \$40 billion, exceeding the half-year totals for 2016 and 2017, according to CRE Financial Council, though far below the high-water mark of \$136 billion in the first six months of 2007. (By the second half of 2008 there was zero issuance and just \$3 billion for all of 2009.)

Deal-making in the credit sector remained similarly active last year, although the aggressive pace of acquisitions for CLO firms in recent years has ebbed. In part, that reflects the limited number of remaining players looking to cash out, as they focus instead on growth and seek like-minded partners. Still, there were two such U.S. deals of note last year, including **THL Credit Advisors'** (NASDAQ: TCRD) acquisition of the CLO business of **Kramer Van Kirk Credit Strategies**. Kramer adds \$3.4 billion in AUM in seven CLOs to the \$12 billion THL already managed in CLOs and direct-lending securities. THL said the deal allows it "to further scale our

CLO asset base and broaden the THL Credit platform." Subsequently, THL closed two CLOs with combined assets of \$1.1 billion. "CLOs are in high demand this year among institutional investors because of their reliable risk-adjusted return profile and favorable floating rate status," THL said. In a second deal, **American International Group** (NYSE: AIG) returned to CLO management by acquiring **Covenant Credit Partners**, a North Carolina firm that focuses on below-investment-grade corporate debt.

In a third and major all-U.S. deal, **Franklin Resources** (NYSE: BEN) paid \$683 million in cash (with additional contingent undefined payments over the next several years) for New York's **Benefit Street Partners**. BSP has \$26 billion in AUM, mainly in private debt/opportunistic credit and long-only liquid credit. The deal bolsters Franklin's alternatives and fixed income platforms "at a time when investors are increasingly allocating capital to less liquid and higher yielding credit opportunities." Franklin also gains control of a firm where AUM has registered average annual growth of 30% since its founding in 2008, including more than doubling between 2015 and September of 2018. In the earnings conference call following the October deal, Franklin Chairman and CEO Gregory Johnson said BSP had been successful expanding with a "relatively small distribution group" that Franklin could

FOR PE FIRMS, IT'S RAINING MONEY

With more than \$1 trillion in dry powder worldwide, private equity firms were awash in capital as the 2018 year began. Still, the money kept pouring in — some \$255 billion in institutional capital in the first eight months of 2018, according to Preqin. Moreover, 86% of investors interviewed by Preqin last June said they plan to "maintain or increase" their PE investments this year.

Much of that capital is making a beeline for U.S. buyout "megafunds" of \$5 billion or more, accounting for a record 15% of total fundraising in 2017, according to a report last year from McKinsey. The consultant says one reason for the growth of megafunds is that they "make pragmatic sense to the growing class of investors that need to put billions to work quickly, as these funds are typically raised by the largest firms, which offer a strong promise that the capital will be deployed." Another reason: The data "suggest" that since 2008 "the average megafund has outperformed other fund sizes."

In 2017, **Neuberger Berman's Dyal Capital Partners** closed its own megafund of \$5.3 billion, the largest-ever such fund geared toward investments in private equity managers and \$2 billion over the original target. Dyal said the fund's objective is to "provide passive, minority equity capital to assist firms with generational transfers, and more often, in the creation of balance sheet capital to help achieve strategic goals." The fund aims to make 10 to 12 investments diversified by asset class, strategy and geography. **Blackstone Group** (NYSE: BX) and **Goldman Sachs** (NYSE: GS) have their own permanent capital vehicles for investment in private equity and other alternative

managers. Goldman closed its third **Petershill** fund last year, with the \$2.5 billion in commitments exceeding the \$2 billion target. The more established players are being joined by a new entrant, Illinois-based hedge fund **Magnetar Capital**, which *Private Equity News* reported aims to raise more than \$1 billion for stakes in private equity and other alternative firms.

Among more general private equity companies, many set new records last year for the size of their latest funds. These included technology specialist **Vista Equity Partners**, which was headed toward \$16 billion for its seventh fund, and **Carlyle Group** (NASDAQ: CG), which closed a U.S.-focused \$18.5 billion fund. Carlyle Partners VII attracted 320 investors from 57 countries, easily exceeding the \$15 billion target to reach its hard cap. In Europe, **EQT's** eighth equity investment strategy fund reached its hard cap of €10.8 billion (\$12.5 billion) last February while China's **Hillhouse Capital Group** set a new threshold for Asian funds of \$10.6 billion.

With all that capital to deploy — and generally robust financial markets in recent years — the multiples paid by private equity firms are rising, reaching a high of 10.7 times EBITDA in 2017, compared with 7.9 in 2012 and 9.2 in 2016, according to McKinsey. But the consultant opines that general partners are heeding the lessons of the pre-financial-crisis boom, "when too much capital was deployed at too-rich multiples over too brief a time." Now, investors are "trying to balance the pressure to deploy capital with the goals to remain disciplined in valuation and rigorous in process."

“immediately” extend to its institutional network “and then explore the retail channel.” (*Franklin also acquired a European value manager; see Traditional Investment Management.*)

As with the three noted transactions, many credit-related deals tended to be either domestic or regional in nature. A European one saw **Natixis Investment Managers** of France acquire the UK’s **MV Credit**, one of the largest independent pan-European credit specialists. Founded in 2000, MV Credit has invested more than €5 billion (\$5.8 billion) in 500 debt financing solutions targeting non-cyclical defensive industries and regions. The firm focuses on upper mid-cap private debt with a philosophy built around “rigorous credit analysis and active portfolio management.” Natixis, with a multi-boutique structure, said the addition “marks another important step in the development of [Natixis’] European real assets range.” MV Credit cited the “tremendous growth opportunities” afforded by its new parent’s “global distribution network” and infrastructure, along with the ability to retain “our full autonomy.” Natixis also acquired a minority stake in a U.S. equity manager (*see Traditional Investment Management*).

Within the U.S., there were several credit deals featuring notable buyers and sellers, with many of the sellers focused on the distribution muscle and capital offered by their new partners. In addition to its investments in the private equity industry, Dyal Capital Partners acquired minority stakes in two significant New York credit firms. The first involved **HPS Investment Partners** (AUM: \$45 billion), one of the largest dedicated mezzanine and direct-lending investors worldwide. HPS, which in 2016 did a management buyout from **JPMorgan Chase** (NYSE: JPM), said the investment

BlackRock (NYSE: BLK) acquired a Los Angeles firm focused on middle-market performing and special situation credit, **Tennenbaum Capital Partners**. Founded in 1999, TCP has \$9 billion in committed capital. BlackRock said the deal will merge its own scale and risk management capabilities with TCP’s niche in the credit market. In a second-quarter earnings call, Gary Shedlin, BlackRock’s chief financial officer,

PRIVATE EQUITY FUND TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------|-------|-------|-------|---------|----------------|
| Number of Transactions | 7 | 6 | 10 | 13 | 18 |
| Combined Value (\$M) | \$354 | \$910 | \$638 | \$4,223 | \$1,831 |
| Total Seller AUM (\$B) | \$39 | \$36 | \$78 | \$118 | \$118 |
| Average Deal Size (\$M) | \$51 | \$152 | \$64 | \$325 | \$102 |
| Average Seller AUM (\$B) | \$5.5 | \$6.0 | \$7.8 | \$9.1 | \$6.6 |

Source: Berkshire Global Advisors LP

said TCP enhances “our position as a leading global credit asset manager, and advanc[es] our goal of providing clients with a diverse range of alternative investment products and solutions.” During the same call, Chairman and CEO Laurence Fink said the company had seen “more momentum” in alternatives fundraising “than at any point in BlackRock’s history.” Last summer, BlackRock closed its first European middle-market private debt fund amounting to €1.1 billion from institutions and family offices. Private credit accounted for 8% of BlackRock’s illiquid alternatives assets of \$67 billion, as of March 2018.

