Berkshire Capital Securities LLC

Investment Management Industry Review

2006

In his once-ubiquitous "Little Red Book," Mao Tse Tung emphasized the importance of "frugality" in furthering economic development.

But as China continues its long march toward bourgeois comfort, the visions of a new generation of chairmen are holding sway. Witness the dream of Xu Qun, chairman of Chinese property company Zhejiang Huamen, who last year announced plans to build the tallest Ferris wheel in the world just north of Shanghai's historic Bund district–complete with an exclusive members-only club bearing an annual fee of $100,000.

Even at those plutocratic prices, observers expect plenty of takers, not least among them, perhaps, the army of American and European bankers who last year flocked to China with their own particular ambitions for establishing a footprint in the hottest economy in the world. **Bank of America**, **BNP Paribas**, **Deutsche Bank** and **Merrill Lynch** were among the more than one dozen major firms that cemented deals in the financial services sector, and by the end of the year non-Chinese firms held stakes in four of the nation's five largest banks. Among them: **China Construction Bank**, which last October raised $9 billion in one of the largest initial public offerings in history–an offering that was oversubscribed 40 to 50 times.

Last year's banking activity itself underscores a broader point in the history of globalization: After a quarter-century of nonstop economic growth, China is no longer the market of the future. By 2005, it had emerged as the fourth-largest economy in the world, powered by a growing trade surplus that reached $102 billion (total trade: $1.4 trillion). China has also amassed $819 billion in foreign reserves, cash the government is using to buy U.S. Treasury bonds and invest in projects and companies around the world.

Steady Gains

GDP Growth

	2004	2005*	2006*
U.S.	4.2%	3.5%	**3.3%**
Euro Area	2.0	1.2	**1.8**
U.K.	3.2	1.9	**2.2**
Japan	2.7	2.0	**2.0**
China	9.5	9.0	**8.2**
Global	5.1	4.3	**4.3**
World Trade	+10.3%	+7.0%	**+7.4%**

**Projected ♦ Source: IMF*

As the country sought outlets for all those greenbacks, euros and yen, it found a great deal of company. The world, it appeared, was awash in money. OPEC members were gushing with it, having taken in a record $400 billion from oil exports. One result: a 60% increase in the foreign assets held by Saudi Arabia's central bank during the first 10 months of 2005. In the U.S., corporate America continued its uninterrupted string of quarterly double-digit earning gains going back to the third quarter of 2003, a record that has enabled Standard & Poor's 500 companies to stockpile an estimated $2 *trillion* in cash, double the level in 1997.

A good portion is being returned to shareholders: regular dividend payments by S&P companies hit a record $200 billion in 2005 and announced stock buybacks reached $456 billion, a 50% increase above the previous high set in 2004. Still another big chunk is being used to buy companies: last year, M&A activity rose by a third in the U.S. to $1.1 trillion, according to Thomson Financial.

In Europe, economic growth continued to trail that of the U.S., but corporate earnings and balance sheets were strong–a desirable combination that manifested itself in a 40% jump in M&A activity in Europe, to $1 trillion. In Japan, where the economy finally showed signs of renewal and where the Nikkei 225 Index rose 40%, M&A volume more than doubled to $168 billion. Worldwide M&A activity jumped 38% to $2.7 trillion, the highest level since 2000 and the third highest total ever.

Shadowing the traditional corporate buyers were the increasingly influential and cash-rich private equity firms, which accounted for 15% of those deals ($397 billion), four times the percentage five years ago. Hedge funds, which last year saw their collective

International Markets Lead

	Final Index 2005	Gain/(Loss) v. 2004
DJIA	**10,718**	**(-0.6%)**
S&P 500	**1,248**	**+3%**
Nasdaq	**2,205**	**+1.4%**
FTSE 100	**5,619**	**+16.7%**
DAX	**5,408**	**+27.1%**
Nikkei 225	**16,111**	**+40.2%**

assets under management (AUM) top $1 trillion, were also on the prowl for new places to invest their excess cash. This included acting as financiers for private equity firms, for example, but also involved the outright acquisition of companies.

Given all the cash sloshing about and the low interest rates prevailing worldwide, observers might have anticipated robust stock markets everywhere. That was true in much of Europe, where key indices in Germany (up 27%), France (up 23%) and the U.K. (up 17%) all turned in strong performances. Many Asia-Pacific and Latin American markets also registered double-digit gains. But in the world's largest equity market, the major indices again struggled to eke out gains.

The Dow Jones Industrial Average ended the year in virtually the same place it started, dropping less than 1%, still 1,000 points below the high of 11,723 reached in January 2000. The broader S&P 500 fared only slightly better, rising 3%, while the Nasdaq increased a paltry 1.4%. For the glass-half-full crowd, the combination of strong earnings growth and a flat market did have the effect of ratcheting down valuations. But at 16 times projected 2006 earnings, they still remain above historical markers. Indeed, a large part of the appeal of European stocks last year rested on their more reasonable price points (major European stocks trade below 13 times projected 2006 earnings).

Relative valuations were one factor in the shift of U.S. money outside the country. Research firm Strategic Insight figures net inflows into international mutual funds hit a record $150 billion in 2005, surpassing net inflows into domestic funds for the first time in 15 years. At the same time, non-Americans were eagerly purchasing U.S. assets, including a record net $161 billion of U.S. securities other than Treasuries in the third quarter, according to the U.S. Department of Commerce.

Americans, meanwhile, continued to fuel the domestic and world economies by consuming with abandon, spending more than they earned for the first time since the Depression-haunted year of 1933. This neat trick was enabled by a red-hot housing market: **Goldman Sachs** figures Americans withdrew more than $800 billion of equity from their homes in 2005.

The tendency of American baby boomers in particular to put off saving today what they can plan to save tomorrow underlines the asset management industry's continuing growth potential and attractiveness. However, last year, several diversified financial services firms began to reassess the value of being all things to all people, including their fund manager.

In one of the largest such transactions, **Citigroup** swapped its funds and other investment products for **Legg Mason**'s brokerage operations and in the process eliminated an underperforming business as well as the attendant conflict-of-interest issues posed by being both a manufacturer and distributor of mutual funds. The $3.7 billion deal also gained Citigroup an attractive shareholding in Legg. For its part, Legg more than doubled its AUM to $850 billion while adding distribution muscle via Citigroup's network of financial advisors.

Other diversified financial firms either reviewed or were being forced to consider the separation of their fund or asset management arms. Prior to the Citigroup announcement, Merrill Lynch was reportedly talking with Legg Mason about a deal that would have given its fund operations more independence. By year-end, Merrill was taking the alternative step of rebranding its funds in hopes of finding greater acceptance in the distribution channels. **Northwestern Mutual** sold most of its fund business to **American Century Investments** while another insurer, **Nationwide**, hired **Morgan Stanley** to review its investment in Gartmore, the U.K. fund manager it acquired in 2000. At Morgan Stanley itself, analysts began calculating the value of its various businesses as stand-alones following the resignation in June of CEO

LET'S MAKE A (BIG) DEAL

Worldwide M&A Activity

No. of Announced Deals	2004	2005
Worldwide (WW)	31,467	32,568 (+4%)
U.S.	8,550	9,045 (+6%)
Finance & Insurance Sector (WW)	2,420	2,666 (+10%)
$1 Billion-Plus Deals (WW)	353	476 (+35%)
Value ($ Billions)	**2004**	**2005**
Worldwide (WW)	$1,953	$2,703 (+38%)
U.S.	$849	$1,131 (+33%)
Finance & Insurance Sector (WW)	$324	$453 (+40%)
$1 Billion-Plus Deals (WW)	$1,161	$1,862 (+60%)

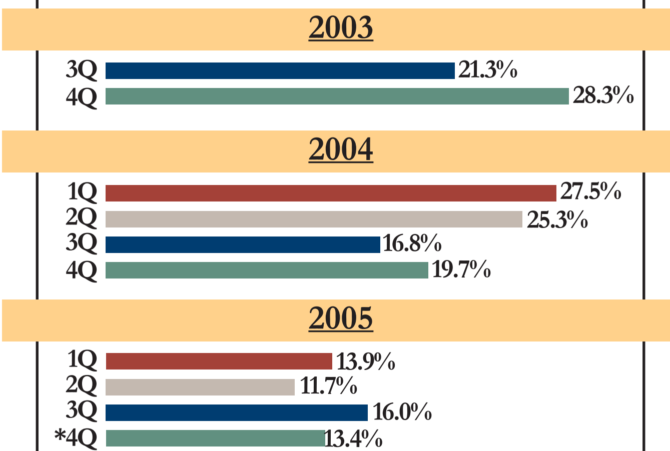
Sources: Thomson Financial (Worldwide, U.S.); Dealogic (Finance & Insurance, $1b-plus)

Philip Purcell. By year-end, new CEO John Mack was talking to **BlackRock Inc.** about merging their respective asset management arms.

