Investment Management Industry Review 2004

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The Markets Make a Strong (But Silent) Return

Although financial markets bounced back smartly in 2003, it was in many ways a strangely unemotional rebound for most of the year. For one thing, it was to a certain extent expected, as history weighed in favor of some sort of bounce after three years of negative returns. The last time the U.S. market endured four straight years of declining prices—from 1929 to 1932—the country was in the midst of the Great Depression.

More importantly, conflicting signals regarding economic prospects in the U.S. and Europe remained important checks on unbridled optimism. Then, too, U.S. stocks were hardly a bargain, making many traditional value investors uneasy even before the year's ride began. Warren Buffet, for one, declared in February 2003 in his Berkshire Hathaway shareholder letter that he found "very few [common stocks] that even mildly interest us," despite the three-year run of falling prices. He attributed this "to the insanity of valuations reached during The Great Bubble."

The Rally Finally Gets Going

Performance of key stock indices

	2000	*2001*	*2002*	***2003***
DJIA	-6%	-7%	-17%	**+25%**
S&P 500	-10	-13	-23	**+26**
Nasdaq	-39	-21	-32	**+50**
FTSE 100	-10	-16	-25	**+14**
DAX	-8	-20	-44	**+37**
Nikkei 225	-27	-24	-19	**+25**

Lingering qualms aside, money managers and individuals alike became buyers again, helping to drive 25% and 26% increases in the Dow Jones and S&P 500, respectively. The speculators among them were back as well, helping to reinflate tech stock valuations and offering some assistance to Nasdaq's sharp turnaround (up 50%). By the summer, **Merrill Lynch**'s index of 100 leading tech stocks was trading at 35 times *forward* earnings.

Nasdaq's OTC Bulletin Board, an incubator for the smallest and riskiest stocks, was also humming along, with trading volume in September passing 40 billion shares—2½ times the level in September 2002; dollar volume, at $5.4 billon, was more than six times higher.

Not surprisingly, margin debt extended by NASD-registered brokerage firms was also skyrocketing, hitting a record $26 billion in July—a fivefold increase from the beginning of the year. The once-storied day traders were behind much of the froth, which was good news for the brokerage firms catering to the keyboard set. **Ameritrade** and **E*Trade** reported record quarterly earnings in October, with the latter recording a 42% increase in daily trades in the U.S. versus the year-earlier period.

The turning financial tide was also good news for the asset management industry. Before news of the mutual fund trading scandal broke in September, U.S. equity mutual funds were again basking in the warm glow of fresh capital and good feelings, with net inflows having been recorded each month between April and September, when the amount reached $17.3 billion, according to the Investment Company Institute.

In September, equity funds' assets ($3.2 trillion) were 29% higher than during the same period in 2002. And while the widening scandal resulted in large outflows from major fund managers such as Putnam Investments—which suffered an 11% drop in assets under management (AUM) in November—equity funds as a whole recorded an estimated $24.5 billion in net inflows in October, according to AMG Data Services.

The stock prices of publicly traded U.S. asset managers sailed above the equity wave, with many comfortably outpacing the S&P 500, although earnings among these companies remained sluggish in the first half. **Franklin Resources** stock jumped 41% in the first 11 months of the year, with operating income finally recovering in the third quarter to rise 10% versus the previous

Again, the U.S. Leads

GDP growth

	*2003**	*2004**	*2005**
U.S.	2.9%	4.2%	3.8%
Euro Zone	0.5	1.8	2.5
Japan	2.7	1.8	1.8
OECD	2.0	3.0	3.1

* Projected (as of Nov. 2003)
Source: OECD

year. At **T. Rowe Price**, third-quarter income jumped 45%, while the stock was up 56% in the first 11 months.

The stocks and earnings of financial services companies in general fared well in 2003, with the Dow Jones financial industry index up nearly 24% through November, more than three points above the S&P 500. In the third quarter, **Bank of America**, **Citibank** and **Merrill Lynch** all reported record earnings. Overall, earnings of U.S. companies rebounded strongly, with three consecutive quarters of double-digit gains.

In the first half of 2003, some skeptics attributed a good deal of the profit bounce to the impact of a weaker dollar that helped earnings translations, as well as skimpier investment. But by the third quarter, the stunning 8.2% GDP growth in the U.S. and a 41% earnings jump among *BusinessWeek*'s Corporate Scoreboard of 900 companies suggested a firmer footing for the recovery of profits and the economy.

In Europe, investors were also awaking from the bad dream that began in 2000. The FTSE 100 rose 14% and mutual fund net inflows among individuals in the U.K. grew stronger during the course of the year, in July registering a 50% increase over July 2002. But for most of the year, investors in the U.K. followed a conservative course, choosing bond funds over those investing in equities, according to the Investment Management Association. Although the hoped-for economic rebound never occurred in the euro zone, where GDP growth is expected to be 0.5% at best, markets still enjoyed varying gains, with Germany's DAX up 37% and France's CAC 40 rising 16%.

Continental Europe's traditionally conservative individual investors, unnerved by the bear, did return to the markets, though not with the same conviction as Americans. In August, equity funds accounted for one-quarter of mutual fund sales in Europe, compared with just 5% in August 2002, but monthly flows during the year tended to shift between net redemptions and sales, according to data from FERI, the European mutual fund tracker.

The Wall Street Journal Europe's semiannual survey of Western European investors, taken in the spring, also showed lingering bearishness, with only 4% of respondents saying they had increased their holdings of individual equities or equity funds in the past half-year.

Significantly, the widening chasm between Europe's slow economic growth and flat-to-negative population growth and its ambitious social contract finally led both conservative and Social Democratic governments in the continent's three largest countries to begin the politically charged process of reforming their state pension systems. In the face of a series of strikes, France's center-right government did push through limited changes, requiring 2½ years of additional service before members of its large public sector workforce can qualify for a full pension.

Germany and Italy, which face similar pressures from their politically potent unions, are mulling similarly modest immediate changes in their pension schemes. Germany, having endured yet another year of economic stagnation, has already warned of a $10 billion pension shortfall in 2003 that will necessitate either cuts in payments or additional taxes in 2004.

For asset managers, the near-term implications of these developments are uncertain in a region where the state rather than the individual has long been considered the proper authority for such matters. In Germany, where the pay-as-you-go state pension scheme was inaugurat-

A Turn Up

Worldwide M&A activity

Number of Announced Deals	*2002*	*2003*
Worldwide	26,270	27,612
U.S.	6,920	7,519
Finance & Insurance Sector (Worldwide)	2,737	2,561
$1 Billion-Plus Deals (Worldwide)	236	245
Value ($ billions)	*2002*	*2003*
Worldwide	$1,210	$1,330
U.S.	$432	$524
Finance & Insurance Sector (Worldwide)	$213	$317
$1 Billion-Plus Deals (Worldwide)	$664	$712

Sources: Thomson Financial (Worldwide, U.S.); Dealogic (Finance & Insurance, $1b-plus)

Future Burdens

Public pension costs as % of GDP

	2000	*2020*
France	12.1%	15.0%
Germany	10.8	12.1
Italy	13.8	14.8
U.K.	5.5	4.9
EU15	10.4	11.5
U.S.	4.2	5.8

Sources: European Commission; OASDI Trustees Reports

ed in the 1880s by Bismarck, the limited private pension plan introduced by the government in 2001 has yet to catch on. For its part, France has approved a retirement plan in the 2004 budget that allows citizens to save 10% of their income, with the payout in the form of an annuity.

Under the assumption that fiscal reality will ultimately force Europe's governments to place greater responsibility for retirement into the hands of individuals, many asset managers are optimistic about the long-term prospects for reforms that will involve their participation. From the other side of the Atlantic, **American Express** offered a vote of confidence in the future of European asset management when it acquired U.K. fund manager **Threadneedle Asset Management**, portraying the $570 million deal as the opening gambit in its regional ambitions *(see story, p. 13)*.