There were two transpacific deals involving credit targets. Japan’s **Orix Corp.** (NYSE: IX) acquired **NXT Capital**, a Chicago-based middle-market loan specialist that has originated \$20 billion in financing on more than 600 transactions since its formation in 2010. The Japanese press placed the transaction price at about \$900 million. Orix cut the deal through its U.S. unit, which has made three other acquisitions since 2010, including **Boston Financial Investment Management**, a low-income housing tax-credit manager. **Orix Corp. USA** provides “innovative capital solutions” to clients and has \$57 billion in assets under management, administration and servicing. NTX said it will benefit from its new parent’s “global platform, leading-edge approach to business development and financial strength.” Canada’s acquisitive **Fiera Capital** (TSX: FSZ) headed to Asia to buy Hong Kong’s **Clearwater Capital Partners**, an established Asian-focused investor (ex-Japan) in credit and special situations with \$1.4 billion in AUM. Fiera paid nearly \$15 million in cash and shares, with contingent payments that could add \$44 million to the price over five years. Fiera said Clearwater provides entry to Asia’s credit market and combines that firm’s “deep investment experience in Asia” with its own global distribution capabilities. Institutions comprise 53% of Fiera’s AUM (C\$140 billion/\$110 billion) while 9% of assets are in alternatives.

HEDGE FUND / HEDGE FUND OF FUNDS TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------|-------|-------|---------|---------|----------------|
| Number of Transactions | 7 | 10 | 11 | 10 | 13 |
| Combined Value (\$M) | \$76 | \$986 | \$1,874 | \$1,011 | \$1,939 |
| Total Seller AUM (\$B) | \$7 | \$98 | \$89 | \$71 | \$67 |
| Average Deal Size (\$M) | \$11 | \$99 | \$170 | \$101 | \$149 |
| Average Seller AUM (\$B) | \$1.1 | \$9.8 | \$8.1 | \$7.1 | \$5.1 |

Source: Berkshire Global Advisors LP

provides it “with additional resources to pursue strategic initiatives and continue its significant alignment with clients.” The second deal involved **Golub Capital** (AUM: \$25 billion), which focuses on the middle market in such areas as direct lending, late-stage lending and syndicated loans. Among Golub’s investments last year was \$450 million in senior credit facilities to support two acquisitions by San Francisco private equity firm **GI Partners**. The Golub Capital Altman index of middle-market companies showed year-over-year earnings and revenue growth of 13% and 11%, respectively, in the first two months of the 2018 second quarter.

REAL ASSETS

As analysts and media pundits weighed in last year on the 10th anniversary of the financial crisis, the frothy property market that fueled the trouble logged another comeback year. Among investment firms, total real estate AUM (equity and debt) climbed 11.5% in the year through June 2018 to nearly \$1.5 trillion, according to *Pensions & Investments*. In June 2008, the number stood at more than \$1 trillion before plummeting to \$684 billion two years later and beginning a rebound in 2011.

Investors continued to give the asset class a ringing endorsement with their capital last year. Within the private equity industry, real estate funds raised \$61 billion worldwide in the first half of 2018, according to Preqin, on par with first-half trends in recent years. Fundraising was driven by value-added and opportunistic strategies. Dry powder in such funds rose from \$249 billion to \$290 billion between the end of 2017 and the middle of 2018. In September, Bloomberg reported that **Blackstone Group** (NYSE: BX) was aiming to raise \$18 billion for its largest-ever real estate fund, targeting global distressed properties.

Investments in U.S. commercial real estate from overseas also remained strong in the first half of 2018, with non-U.S. capital inflows of \$30 billion up 29% from the same period in 2017, led by European investors, according to **CBRE Group** (NYSE: CBRE). U.S. outflows rose 15% to \$18.2 billion, primarily headed to Europe.

The strong post-crisis comeback combined with climbing valuations have led some observers to raise concerns about the market cycle, with Federal Reserve policy and lagging global growth also weighing on sentiment. Still, few are predicting another crisis. **LaSalle Investment Management** notes in its 2018 mid-year review that global returns “are likely to moderate in coming years” from the annual double-digit recovery prevailing from 2011 to 2015, but adds: “Our forecast doesn’t have plummeting values in it (like in 2009).”

Cushman & Wakefield (NYSE: CWK) declared itself positive on European real estate in its forecast early last year, saying pension fund assets and “an enduring trend for investors to diversify away from equities and bonds” are “supportive of a continuing weight of capital targeting European real estate over the long term, albeit with cyclical deviations.” Commenting on the global real estate investment industry in its 2018 European Outlook Report, CBRE similarly projected continued “rapid growth” in AUM, driven by inflows from wealthy investors and retirement pools. “This will fuel further competition between investors in the search for product to deploy capital.” The company also sees more consolidation among real estate advisors, with the “maturing of the cycle” fueling M&A activity.

With that generally positive outlook worldwide, deal-makers in the real estate advisory sector took the opportunity to expand their footprints across borders last year, with North America and Europe the centers of activity. Multiple buyers sought to either add large investment management platforms or acquire strategic or passive permanent minority stakes. Targets spanned the range of capabilities, from private equity real estate to real estate debt.

One of the largest deals involved a buildout of a global investment platform: **Colliers International Group’s** (TSX: CIGI) \$450 million purchase of 75% of Chicago’s **Harrison Street Real Estate Capital** (AUM: \$14.6 billion), with management retaining 25%. Toronto-based Colliers could pay an additional \$100 million by 2022 based on “accelerated performance targets.” The deal, which was driven in part by the desire of Harrison’s co-founding family to cash out, joins two significant and complementary real estate businesses. “We had to think about the transition from our existing partner ... to the right long-term strategic capital partner,” Harrison co-founder, President and CEO Christopher Merrill told *PERE* magazine.

Colliers offers real estate services such as advisory, sales and leasing, and while the company had an investment advisory arm, Harrison establishes it “as one of the major players in global real estate investment management.” Harrison focuses on the demographically sensitive sectors of education, health-care and storage in the U.S. and Europe; it serves some 250 geographically diverse investors, with 70% holding multiple funds. Colliers operates in 69 markets, with more than half of its revenues in the Americas and the rest split about evenly between Europe and Asia-Pacific. The impact of the deal became quickly apparent in Colliers’ third-quarter results following the closing last July: Investment management revenue was 5% of the total (\$716 million) compared with less than 1% in 2017, while adjusted investment management EBITDA was 12% of that total vs. zero in 2017. Colliers expects Harrison to generate between \$100 million and \$115 million in annual run-rate management fees with the investment business in general providing 35% to 40% EBITDA margins and accounting for 15% of Colliers’ annual EBITDA.

Two other key North American deals also featured Canadian buyers and U.S. targets. In one, Toronto-based **Sun Life Financial** (TSX: SLF) acquired **GreenOak Real Estate** of New York, a global firm with \$11 billion in AUM that primarily pursues a value-add strategy. Sun Life will merge GreenOak with its **Bentall Kennedy** business, which focuses on core real estate investments. The combined firm will have C\$38 billion (\$28 billion) in AUM, with GreenOak adding U.S., European and Asian assets to Bentall Kennedy’s North American holdings. Sun Life said the addition of GreenOak “extends our capabilities in real estate investment solutions in a complementary way.” Sun Life will contribute its interest in Bentall Kennedy and pay C\$195 million in cash to GreenOak shareholders for a 56% interest in the combined **Bentall GreenOak**. GreenOak will hold the remaining interest, with Sun Life having the option to acquire GreenOak’s stake in about seven years. Sun Life, which said the deal should be accretive to underlying earnings per share and return on equity this year, placed the transaction multiple at 12 times estimated 2019 EBITDA.