At **Mellon Financial**, institutional investors began pressing for a spin-off of that bank's large asset management business as a means of unlocking shareholder value. In December, hedge fund **Highfields Capital** raised the temperature by issuing a highly critical public letter to Mellon Chairman and CEO Martin McGuinn urging such an action–a move that also headlined the large positions hedge funds have taken in blue chips and their willingness to assume an activist role.

TEN AND COUNTING

Consecutive Quarters of Double-Digit S&P 500 Companies Earnings Per Share Growth



**Estimate based on sell-side analyst consensus.*
Source: Thomson Financial.

American Express, which in 2003 bought the highly regarded **Threadneedle Asset Management** business in the U.K., executed the spin-off of its Financial Advisors unit, an acknowledgement by the credit card giant that its efforts to help consumers pay for entertainment and also manage their investments was no longer viable. Renamed **Ameriprise Financial** (its American Express funds were rebranded under the RiverSource name), the company began trading on the New York Stock Exchange in October and had enjoyed a 16% rise in its stock by year-end. Ameriprise manages and administers $410 billion in AUM.

Bolstered by a number of major transactions, including Citgroup-Legg, the value of asset management deals in 2005 rose 68% to $15.8 billion, the highest level since the record year of 2000 ($36.4 billion) and the second-highest total over the past decade. The transfer of AUM also jumped significantly, topping the $1 trillion mark for the first time since 2000, while the number of deals (136) remained in line with recent history. The 10 largest deals of 2005 accounted for $11.8 billion in value, larger than the total value from the previous year.

Legg Mason was involved in two of those 10 deals, with the second transaction involving its majority stake in funds of hedge funds giant **Permal** (AUM: $20 billion). The deal, which could cost Legg as much as $1.4 billion, provides the Baltimore money manager with additional products for its institutional and wealth management customers, and comes on the heels of **JPMorgan Chase**'s billion-dollar-plus deal in 2004 for a majority of hedge fund manager **Highbridge Capital Management**.

The demand for alternative investments also showed up in the real estate advisory sector, which registered six deals in 2005, the highest level of activity since 2001. Even the normally low-profile timber business witnessed its second deal in as many years, with **Hancock Timber Resource Group** acquiring the timberland investment management unit of **Prudential Financial**. In another sign of the interest in the sector, private equity firms raised more than $30 billion last year earmarked for property funds, a 50% jump over 2004, according to Private Equity Intelligence.

In a continuation of the trend that began in 2003, the wealth management sector recorded the largest number of asset management transactions (59) last year. Not coincidentally, the number of wealthy individuals ($1 million-plus in financial assets) keeps

INVESTMENT MANAGEMENT TRANSACTIONS

	2001	2002	2003	2004	2005
Majority Equity	118	119	116	118	**121**
Minority Equity	4	16	10	8	**9**
Management Buyout	8	8	9	6	**6**
TOTAL	130	143	135	132	**136**
Value of All Transactions ($b)	15.6	10.3	9.3	9.4	**15.8**
AUM Changing Hands ($b)	830	548	375	720	**1,003**

Source: Berkshire Capital Securities LLC

growing at a nice clip, up 7% to 8.3 million, according to the latest World Wealth Report from Capgemini and Merrill Lynch. The value of wealth management deals, at $6.2 billion, nearly tripled from 2004 which is a record year including the Julius Baer transaction, valued at $4.6 billion.

UBS, an active buyer in recent years, refined its portfolio last year by divesting its Swiss-based SBC Wealth Management unit along with fund manager **GAM**. The buyer: Zurich-based **Julius Baer**, which doubled its private banking assets as a result of the $4.6 billion deal and became the largest independent private bank in an increasingly competitive market.

In the U.S., the list of wealth management buyers included **Boston Private Financial**, **Eaton Vance** and Mellon Bank. Lehman Brothers, which in 2003 made the transformational $2.6 billion acquisition of wealth manager **Neuberger Berman**, was in the market again, this time to buy a small but established New York firm, **Sloate, Weisman, Murray & Co.** (AUM: $300 million). Mellon acquired Atlanta's **City Capital** (AUM: $800 million), the eighth wealth manager it has purchased since 2000.

The institutional sector registered another strong year in 2005, with transaction value of $5.8 billion and an average deal size of $158 million. **AXA**, **HSBC Holdings**, JPMorgan Chase and Merrill Lynch were among the many heavyweights in the market, with several significant cross border deals taking place. Mellon Financial expanded its international presence by acquiring half of **WestAM** (AUM: $49 billion), the asset management business of German Landesbank **WestLB**, while **Aberdeen Asset Management** acquired Deutsche Bank's global fixed-income business (AUM: $80 billion). Serial acquirer **Affiliated Managers Group** made just one deal last year, but chose an institutional target, **First Asset Management** of Canada (AUM: $23 billion).

As with Citigroup, two regional banks, **AmSouth Bancorporation** and **Amcore Financial**, divested themselves of their mutual fund operations, citing the increased costs of regulation and conflict-of-interest concerns. Other deals involved buyers continuing to seek tack-on acquisitions of funds or companies that provide specific expertise and sellers seeking the benefits of scale. **Pioneer Investment Management** was an active player in the U.S., acquiring the fund business of AmSouth (AUM: $5.5 billion) and a medium and large cap firm, **Cullen Value Fund** (AUM: $42 million), which remained in place as sub-advisor, a common arrangement in recent years.

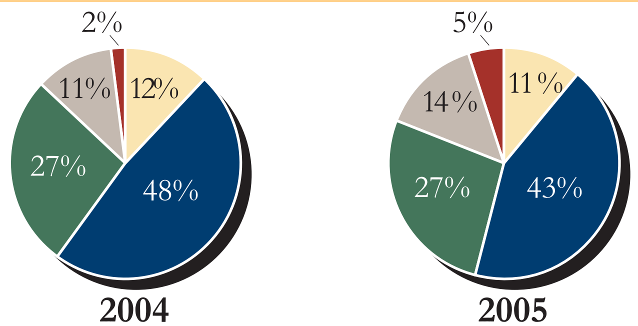
♦ ♦ ♦

After a lull of several years, mergers and acquisitions came roaring back in 2005. To be sure, this activity was a reflection of another year of strong corporate profits, solid balance sheets (cash was the currency of choice in 71% of all deals last year), and the availability of low-cost financing. But it also revealed the return to boardrooms of a certain swagger that had been missing since the end of the bull market. Significantly, activity was as robust in Europe as in the U.S., and Asia (ex-Japan) joined in the merriment by setting M&A records.

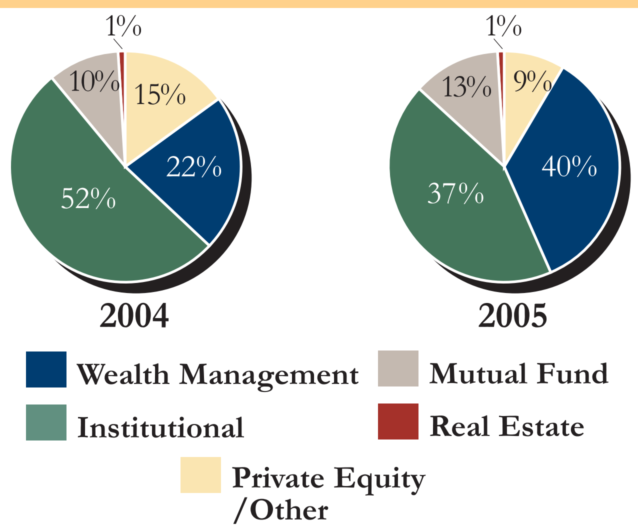
Mega-mergers in the financial services industry continued apace last year. The $41.4 billion tie-up of two Japanese firms, **Mitsubishi Tokyo Financial Group** and **UFJ Holdings**, was the largest banking deal and created the world's largest bank by assets. In the U.S., **Bank of America** led with its $35.8 billion deal for credit card issuer **MBNA**, while **Unicredito**'s $18.3 billion purchase of **HVB** represented the second

WHO'S SELLING

Number of Transactions by Sector as % of Total



Value of Transactions by Sector as % of Total



Source: Berkshire Capital Securities LLC

WHO'S BUYING

Number of Transactions

	2001	2002	2003	2004	2005
Bank	45	49	32	43	**35**
Institutional	12	17	13	19	**19**
Wealth Manager	5	15	12	18	**16**
Mutual Fund	9	15	20	7	**13**
Securities Firm	13	11	11	7	**8**
Trust Company	5	2	9	3	**8**
Financial	8	5	3	8	**6**
Insurance Company	14	15	9	3	**6**
MBO	8	8	9	6	**6**
Real Estate Manager	4	1	2	1	**5**
Other	7	5	15	17	**14**
TOTAL	130	143	135	132	**136**

Source: Berkshire Capital Securities LLC

major European cross border banking deal in as many years. (In general, the value of cross border European transactions doubled from 2004, to $322 million.) With European banks in fine shape and observers expecting another strong year for earnings, the prospects for continued cross border transactions in both banking and asset management remain bullish.