In the U.S. and elsewhere, the pickup in equity markets and expectations of an economic recovery fueled a number of significant deals as the year moved forward. After two declining years, M&A activity worldwide rose 10% to $1.3 trillion in 2003, according to Thompson Financial, with deal value in the U.S. jumping 21% to $524 billion. The number of deals worldwide rose by around 5%.

The financial services industry played host to the year's largest transaction—**Bank of America**'s $47 billion bid in late October for **FleetBoston**. Although driven by BofA's desire to extend its retail banking footprint, the deal also brings together two substantial asset management businesses, with **FleetBoston** contributing one-third of the combined firm's $470 billion in AUM.

FleetBoston in particular had been an active acquirer of mutual funds, including the $900 million purchase of Liberty Financial in 2001. In 2000, BofA paid more than $1 billion for the 50% of fund manager Marsico Capital Management that it did not own. The size of the deal, including the pressure such a union may place on competitors, had observers speculating about other regional banking targets—although the market responded immediately to BofA's premium offer by driving down its stock.

Although markets and fund flows turned positive again, the number (135) and value ($9.3 billion) of asset management deals declined in 2003, with value down for the third straight year and off around 11% from 2002. The total transfer of AUM, at $375 billion, fell to the lowest level in a decade. At the same time, the interest of buyers became notably more active beginning in the second quarter, after the Iraq war ended, the markets turned up and confidence in an economic turnaround increased.

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Lehman Brothers' $2.6 billion acquisition of **Neuberger Berman** was the largest asset management deal of 2003, the first billion-plus deal involving two U.S. firms since 2000—and the first mega-deal since 2001. The acquisition provides Lehman with greater scale in the wealth management, institutional and fund management arenas to offset its traditional strength in bonds *(see story, p. 7)*.

Buyers spent a total of $5.5 billion on the top 10 deals of 2003, a 10% increase from the $5 billion in 2002, but still well below the $10.5 billion in 2001. Overall, the market was characterized by circumspect buyers and bite-size targets. For buyers, the focus remained on adding specific investment expertise or geography; for sellers, a common objective was gaining distribution and other benefits of scale.

For example, **John Hancock Advisers** continued the expertise-for-distribution strategy it has pursued in recent years in the mutual fund sector, acquiring M.S.B. from Chicago's **Shay Assets Management**, a large-cap blend fund that Shay will continue to manage through a sub-advisory agreement. **Charles Schwab** cut a similar

Investment Management Transactions

	1999	*2000*	*2001*	*2002*	***2003***
Majority Equity	85	121	118	119	**116**
Minority Equity	15	4	4	16	**10**
Management Buyout	3	1	8	8	**9**
Total	103	126	130	143	**135**
Value of All Transactions ($b)	17.0	36.4	15.6	10.3	**9.3**
AUM Changing Hands ($b)	562	1,405	830	548	**375**

Source: Berkshire Capital Corporation

sub-advisory deal with **AXA Rosenberg**, in which Schwab "adopted" the firm's U.S. family of funds. Separately, Schwab made its largest deal since acquiring **U.S. Trust** in 2000, by purchasing **State Street**'s private asset management group for $365 million, thereby gaining access to the New England wealth market.

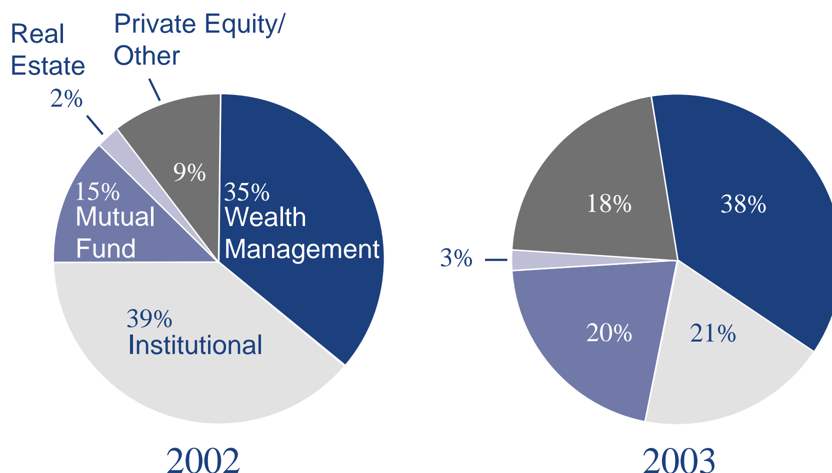
Indeed, the hottest sector by far during the year was wealth management, which saw 51 transactions worth $6.3 billion. Although wealth management remains a very attractive business, the industry has not been immune from the impact of the bear market. According to a Boston Consulting Group report released in July, revenues and assets under management at more than 80 of the world's leading wealth managers dropped by 25% and 14%, respectively, between 1999 and 2002 (though the survey used a broad definition of "wealth," including those with $250,000 in AUM).

For many smaller firms facing such negative performance numbers, the sale to a larger partner became a much more attractive option in 2003. This was true on both sides of the Atlantic, with the Swiss private banking industry a particularly active marketplace. In addition to Charles Schwab, other firms that added to their already large wealth management capabilities included **Deutsche Bank**, **Goldman Sachs**, **Mellon Financial** and **UBS**.

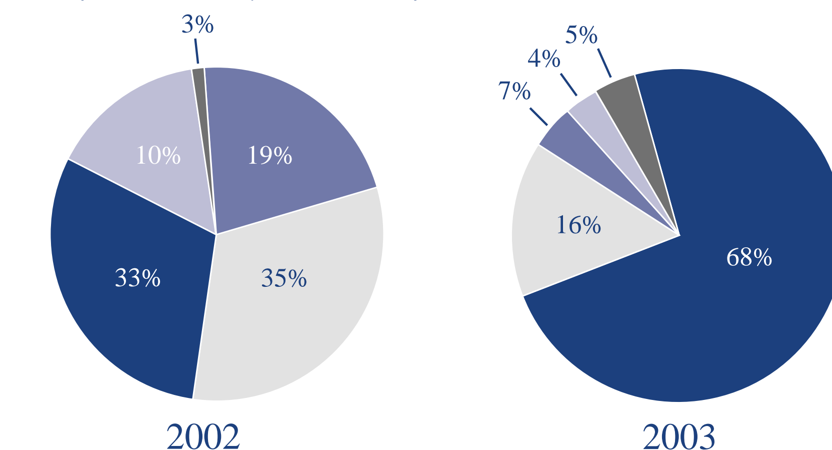
The American Express acquisition of Threadneedle was the key transatlantic deal in a year when few such deals took place. European demand for American asset managers all but disappeared in 2003, even as a strengthening euro provided a currency advantage for the first time in years. Within Europe, cross border deal-making was also quiet, with the exception of the Swiss activity. The declining fortunes of asset managers on the continent, combined with the inability of the

Who's Selling?

Number of transactions by sector as % of total



Value of transactions by sector as % of total



Who's Buying?

Number of transactions

	1999	*2000*	*2001*	*2002*	***2003***
Bank	26	41	45	49	**32**
Mutual Fund	6	17	9	15	**20**
Institutional	10	15	12	17	**13**
Wealth Manager	1	12	5	15	**12**
Securities Firm	13	15	13	11	**11**
MBO	3	1	8	8	**9**
Trust Company	4	5	5	2	**9**
Insurance Co.	18	14	14	15	**9**
Financial	16	2	8	5	**3**
Real Estate Manager	1	0	4	1	**2**
Other	5	4	7	5	**15**
Total	103	126	130	143	**135**

Source: Berkshire Capital Corporation

area's major markets to kick-start their economies, served as two serious brakes on activity.