In the third North American transaction, the real estate unit of **Caisse de depot et placement du Quebec** acquired a U.S. real estate private equity firm, **Callahan Capital Properties**, highlighting the effort by institutions to expand their direct alternatives platforms. The deal also fits CDP’s effort to expand its illiquid investments. CDP’s real estate unit, **Ivanhoe Cambridge**, entered a “strategic relationship” with Callahan in 2012 as it sought to build its U.S. office properties platform. Callahan manages \$10 billion in assets while Ivanhoe develops and invests in urban real estate with partners and has more

than C\$60 billion in assets, primarily in the U.S. and Canada.

A transatlantic deal saw **AXA Investment Managers** acquire the U.S. business of Atlanta's **Quadrant Real Estate Advisors**, amounting to \$9.4 billion in AUM from commercial mortgage loans. AXA said the Quadrant team will "bring deep market expertise and a 20-year track record in the U.S. commercial real estate debt market" to complement its European debt platform. "[Quadrant] will also be a major milestone in our goal of creating one of the largest and truly global real assets investment and management firms," the company said. With the addition of Quadrant's business, AXA IM will have \$20.5 billion in real estate debt AUM, or around one-quarter of total AUM in its real assets business.

In an all-U.S. deal of note, **Blackstone** (NYSE: BX) acquired a minority stake in a Boston-based real estate advisory firm, **Rockpoint Group**, through its Strategic Capital Holdings alternative investment fund. The two firms have worked together on debt and equity transactions over the years. Rockpoint is a value investor focused on coastal U.S. markets with a 24-year track record involving 400 transactions and capital raisings of \$19 billion. The company said Blackstone provides a "permanent capital investment" that will "strengthen our firm while preserving its entrepreneurial culture." Rockpoint also joined Miami-based real estate firm **Related Group** in a venture that plans to spend \$2 billion in acquiring value-added multifamily properties in Florida and several other Sun Belt markets.

Petershill, the alternative investment unit of **Goldman Sachs** (NYSE: GS), entered the real estate investment sector by acquiring a minority stake in an established U.S.-based firm, **Westbrook Partners**. Westbrook manages \$11 billion in assets in a diverse global portfolio. As reported by *The Wall Street Journal*, Westbrook owner and CEO Paul Kazilionis made the deal with Petershill to bolster the company's balance sheet and create a new ownership structure that also includes senior Westbrook executives (see *Private Equity/Credit for more on Petershill*).

In a real estate debt deal in the U.S., LaSalle Investment Management acquired a majority stake in **Latitude Management Real Estate Investors** (AUM: \$1.2 billion), an established commercial real estate bridge lender that provides short-term, floating-rate loans for the middle market. The business will be merged into LaSalle's North American private equity platform, comprising \$21 billion in AUM. LaSalle, part of **Jones Lang LaSalle** (NYSE: JLL), has \$60 billion in AUM in a mix of private and public equity and private debt investments. LaSalle praised Latitude's "differentiated" approach "that has enabled them to grow significant share in the value-add, transitional asset space, while avoiding the risks associated with development lending or higher leverage strategies." In its most recent fund, Latitude raised \$480 million.

Europe was a hub of activity last year with multiple cross border transactions, as the region attracts interest from a range of asset managers drawn to the market's growth potential, investor demand for global diversification, and

REAL ASSETS TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------|-------|-------|-------|-------|-------|
| Number of Transactions | 13 | 15 | 18 | 30 | 44 |
| Combined Value (\$B) | \$1.5 | \$1.5 | \$2.9 | \$3.3 | \$7.2 |
| Total Seller AUM (\$B) | \$93 | \$90 | \$151 | \$184 | \$228 |
| Average Deal Size (\$M) | \$112 | \$102 | \$161 | \$109 | \$164 |
| Average Seller AUM (\$B) | \$7.1 | \$6.0 | \$8.4 | \$6.1 | \$5.2 |

Source: Berkshire Global Advisors LP

the availability of targets. Among the major buyers was **Candriam Investors Group**, which acquired a 40% stake in London's **Tristan Capital Partners**, a pan-European real estate investment platform with €9.1 billion (\$11 billion) in AUM. Brussels-based Candriam, part of **New York Life Insurance**, is a diversified asset manager with €121 billion in AUM, but Tristan represents its entry into European real estate investment management.

Candriam, which has the option to increase its ownership stake in the future, said Tristan will add an asset class "which continues to attract strong institutional investor demand to its multi-specialist offerings." Nearly two-thirds of Candriam's AUM is from institutions. For Tristan, the benefit is the connection to a large global platform and greater operational and financial resources. Last year, Tristan began raising a €1.5 billion opportunistic fund targeting a 12% to 14% net internal rate of return.

Macquarie Group (ASX:MQG) added a real estate investment platform through the purchase of a German-based real estate manager, **GLL Real Estate Partners** (AUM: €7 billion). GLL, founded in 2000, manages a property portfolio focused on core and core-plus offices throughout Europe and in the U.S. Macquarie cut the deal through its infrastructure and real assets division (AUM: A\$155 billion/\$120 billion). Macquarie, which had €3.6 billion in real estate AUM prior to the deal, has been seeking to expand that business to complement its leading infrastructure platform.

In addition to its deal with Latitude Management, LaSalle Investment Management crossed the Atlantic to acquire the multi-manager real estate business of London's **Aviva Investors**, with \$7 billion in AUM, as well as Encore+, a continental European €1.7 billion real estate fund the two firms had been running for 11 years. Saying it will "focus on being a direct operator in real assets," Aviva simultaneously combined its direct real estate, private debt, structured finance and infrastructure businesses into a single real assets unit. LaSalle called a "strong multi-manager" business "increasingly important" to its clients.

Dyal Capital Partners, the alternative investment arm of **Neuberger Berman**, acquired a minority stake in London-based **Round Hill Capital**, which has invested €6.5 billion of capital in real estate assets since its founding in 2002, with a particular focus on the residential sector. The deal marks Dyal's entry into European real estate (see *Private Equity/Credit for more on Dyal*). Round Hill said Dyal's "permanent capital investment and our business platform resources" will enhance its development as "one of the leading global real estate investment managers."

In a domestic UK deal, **Savills Investment Management** bought a 25% stake in a commercial real estate debt manager, **DRC Capital**, with the option to acquire the remaining 75% by 2021. Founded in 2012, DRC Capital has £2 billion in AUM across high-yield, senior debt and whole loan funds. For SIM (AUM: £16 billion/\$20 million), a unit of real estate services provider **Savills plc** (LON: SVS), DRC adds a debt investment capability to its investment product offerings. "This will enhance our service to clients ... seeking income-focused investment opportunities in European real estate," the company said. At year-end 2017, DRC closed a £600 million European high-yield fund, the third such fund it has managed, surpassing the target by £100 million, with new investors comprising 40% of assets. In 2017, more than \$10 billion was raised in Europe for real estate debt investments, double the level in 2016, according to *Real Estate Capital*.