After several relatively quiet years, the asset management industry joined in the flurry of deal-making in 2005, recording its highest level of activity (as measured by value) since the extraordinary year of 2000, when 10 transactions of $1 billion or more were recorded. We expect the aggressive pace of deal-making to continue into 2006, in particular as financial services firms pursue their reviews of the traditional "supermarket" model, including the merit of retaining their asset management arms in whole or part.

Last year, both Citigroup and American Express provided an early indication of the prevailing sentiment among some blue chip financial firms, and as the new year dawned reports surfaced that Morgan Stanley was seeking to remake its asset management business via a possible merger with BlackRock. Wall Street's current affection for asset managers is also having an impact on the outlook of firms. As just one example, consider that BlackRock was trading at 36 times trailing earnings as of early January, while the stock rose 42% in 2005. Its potential suitor, Morgan Stanley, was trading at 15 times earnings and its stock rose just 4% last year. (In early 2006, BlackRock inked the deal with Merrill Lynch after talks with Morgan Stanley broke down.) Similarly, Legg Mason was sporting a greyhound-like price-earnings ratio of 33, while Citigroup's 10 was in line with valuations being dealt to major banks. As part of its deal with Legg, Citi made sure it can bask in the glow of that luster by taking $1.5 billion of the firm's common and convertible preferred shares.

Some parting thoughts follow on several trends we see in the investment management and financial services industries:

- Mutual fund consolidation has begun a new round, with many players determining whether they can realize much of the benefit through distribution fees while selling the asset management operations to a select set of firms focused on managing the investment process.
- Even as several alternative investment strategies have struggled to justify their full fee structure, the broader investment industry appears to be acknowledging that alternative products are now an integral part of a full investment array.
- Open architecture investment structures are increasingly a requirement in the wealth management world and will continue to impact the nature of investments offered by those firms.
- More robust economic growth around the world and the resultant increase in international trade and financial activity are once again driving interest in cross border expansion on the part of the strongest financial services firms.
- The increased interest in financial services by many private equity firms suggests that many of the savvier investment pools see continued growth in the earnings of investment firms for some time to come.
- The seemingly endless run of talented investment professionals from traditional investment strategies to alternatives may be starting to balance out, as we see defections from alternative firms to traditional managers with greater fundamental demand and less volatility.

H. Bruce McEver
Chairman

R. Bruce Cameron
President

WEALTH MANAGEMENT

ALTHOUGH THE FINANCIAL MARKETS HAVE BEEN UP AND DOWN SINCE THE COLLAPSE OF THE BULL MARKET, THE RANKS AND ASSETS OF THE GLOBAL ELITE HAVE CONTINUED TO ADVANCE. In their latest World Wealth Report, Capgemini and Merrill Lynch figure the number of individuals with at least $1 million in financial assets increased 7.3% between 2003 and 2004, to 8.3 million, with their assets growing 8.2% to $31 trillion–nearly three times the size of the U.S. economy.

The most coveted among that group–those with $30 million or more in financial assets–saw their ranks grow 9% to 77,500. By Capgemini and Merrill's reckoning, the future for the $1 million-plus group is extremely promising: assets are projected to grow at an annual rate of 6.5% through 2009, to $42 trillion.

Worldwide, there are thousands of firms pitching for that business, providing a wealth of opportunities for buyers seeking to add clients, assets, geography or additional capabilities. Indeed, for the third year in a row, the sector accounted for the largest number of deals in the asset management industry (43% of all transactions), as it kept pace with the record number of deals in 2004. Transaction value, at $6.2 billion, decreased from 2004 excluding the Julius Baer transaction.

"The most active yard in Europe these days is Switzerland, which last year played host to the largest wealth transaction, as Julius Baer bulked up via its $4.6 billion cash-and-stock deal for UBS' SBC Wealth Management business as well as fund manager GAM."

In the U.S., pricing for quality companies in key markets remained robust, though second-tier firms hoping to catch some of that glitter were mildly disappointed. Although the attractive pricing environment is a powerful-enough lure for many sellers, compliance-related costs are also causing firms to reassess the value of independence. Meanwhile, buyers last year continued to encompass a diverse group of financial services and asset management firms, ranging from major U.S. or international players such as **Eaton Vance**, **Mellon Financial** and **UBS** to local or regional banks like **Sandy Spring Bancorp** of Maryland and **Compass Bancshares** of Alabama. Although European firms showed more interest in U.S. wealth managers last year, they continued to focus on their own backyard.

The most active yard in Europe these days is Switzerland, which last year played host to the largest wealth transaction, as **Julius Baer** bulked up via its $4.6 billion cash-and-stock deal for **UBS**' SBC Wealth Management business as well as fund manager **GAM**. The deal continued the consolidation trend among Swiss private banks, which are being squeezed by regulators for greater transparency and, not coincidentally, other money centers for their rich clients.

Baer, with $54 billion in private banking AUM prior to the transaction, reflected the competitive pressures on small- to mid-size Swiss banks, as it continued to endure net withdrawals in the first half of June 2005, following a similar performance for the full year 2004. Chairman Raymond Baer acknowledged the new landscape at the firm's annual meeting in April 2005, saying, "We must assume that private banking is entering into a phase of consolidation in Switzerland. Money is flowing less strongly from our traditional client markets."

The deal nearly doubles Baer's private banking AUM and, in line with the firm's grander ambitions, extends its footprint from Western Europe into emerging markets worldwide. The deal also ended speculation that Julius Baer itself was a takeover target, rumors fueled earlier in the year when the controlling Baer family ended the two-tier corporate structure that provided it with voting control.

UBS created SBC Wealth Management in 2003 as the holding company for its independent Swiss private banks and for GAM, allowing at the time that the unit could play "a future role in the consolidation of the private banking industry." An active buyer of European wealth managers in recent years, UBS made just one deal in 2005, buying a small Milanese firm, **Etra SIM** (AUM: $600 million), that helps expand its business in Italy–and its growing "onshore" presence. Operationally, the company consolidated its U.S., Swiss and international wealth businesses into a larger Global Wealth Management & Business banking group, a move aimed at driving greater consistency and economies of scale.

The U.K. was the scene for a second major European transaction, as **Rensburg PLC** made a "transformational" deal for **Carr Sheppards Crosthwaite** that created the seventh-largest private client manager in the U.K., with $18 billion in AUM. The $330 million transaction provides Rensburg with what it described as "a strong pan-UK presence enabling significant geographic diversification." Under the terms of the deal, CSC parent **Investec** of South Africa took a 48% share of the enlarged company. The transaction also blocked the ambitions of another British private client advisor, **Rathbone Brothers**, whose two earlier bids for Rensburg were rejected by that company's board.

"Within the U.S., there were a number of familiar buyers in the wealth sector, including Boston Private Financial, Eaton Vance, Lehman Brothers, Mellon Bank, and Sanders Morris Harris. Boston Private made the largest deal, acquiring a fast-growing private bank in Coral Gables, FL., Gibraltar Financial Corp., for $245 million."

There were several cross border deals of note, including two in Europe: **Barclays**' acquisition of the wealth business of **ING** and **Fortis**' purchase of **Dryden Wealth Management**, the international wealth management business of **Prudential Financial**. In a transatlantic deal, **EFG Bank** of Switzerland acquired Miami-based **Dresdner Lateinamerika Financial Advisors.** (*See Cross Border section for information on these transactions.*)

Within the U.S., there were a number of familiar buyers in the wealth sector, including **Boston Private Financial**, Eaton Vance, **Lehman Brothers**, Mellon Financial and **Sanders Morris Harris**. Boston Private made the largest deal, acquiring a fast-growing private bank in Coral Gables, FL., **Gibraltar Financial Corp.**, for $245 million. Under Chairman and CEO Timothy Vaill, Boston Private has made clear its ambition to build a national footprint, and the cash-and-stock deal provides the firm with entry to South Florida's lucrative but competitive Gold Coast. Gibraltar started as a small savings bank more than a decade ago and in the five years through 2004 recorded average annual growth of 26% for assets and 54% for net income.

Another New England firm, Eaton Vance, was in the market again, making a tack-on acquisition of Phoenix-based **Weston Asset Management** (AUM: $105 million). Lehman Brothers, which in 2003 catapulted its wealth management business into the big leagues by acquiring Neuberger Berman, purchased an established large and mid cap value investor, **Sloate, Weisman, Murray & Co.** (AUM: $300 million).

