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As markets rebound, some managers weigh the public option

Goosed by easy money, a dearth of options for generating yield, a general sense that the financial crisis has been tamed, and an improving U.S. economy, the markets were positively giddy for much of the first half — until the prospect of a softening and ultimate end of the Federal Reserve's quantitative easing program reared its head in June. The S&P 500 and Dow Jones Industrial Average both reached new records in the second quarter while Nasdaq delivered similarly impressive gains. In Japan, where the stock market and economy have been in the doldrums for two decades, Prime Minister Shinzo Abe's stimulative "Abenomics" program helped fuel a 19% first-quarter gain for the Nikkei 225.

In the U.S., institutions and individuals began sinking money back into equities, reversing the sea of red ink prevailing in recent years. In the first quarter of 2013, stock funds recorded net inflows of $66 billion, according to the Investment Company Institute. Bond funds generated slightly higher positive inflows of $69 billion, although that number was lower than during the same period in 2012. U.S. equity exchange traded funds saw assets jump 23% in the year through April 2013 to $854 billion. Money market funds, which served as a safe haven after the financial crisis, had outflows of $101 billion in the first quarter and accounted for 20% of mutual fund assets, compared with 40% in 2008.

Amid the return of animal spirits in those early months, asset managers delivered solid results. During **BlackRock**'s first quarter, AUM rose 7% year over year to approach $4 trillion while net income increased 10%. At **Franklin Resources**, net income and AUM both rose 14% in the quarter ending March, while **Affiliated Managers Group** registered a 44% increase in economic earnings per share and an 18% jump in AUM. Given those results and the turn in investor sentiment, it's not surprising that publicly traded asset managers enjoyed strong returns early in 2013. By end of May, asset managers as a whole were among the best performers within the Dow Jones U.S. Total Market Industry Groups, having climbed 26% year-to-date.

As smaller and mid-size asset managers weigh the possibilities for monetizing their investments and strengthening their businesses, the fading of the financial crisis and the more bullish sentiment prevailing in the early part of 2013 has led some to consider a second option outside of selling: going public. In recent years, the public option has primarily been used by leading alternative managers such as **Apollo Global Management**, **Blackstone Group**, **Carlyle Group** and **Oaktree Capital**. This year, two traditional asset managers that withdrew public offerings in 2011 and 2012 have either gone public or announced plans to do so. In March, **Artisan Partners Asset Management** (AUM: $80 billion), a rapidly growing U.S. and global equity specialist based in Milwaukee, began trading on the New York Stock Exchange. Artisan's initial public offering marked the first flotation in the U.S. for a traditional asset manager since Rochester, N.Y.-based **Manning & Napier** (AUM: $48 billion) went public in November 2011. Another

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fast-growing firm, **Silvercrest Asset Management Group** (AUM: $14 billion), filed to go public in April after withdrawing its proposed IPO last year.

Artisan, an institutional firm founded in 1994, had planned an IPO in 2011 but ultimately backed out, citing “unfavorable market conditions.” The firm raised $332 million with an offering price of $30 that was reportedly oversubscribed and that exceeded the initially anticipated range of $27 to $29. The IPO pricing gave Artisan an overall valuation of around $1.9 billion, or 2.4% of AUM. The majority of the proceeds are being used to pay down debt and buy shares from outside investors, with the rest being applied to a distribution for pre-IPO partners and for working capital.

Early on, Artisan’s performance has been strong: The stock rose 56% through May of this year. At a valuation of about 19 times forward earnings, Artisan was also at the higher end of a peer group that includes **Janus Capital** and Manning & Napier, according to Thomson Reuters. In its prospectus, Artisan spelled out three longer-term purposes in going public:

- To preserve its independence by creating a system through which owners can monetize their equity “over a structured time frame.”
- To encourage and establish a mechanism for an “equity ownership culture.”
- And to enhance growth by creating “additional financial flexibility.”

Artisan’s rationale for going public mirrors much of the motivation driving asset managers to make an ownership change. This is particularly true for firms headed by baby boomers, as they prepare for a changing of the guard in the years ahead. While Artisan founder Andrew Ziegler fits into that boomer demographic, he created a complex structure with separate share classes that allows him to retain control of the company and its board, highlighting that option for owners who want to maintain a tight rein within the context of public ownership. The company also created a general partnership designed to pay out most of its earnings in dividends.

Silvercrest, an ultra-high-net-worth manager based in New York, filed for a $62 million IPO that values the company at $146 million, or around 1% of AUM. The 11-year-old company, which counts Microsoft co-founder Paul Allen as an investor, withdrew a public offering last November, saying “market conditions simply did not provide a valuation appropriate for Silvercrest’s growing business.” The company says it will use the proceeds to purchase shares from existing limited partners and for general business purposes that could include acquisitions, among other business-building plans. In a 2012 interview with AdvisorOne.com, Silvercrest president Richard Hough also noted the company’s belief that employees “with a long-term future at the firm and who we think are significant contributors to the business” should have “a stake in the business.”