The mutual fund industry was similarly subdued, with the exception of Canada, which for the third year running played host to several important transactions. The primary player in 2003, **CI Fund Management**, did three asset management deals that made it No. 2 in that country's mutual fund industry. Elsewhere, the mutual fund deals that did get done tended to be highly focused, with an average transfer in the sector of just $800 million in AUM.

In addition to the actions by John Hancock and Charles Schwab, **Federated Investors** acquired eight relatively small mutual funds run by **Riggs Investment Advisors**, while **Pioneer Investment Management** scooped up a half-dozen funds in two deals with total AUM of $164 million. Three years ago, Pioneer was acquired by **Unicredito Italiano** in a headline transaction. In the U.K., high-profile newcomer **New Star Asset Management** made news with three domestic acquisitions that expanded its presence in the retail fund business.

Similar to activity in the mutual funds area, institutional deals involved tack-on moves, with one of the larger ones being **Principal Financial Group**'s $100 million purchase of a 68% stake in high-yield and distressed securities specialist **MW Post Advisory Group**. The hedge fund acquisitions that added color to the deal picture in 2002 were far less numerous in 2003, though interest in alternative investments remained keen.

In the last week of October, a shot was fired signaling the start of financial institution M&A activity, in the form of the Bank of America-FleetBoston deal. With that transaction providing the fuel, the financial services industry is likely to witness a healthy round of deal-making in 2004.

In the last week of October, just before the release of the unexpectedly strong economic growth numbers in the U.S., a shot was fired signaling the start of financial institution M&A activity, in the form of the BofA-FleetBoston deal. With that transaction providing the fuel, the financial services industry is likely to witness a healthy round of deal-making in 2004. Within the asset management industry, we believe the following trends and events could impact deal activity:

- When the current regulatory cloud over the mutual fund industry clears, many smaller and midsize firms—as well as those owned by institutions particularly sensitive to the regulatory and reputational issues raised in the recent revelations (such as banks and insurance companies)—will find it easier to partner or sell than remain independent or subscale in a consolidating business.

- It is becoming increasingly difficult for even the larger, well-heeled company to gather new business in the wealth management arena, as competition is fierce and the improvement in the market has made customers less prone to change advisors. There continue to be a significant number of competitors battling for a growing, albeit limited, set of prospective clients.

- The rush to acquire hedge funds that took place in 2002 but slowed in 2003 will likely remain less robust in the coming year, and deals that do get done will probably target fund of funds managers.

- A few far-sighted U.S. firms will begin to venture back into Europe but cross border movement the other way is unlikely, even as the weak dollar makes U.S. acquisitions an attractive and prudent option.

H. Bruce McEver
Chairman

R. Bruce Cameron
President

Wealth Management

As gauged by every key metric—including number of deals (51) and value ($6.3 billion)—wealth management was by far the hottest sector in the asset management industry in 2003. The sector also played host to the industry's largest deal—**Lehman Brothers**' $2.6 billion acquisition of **Neuberger Berman** *(see story, p. 7)*. While primarily a bank deal, **HSBC**'s $1.3 billion acquisition of **Bank of Bermuda** also had a significant private banking component to it. And unlike other parts of the asset management industry, where concerns about growth have acted as a check on pricing, buyers remain willing to pay attractive multiples for wealth managers. Lehman, for example, paid the equivalent of 4.1% of AUM, while **Charles Schwab** paid 3.2% of AUM for the private asset management business of **State Street**.

For buyers, the appeal of wealth management firms is straightforward: access to lots of money, loyal customers and potentially high margins. For banks, there's an additional lure: the possible spin-off benefits, such as handling the investment or commercial banking needs of a client's corporation.

But as attractive as the business can be, for many smaller firms grappling with falling assets in recent years, the strain of keeping up with costs (including paying for talent) and technology have made partnerships with larger organizations an equally attractive option. In addition to Lehman and Schwab, those high-profile buyers in 2003 included **Deutsche Bank**, **Goldman Sachs**, **Mellon Financial**, **Societe Generale** and **UBS**.

Clients themselves are also driving many of the deals, on both sides of the negotiating table. Having been stung like most investors by the bear market, high net worth individuals have become far more demanding about overall results and preservation of principal. For both buyers and sellers, that means seeking out better products and greater expertise.

Eaton Vance's 80% acquisition of **Parametric Portfolio Associates** of Seattle (AUM: $4.7 billion) is a good example of a deal done to gain a particularly coveted jewel—superior technology. Eaton Vance enjoys a niche as a tax-efficient investor, and the customized portfolio technology Parametric uses for its separate accounts business offers broad application for Eaton Vance's business. Parametric has achieved a strong reputation for delivering results based on client's tax or risk profile, using its proprietary systems.

In another technology play, **SunGard**'s Wealth Management Services group acquired London Pacific Advisory Services from parent **London Pacific Group**. The two firms aim to combine their operations to produce what SunGard described as "end-to-end" technology solutions for separately managed accounts at wealth management firms.

Goldman Sachs' acquisition of **Ayco Company** was done to gain access to a more traditional kind of expertise—fee-based financial counseling. "Combining our investment management expertise with Ayco's financial planning capabilities benefits all of our clients, and enhances our private wealth management platform," said Peter Kraus and Philip Murphy, co-chiefs of Goldman's investment management group. Ayco, founded in 1939 and owned by **American Express** for 11 years before a management buyout in 1994, provides investment management and administrative services for $6 billion in assets.

For the most part, however, U.S. deals continue to be driven by the desire of buyers to expand into new territory, in a business that is still very local and very personal. Mellon Financial has been a notable player on this front, as its acquisition in 2003 of Atlanta's **Arden Group** (AUM: $750 million) marked the fourth "geographic" deal it has made in the last three years. Said David Lamere, vice chairman and president of Mellon's private wealth management group: "Our approach has been to expand by focusing on strong regional markets where we do not have a presence, and the Atlanta area clearly supports that strategy." Mellon has also acquired firms in California, Ohio and the state of Washington.

Charles Schwab's $365 million acquisition of State Street's private asset management group (AUM: $11.5 billion) provides its **U.S. Trust** wealth management arm with access to the lucrative New England market, filling a significant hole in that company's broad geographic reach. The deal also heralds

Wealth Management Transactions

	1999	*2000*	*2001*	*2002*	***2003***
Number of Transactions	33	44	41	50	**51**
Combined Value ($b)	4.1	6.7	2.2	2.0	**6.3**
Total Seller AUM ($b)	95	186	53	63	**189**
Average Deal Size ($m)	124	153	53	39	**124**
Average Seller AUM ($b)	2.9	4.2	1.3	1.3	**3.7**

Source: Berkshire Capital Corporation

Schwab's return to the market, after its stunning purchase of U.S. Trust in 2000.

In 2002, U.S. Trust accounted for one-fifth of Schwab's operating income and enjoyed a 27% increase in new assets from Schwab referrals. State Street, which in 2002 acquired the global custody business of Deutsche Bank, said the sale is part of an effort to focus on its core businesses, including institutional money management.

City National Corp. of California pulled off its third and largest wealth management deal since 1998 by acquiring Chicago's **Convergent Capital Management**, which holds interests in 10 affiliates (eight of which are majority holdings). The $49 million transaction (including assumption of more than $7 million in debt) nearly doubled CNC's AUM, to around $14 billion, and extends its presence to several new states while strengthening its existing footprint in California. For Convergent's management, CNC offers the capital for acquisitions and expansion that its shareholders, including troubled insurer Conseco, had been unable or reluctant to invest in recent years. Convergent's revenues grew at a compound annual rate of 19% in the five years through 2002.

Amvescap's acquisition of **Stein Roe Investment Counsel** extends the footprint of its **Atlantic Wealth Management Group** into Chicago and California while doubling Atlantic's AUM to $16 billion. Prior to the $118 million cash-and-shares deal (which provides for an additional $43 million in performance-based payments), Atlantic had offices in eight states around the country and in the District of Columbia.

