BERKSHIRE GLOBAL ADVISORS

NEWSLETTER | Q1 2019

NEW YORK | LONDON | SYDNEY | SAN FRANCISCO | DENVER

For more than 35 years, Berkshire Global Advisors has been a leading provider of trusted M&A and strategic advice to the financial services industry. As a global specialist investment bank, our unparalleled market knowledge and relationships enable us to deliver exceptional results for our clients.

Across borders, market cycles and industry sub-sectors, Berkshire Global Advisors provides effective, conflict-free advisory services to CEOs and their executive teams, business owners and financial sponsors. www.berkshireglobal.com

Berkshire Global Advisors LLP

527 Madison Avenue, 3rd Floor
New York, NY 10022
+1 212 207 1000

One Market Street, Spear Tower, Suite 3600
San Francisco, CA 94105
+1 415 293 8426

999 Eighteenth Street, Suite 3000
Denver, CO 80202
+1 303 893 2899

Berkshire Global Advisors Limited

11 Haymarket
2nd Floor
London, SW1Y 4BP
+44 20 7828 2828

Berkshire Global Advisors Pty Ltd

Level 18, 1 Castlereagh Street
Sydney, NSW, 2000
+61 283 200 841

Wealth industry is in early stages of dramatic changes

Bolstered by the millions of affluent individuals minted during the economic, technology and stock market booms of the 1980s and 1990s, wealth management in the U.S. expanded from its roots as a cloistered and tradition-bound industry dominated by blue-chip firms and large banks to incorporate the growth of upstart independents.

Today, with some 5,000 registered investment advisors alone, the U.S. independent wealth industry nevertheless remains in the middle innings of its modern evolution. Moreover, with nearly 12 million households having a net worth of $1 million or more, another 31 million mass affluent households, and the ubiquity of individual retirement plans, the opportunity for independents remains vast.

As the industry has grown, some 200 to 250 independent firms have developed the size, scale and sophistication to position themselves as leaders among their peers. The majority are local firms with roughly $2 billion to $5 billion in AUM. They are joined by two dozen regional leaders with some $5 billion to $10 billion in AUM and another 10 national giants with upwards of $20 billion in AUM.

For the most part, these leaders are focused on investing in, and planning for, long-term independence, a philosophy that differentiates them from many smaller firms aiming to maximize cash flow in the medium term as part of an exit strategy. Still, as leaders confront the challenges posed by costs, regulations, talent recruitment and client demand for more services and better technology — including proprietary technology — their ranks will evolve in the decade ahead. While many firms will stick to organic growth alone, others will absorb smaller competitors, pursue combinations of equals, or opt to fold into banks and diversified financial services firms of varying sizes. Additionally, the leaders will continue to pinpoint either local, regional or national footprints.

The recent experience of the U.S. securities industry provides a useful if imperfect blueprint for where the wealth industry could be headed over the long term. By the 1970s, after some 50 years of history, the industry had about 30 relatively small and narrowly focused leaders. But in the decades that followed, leadership passed to 10 large, broadly based companies before consolidating more recently around four global and diversified giants. One of those, **Morgan Stanley** (NYSE: MS), was an old-fashioned investment bank with a few hundred employees in the 1960s, but during the following decade it began to metamorphose into the diversified and global financial services firm that exists today.

Wealth sector development involves consolidation, and that process is being led by three groups: consolidators (or aggregators), strategic buyers and other independent firms. The private equity-backed consolidators pursue a business model involving the aggressive rollup of small firms, often with well below $500 million in AUM. For

continued on next page

example, Denver-based **Mercer Advisors**, backed by **Genstar Capital**, has enhanced its large national presence so far this year by acquiring firms in California, Colorado and Michigan that had an average of $230 million in AUM. "Private equity has helped to accelerate the pace of consolidation, but it didn't cause consolidation in the RIA space," Mercer Vice Chairman Dave Barton told *InvestmentNews* in March. "It's a competition issue. Smaller firms realize the larger firms can offer more services in addition to investment management and financial planning."