Although robust equity markets help influence a decision to go public, the financial crisis and demographics could also have an impact. For one thing, the increased regulatory burden in the financial sector has already added “red tape” to the operations of private firms, narrowing that gap with their public competitors. Additionally, a public flotation can address one of the primary post-crisis issues facing many smaller firms — competitiveness — by providing the capital for acquisitions, new product investment and other growth initiatives. Going public can also assist with employee retention by creating an incentive in the form of share ownership, as Richard Hough alluded to in his interview with AdviserOne.com. Finally, many institutional investors prefer dealing with public companies, which they see as providing greater transparency and stability.

The IPO option notwithstanding, the overwhelming number of asset managers will continue to opt for a sale in whole or part. In choosing that route, the activity in the IPO market may provide a measure of support by setting broad parameters on valuations. While determining an appropriate valuation can often prove thorny for buyers and sellers, the issue became particularly pronounced in the wake of the financial crisis. The instability in stock markets and the global economy that followed caused buyers to fret about overpaying for assets and sellers to stew about low-ball offers. The tension between the two sides caused many deals to disintegrate. In a reflection of that and the general skittishness about the future, asset management deal numbers hit a recent low of 135 in 2009. Those numbers have been rebounding since, reaching 169 last year.

There have been notable changes in what buyers are seeking and buyer type since 2007-08, however. Emerging market capabilities is one hot area, as the world acknowledges the ascendancy of those markets and the fiscal and demographic challenges facing the West. Western buyers are targeting asset managers that are either based in emerging markets or U.S. and European managers specializing in those investments. In April, Franklin Resources acquired a Mexican institutional investor, **Heyman y Asociados** (AUM: $1.1 billion), as part of an effort to extend its established presence in that market. **MetLife** took a majority stake in Chile’s largest pension administrator, **AFP Provida** (AUM: $45 billion). Two years ago, London’s **Ashmore Group** made a major acquisition of a U.S.-based emerging markets equity specialist, Emerging Markets Management.

High-yield and credit-related specialists have also been in demand. Carlyle Group has been notably active, cutting five deals for collateralized loan obligations (CLOs) since 2010. This year, **Allied World Assurance Company Holdings** of Switzerland acquired a minority interest in high-yield specialist, Los Angeles-based **Crescent Capital Group** (AUM: $11 billion). Exchange traded funds have been another area of interest, though opportunities for acquisitions in that dynamic but highly concentrated market are limited. Two of the most significant deals over the past year involved the industry’s leading player, BlackRock, which extended the

dominant position of its **iShares** business in the Canadian market through the purchase of Claymore Canada and enhanced its leading position in Europe by acquiring **Credit Suisse**'s ETF business (the fourth-largest in Europe).

Several insurance firms that emerged from the financial crisis in good shape have also been buyers, the two most aggressive being **New York Life Insurance Co.** and **Principal Financial**. Last year, through its asset management unit, New York Life made three investments in traditional and alternative managers, including a minority stake in large-cap specialist **Cornerstone Capital Management**. As part of the deal, one of Cornerstone's large-cap funds was reorganized into the insurer's **MainStay Investments** fund family. While New York Life has focused on the U.S., Principal Financial has been zeroing in on international acquisitions as it seeks to expand its footprint and capabilities. This includes the March purchase of a 55% stake in **Liongate Capital Management** (AUM: $2.1 billion), a global alternatives investor based in London and New York that manages portfolios of hedge funds. A third major insurer, **Nationwide Mutual Insurance**, in April acquired 17 equity and bond funds from San Francisco's **HighMark Capital Management**. In total, the funds have $3.6 billion in AUM.

Canadian banks and asset managers, which also emerged unscathed from the financial crisis, have capitalized on the weakness of competitors elsewhere to become aggressive international buyers, including in the U.S. In April, **Canadian Imperial Bank of Commerce** agreed to pay $210 million for **Atlantic Trust Private Wealth Management**, an **Invesco**-owned Texas-based wealth manager with $20 billion in assets. This follows the CIBC's $848 million acquisition in 2011 of a minority stake in mutual fund provider **American Century Investments**.

Private equity firms seeking to deploy their capital have joined the mix, evidencing an eclectic appetite in their purchases, with some firms cutting deals to expand their platforms and others doing so on behalf of clients through traditional limited-life vehicles. This year, **Ares Management, KKR & Co.** and **Sound Harbor Partners** have entered the market to make a variety of acquisitions. In 2012, **Friedman, Fleischer & Lowe** took a majority stake in **Strategic Investment Group**, an investment outsourcing firm for institutions with $29 billion in assets. That same year, **Lee Equity Partners** acquired a publicly traded mass affluent manager, **Edelman Financial Group**. Carlyle Group bought majority stakes in bond manager **TCW** (using capital from two of its private equity funds) and in a commodities hedge fund, **Vermillion Asset Management**. KKR & Co. acquired a large fund of hedge funds business, **Prisma Capital Partners**. **Rosemont Investment Partners** supported the management buyout of $2 billion of institutional assets run by the Midwest-based growth and value equity teams at **Fifth Third Bancorp**. ▲

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