The REITs sector in the U.S. was active, as opportunistic buyers sought to capitalize on weak valuations prevailing for two years that sank to double-digit discounts to net asset value in the 2018 first quarter. The two key buyers were **Brookfield Asset Management** (NYSE: BAM) and Blackstone, which both made multiple public-to-private deals. The largest, valued at around \$15 billion, saw BAM acquire the 66% it did not already own of **GGP**, the second-largest mall owner in the U.S. BAM cut the deal through its publicly traded real estate subsidiary, **Brookfield Property Partners** (NASDAQ: BPY). In a second deal valued at \$11.4 billion, BAM acquired **Forest City Realty**, a commercial, mixed-use and residential firm focused on key urban markets such as New York and San Francisco. In an interview with *The Wall Street Journal*, **Brookfield Property Group** CEO Brian Kingston said many of Forest City's projects are "transit-oriented" and mixed use, adding, "It's exactly in our sweet spot." Blackstone's two largest transactions involved the \$7.6 billion purchase of **Gramercy Property Trust**, an industrial property investor, and the \$4.8 billion acquisition of **LaSalle Hotel Properties**.

Although investor interest in other areas of the real assets universe remains strong — in the first half of 2018 infrastructure funds alone raised \$38 billion, according to Preqin — deal activity is limited by the dearth of privately held firms seeking capital events and the lack of divestitures by asset managers of such units.

WEALTH MANAGEMENT

In a move with significant implications for the U.S. wealth industry, **Focus Financial Partners** (NASDAQ: FOCS) took the next step in its evolution last July with a \$535 million initial public offering. Founded in 2006, Focus is the wealth industry's leading aggregator and the first to go public. The IPO followed a 2017 investment from **KKR & Co.** (NYSE: KKR) and **Stone Point Capital** that assigned a \$2 billion valuation to Focus and gave the two private equity firms majority control.

Although the IPO valuation was similar, and below Focus' initial expectations, the stock price had climbed 36% within a couple of months after trading commenced before sinking with the larger market in the fourth quarter, albeit more sharply, and ending the year more than one-quarter off the opening-day price. At the IPO price, Focus' price-earnings ratio was 23 times estimated 2018 earnings and 17 times

2019, by **William Blair**'s reckoning. Those healthy valuations reflected the robust stock market at the time, but also the company's prospects: In the years ahead, Focus suggests it can maintain the 20%-plus annual growth in revenue and adjusted EBITDA that has characterized its performance in recent years.

Achieving that growth will involve the continuance of an aggressive acquisition strategy, and Focus cites a universe of more than 500 "high-quality" U.S. targets for itself and another 5,000 "suitable targets" for its affiliated firms. Accordingly, William Blair calls an investment in Focus "a bet on the company's ability to do accretive M&A activity" while also highlighting a potential competitive advantage: "The end game for the company is known, which in some cases may be important for prospect firms considering its model relative to that of other aggregators." Focus has more than 60 affiliates and recorded \$231 million in revenue in the 2018 second quarter.

For high-profile competitors such as **HighTower Advisors** and **United Capital**, a publicly traded Focus provides a yardstick on two fronts. First, those firms and other smaller but ambitious aggregators will monitor the performance of Focus' stock as they, and their private equity backers, weigh the public option in the years ahead. Just as importantly in the near term, aggregators can use Focus in part to value their own firms with an eye on arbitraging the prices they pay for targets.

Focus targets will also have a public valuation model to consider on any deal that incorporates equity. In one of its largest-ever deals two months after the IPO, Focus acquired **Loring Ward Holdings**, with half the \$235 million price paid in equity. Loring Ward is an established Silicon Valley provider of wealth services to financial advisors and their clients. In a video describing the deal, Focus founder, Chairman and CEO Rudy Adolph called the transaction "an excellent example of a deal that would have been difficult to execute as a private company. As such, our recent IPO was truly an enabler of this important transaction." But soon after, as markets grew volatile and Focus' stock price and valuation declined sharply, the company was reminded of how quickly fortunes can change on the public markets.

For buyers and sellers outside the aggregator universe, a public Focus has more limited value but could provide an additional metric for some negotiators. **Silvercrest Asset Management Group** (NASDAQ: SAMG), a wealth manager with \$22 billion in AUM, went public in June 2013 and provides the only other such benchmark for wealth managers; its stock had risen by 46% five years after the IPO.

At HighTower, with assets of \$55 billion, founder Elliot Weissbluth said the firm has no near-term plans to follow Focus' lead. "People have been asking me when we're going public ever since we started the firm, and my answer is still, 'Come back and ask me in a couple of years,'" he told *InvestmentNews* last year. "We are still active acquirers of practices and still active growers of the business." In 2017, HighTower sold a majority stake to **Thomas H. Lee Equity Partners**, and some observers wonder if the private equity firm may have a more accelerated IPO timetable in mind than Weissbluth, who stepped down as CEO last year to assume the chairman's role.

HighTower's major deal last year involved Houston-based **Salient Private Client**, which gives the company entry to the Texas market as well as an ultra high net worth clientele. Salient has \$4.5 billion in assets, a level well above what Weissbluth has described as HighTower's ideal target: Managers with between \$200 million and \$800 million in AUM and revenues of \$1 million to \$2 million. "We will certainly look at more large firms if there is an opportunity, but there are a limited number on the market," he told Financial Planning last April. Meanwhile, HighTower added a new chief to its expanded M&A team, Marc Cabezas, a veteran of Focus and **Edelman Financial Services**.

Against the backdrop of the Focus IPO, the aggressive pace of acquisitions by the numerous and growing number of aggregators and deals between independent wealth managers added up to another year of solid activity for the industry. There were 112 transactions valued at \$5.3 billion in 2018, including two megadeals, with higher percentages of upfront cash and shorter time frames for payouts characterizing many deals. The private equity industry that has bankrolled

geographically diverse mass affluent advisor with \$3.3 billion in assets and an aggressive marketing culture. Following the deal, Simply Money co-founder and CEO Nathan Bachrach acknowledged in a podcast the dilemma facing many smaller firms, saying, "The challenge [is] how do you grow faster and how do you expand into new markets, and I will tell you that if you want to do it right it takes capital.... Capital was certainly something we needed, as well as expertise we didn't have."

The private equity industry is extending its considerable capital (see sidebar in *Private Equity/Credit*) to unique startups such as **Facet Wealth**. That Baltimore firm secured a new round of \$33 million in funding last September from **Warburg Pincus** and existing shareholder **Slow Ventures**, a San Francisco tech investor founded by former Facebook employees. Facet Wealth acquires mass affluent clients from firms focused on their more profitable high net worth (HNW) customers; it offers to transfer the clients back if their assets top \$1 million. Facet Wealth touts the ability to deliver personalized and profitable fee-based services (averaging 41 basis points) by employing technology that can allow one advisor to handle 250 clients.

WEALTH MANAGEMENT TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|--------------------------|-------|-------|-------|-------|--------------|
| Number of Transactions | 49 | 71 | 76 | 80 | 112 |
| Combined Value (\$B) | \$4.0 | \$3.9 | \$6.5 | \$5.3 | \$9.7 |
| Total Seller AUM (\$B) | \$412 | \$206 | \$298 | \$334 | \$598 |
| Average Deal Size (\$M) | \$81 | \$54 | \$86 | \$66 | \$87 |
| Average Seller AUM (\$B) | \$8.4 | \$2.9 | \$3.9 | \$4.2 | \$5.3 |

Source: Berkshire Global Advisors LP

the aggregators made its presence felt directly in the largest wealth deal last year: **Hellman & Friedman's** all-cash \$3 billion acquisition of publicly traded robo advisor **Financial Engines**. H&F merged Financial Engines with Edelman Financial Services, an H&F-controlled firm (see sidebar).