In Europe, the ongoing consolidation of Switzerland's wealth industry was the biggest story by far. As in the U.S., the mix of falling assets and declining income combined with lingering bull market costs continue to weigh on independent firms. But Swiss-based wealth managers face one additional issue with implications for the competitiveness of many independent firms: the country's offshore banking system is under increasing pressure from the U.S. and EU for greater transparency, with the EU eager to account for its citizens' untaxed assets.

May was a particularly active month for deal-makers in Switzerland, as three mid-size transactions were struck within the space of a couple of days. **EFG**'s acquisition of **Banque Edouard Constant** merges the operations of two independent firms into a more formidable entity with $13 billion in assets, **EFG Private Bank**. Although BEC suffered from management turnover and high costs, EFG was attracted by the company's strong client base from several countries. The combination will allow for "cost rationalization opportunities through increased transactions volumes, efficient operational processes and premises consolidation," the banks said. EFG, controlled by the billionaire Latsis family of Greece, took a majority stake in the new firm.

Potential synergies and the

Lehman Bets on Asset Management

In acquiring **Neuberger Berman** for $2.6 billion, **Lehman Brothers** cut the largest all-U.S. asset management deal since **Charles Schwab**'s $2.7 billion purchase of **U.S. Trust** in 2000. (**Alliance Capital**, which acquired **Sanford Bernstein** for $3.5 billion that same year, is owned by **AXA Group** of France.) As was the case with Schwab, Lehman is making a major and fairly pricey bid to diversify: it paid 4.1% of AUM and nearly 14 times pre-tax earnings for Neuberger (though Schwab paid a much richer 22 times EBITDA for U.S. Trust).

Lehman's bottom line will hinge on the similarities ending there, however. Whereas Schwab walked straight into the bear market, Lehman's acquisition is predicated on a continued shift back to equities and its need to balance a business that relies somewhat heavily on a robust bond market.

In Neuberger, Lehman gains scale primarily in wealth management—where Neuberger has built a strong, high-margin business—but also in the institutional and mutual fund areas. The addition of Neuberger's $64 billion in AUM provides Lehman with a total of more than $100 billion in managed assets.

The timing of the acquisition made sense for another reason: with its stock trading at a relatively high valuation, Lehman was able to use its shares as the primary currency in the deal. Lehman Chairman and CEO Richard Fuld Jr. called Neuberger "an ideal partner," saying, "Strategically, this acquisition meets our objectives of enhancing business diversification and growing our higher margin businesses. Financially, we expect the combination to further improve our ability to generate consistent and attractive cross-cycle results and create additional value for our shareholders."

Neuberger said the deal would provide its clients with a broader array of products and a global distribution system. The company will be wrapped into the wealth and asset management group of Lehman's Client Services but will retain its name. As a result, client services will see its share of the revenue stream at Lehman jump from 13% to 21%, based on 2002 pro forma numbers. In 2003, Lehman also acquired the private equity fund of funds investment manager **Crossroads Group** *(see Alternative Investments, p. 14).*

opportunity to triple the size of its Swiss business drove Societe Generale's acquisition of 67% of **Compagnie Bancaire Geneve** (AUM: $9 billion). SocGen plans to merge CBG with its existing Swiss private bank, **SG Ruegg**, to create a firm with more than $13 billion in AUM. SocGen, which reportedly paid $230 million for its stake, made two other acquisitions of wealth managers in 2001 and 2002, in Belgium and Japan.

In the third deal last May, **LGT Group**, owned by the royal family of Liechtenstein, acquired **STG Schweizerische Truehandgesellschaft**. The $150 million transaction provides LGT with $5.3 billion in AUM and strengthens its advisory services, but left STG parent **Swiss Life** writing off a $75 million loss on its investment (Swiss Life has also been trying to sell another Swiss private bank it acquired, **Banca del Gottardo**). Worldwide, LGT had some $11 billion in AUM prior to the deal.

Separately, Deutsche Bank expanded its wealth management business with the purchase of another Swiss private bank, **Rud, Blass & Cie** (AUM: $5.3 billion), from **Zurich Financial Services**. The deal provides the German bank with a presence in Switzerland's onshore market through a company noted for its management of Swiss and European equities and Swiss real estate investment products.

Banque Privee Edmond de Rothschild was also in the market, acquiring a majority stake in **Rouiller, Zurkinden et Cie Finance**, a 5-year old firm catering to private and institutional clients. **Royal Bank of Scotland**, which operates a large wealth management business through **Coutts Group**, paid $380 million for **HVB Group**'s Swiss private banking business, **Bank von Ernst & Cie** (AUM: $10 billion). The deal expands Coutts' Swiss asset base by 50%. (During 2003, RBS divested itself of three non-core U.S. and Latin American wealth managers. Buyers included **J.P. Morgan Chase**, **Patriot Bank** and **Banco Santandar Central Hispano**.)

Elsewhere in Europe, the world's leading private bank, UBS, made two acquisitions, first buying the French wealth management unit of **Lloyds Bank**. The deal netted the Swiss giant some $1.1 billion in AUM and expands its presence in a market it entered in 1999. UBS also added $1.4 billion in AUM to its sizable German operations by acquiring **Merrill Lynch**'s private client business in that market. Both transactions are in line with statements UBS has made regarding its intention to target smaller companies in Europe and the U.S. for purchase.

British private equity firm **Candover Investments** paid $210 million for a majority shareholding in the trust and fiduciary services business of Anglo-Dutch private bank **Insinger de Beaufort**, in a bid to bulk up ahead of expected consolidation of the trust and fiduciary sector. Insinger retained a "significant stake" in the renamed firm, **Equity Trust**.

Within the U.K., **Barclays Bank** paid $350 million for **Old Mutual**'s **Gerrard Management Services** (AUM: $21 billion), a venerable British firm that serves both high net worth and "affluent" clients. The deal vaults Barclays from No. 8 to No. 1 in the U.K. private client business, with $35 billion in discretionary and advisory assets.

Prior to its acquisition by **Aberdeen Asset Management** in September *(see Mutual Funds, p. 10)*, **Edinburgh Fund Managers** sold off its private client unit to **Tilney Holdings**. Tilney, the U.K.-based private client arm of U.S. financial services firm **Refco Group**, added $400 million in AUM to the $1.2 billion in assets it already managed in Scotland.

Institutional Advisors

The institutional sector, which in 2002 maintained a brisk number of deals, albeit for far less money than in recent years, experienced a significant falloff in activity in 2003. The number of transactions dropped to 27 from 56 in 2002, and total value declined for the third year running, to $1.4 billion.

Not surprisingly, institutional transactions came in at lower multiples, of around 10 times EBITDA, compared with the mid-teen levels of the previous two years. Although price-to-revenues multiples proved more resilient, at 3 to 5½ times, buyers sent two clear and related messages: the era of major strategic acquisitions at any price is over; and, in the post-bubble world, growth expectations are being set far more conservatively. By midyear, that message began to sink in, as many potential sellers began to lower their pricing expectations and thereby remove a key stumbling block to some transactions.

While transactions were small—only a few topped even the $100 million mark and average seller AUM was just $4.4 billion—the checklist of buyers remained impressive, as a number of prominent U.S. firms opportunistically and selectively sought solid companies with specific capabilities.

In one of the larger such deals, **Principal Financial Group** added to its institutional capabilities in alternative investments by paying around $100 million for 68% of Los Angeles-based **MW Post Advisory Group**, a specialist in high-yield and distressed securities. A privately held firm started up in 1991 by Larry Post, a noted figure in the high-yield arena, MW Post has $3.4 billion in AUM.