In the New England market, several smaller players teamed up to better serve their customers and shareholders. **Washington Trust** of Rhode Island increased its assets under administration by more than 50% to $3.1 billion with the acquisition of **Weston Financial Group**, while extending its reach north to the Boston area. Weston, founded in 1979 and based in Wellesley, provides comprehensive planning and counseling services through third-party wealth management products. The $26 million deal includes a minimum $6 million earn-out in the three years through 2008. "This is a major acquisition for us," said John Warren, chairman and CEO of Washington Trust. "It significantly increases the size and capabilities of our wealth

WEALTH MANAGEMENT TRANSACTIONS

	2001	2002	2003	2004	2005
No. of Transactions	41	50	51	64	**59**
Combined Value ($b)	2.2	2.0	6.3	2.1	**6.2**
Total Seller AUM ($b)	53	63	189	94	**119**
Average Deal Size ($m)	53	39	124	33	**106**
Average Seller AUM ($b)	1.3	1.3	3.7	1.5	**2.0**

Source: Berkshire Capital Securities LLC

management group and expands our presence in the New England marketplace."

Within Connecticut, **NewAlliance Bancshares** of New Haven did a $19.3 million cash-and-stock deal for Hartford-based **Trust Company of Connecticut** (AUM: $700 million) that adds significantly to its wealth management business. Trust Company will continue to operate under its name.

NewAlliance was formed in 2004 from the merger of three local banks, with wealth management being one of its "focus" areas. Farther south along the Eastern Seaboard, Sandy Spring Bancorp of Maryland acquired **West Financial Services** of Virginia, a 23-year-old firm with $550 million in AUM, in a deal that allows Sandy Spring to diversify its sources of income. Hunter Hollar, president and CEO of Sandy Spring, said, "This opportunity allows us to broaden our market as well as expand the depth of investment resources and types of solutions we can offer our clients."

Mellon Financial, among the most active buyers of wealth firms in recent years, completed one deal in 2005, acquiring **City Capital** (AUM: $800 million), an Atlanta firm that strengthens the bank's presence in that important market. Two years ago, Mellon entered Atlanta via its acquisition of Arden Group, a firm of similar size to City Capital.

Houston's Sanders Morris Harris, listed for two straight years among *Fortune's* "America's Fastest Growing Companies," acquired a majority interest in **Edelman Financial Center** of Virginia (AUM: $2.6 billion), which serves wealthy individuals as well as the mass affluent market. (A second investment by SMH involved a 20% stake in **Astor Asset Management**, a Chicago firm that serves institutions and private investors through separately managed accounts.) SMH, whose wealth advisors manage more than $7 billion in assets, follows an acquisition strategy centered on "smaller, specialized regional financial firms that want to affiliate with a larger company while still retaining their identity and entrepreneurial culture."

"Mellon Financial, among the most active buyers of wealth firms in recent years, completed one deal in 2005, acquiring City Capital (AUM: $800 million), an Atlanta firm that strengthens the bank's presence in that important market. ."

In a teaming of two Houston financial firms, **Encore Bank** enhanced its wealth capabilities by acquiring **Linscomb & Williams** (AUM: $1.2 billion), which will continue to operate as an independent affiliate. Encore, which began life as a mortgage broker, also has a presence on Florida's west coast. Compass Bancshares, which operates in several Southern and Southwest states, acquired **Stavis, Margolis Advisory Services**, a Houston firm with $500 million in AUM that enhances Compass' wealth capabilities. "The acquisition is consistent with our business plan aimed at increasing fee-based revenues," said D. Paul Jones, Jr., Compass chairman and CEO. ♦

INSTITUTIONAL ADVISORS

FOLLOWING ITS BOUNCE-BACK YEAR IN 2004, THE INSTITUTIONAL SECTOR ROARED AHEAD IN 2005, WITH 37 TRANSACTIONS VALUED AT $5.8 BILLION–THE SECOND HIGHEST AMOUNT SPENT ON DEALS SINCE THE HEADY YEAR OF 2000 AND EASILY EXCEEDING THE COMBINED TRANSACTION VALUE OF THE PREVIOUS YEAR. As in 2004, however, buyers continued to face a somewhat limited crop of interested sellers that could offer the combination of specific investment styles and solid performance.

The attractive firms that did choose to go on the sale block found a solid representation of global giants in the market, including **Allianz**, **AXA**, **Deutsche Bank**, **HSBC Holdings**, **JPMorgan Chase & Co.**, **Mellon Financial** and **Merrill Lynch**. Three of those firms–Allianz, Deutsche Bank and HSBC–were on both sides of the bargaining table, an indication of the fine-tuning taking place in some corporate portfolios. Smaller but active acquirers of asset managers like **Affiliated Managers Group** and **Sanders Morris Harris Group** were in the market as well.

The continuing attractiveness of the sector was also highlighted by **Fidelity Investments**' announcement last year that it was creating a separate company designed to target institutions more aggressively. Fidelity, with some $80 billion in institutional AUM (8% of total AUM), plans to sink $100 million into the firm, named **Pyramis Global Advisors**, over the next several years.

Fidelity's move was driven by the demands of its business, where retail fund flows have slowed, as well as the marketplace: a recent report by the Conference Board showed that U.S. institutional investors controlled $19.6 trillion in assets in 2003, only slightly below the peak reached in 1999, of $19.7 trillion. Institutions have tightened their hold on the 1,000 largest U.S. companies, too, with their share of equity jumping 8 percentage points between 2000 and 2004, to 69.4%. The study also found that the 25 largest U.S. pension fund investors abroad continue to expand those investments.

One of the larger American institutional managers, Mellon Financial, expanded its international presence by acquiring half of **WestAM** (AUM: $49 billion), the asset management business of German Landesbank **WestLB**. The transaction provides the Pittsburgh-based bank with a strong distribution network in Germany, where it already had a small business, and with access to France through WestLB's subsidiary in that country. Mellon also operates in the U.K., where it has acquired two companies since 1998.

Said Ron O'Hanley, vice chairman of Mellon Financial and head of its institutional business: "Consistent with our strategy, this partnership enables WestLB to focus on its client and distribution strengths and Mellon to leverage its recognized asset management product strengths." In a second transaction made soon after the WestAM deal, Mellon acquired **City Capital** (AUM: $800 million), which provides Mellon with both a wealth management and institutional business in the Atlanta area.

> ***"The consolidation trend in the U.K. included the teaming of two domestic firms, as Britannic Group acquired Century Group Ltd. (AUM: $3 billion) for $76 million."***

In another major European deal with a U.S. component, **Aberdeen Asset Management** acquired Deutsche Bank's global fixed-income business, based in the U.K. and Philadelphia, for an amount that could reach $465 million. The transaction, which nearly triples Aberdeen's AUM to $124 billion, also allows the company to move beyond the "split trusts" scandals that drove the sale two years ago of its retail fund business to another British firm, **New Star Asset Management**. The four-month-long auction for Deutsche's business–which in the U.K. had been suffering from defections of clients and staff–drew a number of large asset managers. Martin Gilbert, chief executive of Aberdeen, called the deal "transformational" and said it "will substantially increase our scale and diversify our revenue streams."

Deutsche Bank was also in the buyers' market last year, taking a minority stake in a joint venture with Beijing's **Harvest Fund Management**. The two sides touted the deal as a teaming of global and local expertise and leadership. Harvest is the third-largest fund manager in China, with $3.4 billion in AUM. *(For more discussion about activity in China, see pg. 13.)*

In another cross border institutional deal involving a British target, **AXA Investment Managers** acquired London-based **Framlington Group** from HSBC and **Comerica Inc.**,

INSTITUTIONAL ADVISOR TRANSACTIONS

	2001	2002	2003	2004	2005
No. of Transactions	44	56	27	36	**37**
Combined Value ($b)	7.3	3.6	1.4	4.9	**5.8**
Total Seller AUM ($b)	593	294	118	550	**642**
Average Deal Size ($m)	169	65	54	136	**158**
Average Seller AUM ($b)	13.8	5.2	4.4	15.3	**17.4**

Source: Berkshire Capital Securities LLC

a $300 million transaction that netted the French firm $7.8 billion in AUM. Following AXA's strong performance in 2004, Chief Executive Henri de Castries indicated that the insurance and asset management giant would be on the acquisition prowl, with Asia a particular focus. Through the acquisition, AXA enhances its presence in the U.K. and gains access to Framlington's equity products for distribution elsewhere in Europe and Asia.

The consolidation trend in the U.K. included the teaming of two domestic firms, as **Britannic Group** acquired **Century Group Ltd.** (AUM: $3 billion) for $76 million. The deal furthers Britannic's goal of becoming a major player in the "closed-life" fund market. In 2004, the insurer acquired the U.K. closed-life operations of **Allianz Cornhill Insurance**.