In a similar direct and noteworthy deal, **Lightyear Capital** acquired **Emigrant Bank's** majority stake in **HPM Partners**, a New York-based firm with more than \$9 billion in AUM, 1,700 clients and six offices nationwide. Subsequently, HPM told Financial Advisor IQ it would seek "like-minded" wealth managers in search of scale, underlining how private equity investors are providing non-aggregators with the capital to expand via acquisition. Another Lightyear-owned firm, **Wealth Enhancement Group** of Minneapolis, added some \$1.1 billion in assets with the acquisition of three firms in diverse locations to bump its total assets above \$9 billion. The company's goal is to more than triple assets within 10 years. In November 2017, Lightyear closed a \$1 billion financial services buyout fund.

California's **Hanson McClain Advisors** is another example of an independent firm that is aiming to build a national presence with the backing of a new private equity parent, middle-market investor **Parthenon Capital Partners**. Last year, Hanson cut its first deal since Parthenon took a majority stake in mid-2017, acquiring an established Cincinnati firm, **Simply Money Advisors** (AUM: \$780 million), to create a more

While the aggregators and private equity firms command most of the headlines, independent firms continue to cement deals on their own. The hot wealth centers along the West Coast have been a particular center for such activity in recent years. **Private Ocean** of the San Francisco area cut two deals in the region in 2018, one for **Mosaic Financial Partners** of San Francisco and a second for **Lakeview Financial Group** of Seattle. The two firms add \$1 billion in assets to the \$1.2 billion Private Ocean managed prior to the transactions. In explaining the larger deal for Mosaic, Private Ocean co-founder and CEO Greg Friedman told WealthManagement.com, "We put a lot of effort into investment management but we start with financial planning. And if you look at the technology stack you will find about 80% alignment in what we use." Both Friedman and his Mosaic counterpart co-founded and sold software companies.

An Atlanta-area firm, **Homrich Berg**, acquired a small local competitor, **Compass Financial Consulting**, adding \$240 million in AUM to cross the \$5 billion mark in assets, more than double the amount it managed in 2011. Compass praised Homrich Berg's reputation and called the firm "the best fit ... to allow us to continue to grow." In another small local deal, **Savant Capital Management** of Illinois enhanced its footprint in the state with the acquisition of Chicago-based **D3 Financial Counselors**, adding \$290 million in AUM to the \$6.3 billion it already managed. As is the case with Savant Capital, D3 is a fee-only firm. In late 2016, Savant Capital raised \$50 million from family offices and other investors in part to fuel acquisitions.

One important transaction last year that went against the grain of consolidation saw wealth manager **Bingham, Osborn & Scarborough** regain its independence when management bought back the majority interest held by **Boston Private Financial Holdings** (NASDAQ: BPFH). Based in San Francisco and with a history spanning 33 years, BOS has \$4.7 billion in AUM. Boston Private made an initial minority investment in 2003, when BOS had \$800 million in assets, and added to that

stake in the years that followed. Boston Private, which will receive \$21 million in cash and a share of revenues over eight years, said it would use the proceeds to buy back shares and invest in the expansion of its wealth business. BOS said the deal “aligns perfectly with our long-term vision for the firm as well as our entrepreneurial spirit.” The buyout was supported by New York’s **Kudu Investment Management**, which provides passive and patient capital to asset and wealth managers; it assumed a 32% stake in BOS. Last year, New York-based Kudu received a \$250 million investment from funds managed by alternatives firm **Oaktree Capital Management**.

The regional and community banks that have been expanding their fee-based businesses in the post-financial-crisis low-interest-rate environment have been notable participants on the buy side in recent years, with multiple such deals in 2018. Among the key buyers last year were **Fifth Third Bancorp**

(NASDAQ: FITB) and **Citizens Financial Group** (NYSE: CFG), the latter of which cut the larger deal in acquiring **Clarfeld Financial Advisors**. Based in a New York City suburb, Clarfeld is an established firm with \$6.8 billion in AUM and another \$900 million under administration; it nearly doubles Citizens’ wealth AUM. Providence, R.I.-based Citizens, which will merge its wealth business into Clarfeld and retain the brand name, is hoping to convert more of its affluent banking customers into wealth clients through the addition of Clarfeld. Fifth Third acquired **Franklin Street Partners**, a North Carolina manager founded in 1990 that has \$2 billion in assets, including an advisory practice for professional athletes. Fifth Third had an existing presence in North Carolina.

Outside the U.S. there were a number of significant deals, led by **Scotiabank’s** (TSX: BNS) C\$2.6 billion (\$2 billion) purchase of **MD Financial Management**, which serves Canadian

NORTH AMERICA RECORDS TWO MEGADEALS

Deal-makers on both sides of the U.S.-Canadian border accounted for the two major transactions in the wealth sector last year, with the larger one involving **Hellman & Friedman’s** \$3 billion acquisition of publicly traded **Financial Engines**. H&F, which paid a 41% premium to Financial Engines’ trailing 90-day average share price, merged the company with its majority-owned and mass affluent advisory firm, **Edelman Financial Services**, rebranding the combination **Edelman Financial Engines**. The lion’s share of Financial Engines’ business involves serving 750 companies with their retirement accounts, including 140 from the Fortune 500. The Silicon Valley-based company has \$1.2 trillion in defined contribution assets under contract, including \$156 billion in AUM, and another \$13 billion in retail and taxable assets.

Part of the logic behind the merger involves combining Financial Engines’ tech-oriented but lower-margin 401(k) business with Edelman’s bricks-and-mortar and higher-margin advisory service, which has \$22 billion in assets. H&F is also counting on Edelman getting a handoff of Financial Engines’ 401(k) clients as they change jobs or retire and seek more personalized investment help. “The right product at the right time ... is real financial advice,” H&F partner Allen Thorpe told *The Wall Street Journal*. “How can you deliver high-quality financial advice at scale? We now have many more tools to do that.” **United Capital** CEO Joe Duran referred to the deal as the “great hybridization,” explaining to *WealthManagement.com*, “Everyone’s rushing to the middle ground, and the middle ground is basically that you’re both digital and human.”

Co-founded in 1996 by Nobel Prize economics laureate William Sharpe, Financial Engines went partway toward adding a human touch in 2015 when it acquired the nationwide Mutual Fund Store, which served a mass affluent clientele. In combination, Edelman and Financial Engines approach \$200 billion in AUM, and marketing savvy Edelman founder and Chairman Ric Edelman is aiming to build a \$1 trillion RIA. “I think in the future we will turn

and look backwards and say that this transaction was the beginning of a sea change in the financial services industry,” Edelman told *Financial Planning*.

In the second deal, **Scotiabank** (TSX: BNS) paid C\$2.6 billion (\$2 billion) in cash for **MD Financial Management**, which serves Canadian doctors, their families and employees. MDFM has C\$38 billion in AUM and another C\$11 billion in assets under advisement. Scotiabank acquired the firm from the Canadian Medical Association (CMA), with most of the cash deal covered by a share offering. Pricing was 5.3% of assets and 9.7 times trailing EBITDA, including run-rate synergies.

Established in 1969, MD Financial serves 110,000 clients, with 63% of assets comprising clients with C\$1 million or more in assets with the firm. Those assets have also been sticky: 80% of relationships have lasted more than 10 years, and fund flows have been positive each year for the past decade. MDFM’s formidable numbers aside, Scotiabank sees room for expansion by grabbing share in the physician segment, where MDFM’s share by total universe of clients is 25%, and by deepening the bank’s relationship with those customers. As part of the transaction, Scotiabank entered a 10-year agreement in which CMA will promote the bank as the preferred provider of financial products to doctors and their families. In a philanthropic twist, Scotiabank agreed to invest C\$115 million over 10 years to support the medical profession and health care in Canada.