For Iowa-based Principal, the acquisition offers "attractive yield enhancement and diversification benefits to our clients," according to Principal Global Investors CEO Jim McCaughan. Larry Post cited the "deeper resources, broader product development opportunities and global distribution capabilities" of Principal, along with its ability to "help take our firm to the next level."

Another Midwest asset manager, **Victory Capital Management**, part of Cleveland's **KeyCorp.**, acquired **NewBridge Partners** of New York, a 4-year-old growth equity firm that complements Victory's existing value focus. The third asset management firm Victory has acquired since 1995, NewBridge adds $2 billion in AUM to the $60 billion already managed by the company. "By joining Victory, our team gains the commitment, investment resources and stability of a larger firm with a long history of success," said NewBridge CEO Jim Cowperthwait. "This means more support in every area of our business—research, operations, sales and client service."

Baltimore's **Mercantile Bankshares Corp.** (AUM: $15.4 billion) went to the heartland to acquire **Boyd Watterson** (AUM: $3.8 billion), an established Cleveland firm that offers a fixed income capability and enhances Mercantile's existing Taft-Hartley pension plan business. Mercantile paid $19 million for the acquisition and assumed "certain indebtedness" of Boyd Watterson; the company could make additional performance-based payments of $9.5 million. In an effort to generate more income outside its traditional banking lines, Mercantile has made four acquisitions of asset managers since 2002, including a minority stake in a hedge fund and private equity firm run by President Bush's brother, Marvin Bush.

Wealth manager **Boston Private Financial Holdings** announced that it planned to acquire an 80% interest in New York's **Dalton, Greiner, Hartman, Maher & Co.**, a small- and mid-cap value manager with $2.2 billion in institutional AUM. In addition to providing core institutional capability, the deal extends Boston Private's geographic reach into the New York metropolitan area, where it also hopes to build a wealth management business. Prior to the deal, the acquisitive Boston Private had established a presence in New England and California through six operating companies with a total of $6.8 billion in AUM.

Along the West Coast, **Wells Fargo** picked up a specialized Portland, Ore., investment manager, **Benson Associates**, with $1.3 billion in AUM from large and mid-sized firms. For Wells Fargo, the acquisition of the 6-year-old firm adds small-cap expertise to its institutional investments group, while Benson Associates gains access to distribution and technology. The deal continues Wells Fargo's tack-on approach to asset managers also evident in the 2002 acquisition of a Silicon Valley private bank, **Nelson Capital Management**.

Several U.S. subsidiaries of European firms were also active, including **ING Investment Management Americas**, which acquired **Delta Capital Management**, a New York firm with a large-cap value focus and $275 million in AUM. In a similar bid to gain specific expertise, **Gartmore Global Investments** acquired **Groupama Asset Management**, a separate account manager with growth equity and fixed income products and $1.2 billion in AUM.

Within Europe, deals were limited in number and scale, with the most notable one involving the acquisition by Italy's **Rasbank** of **Commerzbank Asset Management Italia** (AUM: $770 million). Rasbank, part of **Allianz**, said the deal will allow it to expand and strengthen its distribution capacity. Commerzbank has for the last two years been shedding asset managers as it seeks to refocus its business and strengthen its financial position, although the firm did acquire a small Spanish institutional unit from **HSBC** in early 2003.

Allianz, facing problems in its **Dresdner** banking unit, has indicated it has no plans to divest itself of the numerous high-profile asset managers acquired in recent years. But Allianz did sell off its Mexican pension arm to a local subsidiary of HSBC, saying **Afore Allianz Dresdner** (AUM: $1.1 billion) was too small and the synergies with its larger asset management business too limited to justify a continued presence in the market. The emerging Mexican pension market, with some 25 million participants, gener-

Institutional Advisor Transactions

	1999	*2000*	*2001*	*2002*	***2003***
Number of Transactions	38	50	44	56	**27**
Combined Value ($b)	4.1	17.0	7.3	3.6	**1.4**
Total Seller AUM ($b)	178	890	593	294	**118**
Average Deal Size ($m)	107	340	169	65	**54**
Average Seller AUM ($b)	4.7	17.8	13.8	5.2	**4.4**

Source: Berkshire Capital Corporation

ated several deals in 2002.

Old **Mutual** continued to unwind some of the smaller asset management holdings it gained three years ago through the acquisition of UAM, selling off three institutional firms. **Bank Sarasin** acquired the smallest of the three firms, while the two larger ones were purchased via management buyouts that allowed the principals to regain control of the firms and establish new economic incentives.

The two MBOs involved **Rice, Hall, James & Associates**, a San Diego-based small- and mid-cap investor with $1.7 billion in AUM; and **Northern Capital Management**, a growth and balanced equity manager based in Wisconsin with $1.2 billion in AUM. Old Mutual has shed about 20 of the dozens of affiliates it acquired from UAM, a divestiture process the company says is now largely complete.

Mutual Funds

After enduring nearly three years of some of the worst conditions it has ever faced, the U.S. mutual fund industry took its first tentative steps to recovery in 2003, in sync with the movement of equity markets.

Equity mutual funds enjoyed consistent net inflows beginning in April, while assets were 29% higher in September than during the same period in 2002. And while the trading scandals that became public in September damaged many prominent firms and gave the industry a series of black eyes that are unlikely to clear up in 2004, the public remained strong buyers of equity funds in October, with AMG Data Services reporting the largest monthly net inflow ($24.4 billion) of the year, to that point.

The industry's improved outlook did not generate a corresponding rise in transaction activity, however, as nearly every metric sank to the lowest levels since 1998. Indeed, after three years of ever-smaller deals, the banner years of 1999-2000, when a total of $20 billion in transactions were completed, are beginning to look like an aberration. At the same time, the sheer size of the mutual fund universe and the pressure on profitability and resources continues to argue in favor of increasing tie-ups between attractive smaller firms and well-heeled suitors, at minimum.

In 2003, only a handful of transactions involved the transfer of even $1 billion in AUM, with many dropping well below the $100 million mark and limited to the purchase of individual funds, rather than companies. **John Hancock Advisers** has been a notable exponent of this strategy. In 2003, it acquired M.S.B. from Chicago's **Shay Assets Management** (AUM: $6.4 billion), a large-cap blend fund with $52 million in assets. Although the fund was re-branded under the Hancock line, Shay will continue to manage it through a sub-advisory agreement.

In 2002, Hancock made two similar acquisitions that left accomplished fund managers in place while it focused on packaging and distribution; assets in those two funds had grown fivefold by 2003, to a combined $700 million. Said Chairman and CEO of John Hancock Funds Maureen Goldfarb: "Once again, as part of our strategic plan to grow assets, we have been able to acquire a top-performing mutual fund with an excellent portfolio management team that will complement our existing product line and greatly benefit our customers."

There were several other similar deals, including one in which **Charles Schwab** "adopted" the **AXA Rosenberg** family of funds (AUM: $1.4 billion), wrapping them into a new Laudus Rosenberg fund line. Under the agreement, California-based AXA Rosenberg (part-owned by **AXA Group**) will continue to manage the funds as a sub-advisor, while Schwab sells the funds through advisors and its OneSource mutual fund program. "By joining efforts with Schwab, we are taking the next logical step to extend our investment capabilities to a broader investment audience," said Ted Lyman, president of AXA Rosenberg Funds.

Meanwhile, **Pioneer Investment Management** (owned by **UniCredito Italiano**), made two acquisitions that brought it six small funds with a total of $164 million in AUM, from **L. Roy Papp & Associates** and **Oak Ridge Investments**. In both deals, Pioneer retained the firms as sub-advisors.