"HSBC picked up a small specialist manager in emerging markets fixed-income products, Atlantic Advisors (AUM: $700 million), as the banking giant continued to enhance its fixed-income capabilities."

In a significant transaction that could presage similar moves by other multi-nationals, Dutch electronics firm Philips sold its in-house fund manager, **Philips Pensions Competence Center BV**, to Merrill Lynch. Merrill also secured a plum 7-year contract to manage the $16 billion pension fund. The deal makes Merrill the largest non-Dutch active pension manager in the country, which is Europe's second-largest pension market after the U.K. Robert Doll, president and chief investment officer of Merrill Lynch Investment Managers, said the transaction provides the firm with "a leadership position to conduct similar deals across Europe." (Separately, Merrill acquired the U.S. defined contribution record-keeping business of **Amvescap**.)

Boston's Affiliated Managers Group traveled north to grab equity interests in six Canadian asset managers via its acquisition of First Asset Management, a privately held holding company. Combined, the firms manage $23 billion in assets for institutions, as well as high net worth individuals. AMG said the investment would broaden the company's "international presence through partnerships with a number of Canada's leading mid-sized asset management firms." First Asset has followed an acquisition strategy similar to AMG's, in which managers at targeted firms retain a significant equity stake and operating autonomy.

Meanwhile, a major Canadian player, **Sun Life Financial** of Toronto, sold its minority share in one of Chile's largest pension funds, **Administradora de Fondos de Pensiones Cuprum**. Sun Life said the $120 million sale (to Chilean financial service firm, **Empresas Penta**) was in keeping with its effort to divest businesses in markets "where we do not have a meaningful presence." Sun Life also acquired the Hong Kong insurance and pension operations of **Commonwealth Bank of Australia**.

The **Citigroup-Legg Mason** deal involved the largest transfer of institutional assets, with approximately half the $437 billion in AUM acquired by Legg Mason being institutional dollars, an amount that brings its institutional AUM to some $500 billion. *(See Mutual Fund section for more on the Citigroup deal.)* Other transactions within the U.S. were small and highly focused.

BB&T Corp. added fixed-income and equity capabilities and increased its AUM by one-third via its purchase of a 70% stake in a fellow North Carolinian firm, **Sterling Capital Management**. A privately held company, Sterling more than doubled its AUM between 2000 and 2004, to $8 billion. In a much smaller deal, the asset management arm of **Lazard Freres & Co.** acquired a 6-year-old growth manager, **Knelman Asset Management Group** of Minneapolis (AUM: $250 million), to complement its relative-value approach.

HSBC picked up a small specialist manager in emerging markets fixed-income products, **Atlantic Advisors** (AUM: $700 million), as the banking giant continued to enhance its fixed-income capabilities. Peter Marber, president of New York-based Atlantic, said the deal provides his firm with "a great global platform for our specialized products." **JPMorgan Fleming Asset Management** acquired the high-yield investment advisory and fund administration business of Cincinnati-based **Pacholder Associates** (AUM: $2.5 billion). JP Morgan said the acquisition will "provide our clients with a full range of high-yield and distressed debt investment advisory services at a time when they are looking for expanded yield opportunities." Sanders Morris Harris Group of Houston, an active deal-maker with $10 billion in AUM, took a 20% stake in Chicago's **Astor Asset Management**, which manages assets for institutions and private investors using Exchange Traded Funds.

In a management buyout deal with a private equity component, executives at Boston's **Cadence Capital Management** (AUM: $6 billion) acquired a majority stake in their 17-year-old firm from **Allianz Global Investors**, which said the transaction "allows us now to further focus our activities on our core group of investment managers." Cadence will continue to manage four Allianz funds with $2.4 billion in AUM, under a subadvisory agreement. **Rosemont Investment Partners**, a private equity firm active in the asset management industry, provided the equity capital for the deal and became the sole outside shareholder. Philadelphia-based Rosemont has made 10 such investments since its formation in 2000.

Through a subsidiary, **Nicholas-Applegate Capital Management**, Allianz acquired the international equity business (AUM: $1 billion) of **Duncan-Hurst Capital Management**, in a teaming of two San Diego firms. "International equity plays an increasingly important role in institutional portfolios, and we are committed to providing the highest-caliber talent and services to the asset class," said Marna Whittington, Nicholas Applegate president and CEO. ♦

MUTUAL FUNDS

FOR ANOTHER YEAR, A DISPIRITED MARKET FAILED TO STEM THE POSITIVE FLOW OF MONEY INTO EQUITY FUNDS IN THE U.S., BUT INVESTORS CONTINUED TO CHOOSE MONEY MANAGERS CAREFULLY. The three largest players–**Vanguard, Capital Group Companies** (American Funds) and **Fidelity Investments**–captured 54% of net fund flows in the first 11 months of 2005, according to Financial Research Corp. That was 13 percentage points below their combined share during the same period in 2004–when the market-timing scandals were top of mind–but still above their share in 2003. At the same time, firms tarnished by the scandals continued to experience heavy outflows.

The big three firms haven't been the sole beneficiaries of the scandals: the more transparent exchange-traded funds (ETFs) have enjoyed a good run, too. Following a torrid 2004, when assets jumped 50% to $226 billion, ETFs recorded 11% growth in the first eight months of 2005. Meanwhile, some of the biggest losers have been the small mutual fund companies suddenly grappling with added regulatory costs. Researcher Cerulli Associates figures the expense of a new chief compliance officer alone can reduce the profitability of a small fund manager by up to 10%, while **Legg Mason** Chairman and CEO Raymond "Chip" Mason has stated that firms now require at least $50 billion in AUM to remain competitive.

> ***"Legg Mason, which experienced a stunning 34% organic gain in AUM in the 12-month period through September 2005, added $437 billion in AUM from Citigroup to more than double its AUM to $850 billion."***

Despite the pressures on mutual fund providers, deal activity remained relatively modest for a third consecutive year, with 19 transactions worth $2 billion, AUM transferred more than tripled to $10.2 billion per deal on average. At the same time, there was a clear stirring within the industry, as numerous diversified financial firms began to reassess the value of maintaining fund operations that are increasingly expensive to operate, given new regulatory demands, and that lay outside their core competencies. **Citigroup** was the most prominent example of that reversal in action, as it swapped its funds and other investment products for Legg Mason's brokerage operations, in a $3.7 billion deal that included a $1.5 billion investment in Legg Mason.

For Citigroup, the deal furthers Chairman and CEO Charles Prince's high-profile effort to strengthen the bank's image, by eliminating a source of regulatory conflict–and at a small price: the divested businesses contributed just 1% of net income ($241 million) in 2004. In addition, Citigroup gains a stake in a premier asset manager with a rich stock valuation, as well as access to Legg Mason's mutual funds. In a statement that could serve as the model for firms making mutual fund divestitures in the post-Spitzer era, Robert Willumstad, president and chief operating officer of Citigroup, said, "After careful review, we determined that our emphasis should continue to be on expanding access to best-in-class investment products, rather than on manufacturing proprietary asset management products."

Legg Mason, which experienced a stunning 34% organic gain in AUM in the 12-month period through September 2005, added $437 billion in AUM from Citigroup to more than double its AUM to $850 billion. (The acquired assets are evenly split between retail and institutional business.) In addition to catapulting Legg Mason into the No. 5 spot among U.S. mutual fund managers, the deal provides access to Citigroup's extensive sales force. Legg Mason also figures synergies will save the firm $80 million annually. From the investor perspective, meanwhile, Legg Mason now provides a pure asset management play. Raymond "Chip" Mason said the transaction allows the company to become "a more singularly focused, more profitable and certainly more influential organization within the global asset management community."

Other deals in the U.S. involved relatively small acquisitions, with some regional banks citing the burden of new regulations in explaining their decision to throw in the towel on active fund management. That was the case with **AmSouth Bancorporation**, which sold its portfolio of 23 mutual funds (AUM: $5.5 billion) to **Pioneer Investment Management**, for $65 million. "Because it has become more difficult and expensive for small mutual fund families to compete effectively, we have decided to focus on the key services that have distinguished our asset management business for the past 80 years," said AmSouth chief executive Dowd Ritter.

Pioneer wrapped 16 of the 23 funds acquired into its existing portfolio, while the remaining ones were rebranded under the Pioneer name. Said Pioneer President and CEO Osbert Hood: "In this competitive mutual fund industry, gaining scale by increasing assets under management is a key factor in being able to offer competitively priced products. As industry consolidation continues, we expect to take advantage of more opportunities to strengthen our business and serve our shareholders."