“The acquisition of MD adds significant scale to our wealth management business, as well as access to, and expertise in serving, one of Canada’s more affluent client segments,” said Scotiabank President and CEO Brian Porter. The deal came on the heels of Scotiabank’s acquisition of **Jarislowsky Fraser** for nearly C\$1 billion (see *Traditional Investment Management*), and brings the bank’s AUM to C\$233 billion.

doctors and their families (see sidebar). But the most notable action involved Swiss private banks engaged on both sides of the negotiating table in domestic and cross border deals. This followed a record-setting 2017 in which 16 domestic and cross border transactions took place with a Swiss buyer or seller, according to KPMG.

Confronted by tougher regulations and non-Swiss competitors, the number of Swiss private banks has been dropping steadily, from 163 in 2010 to 108 in 2017. The smallest banks — those managing CHF5 billion (\$5.1 billion) or less — have been the biggest casualties, accounting for nearly all the decline. “There are still many banks in the weaker half of the industry that will struggle to survive much longer,” Christian Hintermann, KPMG’s head of financial services transformation, said in a 2018 corporate video. Still, KPMG sees progress, with the majority of Swiss private banks showing improvement in return on equity and profitability, although costs remain a challenge. Additionally, while industry AUM showed strong growth of CHF200 billion in 2017, 90% was due to market performance.

In the major domestic consolidation transaction, **Vontobel** (SW: VONN) paid CHF700 million for **Notenstein La Roche Private Bank** (AUM: CHF16.5 billion). The deal significantly strengthens Vontobel’s domestic position: 70% of Notenstein’s AUM is Swiss-based, 90% of the accounts have assets above CHF1 million, and the firm has 13 offices in the country. By comparison, 40% of Vontobel’s AUM of CHF191 billion (total assets: CHF254 billion) is from Swiss clients. “Notenstein La Roche will predominantly bring us a broader, more regional presence in Switzerland, which has to be the base for more ambitious organic growth going forward,” Vontobel CEO Zeno Staub said during the first-half earnings call. Cooperative bank **Raiffeisen Switzerland** sold the business three years after acquiring and merging La Roche & Co. with its existing private banking business to form Notenstein La Roche. “We had to acknowledge that our private banking ambition couldn’t be fulfilled,” former Raiffeisen CEO Patrik Gisel said at the time of the sale. Vontobel also acquired CHF\$1.2 billion in AUM and related clients from the North American wealth business of another Swiss private bank, **Lombard Odier**.

Julius Baer (SWX: BAER) made four deals outside Switzerland, extending majority ownership of Italy’s **Kairos Investment Management** (AUM: €11 billion/\$12.5 billion) to 100%; expanding its presence in Brazil with the purchase of a leading independent wealth group, **Reliance Group** (AUM: \$5 billion); and entering a wealth joint venture with Thailand’s **Siam Commercial Bank** (SET: SCB). In Japan, **Nomura Holdings** (NYSE: NMR) acquired 40% of **Julius Baer Wealth Management**, which serves its HNW clients in that country. As part of the agreement, Julius Baer will provide discretionary mandate services to Nomura’s HNW customers in Japan. Julius Baer called the deal a “major milestone” that will allow it to “share our internationally diversified offering with a new audience and maximize the value of our presence in Japan.” Nomura is the leading brokerage in Japan.

Union Bancaire Privee cut two cross border deals to expand its existing presence in Luxembourg and the U.K. while **UBS** (SWX: UBSG) rounded out the activities of the major Swiss banks with the acquisition of part of **Nordea**’s (STO:NDA) Luxembourg private bank, adding €13 billion in AUM. UBS said the deal extends its business of serving Nordic wealth

management clients to a “leading position in Luxembourg and in Europe.” In an interview with Bloomberg after the deal, CEO Sergio Ermotti said UBS’ focus is on organic growth, but added, “Of course we look at small acquisitions here and there to complement our portfolio.” In the first half of 2018, UBS’ global wealth business had record invested assets of CHF2.4 trillion and 10-year highs in net interest income and recurring net fee income.

In Asia-Pacific, the investigation of misconduct in the financial services industry by the Australian Royal Commission, which released a 1,000-page interim report last September, is resulting in tectonic shifts in the nation’s wealth sector. Australia’s four major banks have been a particular target, as well as **AMP Ltd.** (ASX:ASE) and **IOOF Holdings** (ASX:IFL). **Australia & New Zealand Banking Group** (ASX: ANZ) kicked off the banking restructurings in late 2017 with the A\$975 million (\$710 million) sale of its wealth, asset management and pensions businesses to IOOF, where the two top executives took leave last December after regulators charged they had failed to “act in the best interests” of their pension clients. The wealth part of that deal closed last year while regulators scrutinize the rest of the transaction. ANZ was joined by two of the other big four in 2018, with **Commonwealth Bank of Australia** (ASX: CBA) announcing in July it will spin off its wealth business and **National Australian Bank** (ASX: NAB) spelling out plans last May to sell its wealth arm. Last year, CBA sold its global asset management business to **Mitsubishi UFJ Financial** (NYSE: MUFJ) for A\$4.1 billion (see *Traditional Investment Management*).

SECURITIES & INVESTMENT BANKING

In 2016, securities firms in the U.S. spent a great deal of time and money preparing for the introduction of the fiduciary rule initiated by the Obama administration. That rule enforced a higher fiduciary standard on brokers for clients’ retirement accounts, though it also applied to advisors, and drove a shift from commission- to fee-based services. But last March a U.S. appeals court threw out the controversial rule, citing “regulatory abuse of power” by the Department of Labor that drew up the rule. The Trump administration, which viewed the rule as burdensome and had delayed implementing parts of it, declined to appeal the court’s ruling.

Last April, as the industry’s pre-fiduciary rule standards came back in force — and as a handful of states said they might push their own fiduciary rules — the U.S. Securities and Exchange Commission stepped into the void, proposing a “Regulation Best Interest” that sought a more moderate path between the interests of investors for transparency and protection and the needs of providers for flexibility in client relationships. As the SEC rule undergoes its own period of scrutiny, many firms that have already adopted the fiduciary rule plan to stick with it, including **Charles Schwab** (NYSE: SCHW). “Most [brokers] are on the path towards a fiduciary standard and are not going back,” **AssetMark** President and CEO Charles Goldman told *The Wall Street Journal* after the court decision.

Still, there could be some tweaks. **Merrill Lynch**, which in 2016 promoted its shift to a fiduciary model in a high-profile ad campaign, took a step back after the court decision and

ultimately chose to reinstitute optional commission-based accounts. The company said it did so in response to client demand. "They wanted to have what they felt was control over paying whenever they transacted," one Merrill executive told AdvisorHub. "That came through pretty loud and clear."

Amid those shifting regulatory sands, broker-dealers enjoyed a solid first three quarters with strong client trading boosting revenues and spreads on client cash balances improving in line with rising interest rates. Charles Schwab added a record 1.2 million new client accounts in the first nine months while average daily trades reached a third-quarter record of 683,000 and related revenue rose by 17% over the previous year's period. At **E*Trade Financial Corp.** (NASDAQ: ETFC), third-quarter revenue was a record \$720 million while year-over-year daily trades rose 29% to more than 266,000. **Interactive Brokers Group** (IEX: IBKR) enjoyed a 34% increase

and brokerage business to **Woodbury Financial Services** of Minnesota. The addition of the bank's \$10 billion in assets represents Woodbury's largest-ever acquisition, bringing its total assets to \$49 billion. Woodbury, founded in 1968, is part of a network of four broker-dealers owned by Advisor Group, which is in turn owned by **Lightyear Capital** and Canadian pension manager **PSP Investments**.