Another major asset manager, **Federated Investors**, also went trawling for relatively small fish, acquiring eight mutual funds run by

Mutual Fund Transactions

	1999	2000	2001	2002	**2003**
Number of Transactions	28	29	26	22	**28**
Combined Value ($m)	8,335	12,022	5,921	3,400	**666**
Total Seller AUM ($b)	275	323	154	132	**21**
Average Deal Size ($m)	298	415	228	155	**24**
Average Seller AUM ($b)	9.8	11.1	5.9	6.0	**0.8**

Source: Berkshire Capital Corporation

Riggs Investment Advisors, which it wrapped into its existing Federated funds. While the deal added only $470 million in AUM—Federated manages $200 billion in total—it was actually larger than three other mutual fund acquisitions the Pittsburgh firm has made in recent years (as measured by AUM). The company's president and CEO, J. Christopher Donahue, promised more of the same, saying, "Federated will continue to pursue growth through other bank fund asset transactions, as we're witnessing a strong trend toward these opportunities."

Just before the February announcement of its merger with **Prudential Financial**'s brokerage businesses, **Wachovia Corp.** completed the acquisition of three funds through its **Evergreen Investments** asset management division. The purchase of the Undiscovered Managers funds subadvised by **J.L. Kaplan Associates** helped Evergreen tie up the loose ends from its 2002 acquisition of Kaplan, a mid- and small-cap money manager.

Kansas City's **Waddell & Reed Financial** (AUM: $32 billion) paid $26 million to acquire $2.1 billion in **Advantus Capital Management** assets, primarily in the Advantus Series Fund, a fund family underlying variable annuity and other insurance products. (Advantus is a subsidiary of **Securian Financial Group**, which also owns **Minnesota Life Insurance**.) Importantly, Waddell & Reed also gains access to Securian's nationwide distribution network for its W&R Target and Ivy mutual funds. Waddell & Reed took over the Ivy funds in 2002 when it acquired the U.S. mutual fund subsidiary of Canada's **Mackenzie Financial**.

Smaller firms were also making acquisitions to enhance their product offerings and competitiveness. **Hennessy Advisors** acquired five funds from **Lindner Asset Management**, a value investment firm that was a strong performer during the 1970s and 1980s but slumped in the tech-driven 1990s, when assets began to plummet from a high of $4 billion to $300 million by the time of the acquisition. An OTC-traded asset manager with $900 million in AUM prior to the deal, Hennessy plans to wrap the funds into its existing offerings. During the year, Hennessy also acquired the management contracts for **SYM Select Growth**, a mid-cap fund with $27 million in AUM.

North Dakota-based **Integrity Funds**, another OTC-listed firm, acquired funds from three companies, adding a total of $120 million in AUM to its pre-existing $300 million. Among them: equity funds from Oregon's **Willamette Asset Managers** and New York's **Canandaigua National Bank and Trust** that helped the 16-year-old firm extend its portfolio beyond fixed income offerings and expand its reach. Chairman and CEO Robert Walstad said the deals "have transformed us from a regional firm in the upper Midwest to more of a national firm with the ability to offer our shareholders and other investors a much broader, diversified family of funds."

Two other small fund managers in New York, **Orbitex Management** and **Saratoga Capital Management**, also sought to strengthen their operations by merging into a new entity twice as large as the stand-alone firms, with $500 million in AUM. The rationale: more investment choice for customers, as the two firms bring differing investment styles; economies of scale; and better distribution.

While Americans took their deals in bite-size portions, the Canadians were again sitting down for three-course meals. Within the space of two days in August, **CI Fund Management** snared three asset managers and moved up a couple of notches to No. 2 in Canada's rapidly consolidating fund industry. In 2001, CI unsuccessfully courted fund giant **Mackenzie Financial Corp.**, which was acquired by **Investors Group** to form Canada's largest mutual fund company. The three deals done in 2003 place CI just a notch below Investors Group, with more than $28 billion in AUM.

The cash-and-share transactions, which included the financial participation of CI minority shareholder **Sun Life Financial Services**, involved a total price tag of nearly $730 million, the lion's share of which went for the acquisition of **Assante Corp.**'s Canadian operations (at nine times EBITDA). Assante (AUM: $5 billion) brings a mutual fund business, a high net worth operation and one of the country's largest networks of financial advisors, who administer $12 billion in assets.

The two other deals involved **Synergy Asset Management** and **Skylon Capital**. The larger of the two companies, Synergy (AUM: $1 billion), had built a strong brand name in the mutual fund industry and enjoyed an unbroken string of positive monthly net sales during its six years as an independent company. "The growth in assets through these transactions will solidify our position at the very top tier of Canadian fund companies and will allow us to take advantage of economies of scale," said William Holland, president and CEO of CI. In total, the deals raised CI's AUM by nearly one-third and are expected to boost CI's 2004 earnings by more than a third.

Among European firms, activity was even quieter than in the U.S., and interest in transatlantic deals was virtually nonexistent. The most interesting news was made in the U.K., where fast-growing newcomer **New Star Asset Management** (AUM: $8 billion) expanded its retail fund business via three transactions. New Star was founded in 2000 by

storied money manager John Duffield, who also started and built **Jupiter Asset Management** into one of the U.K.'s most successful fund managers, before selling it to **Commerzbank** in the mid-1990s.

Two of the deals New Star cut were with Scotland's **Aberdeen Asset Management**, which as a result of losses it has suffered in its scandal-plagued "split-capital" funds is busy trimming debt and narrowing its focus. (A type of mutual fund, a split has more than one class of shares, such as capital and income shares, and tends to have a fixed life, with assets ultimately distributed among the investors or reinvested in new funds.) The larger deal, done in January, involved New Star's $150 million purchase of a mixed bag of six Aberdeen retail funds with $3 billion in AUM.

New Star followed up on Aberdeen's $58 million acquisition in September of another troubled Scottish fund group, **Edinburgh Fund Managers Group**, by purchasing from Aberdeen two dozen Edinburgh retail funds that it plans to re-brand under its own name. New Star paid $53 million in cash and stock for the funds (total AUM: $1.4 billion).

For its part, Aberdeen was left with $3.8 billion in AUM from Edinburgh for an effective price of about $5 million, plus the assumption of certain debt and liabilities. Although observers believe the Aberdeen-Edinburgh deal creates a stronger single entity, there are concerns about the "stickiness" of the combined companies' asset base. New Star also acquired 13 of **Exeter Investment Group**'s mutual funds and sub-funds, with combined AUM of around $500 million, for approximately $16 million in upfront and deferred payments.

In a deal with implications for the exchange-traded fund market in Europe, **Barclays Global Investors** acquired the two remaining ETFs run by **Merrill Lynch International**, both of which are linked to Dow Jones European Stoxx indexes. Merrill, which had already closed 13 ETFs prior to the deal, lacked the scale to run the funds profitably, and other players are expected to drop out in the near future as the fast-growing sector consolidates.

There were some interesting transactions in two of the world's key developing markets. In China, several major asset managers took minority stakes in Chinese fund managers, including **ABN Amro**, **Bank of Montreal** and **J.P. Morgan Chase**. Bank of Montreal, which acquired an interest in **Fullgoal Fund Management** of Shanghai, said it plans to introduce Chinese mutual funds to international investors and, when regulations allow, offer mutual funds from other countries to Chinese investors.

In India, which has also seen impressive growth in its middle class, Iowa's **Principal Financial** entered into its second local mutual fund joint venture in three years, this time with **Punjab National Bank** and **Vijaya Bank**.

Cross Border

Save for one marquee deal—**American Express**' acquisition of **Threadneedle Investments**—the cross border theater was notably short on drama in 2003. Within Europe, cross border transactions were small and uneventful, with the exception of Switzerland's private banking industry, which continued to consolidate. And outside of the Amex deal, transatlantic activity was equally subdued.

To a degree, the paucity of deals within Europe reflects recent financial reality, as the bear market has made the asset management industry on the continent decidedly less attractive at the moment. In its latest survey of European asset managers, for example, McKinsey & Co. found that in 2001 the industry's costs rose 4% in the face of declines in the key metrics of AUM (down 3%), net revenues (off 26%) and profits (down 48%). But there are also longer-term concerns about the bear's impact on Continental Europe's nascent equity culture.