MUTUAL FUND TRANSACTIONS

	2001	2002	2003	2004	2005
No. of Transactions	26	22	28	14	**19**
Combined Value ($b)	5.9	3.4	0.7	0.9	**2.0**
Total Seller AUM ($b)	154	132	21	43	**194**
Average Deal Size ($m)	228	155	24	63.9	**106**
Average Seller AUM ($b)	5.9	6.0	0.8	3.1	**10.2**

Source: Berkshire Capital Securities LLC

Pioneer, owned by **Unicredito** of Italy, also acquired the established **Cullen Value Fund** (AUM: $42 million), a transaction designed to strengthen its lineup of medium and large cap funds. In a continuation of the strategy Pioneer has pursued in its other deals, **Cullen Capital Management** remained in place as subadvisor for the new Pioneer Cullen Value Fund. Since 2003, Pioneer has made five mutual fund acquisitions.

The new regulatory environment helped spur the divestiture of mutual funds by another regional bank, Illinois-based **Amcore Financial**. In explaining the sale of its three **Vintage** equity mutual funds (AUM: $142 million) to **Federated Investors**, Amcore Chairman and CEO Kenneth Edge said, "Clients today are looking for objectivity from their investment managers, and continuing to open our investment architecture provides that objectivity and complements our role as a trusted financial advisor."

Federated, which wrapped the Vintage funds into existing Federated funds, has made a number of small mutual fund acquisitions in recent years, with bank-managed funds a particular target. (Separately, Amcore divested itself of its fixed-income institutional manager, **Investors Management Group**, which was acquired by **West Bancorporation**.) Federated also acquired $200 million in mutual fund assets from the **Mason Street** Index 400 Stock Fund, which it will wrap into an existing Federated fund, while **American Century Investments** acquired the remaining 10 Mason Street funds (AUM: $1.7 billion). American Century plans to rebrand the funds under a new American Century-Mason Street name or under its own name. **Mason Street Advisors**, owned by insurer **Northwestern Mutual**, will remain as subadvisor for several of the funds.

Henlopen Fund manager Michael Hershey also pointed to the "current regulatory environment" in explaining the sale of his 13-year-old small cap fund to **Hennessy Advisors**. The deal, priced at 2.25% of assets, or $6.7 million, added $300 million in AUM to Hennessy's pre-existing total of $1.4 billion. Based in the San Francisco area, the publicly traded Hennessy ran a $20 million fund business before embarking on a series of four acquisitions, beginning in 2000. The push for scale and cost-reduction was the driving force behind **Asset Management Fund**'s (AUM: $3.7 billion) acquisition of $95 million in mutual fund assets from Boston's **Bank Investment Fund**. In 2003, AMF owner **Shay Assets Management** sold its M.S.B. large cap blend fund to **John Hancock Advisors**, while remaining as subadvisor.

Canada, one of the most active markets for mutual fund transactions in recent years, was more notable for the deal that didn't take place than for the one that did, as **CI Financial** (AUM: $39 billion) failed for the second time in recent years to snare a large fund manager. The No. 3 mutual fund company in Canada, CI Financial made an unsolicited offer for **AIM Trimark** that was rejected by parent **Amvescap**. The deal would have doubled CI's AUM and made it the largest mutual fund company in Canada.

CI's response to the rebuff? A bid for the much-larger Amvescap itself (AUM: $380 billion), at what CI called a "significant" premium to the London firm's share price. That offer was rejected as well, and while CI declined to pursue a hostile bid, many observers continue to view Amvescap as a potential takeover candidate. In 2001, CI lost out to **Investors Group** in the battle for Canadian fund giant Mackenzie Financial Corp. Investors Group is now the leading mutual fund firm in Canada. A year later, CI acquired the mutual fund operations of **Sun Life Financial Services** in a shares-for-assets swap that left the insurer with a 30% stake in CI. The deal also provided CI with access to the largest insurance sales force in Canada, and a well-heeled partner. In 2003, CI was again in the market, scooping up three asset managers.

Another major Canadian fund manager, **AGF Management** (AUM: 28 billion), was successful in a more modest bid, for **ING Investment Management**'s 14 Canadian mutual funds (AUM: $200 million). The funds were either merged into existing AGF funds or rebranded under the AGF name, though ING remained as the subadvisor for the largest fund, the Canadian Dividend Income Fund.

"This is an important acquisition that creates the opportunity for AGF to build stronger distribution and subadvisory relationships with ING," said Blake Goldring, president and CEO of AGF. John Lockbaum, senior vice president and managing director of ING Investment Management, said the deal would allow the company to "focus more intensely on the distribution of quality third-party investment products to its current clients." In 2004, AGF acquired two Canadian wealth managers that helped extend its footprint nationally. ♦

CROSS BORDER

THE LONG-AWAITED INVASION OF CHINA'S FINANCIAL SERVICES INDUSTRY FINALLY BEGAN LAST YEAR, AS BANKERS AND ASSET MANAGERS FROM EUROPE AND THE U.S. CEMENTED A STRING OF AGREEMENTS INVOLVING EQUITY SHAREHOLDINGS OR JOINT VENTURES. The list of deal-makers read like a "Who's Who" of bankers and investment companies: **Bank of America**, **BNP Paribas**, **Credit Suisse First Boston**, **Deutsche Bank**, **Goldman Sachs**, **ING Group**, **Merrill Lynch**, **Principal Financial Group**, **Royal Bank of Scotland** and **UBS**. Although most of the deals involved banking, a number of asset management tie-ups were also concluded.

As China passed the latest signpost along its 25-year road toward reform, in another tradition-bound region the longstanding barriers to cross border banking transactions continued to weaken as well. For the second year in a row, Europe played host to a major cross border bank deal (**UniCredito**'s $19 billion acquisition of **HVB**) and then watched as a second high-profile transaction was completed in the face of protectionist opposition (**ABN**'s $3.9 billion bid for **Banca Antonveneta**). Flush with cash, European banks also continued to cut deals in the U.S., with **Santander Central Hispano**'s acquisition of a 20% stake in Philadelphia-based **Sovereign Bancorp** generating the most headlines.

> ***"The asset management industry was also very active, with 35 cross border deals worldwide valued at $8.5 billion, the third-highest dollar total during the past decade."***

The asset management industry was also very active, with 35 cross border deals worldwide valued at $8.5 billion, the third-highest dollar total during the past decade. The institutional sector was notable for the size of many of its cross border deals, with the largest ones containing a transatlantic element, including **Mellon Financial**'s acquisition of a 50% stake in the asset management business of German Landesbank **WestLB** and **Aberdeen Asset Management**'s purchase of Deutsche Bank's global fixed-income business, based in the U.K. and the U.S. *(See Institutional section for more information about these deals and others.)*

In a third deal bridging the Atlantic, **Capital Dynamics**, an international private equity manager based in the U.S. and Switzerland, acquired British private equity fund of funds manager **Westport Private Equity**, from hedge fund manager **Man Group**. The transaction more than doubles Capital Dynamics' AUM to $5.3 billion (managed on behalf of 40 institutions), making it one of the world's largest independent private equity asset managers.

Bank of New York also scooped up a firm with operations on both sides of the Atlantic, **Alcentra Group** (AUM: $6.2 billion), a specialist in "sub-investment grade" debt. A 3-year-old firm with offices in London and Los Angeles, Alcentra serves institutions and high-net-worth investors; it was built via the acquisitions of Barclays Capital Asset Management in Europe and Imperial Credit Asset Management in the U.S. "Sub-investment grade debt fund management and structured credit are highly attractive, fast-growing market segments, and Alcentra has developed a significant profile in these areas," said Thomas Renyi, chairman and CEO of BNY. Aided by several acquisitions, BNY's AUM has more than doubled since 1998, last year topping the $100 billion mark. Separately, BNY and **Nordea** entered into a "strategic agreement" for BNY to provide global custody and related services to the Swedish bank's institutional clients in the Nordic and Baltic Sea regions.

CROSS BORDER TRANSACTIONS

U.S. - INT'L	2001	2002	2003	2004	2005
No. of Deals	17	23	12	15	**12**
Value ($b)	5.9	1.7	1.1	3.4	**1.6**
INT'L - INT'L					
No. of Deals	18	20	16	15	**23**
Value ($b)	1.1	2.6	0.5	0.9	**6.9**
TOTAL					
No. of Deals	35	43	28	30	**35**
Value ($b)	7.0	4.3	1.6	4.2	**8.5**

Source: Berkshire Capital Securities LLC

Within Europe, the wealth management sector recorded another busy year, as several firms sought to expand their businesses via targeted acquisitions, including **Barclays**, which bought ING's French wealth business. "France is one of the most attractive wealth markets in Europe, with 4 million affluent individuals and forecast growth in investible assets of over 7% per annum," said David Roberts, chief executive of Barclays International Retail and Commercial Banking.