Advisor Group capitalized on another large parent shedding a U.S. broker-dealer as it acquired **Signator Investors** from **John Hancock**, part of **Manulife** (TSX: MFC). Signator, with 1,800 professionals and \$50 billion in assets, will merge with the largest of Advisor Group's holdings, **Royal Alliance Associates**, to make the New Jersey firm a top-10 independent broker-dealer. Prior to the deal last June, Royal Alliance had enjoyed a record recruiting year, adding 171 new advisors representing \$4 billion in assets. Advisor

Group noted that both Royal Alliance and Signator employ the Super Office of Supervisory Jurisdiction model, creating "an ideal situation for Signator's managing partners to affiliate with a firm of like-minded peers and business owners." Manulife and John Hancock become the latest in a recent line of insurers quitting the broker-dealer business.

Aggregator Atria Wealth Solutions joined the buyers last year by acquiring a mid-size independent firm, **Cadaret, Grant**

& Co. Based in Syracuse, N.Y., Cadaret founder and CEO Art Grant had for several years been considering alternative ownership solutions for his 33-year-old firm, which supports more than 900 financial advisors nationwide with over \$23 billion in assets. "I'm making a bet the management of Atria will take this firm into the future, make it better, focus on the firm's strengths like culture, policy and employees, and not turn it upside down," Grant told *InvestmentNews*. This is the third transaction for Atria, which previously acquired **CUSO Financial Services** and **Sorrento Pacific Financial**, San Diego-based firms with combined assets of approximately \$30 billion.

Genstar Capital's purchase of a majority stake in Cetera Financial Group represented a direct and major investment by a private equity firm. Cetera management retains a "meaningful" minority share. The deal, which press reports said could involve a price of up to \$1.7 billion, gives Genstar control of the second-largest network of independent broker-dealers by number of advisors (8,000) and six firms that generated \$1.8 billion in revenues in 2017. The deal also ends a challenging period for Cetera, which went through a successful restructuring after the bankruptcy of parent RCS Capital Corp. in 2016 and embarked on a capital structure

SECURITIES & INVESTMENT BANKING TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|---------|---------|---------|---------|----------------|
| Number of Transactions | 110 | 79 | 69 | 69 | 76 |
| Combined Value (\$B) | \$14.2 | \$13.2 | \$14.2 | \$10.4 | \$9.9 |
| Average Deal Size (\$M) | \$257.5 | \$357.8 | \$568.0 | \$346.1 | \$331.0 |

Source: Berkshire Global Advisors LP

in net interest income over the 2017 third quarter and a 10% bump in daily trades.

E*Trade was also among the firms making acquisitions in 2018, as the ongoing pursuit of scale continued into another year, with sellers buoyed by improving valuations in line with the macro environment. In addition to E*Trade, other active consolidators in the market last year included **Advisor Group** and **Atria Wealth Solutions**, both backed by private equity firms. Another key player, **LPL Financial** (NASDAQ: LPLA), weighed a bid for **Cetera Financial Group**, which was ultimately acquired by **Genstar Capital**.

E*Trade, which paid a total of \$1 billion for two companies in 2016 and 2017 — the larger of which (\$725 million) involved the parent of online derivatives brokerage OptionsHouse — paid \$170 million to **Capital One Financial Corp.** (NYSE: COF) for its online retail brokerage accounts. For E*Trade, the transaction added one million accounts with \$18 billion of client assets, including \$1.9 billion in cash balances, to the six million accounts it already had. While the acquired accounts have lower trading activity than the typical E*Trade client, CEO Karl Roessner told analysts "we're very excited by the potential that's within the account base and for us to engage with them on our platform." E*Trade said the deal will be accretive to earnings this year. In a third-quarter earnings call, Roessner said the company will "remain disciplined" in its purchases but wouldn't shy away from "larger deals that may drive shareholder value over time."

As part of a renewed focus on its banking and credit card businesses, Capital One also sold its brick-and-mortar asset man-

INVESTMENT BANKING ADVISORY FIRM TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|---------|-----------|---------|-----------|----------------|
| Number of Transactions | 14 | 17 | 18 | 17 | 19 |
| Combined Value (\$M) | \$956.6 | \$3,915.9 | \$201.9 | \$1,828.1 | \$127.7 |
| Average Deal Size (\$M) | \$191.3 | \$559.4 | \$40.4 | \$609.4 | \$42.6 |

Source: Berkshire Global Advisors LP

INSTITUTIONAL BROKER-DEALER TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-----------|-----------|---------|-----------|-----------|
| Number of Transactions | 34 | 26 | 12 | 13 | 17 |
| Combined Value (\$M) | \$3,770.1 | \$4,204.8 | \$286.1 | \$1,542.9 | \$1,786.6 |
| Average Deal Size (\$M) | \$198.4 | \$382.3 | \$95.4 | \$171.4 | \$198.5 |

Source: Berkshire Global Advisors LP

review in early 2018. The firms said the transaction provides Cetera “access to significant capital for future investments” in such areas as technology, customer service and operations. Founded in 1988, Genstar has invested in 20 financial services firms, including such current holdings as **Artivist**, a retail packager and distributor of alternative investments, and wealth manager **Mercer Advisors**.

Virtu Financial (NASDAQ: VIRT) made its second megadeal for a public company in as many years, agreeing to pay nearly \$1 billion for brokerage **Investment Technology Group** (NYSE: ITG). ITG provides technology-enabled trading solutions for a largely institutional client base, including transaction cost analyses for 75% of the world’s largest asset managers. ITG comes on top of Virtu’s \$1.4 billion deal in 2017 for KCG Holdings, a wholesale market-making and independent agency execution business. ITG provides diversification for Virtu’s volatile high-frequency trading business by adding more stable technology and execution services revenue. On a pro forma basis, Virtu’s revenue from such services will climb from 10% to 37% of the total, with market-making comprising the rest. Virtu also expects to gain annual cost synergies of \$123 million.

Investment bankers focused on the middle market continued to team up in the search for scale. Several of the deals last year also targeted highly specialized firms focused on industries such as beverages and media. Among the ongoing sellers are established independent firms that lack a viable

ownership transfer plan for partners and are seeking a path to liquidity at a time when valuations are attractive. Outside investors seeking an exit are another factor in some deals. Deals are often structured with an earnout that effectively aligns the financial interests of sellers, who are more often than not the key revenue producers, with those of the strategic partner. “The days of the local or even regional firm are over,” **Capstone Headwaters** CEO John Ferrara told Axial, an online middle-market private network. “Having scale, reach, reputation and senior people with industry experience is the ante today. Private business owners are more sophisticated and expect more from investment banking firms today.”

Capstone Headwaters is itself a result of last year’s purchase by Boston’s **Capstone Partners** of Denver-based **Headwaters**. The transaction, which culminated years of related discussions between the firms, created a more formidable middle-market competitor with 150 professionals covering 16 industries, 17 offices throughout the U.S., and a presence in the UK and Brazil. Capstone founder Ferrara said the

combination “completes the buildout of our sector coverage and greatly expands our geographic presence.” Philip Seefried, who co-founded Headwaters in 2001, told the *Denver Post* the deal was also driven by the desire of longtime shareholders to cash out, as well as the push for talent. “We were seeing our growth flatten out because the market was good. There weren’t as many free bodies around that fit our profile,” he said. In its third-quarter

2018 newsletter, Capstone Headwaters called the M&A market “white hot [amidst] the longest period of economic expansion in U.S. history.”