Several surveys in 2003 showed a great deal of lingering concern among European investors, even as

Cross Border Transactions

	1999	2000	2001	2002	**2003**
U.S. -Int'l					
Number of Deals	23	23	17	23	**12**
Value ($b)	7.4	13.8	5.9	1.7	**1.1**
Two Int'l Firms					
Number of Deals	15	21	18	20	**16**
Value ($b)	3.5	4.8	1.1	2.6	**0.5**
Total					
Number of Deals	38	44	35	43	**28**
Value ($b)	10.9	18.6	7.0	4.3	**1.6**

Source: Berkshire Capital Corporation

stock markets turned up. As U.S. investors were pouring $12 billion into equity funds in May, for example, the total in Europe was just $1.8 billion, according to FERI, which tracks fund data. A midyear study by *The Wall Street Journal Europe* and Gfk Ad Hoc Research of Brussels found that only 4% of those surveyed in Europe had increased their investments in stocks or equity funds, compared with 23% of Americans.

But European firms remained just as wary of the U.S. At the height of the buy-American surge in 2000, there was a host of $1 billion-plus transactions, many at very pricey multiples. That flurry alone contained the seeds of an inevitable drop-off in mega-deals, but the bear market that followed appeared to culminate in 2003 in a chill on smaller deals too. Indeed, even the edge provided by the more muscular euro could not coax many European financial firms into the U.S. On the other side of the Atlantic, American firms were similarly disinclined to invest in Europe. Moreover, there was no continuing interest in niche products to drive deals, as there was in 2002, when a number of transatlantic transactions involved alternative investment plays.

For its part, Amex appears to be taking a contrary approach, positioning the $570 million deal for Threadneedle as the first shot in a possible expansion of its asset management capabilities in Europe *(see sidebar, below)*. The past year's

Cross Border Transactions by Domicile and Type

SELLER *BUYER*

2003	*U.S.- Int'l*	*Int'l- U.S.*	*Int'l Int'l*	TOTAL
Personal/Trust	1	3	6	10
Institutional	1	1	5	7
Mutual Funds	3	0	3	6
Other	2	1	2	5
Total	**7**	**5**	**16**	28

2002	*U.S.- Int'l*	*Int'l- U.S.*	*Int'l Int'l*	TOTAL
Institutional	7	6	8	21
Personal/Trust	2	3	8	13
Mutual Funds	2	1	2	5
Real Estate	1	1	0	2
Other	0	0	2	2
Total	**12**	**11**	**20**	43

Source: Berkshire Capital Corporation

Amex Secures a European Foothold

With its purchase by **American Express**, **Threadneedle Asset Management** has likely found a more committed partner than its previous owner, **Zurich Financial Services**, which had only just acquired the firm in 1999. For Amex, the $570 million acquisition—the largest cross border deal in 2003—is part of an aggressive effort to establish a significant asset management footprint in Europe and collect the talent necessary to be successful. London-based Threadneedle (AUM: $75 billion) is the U.K.'s fourth-largest retail fund manager and one of the most established and well-regarded.

Amex was able to acquire that scale and know-how on favorable terms, paying only 0.8% of AUM, in part because a large chunk of Threadneedle's assets are managed for Zurich Financial Services U.K. Under the terms of the transaction, Threadneedle will continue managing these assets for a period of up to eight years. Prior to the deal, Amex had $231 billion in managed and administered assets, with nearly all of it in the U.S. and only $4.4 billion in AUM in the U.K. (Amex assets declined 9% in 2002 and continued to drop in the first half of 2003.) Said Jim Cracchiolo, group president of Amex's global financial services unit: "We see tremendous potential for long-term growth in the European asset management market, and by adding Threadneedle to our global asset management business American Express will be well-positioned to capitalize on that opportunity."

For Amex, Threadneedle represents its first major acquisition since the 1980s; it was also the largest acquisition of a European asset manager by a U.S. firm since the former Chase Manhattan paid $4.1 billion for Robert Fleming in 2000. The sale by Zurich is part of the insurer's effort to focus on its core business and shore up its finances. In 2001, Zurich sold its large U.S. **Scudder** asset management business to **Deutsche Bank**, for $2.5 billion. Zurich's latest action has increased speculation about whether other large European life insurers may opt to divest their own asset managers.

activity in Europe aside, Amex could find a number of targets in the years ahead, as some of the banks and insurance companies that dominate Continental Europe's asset management industry are expected to divest themselves of these operations.

In total, there were 28 cross-border transactions in 2003, compared with an average of just over 40 per year between 2000 and 2002, with deal value dropping again, to $1.6 billion. The number of deals involving a U.S. buyer or seller declined to just 12, with a value of $1.1 billion. Amid this sparse landscape, **Prudential Financial** was one of the more active bidders, as it cut two deals with distressed sellers—on top of the six international acquisitions and joint ventures Pru completed in 2002 in Europe and Mexico.

In the U.K., Prudential acquired about half of the asset management business of publicly traded London stock broker **Teather & Greenwood**, which has been restructuring its troubled operations. The $6 million deal gave Prudential $1 billion in AUM and enhances its private client operations in the U.K., now managed through **Dryden Wealth Management Ltd.**, the recently launched successor to Prudential-Bache.

In South Korea, Prudential signed a memorandum of understanding to acquire a majority stake in two insolvent financial services units of the massive Hyundai conglomerate. The $400 million transaction, if completed, will give Prudential control over **Hyundai Investment Trust Management** and **Hyundai Investment and Securities Co.**, the latter of which is the fourth-largest asset manager in the country, with $14 billion in AUM.

Prudential, which already had an insurance presence in South Korea, emphasized its "continued belief in the growth potential of the Korean asset management industry" and in Seoul's commitment to reform of the financial sector. In recent years, numerous U.S. and European firms have taken stakes in Korea's banking industry, which faced a meltdown during the Asian financial crisis of the late 1990s.

Several other global players were cutting interesting deals in Asia's two major developing nations. In China, **ABN Amro**, **Bank of Montreal** and **J.P. Morgan Chase** all took minority stakes in local fund managers *(see Mutual Funds, p. 10)*. Given the country's rapid economic growth, high savings rate and liberalizing economy—not to mention its underfunded state pension schemes—some asset managers are beginning to look upon China in much the same way consumer goods companies did 20 years ago. The Bank of Montreal, for one, called its Chinese business "among the most important long-term initiatives we have outside of our North American base."

In India, with its large and growing middle class and emerging private pension fund industry, Iowa's **Principal Financial** entered into its second local mutual fund joint venture in three years, this time with **Punjab National Bank** and **Vijaya Bank**. **ICICI Prudential**, a joint venture between Indian banking giant ICICI and Prudential plc of the U.K., dominates the private pension market.

Meanwhile, in Taiwan, Australia's **Macquarie Bank** took a 40% stake in **United Securities Investment Trust**. The deal, done through Macquarie's funds management joint venture, adds $900 million in AUM to the firm's pre-existing $3.2 billion in the Asia region. Macquarie, which in total manages or administers $22 billion in assets, also has interests in asset managers in South Korea and Malaysia. Taiwan is considered a potentially attractive market for fund management, due to the high incomes and savings rate of its citizens and the low level of fund ownership.

The major activity within Europe took place in Switzerland's private banking industry, where many independent firms have been squeezed by the bear market, increased transparency requirements and high cost structures *(see Wealth Management, p. 6)*. On top of those factors, pressure from the EU and the U.S. for greater transparency has raised concerns about the future of Switzerland's large offshore industry. As a result, many independent private banks are seeking to merge with other independent firms or to find a safe haven within the arms of resource-rich global financial services firms.