Barclays, whose goal is to achieve parity between its

U.K. and international businesses, has identified wealth management as an "engine of growth." In the first half of 2005, the bank recorded a 39% gain in pretax profits in its wealth management unit. Barclays also made banking acquisitions in South Africa and Spain and smaller deals for finance and credit card businesses in Italy and the U.S.

In a second divestiture, ING sold its 70% stake in **Banque Baring Brothers** (AUM: $2 billion) to the Swiss private bank's chief executive and 30% shareholder, Eric Sturdza. ING said it will focus on expanding its business in that market through its branded entity, ING Bank (Switzerland). Belgian-Dutch bank and insurer **Fortis**–another European firm that, like Barclays, is aiming to expand beyond its core markets–purchased **Dryden Wealth Management** (AUM: $11 billion), the international wealth business of **Prudential Financial**. The $104 million deal (with another $40 million possible via a contingency fee) provides Fortis with operations in seven major financial centers in Europe and Asia. In line with its ambitions, Fortis also announced a management shakeup aimed at building a more globally minded senior team.

Cross Border Transactions by Domicile and Type

2005 (Buyer: / Seller:)	U.S. - Int'l	Int'l - U.S.	Int'l - Int'l	Total
Wealth Management	0	1	10	**11**
Institutional	5	3	4	**12**
Mutual Fund	0	0	1	**1**
Other	2	1	8	**11**
TOTAL	**7**	**5**	**23**	**35**

2004 (Buyer: / Seller:)	U.S. - Int'l	Int'l - U.S.	Int'l - Int'l	Total
Wealth Management	0	0	12	12
Institutional	1	7	3	11
Mutual Fund	2	1	0	3
Other	0	4	0	4
TOTAL	**3**	**12**	**15**	**30**

Source: Berkshire Capital Securities LLC

A fast-growing independent Swiss private bank, **EFG International**, made three small cross border deals that added a total of $3 billion in assets to the $27.5 billion it already managed. The firm acquired London's **Chiltern Wealth Management** and **Bank von Ernst** in Liechtenstein, along with the Miami-based wealth management business of **Dresdner Bank**, Dresdner Lateinamerika Financial Advisors, which serves Latin American clients. In the fourth quarter of 2005, EFG completed an IPO on the Swiss Exchange, calling it "the next logical step forward in our efforts to become a leading global private bank."

In a second and more significant transatlantic deal, BNP Paribas purchased **FundQuest** of Boston, a 12-year-old open-architecture firm providing services to wealth managers. FundQuest has $10 billion in assets under management and administration. BNP's European subsidiary, **Cortal Consors Fund Management** (AUM: $18 billion), follows a strategy similar to FundQuest, creating the opportunity for the two firms to "join forces" and "become an integrated global market leader that uses open architecture to deliver wealth management solutions for institutions and advisors." Within Europe, BNP acquired Dutch private bank **Nachenius, Tjeenk & Co.** (AUM: $1.5 billion), a venerable firm that provides BNP with entry to the Netherlands "and completes our presence in the most attractive European onshore markets." BNP is the fourth-largest private bank in Europe.

Another active deal-maker, **KBC Group** of Belgium, acquired **Rabobank**'s Dutch private bank, **Effectenbank Stroeve** (AUM: $3.8 billion), merging that company with its existing Dutch business, **Theodoor Gilissen Bankiers** (acquired in 2003). The combination of the two old-line firms creates the fifth-largest private bank in the Netherlands, with $9 billion in AUM. Within its home market,

> *"ING focused on an emerging market in Europe's backyard, as it paid $41 million to acquire the leading voluntary private pension manager in the Slovak Republic, VSP Tatry Sympatia"*

KBC also purchased the private banking business of HSBC.

Royal Bank of Canada, with private banking operations in 21 countries, greatly expanded the size of its U.K. trust business through the acquisition of Jersey-based **Abacus Financial Services** (assets under administration: $40 billion). Huw Bolle-Jones, group chief executive of Abacus, said the deal would provide his clients "with access to the services and strength of a full-service global financial institution." Founded in 1967 by the Coopers & Lybrand accounting firm, Abacus became a wholly independent firm in 1998.

Amid all this activity, UBS, which acquired four European wealth managers in 2004, took a breather last year, making just one deal for a small Milanese firm, Etra SIM (AUM: $600 million), to expand its business in Italy.

While China garnered most of the attention last year, several asset managers were busy cutting deals in another fast-growing emerging market, India. Sun Life Financial purchased the Indian mutual fund business of **Alliance Capital**, through its two 50-50 joint ventures in India with **Aditya Birla Group**, a diversified conglomerate. Separately, Sun Life sold its minority stake in a Chilean pension fund, with the two deals underlining the Canadian firm's strategy of "building sustainable scale and scope in the businesses and geographies in which we choose to compete" and exiting businesses in markets "where we do not have a meaningful presence."

BNP Paribas took a 49.9% stake in an asset management joint venture with **Sundaram Finance**. Gilles Glicenstein, chairman of BNP Asset Management, called India "one of the most exciting and rapidly developing markets in the world" and said the joint venture will "strengthen our already significant presence in new markets." Fortis entered a strategic non-equity alliance with India's second-largest bank, **ICICI Bank**, to provide wealth management services. Merrill Lynch Capgemini figures there are 70,000 resident Indians with at least $1 million in financial assets, with that number growing at a double-digit annual rate.

ING focused on an emerging market in Europe's backyard, as it paid $41 million to acquire the leading voluntary private pension manager in the Slovak Republic, **VSP Tatry Sympatia** (AUM: $211 million), in a bid to strengthen its existing business in that country. Jan Nijssen, who heads up ING's global pensions group, said the VSP transaction is in line with the company's "strategy of pursuing carefully selected add-on acquisitions that strengthen ING's position in key growth markets" and in its "principal growth areas," such as retirement services and pensions. ING is the leading company in Central Europe in the pension and life insurance businesses. ♦

ALTERNATIVE INVESTMENTS

REAL ESTATE

THE REAL ESTATE ADVISORY SECTOR RECORDED ITS HIGHEST LEVEL OF ACTIVITY SINCE 2001, WITH TWO MAJOR INSURERS DIVESTING THEMSELVES OF THEIR PROPERTY BUSINESSES AND A TIMBER BUSINESS CHANGING HANDS FOR THE SECOND YEAR IN A ROW. There were six deals in 2005 valued at $221 million and a transfer of $3.7 billion in AUM. In part, the flurry of activity reflects the increased demand among institutions for alternative investments, including real estate, and their resultant attractiveness. Even the relatively obscure timber sector has nearly doubled since 1999 to close in on $30 billion in assets, with particularly strong gains in the three years through 2005.

One of the largest players in that sector, **Hancock Timber Resource Group**, added to its portfolio last year by acquiring the timberland investment management unit of **Prudential Financial**, amounting to some 450,000 acres of timberland in the U.S., New Zealand and Brazil worth $660 million. Prudential's timber group had been part of the institutional asset management arm of **Manulife Financial Corp.** The deal gave Hancock total acreage and AUM of 2.5 million acres and $3.1 billion, respectively.

Dan Christensen, HTRG president, said the acquisition "will provide additional economies of scale which ultimately will benefit our investors" and grants the company entry into South America. "In a global economy, we believe that having access to timber markets around the world will provide excellent long-term opportunities for our clients." HTRG is the world's largest institutional timberland investment manager. In 2004, **Regions Morgan Keegan**, the asset management arm of Alabama's **Regions Financial Corp.**, acquired the timberland investment management business of **Wachovia**.

In a second deal involving a divestiture by an insurance parent, **Municipal Mortgage & Equity** acquired **MONY Realty Capital** (AUM: $2 billion) from **AXA Financial**, the second real estate investment management transaction the Baltimore firm has made in the last three years. With a business built on commercial real estate debt portfolios, MONY Realty extends MuniMae's reach beyond multi-family housing. MuniMae CEO and President Michael Falcone said the deal "jump-starts the growth of our investment advisory business" and "allows us to provide existing products to new customers and new products to existing customers." Prior to the deal, MuniMae had $9.3 billion in AUM. In 2003, MuniMae acquired the Housing and Community Investing business of **Lend Lease Corp.**, which at the time was unwinding its U.S. operations.

One of the leading institutional real estate advisory firms, **Capri Capital Advisors** (AUM: $2.3 billion), acquired **Trilogy Capital Advisors**, a six-year-old real estate securities hedge fund. The deal provides Capri with a new menu of investments for its clients while offering Trilogy access to Capri's infrastructure and additional financing via Capri's strategic partner, **CharterMac** (which provided funding for the acquisition). In a bid to expand its business in New England and Washington, D.C., **Jones Lang LaSalle** acquired a privately held commercial real estate and investment company that targets both those geographic markets, **Spaulding & Slye** (AUM: $1 billion). The $150 million transaction includes an earn-out provision and additional consideration. In a real estate-related transaction in the continuing care retirement community sector, **Sunrise Senior Living Inc.** acquired **Greystone Communities**, a $45 million-plus deal that extends Sunrise's participation in the nonprofit arena.