In another deal targeting a middle-market firm covering multiple industries, **MUFG Union Bank** acquired **Intrepid Investment Bankers**, a Los Angeles-based regional firm that provides M&A, capital raising and strategic advisory services. MUFG Union, part of **Mitsubishi UFJ Financial Group** (NYSE: MUFG) and with a large presence in California, said the two firms served similar clients in the same markets and that the addition will “greatly complement the product and coverage capabilities of our commercial banking team and drive accretive asset growth in our wealth market business.” Intrepid, founded in 2010, said its new parent provides a “large base of commercial lending clients” and additional resources. Intrepid co-founder and CEO Ed Bagdasarian told the *Los Angeles Business Journal* the company had a record year in 2017 as

FULL-SERVICE INVESTMENT BANK TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-----------|-----------|-----------|---------|---------|
| Number of Transactions | 13 | 5 | 6 | 8 | 4 |
| Combined Value (\$M) | \$1,071.7 | \$1,760.0 | \$3,314.7 | \$698.3 | \$421.6 |
| Average Deal Size (\$M) | \$153.1 | \$440.0 | \$1,657.4 | \$116.4 | \$210.8 |

Source: Berkshire Global Advisors LP

demand for investment banking services increased in “our sweet spot” of firms with \$50 million to \$300 million in annual sales. Increased M&A activity has also tracked the fortunes of private equity firms, Bagdasarian noted. “They are applying pressure and values are going up,” he said. Mitsubishi UFJ also acquired **Commonwealth Bank of Australia’s** (ASE: CBA) large global asset management business (see *Traditional Investment Management*).

Fifth Third Bancorp’s (NASDAQ: FITB) acquisition of **Coker Capital Advisors** is an example of a transaction targeting a specialist firm: Coker has a niche in middle-market healthcare

DISCOUNT / ELECTRONIC BROKER TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|---------|--------|-----------|---------|-----------|
| Number of Transactions | 7 | 9 | 5 | 8 | 10 |
| Combined Value (\$M) | \$257.4 | \$66.1 | \$2,521.9 | \$243.6 | \$5,627.1 |
| Average Deal Size (\$M) | \$85.8 | \$22.0 | \$1,261.0 | \$81.2 | \$1,125.4 |

Source: Berkshire Global Advisors LP

RETAIL BROKERAGE FIRM TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-----------|-----------|-----------|-----------|---------|
| Number of Transactions | 16 | 7 | 10 | 4 | 12 |
| Combined Value (\$M) | \$5,635.9 | \$1,125.7 | \$3,070.8 | \$3,599.0 | \$632.8 |
| Average Deal Size (\$M) | \$704.5 | \$562.8 | \$511.8 | \$1,799.5 | \$126.6 |

Source: Berkshire Global Advisors LP

that strengthened Fifth Third's existing capabilities in that area — the largest vertical market at the bank but one that lacked an M&A unit. The deal also meets Fifth Third's strategy of expanding fee revenue via organic growth and acquisitions. Coker, whose coverage extends to physicians' practices, executed healthcare transactions valued at \$65 billion during its nine years as an independent firm. Although the two firms considered a partnership agreement, Coker ultimately opted to be wrapped into Fifth Third, saying it "will enable us to extend our reach and introduce enhanced capabilities to our clients."

A second specialized deal saw **Cascadia Capital** acquire **First Beverage Financial**, which targets the beverage industry and has a particular niche among craft brewers. The company, part of Los Angeles-based **First Beverage Group**, advised on 25 deals in the four years leading up to the sale, 18 involving craft brewers. Cascadia, based in Seattle, is a diversified middle-market firm whose consumer practice complements First Beverage's business. "Cascadia has a much larger consumer platform," Townsend Ziebold, a First Beverage Financial managing partner now with Cascadia, told Brewbound. "This gives us a deeper knowledge and more capability in all things consumer.... we viewed this as a classic one plus one equals three situation." Cascadia Chairman and CEO Michael Butler told the *Seattle Times* that the addition of First Beverage will allow his company to pursue opportunities in the alcoholic beverage industry "much more aggressively" while expanding

INDEPENDENT BROKER-DEALER TRANSACTIONS

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|-------------------------|-----------|--------|---------|---------|--------|
| Number of Transactions | 8 | 3 | 6 | 5 | 4 |
| Combined Value (\$M) | \$1,245.3 | \$25.0 | \$102.6 | \$375.6 | \$67.7 |
| Average Deal Size (\$M) | \$311.3 | \$25.0 | \$34.2 | \$375.6 | \$67.7 |

Source: Berkshire Global Advisors LP

the number of bankers in its consumer and retail practice to 14. "[The deal is] a testament to the growth we see in the consumer sector," he said.

In a third such deal, this time crossing borders, **GP Bullhound** of London acquired New York's **AdMedia Partners**, a prominent M&A specialist in the digital, marketing and media sectors. Founded in 1990, AdMedia has completed more than 250 deals with a combined value of \$12 billion. GP Bullhound is a technology advisory and investment firm with offices in Europe, Asia and the U.S., but AdMedia gives it entry to the East Coast market. GP Bullhound said the two firms "are a natural fit, sharing a passion for working with entrepreneurial

category leaders." **Janney Montgomery Scott's** acquisition of middle-market specialist **HighBank Advisors** also extends Janney's M&A capabilities along the East Coast, where both firms are headquartered, while adding coverage in business services. Janney noted that the expansion of its M&A business "aligns with the interests of many of our private wealth clients who are business owners in need of services related to selling their business or raising capital."

The shrinking universe of independent public finance firms grew smaller still last year when **Huntington Bancshares** (NASDAQ: HBAN) acquired **Hutchinson, Shockey, Erly**, which underwrites and structures debt for state and local governments and nonprofits. Chicago-based HSE was established in 1957. Columbus, Ohio-based Huntington said the addition will "complement the growth we've experienced in our existing government banking and public finance businesses." Through its investment banking unit, **Guggenheim Partners** acquired prominent restructuring specialist **Millstein & Co.**, culminating several years of overtures. Guggenheim said Millstein will allow it to "build on the significant success of our restructuring and liability management practice." In an interview with CNBC, Guggenheim Partners Executive Chairman Alan Schwartz noted the potential financial "cliff" ahead for governments, saying, "Being positioned to be a leading firm in sovereigns and municipals whenever a downturn comes is a great balance to a portfolio of businesses." Through 2016, Millstein had for several years been advising the government of Puerto Rico on its debt restructuring. The high-profile founder and CEO of Millstein, Jim Millstein, will join **Guggenheim Securities** as co-chairman.

There was one major consolidation deal within the exchange industry: **CME Group's** (NASDAQ: CME) \$5.4 billion acquisition of the UK's **NEX Group**, which runs BrokerTec, the leading fixed income electronic trading platform, including for U.S. Treasuries. Strategically, the deal combines CME's massive derivatives platform, including U.S. interest rate futures, with BrokerTec, which in addition to U.S. Treasuries handles U.S. repos and agency securities, as well as European sovereign debt and repos. CME said the deal will also "facilitate the development of innovative post-trade services and data offerings to further enhance cost-effective trading and risk management." Significantly, the combined platforms will provide a single access point for traders in derivatives and fixed income products. In a minor deal, **Intercontinental Exchange** (NYSE: ICE), owner of the **New York Stock Exchange**, acquired the **Chicago Stock Exchange**, marking the passing of the last independent U.S. regional exchange. For ICE, the benefit involves gaining a valuable exchange license that would otherwise entail a lengthy regulatory review. CSE handles less than 1% of U.S. equity trades. Additionally, ICE more than doubled the 4.7% stake it acquired in 2017 in **Euroclear**, which settles €730 trillion (\$870 trillion) in European securities transactions each year. ❖

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