Outside of Switzerland, **UBS** and London-based **Candover Investments** also made small cross border wealth management acquisitions *(see Wealth Management)*.

Alternative Investments

Real Estate

The real estate advisory sector was driven in 2003 by increased capital inflows, as asset values continued to appreciate in the face of weakening economic fundamentals. Against this backdrop of positive near-term results, several firms sought to position themselves with partners to support expected future growth.

Bank One Corp. acquired **GE Capital**'s **Security Capital Research & Management**, one of the largest investors in REIT securities, with $3.5 billion in AUM. David Kundert, CEO of Bank One's investment management group, said the transaction "expands our growing asset management capabilities and bolsters our strategy to provide institutional clients with a wide range of high-performing products." GE Capital acquired parent Security Capital for $8 billion in late 2001,

Real Estate Transactions

	1999	2000	2001	2002	2003
Number of Transactions	4	1	8	3	**4**
Combined Value ($m)	507	N/A	427	1,022	**361**
Total Seller AUM ($b)	13.6	2.0	19.3	22.8	**21.4**
Average Deal Size ($m)	127	N/A	53	341	**90**
Average Seller AUM ($m)	3.4	2.0	2.4	7.6	**5.4**

Source: Berkshire Capital Corporation

but SCRM was a small component in that deal and did not constitute a good fit for the Connecticut blue chip, which had already sold its real estate private equity advisory business.

As part of a strategic retrenchment, Australia's **Lend Lease Corp.** began in 2003 to unwind the U.S. business it built through acquisitions during the 1990s. In the largest deal by assets, **Morgan Stanley** acquired the majority of Lend Lease's U.S. operations, or about $13 billion in AUM comprising several funds, the Lend Lease U.S. Office Trust and separate accounts.

For Morgan Stanley, the transaction provides stable "core" real estate products and clients that complement its pre-existing business, along with cost-saving synergies. Morgan Stanley, which prior to the deal had $19 billion in real estate AUM, will wrap its new businesses under the corporate brand name.

The other Lend Lease divestiture involved the Housing and Community Investing business (AUM: $3.8 billion), acquired by **MuniMae** for $102 million. The deal more than doubles MuniMae's AUM to $7.4 billion and was described by the firm as being quickly accretive to earnings, with minimal impact on the largely tax exempt nature of its dividend.

For Lend Lease, the transactions represent its exit from a troubled business that included assets from the $400 million purchase of Equitable Real Estate Investment Managers in 1997—at the time the largest-ever real estate advisor acquisition. In the 2003 fiscal year, Lend Lease took a $574 million write-off primarily related to its U.S. real estate holdings. (During the year, **GMAC Commercial Mortgage Corp.** also acquired two commercial real estate businesses from Lend Lease.)

Hedge Funds

Following the heated deal activity in the hedge fund industry in 2002, including the asset management industry's largest transaction (**Man Group**'s acquisition of **RMF Investment Group** in Europe), the sector took a breather in 2003. There were 10 transactions, with buyers showing a preference for fund of hedge funds companies. As befits a universe made up of entrepreneurial shops, the transactions were small, with an average deal size of $20 million and an average transfer of $421 million in AUM.

While M&A activity was down in 2003, the hedge fund industry itself drew record inflows ($45.4 billion in the first three quarters, according to TASS) and continued to take additional steps into the mainstream, in the process providing kindling for future deals. The SEC, for example, spent the year studying new regulations for the funds, and even among traditionally conservative Europeans, hedge funds are finding favor.

A 2003 Morgan Stanley survey of European institutions showed that many plan to employ funds of hedge funds in particular, including the huge Dutch health workers pension fund, PPGM, and the Swedish State Pension Scheme. And in November, the German parliament approved a new investment law allowing for the sale of hedge funds to institutional and individual investors.

Perhaps the most notable deal of 2003 involved the management buyout of 60% of **Carlyle Group**'s fund of funds business, **Carlyle Asset Management Group Rock Creek** (AUM: $600 million). The buyout group was led by Afsaneh Beschloss, who had left a post as treasurer and chief investment officer at the World Bank to build Carlyle's hedge fund operations; her

Hedge Fund Transactions

	1999	2000	2001	2002	2003
Number of Transactions	3	4	6	14	**10**
Combined Value ($m)	56	326	88	1,033	**198**
Total Seller AUM ($m)	675	3,070	14,535	16,648	**4,213**
Average Deal Size ($m)	19	81	15	74	**20**
Average Seller AUM ($m)	225	768	2,423	1,189	**421**

Source: Berkshire Capital Corporation

group is expected to purchase the remaining 40%. For the Washington, D.C.-based private equity giant, the deal represented a quick exit from the hedge fund business, which it referred to as a non-core operation.

In another higher profile deal, publicly traded asset manager **BlackRock Inc.** added fund of funds capabilities and enhanced its high net worth operations with the acquisition of **HPB Management** (AUM: $150 million). In 2002, BlackRock acquired Boston hedge fund **Cyllenius Capital Management**, which at the time had $100 million in AUM. BlackRock, majority owned by **PNC Financial**, manages more than $3 billion in hedge funds, amounting to 1% of its total assets.

In an all-Texas deal, investment bank **Sanders Morris Harris** took a 50% stake in **Salient Partners**, a wealth management firm (AUM: $670 million) that runs a $100 million fund of funds, the Endowment Fund. SMH, traded on Nasdaq, plans to merge the Salient business with its Pinnacle Management & Trust Co.

Gartmore Group, which in 2002 bought a prominent U.S.-based fund of funds manager, **Riverview International**, was in the market again in 2003, acquiring a "long-short" hedge-style mutual fund from Montgomery Asset Management that was not part of the **Wells Fargo** purchase of Montgomery.

Gartmore, which has some $3 billion in hedge fund AUM, also inked an agreement to jointly develop and distribute hedge funds in the U.K. and Japan with **Aspect Capital** (AUM: $2 billion), a six-year-old London firm that specializes in managed futures. (As part of the strategy to position itself as a "diversified specialist" investment manager, Gartmore also started up a private equity unit in 2003.)

Private Equity/ Venture Capital

In 2003, the VC industry put another relatively uneventful year between itself and the swashbuckling days of 1999-2000, when a combined total of $167 billion was raised by nearly 1,100 funds. In the first half of 2003, 60 funds raised $2.9 billion, compared with 80 funds and $3.9 billion in the same period during 2002, according to Thomson Venture Economics.

And despite the surge that many tech stocks enjoyed in 2003, the industry does not appear ready to chase after any dot-com that happens to knock on the door: early-stage investments are at the lowest level since the late 1970s, according to Thomson, even as the industry sits on an estimated $84 billion in capital for both existing and new investments.

In a sign of the changed environment, European buyout groups attracted more capital ($15.4 billion) in the first three quarters of 2003 than did U.S. groups ($9.2 billion), according to AltAssets.

The key private equity deal involved **Lehman Brothers**' acquisition of **Crossroads Group**, a Dallas private equity fund of funds investment manager with $2 billion in AUM. For Lehman, which acquired **Neuberger Berman** in 2003 in part to expand its wealth management business, the transaction provides additional products for these clients, along with greater scale in the private equity industry (following the deal, Lehman had $7 billion in private equity AUM).

Meanwhile, **Deutsche Bank** was selling off a good chunk of its private equity business, which it has come to view as a non-core holding. The bank sold $1.7 billion in assets to a management buyout group and a further $500 million in holdings to **CSFB Private Equity**'s Strategic Partners group, which acquires assets from private equity investors. CSFB Private Equity is the largest such group in the world, with some $27 billion in capital commitments under management.

About Berkshire Capital Corporation

Berkshire Capital has been advising clients since 1983 in connection with merger, acquisition, divestiture and joint venture transactions involving investment management and securities firms and related financial services businesses. Headquartered in New York City, the firm has offices in London, Denver and Philadelphia.

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