In a transatlantic deal, Los Angeles-based **Oaktree Capital Management** acquired 85% of the shares in **GEHAG (Berlin)** from Germany's **HSH N Real Estate**, a subsidiary of **HSH Nordbank**. GEHAG has a broad real estate business that includes fund management. The transaction "provides us with a platform from which to build our real estate activities in Germany," said Oaktree Chairman Howard Marks. With $28 billion in institutional AUM, Oaktree manages a range of investments, from real estate to private equity to high-yield bonds.

Real Estate Transactions

	2001	2002	2003	2004	2005
No. of Transactions	8	3	4	3	**6**
Combined Value ($m)	427	1,022	361	51	**221**
Total Seller AUM ($b)	19.3	22.8	21.4	3.8	**3.7**
Average Deal Size ($m)	53	341	90	17	**37**
Average Seller AUM ($b)	2.4	7.6	5.4	1.3	**0.6**

Source: Berkshire Capital Securities LLC

Hedge Funds & Private Equity

For the third year running, the performance of hedge funds as a whole was below its previous trend line, yet the industry continued its seemingly inexorable march forward. Fund flows remained positive in the first three quarters of 2005, though there was a marked drop after the first quarter, when net inflows reached $27.4 billion, and the industry surpassed the $1 trillion mark for AUM, according to Hedge Fund Research.

Returns were another matter. After underperforming the S&P 500 in 2003 and 2004, hedge fund managers beat the benchmark in 2005, albeit only by a small margin thanks to a late-year surge. Given the industry's array of fee structures, observers question whether investors will be appeased by such results or grow more discerning. Significantly, the tepid performance cut across the range of investment styles, with the exception of those hedge funds targeting emerging markets.

"Although there was a higher level of deal chatter in the hedge fund industry, the actual number of transactions–though higher than in 2004–remained in line with activity in recent years, with 10 deals valued at $1.4 billion."

To an extent, the diminishing returns underline the industry's maturation: with more money and more funds in play–there are now an estimated 8,000 hedge funds–performance is bound to suffer. In a report issued last year, British consulting firm Watson Wyatt estimated that only 5% to 10% of hedge fund managers have the skills necessary to provide superior returns. At the same time, many hedge fund managers are pursuing more traditional investment opportunities as they seek new outlets for their capital–and for generating outsized returns. As just two examples, in 2005, hedge funds helped facilitate realtor Malcolm Glazer's acquisition of the storied Manchester United soccer club and **Texas Pacific Group**'s refinancing of its buyout of retailer J. Crew Group. (There are also reports of key professionals returning to traditional investment management roles after discovering that the grass was not necessarily greener in the hedge fund world.)

Observers estimate that private equity investments now account for more than 5% of industry assets, and the growing links between the two worlds were underlined by **Summit Partners**' (AUM: $8 billion) acquisition last year of a one-third interest in fund of hedge funds manager **Coast Asset Management** (AUM: $5 billion). A 22-year-old venture capital firm based in the U.S. and U.K., Summit paid $127 million for its stake in California-based Coast and said it looks forward to broadening Coast's investor base and developing "additional innovative products." In a similar U.S. deal in 2004, private equity firm **Hamilton Lane** acquired a controlling stake in fund of hedge funds manager **Richcourt Group**.

Although there was a higher level of deal chatter in the hedge fund industry, the actual number of transactions–though higher than in 2004–remained in line with activity in recent years, with 10 deals valued at $1.4 billion. For the second year in a row, the industry did record a potential billion-dollar-plus transaction, as **Legg Mason** acquired fund of hedge funds manager **Permal** for a price that could reach $1.4 billion. In 2004, **JPMorgan Chase** agreed to pay as much as $1.4 billion for its majority stake in hedge fund manager **Highbridge Capital Management**.

Permal had indicated in 2004 that it was "investigating strategic options" and by June of last year the French-owned firm had cemented its new relationship with Baltimore-based Legg Mason. Founded in 1973, Permal is the fifth-largest fund of hedge funds manager in the world and has enjoyed rapid growth since 2002, with AUM nearly tripling to $20 billion. The company manages a dozen funds, eight of which follow a multi-strategy approach, and has a client base located primarily outside the U.S.

HEDGE FUND TRANSACTIONS

	2001	2002	2003	2004	2005
No. of Transactions	6	14	10	5	**10**
Combined Value ($m)	88	1,033	198	1,067	**1,390**
Total Seller AUM ($b)	14.5	16.6	4.2	19.8	**36.4**
Average Deal Size ($m)	15	74	20	213	**139**
Average Seller AUM ($b)	2.4	1.2	0.4	4.0	**3.6**

Source: Berkshire Capital Securities LLC

For Legg Mason, which also acquired the mutual fund business of Citigroup (see p. 11), the acquisition provides additional investment options for its institutional and wealthy clients from a firm that Legg Chairman and CEO Raymond "Chip" Mason said has delivered "attractive returns with low volatility" over the long term. For Permal, the deal provides a far superior fit than it had under previous parent **Sequana Capital** (formerly Worms & Cie), a Parisian firm that derives most of its earnings from paper manufacturing and distribution. Under the terms of the transaction, Legg acquired 80% of Permal with an upfront payment of $800 million, including $200 million in Legg shares. Legg can purchase the final 20% over the next four years.

Lehman Brothers, which in 2004 was reportedly in discussions to increase its 20% stake in U.K. hedge fund **GLG Partners**, last year acquired a similar share in New York's **Ospraie Management** (AUM: $2 billion). Run by an alumni of Julian Robertson's Tiger Management, Dwight Anderson, Ospraie invests in commodities and basic industries. The deal provides Lehman with access to new funds that Ospraie plans to create (the existing ones are closed to new investors), while offering Ospraie access to Lehman's prime brokerage business, as well as its marketing and technology muscle.

In a significant cross border deal, **Bank of Ireland** took a 71% stake in **Guggenheim Alternative Asset Management** (AUM: $2.8 billion), a 3-year-old fund of hedge funds manager based in New York. Management at GAAM and parent **Guggenheim Partners** retained the remainder of the equity. The $184 million acquisition is in line with BOI's strategy of adding "niche, skill-based businesses internationally." Dominic Curcio, a managing partner at Guggenheim Partners, said the transaction "enables Guggenheim Alternative Asset Management to harness Bank of Ireland's international distribution capability, which will accelerate its growth in the institutional market." BOI tapped the U.S. market in 2002 to acquire Connecticut-based **Iridian Asset Management**, an institutional firm that accounts for around 16% of BOI's $62 billion in AUM.

In a Swiss-based transaction, private bank **Vontobel Group** (AUM: $40 billion) took a 56% stake in fund of hedge funds manager **Harcourt Investment Consulting** (AUM: $3.1 billion). The $61 million deal, cut with Harcourt parent **NIB Capital** of the Netherlands, provides Vontobel with additional capabilities in the alternative investments arena. Herbert Scheidt, CEO of Vontobel, said the deal provides his firm's private clients with "access to a broad, first-rate range of products in an ever-more important asset class."

> ***"In the private equity sector, the major deal involved the acquisition by Capital Dynamics of established private equity fund of funds firm Westport Private Equity."***

In a smaller U.K. deal, publicly traded hedge fund manager **RAB Capital** (AUM: $1.8 billion) acquired **Cross Asset Management**, which manages an established European "event-driven" equity fund with some $200 million in assets. RAB Executive Chairman Michael Alen-Buckley said the $16 million deal offered his firm "a top team, giving us another strong, scaleable, and non-correlated product for our portfolio" while demonstrating "that RAB can attract high-quality managers with proven track records."

In the private equity sector, the major deal involved the acquisition by **Capital Dynamics** of established private equity fund of funds firm **Westport Private Equity** (AUM: $2.5 billion) from parent and hedge fund giant **Man Group**. The transaction made Capital Dynamics one of the largest independent private equity managers in the world, with $5.3 billion in AUM, and gave it ownership of a leading advisor in the U.K. and European pension markets. Thomas Kubr, chief executive of Capital Dynamics, said: "As the private equity asset class becomes more institutionalized, client needs have and will continue to become more sophisticated. By integrating Westport into our established asset management business, Capital Dynamics can offer global scale with deep local access and will blend a proven investment process with an innovative, solution-driven approach." Both firms are based in the U.S. and Switzerland. ♦

About Berkshire Capital Securities LLC

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 and Denver.

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"Our mission is to advise clients on the initiation and execution of successful mergers, acquisitions, divestitures, joint ventures and other alliances in the financial services industry."

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