The importance of ongoing acquisitions to the consolidators' business models can be gleaned in **Focus Financial Partners**' (NASDAQ: FOCS) 2018 fourth-quarter results, which showed that companies added that year contributed 65% of revenue growth. Focus has also begun trawling in deeper waters since two new private equity firms assumed a majority stake in 2017, **KKR & Co.** (NYSE: KKR) and **Stone Point Capital**. Soon after, Focus cut its largest-ever deal for **SCS Capital Management**, an ultra high net worth independent based in Boston and New York with $16.5 billion in AUM at the time. Immediately after going public in 2018, Focus paid $235 million in cash and shares for **Loring Ward Holdings**, an established Silicon Valley firm that serves independent financial advisors with fee-based investment portfolios, retirement plan solutions and other services; it has $17 billion in AUM.

Similarly, **HighTower** has upped its ambitions since a 2017 investment from **Thomas H. Lee Equity Partners**, buying consolidator **WealthTrust**, then with $6.4 billion in AUM, and two ultra high net worth independents with a total of more than $7 billion in AUM: Houston's **Salient Private Client** and a Memphis-based firm, **Green Square Wealth Management**. All three deals are far larger than what founder and Chairman Elliot Weissbluth has referred to as HighTower's traditional target: managers with between $200 million and $800 million in AUM.

Strategic buyers include national, regional and community banks, as well as non-bank financial services firms, seeking to expand their fee-based businesses and enhance their client relationships, among other reasons. One of the larger deals took place in December 2017, when **Hancock Whitney Bank** acquired **Capital One**'s (NYSE: COF) wealth business, with more than $10 billion in AUM/A. The addition allowed Mississippi's Hancock Whitney to scale up its trust and wealth business around the Gulf region. As a result, by the fourth quarter of 2018 parent **Hancock Whitney Corp.** (NASDAQ: HWC) reported a sharp increase in trust and investment, annuity and insurance fees to 30% of total non-interest income, compared with 24% during the year-earlier period.

A second such deal took place on the East Coast in 2016: **People's United Bank**'s (NASDAQ: PBCT) acquisition of **Gerstein Fisher**, a wealth and fund manager with $3 billion in AUM at the time. Gerstein Fisher founder Gregg Fisher cited People's distribution network as one reason for the sale, saying it "will allow us to help more people invest smartly" than the firm could "on a standalone basis." In a nod to the stresses posed by the low-rate environment, the bank said the deal "complements recent investments in our fee-based business and will further diversify revenues with additional non-interest income." The following year, the Gerstein Fisher business was "primarily" responsible for an 8.5% jump in non-interest income at People's United.

In the Milwaukee area, bank, insurer and wealth manager **Johnson Financial Group** bought **Cleary Gull Advisors** in 2016, adding $2.1 billion in AUM to create one of Wisconsin's largest wealth managers with $8.5 billion in AUM. For Johnson, the deal provided growth while Cleary Gull gained stability. Michael Cleary, founder and current president of Cleary Gull, described Johnson's "basic strength and appeal" as its roots as a family-owned, Wisconsin-headquartered firm "here to stay for generations." In an interview with the *Milwaukee Journal Sentinel*, Cleary added, "One of the things our clients are going to be looking for in the next five to 10 years is what's next for Cleary Gulf. This solves the problem." Subsequently, Cleary Gull acquired a small Milwaukee firm specializing in individual and government balanced and fixed income accounts.

In addition to the U.S. banks, one of Canada's big five, **CIBC**, has been making an aggressive push into U.S. wealth management via acquisition. In 2017, it concluded a cross border deal for **Geneva Advisors**, a Chicago independent with $8.4 billion in AUM, with a purchase price that could run as high as $200 million based on performance. The deal followed the closing of the bank's major acquisition the previous year of another Chicago firm, **PrivateBancorp**, a commercial bank and wealth manager that expanded the services CIBC could offer its wealthy U.S. clients. CIBC entered the U.S. wealth market in 2013 by acquiring **Atlantic Trust Private Wealth Management** from **Invesco** (NYSE: IVZ). Atlantic Trust, which was wrapped into the CIBC brand in 2018, had $20 billion in AUM at that time. CIBC has $60 billion in AUM/A in the U.S., nearly double the amount in 2016, and the bank is aiming to top $100 billion by the early-to-mid 2020s while lessening dependence on the Chicago market.

Non-bank strategic buyers are also entering the marketplace. For example, a major deal this year involved a financial services buyer, **NFP Corp.**, that is also backed by a private equity firm. The New York-based insurance broker and employee benefits consultant made a splash by acquiring **Bronfman Rothschild**. Formed from the two family offices bearing the firm's marquee name and a wealth manager they acquired, Bronfman Rothschild has itself been an active buyer during its six years in existence; it has $6 billion in AUM. Majority-owned since 2013 by **Madison Dearborn Partners**, NFP also owns New York wealth manager **Sontag Advisory**. By merging the two wealth managers, NFP is creating a more formidable entity with $10 billion in AUM and 1,300 clients, although the ultimate branding of the firm remains uncertain.

"Size and scale matter, and there was a strong business and cultural fit with Sontag," Bronfman Rothschild President and Chief Operating Officer Mike LaMena told Financial Planning.

"With NFP's support, we think it will be a great way to help us grow and serve clients." Based in Maryland, Bronfman Rothschild has a presence on the East Coast and in the Midwest while Sontag has offices in California, Connecticut and Florida, in addition to New York, and clients in 30 states. In an interview with *InvestmentNews*, Sontag President and Chief Operating Officer Eric Sontag indicated that NFP would remain a buyer, saying, "We're not setting a goal to make a set number of acquisitions, but we are interested in growth through acquisitions."

The third and emerging group of deal-makers is the leading independents themselves. A good example is employee-owned **Tiedemann Advisors**, which as part of an expansion from its East Coast base has in recent years cut two significant deals with independents in key West Coast markets. The first, in 2016, was for **Presidio Wealth** of San Francisco. Tiedemann gained $4 billion in AUM to total $13 billion as well as offices in several core wealth markets, while combining with a similar research-driven partner. For Presidio, the link added trust and estate planning services and allowed founder and CEO Brodie Cobb to relinquish his management responsibilities to CEO Michael Tiedemann. "He's 10 years younger than me," Cobb told RIABiz. "When I was 45, I was charging ahead too."

A year later, Tiedemann entered another key market when it acquired a Seattle wealth advisor and family office with $3.4 billion in AUM and a coveted specialty in impact investing, **Threshold Group**. Tiedemann has been quiet since, in line with the caution that Michael Tiedemann brings to such weddings. "The two things that destroy all mergers are mismatches in culture and integration that doesn't go well," he told *Real Assets Adviser* in 2017. "The point is to make sure that we have an institution that goes beyond our lives."

In addition to acquisition or combination, some of the larger independents are positioning themselves for further development and growth by raising capital. For example, **Savant Capital Management** completed a $50 million debt and equity recapitalization in 2016. This deal allowed the then 30-year-old Illinois company to maintain its independence while laying the groundwork for a generational ownership change. In a unique structure, SCM tapped a broad base of about 20 investors, including family offices.

Subsequently, more than twice as many employees held shares (amounting to 75%), and ownership has been expanded in the years since to more than 50 employees. Writing in *Financial Planning* in 2018, CEO Brent Brodeski praised family offices and ultra high net worth investors for their "long time horizons (20 or more years)" and hands-off approach, noting: "The last thing they want to do is operate your business." At the same time, Brodeski said "our investors offer lots of expertise and connections and pledged additional follow-on capital to support M&A." Savant, whose AUM has climbed from $4.7 billion to $6 billion since the recapitalization, has made one small acquisition since that expanded its footprint into the Southwest.

Finally, in a trend that will undoubtedly gain traction, independent wealth managers are acquiring or merging with related businesses. Focus' acquisition of Loring Ward is one prominent example of an aggregator extending its portfolio with a firm that provides investment services to independent advisors. Another took place in April, when ultra high net worth firm **Cerity Partners** of New York acquired Chicago's **Blue Prairie Group**, which has $11 billion in retirement plan AUM. The deal gives Cerity a total of $21 billion in AUM and "adds breadth and depth" to its business by providing "end-to-end solutions for employers and personalized advice for employees." In 2018, **Lightyear Capital** acquired a 50% interest in Cerity. "It's the wave of the future to be diversified," Blue Prairie Managing Partner Ty Parrish told *InvestmentNews*. "There has been a trend over the last half-dozen years with plan sponsors wanting fiduciary advisers to start talking with employees and offer advice on that level. This makes us one of the few companies with an end-to-end solution." ▲