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In the aftermath of structural and regulatory changes, Australia's lucrative asset management industry beckons

With a GDP of $1.3 trillion, Australia ranked as the 13th-largest economy in the world as of 2018 while per capita income of around $57,000 bumps the nation up three places on that list. Those impressive numbers have been driven by an uninterrupted and solid record of economic growth stretching back over three decades, thanks to a significant push from China's demand for Australia's natural resources.

But often lost in discussions of "Australia's economic miracle" is the nation's robust asset management industry. Most of the industry's rapid growth has been fueled by the nation's superannuation program. A compulsory scheme since 1992, the program had amassed more than A$2.8 trillion ($1.9 trillion) in assets by 2018, making Australia the fourth-largest pension market in the world. In the 10 years through 2018, assets in the program recorded average annual growth of 10%, by far the highest level among the world's leading pension markets, according to Willis Towers Watson's latest global survey.

Nearly 15 million people participate in the super program and the assets represent half of the nation's household financial assets. The average account balance is A$144,900, but the median is a much lower A$52,000, reflecting large balances that skew the average, according to the Australian Financial Services Council. Age naturally plays a significant role in varying account balances, too: In the 65-to-74-age bracket the median balance is highest at about A$225,000 while in the 45-to-54-age group it is A$100,000.

As a percent of the overall Australian retirement market by assets, including defined benefit plans, super accounts for 86%, up six percentage points from 2008. This compares with defined contribution plan percentages of 62% in the U.S. and just 5% in Japan. Importantly, through the ups and downs of financial markets, the super program has a guaranteed rate of growth via the current 9.5% employer annual contribution based on employees' "ordinary" wages (employees can also make their own contributions). That rate is scheduled to increase in half-point increments beginning in 2021 before topping out at 12% in 2025. Driven by those contributions and appreciation, KPMG figures super assets could double from the current level over the next 10 years.

The super program has four main segments through which the public participates, each with a market share between 22% and 27%: industry, sponsored by unions and employer organizations; public sector, serving government employees; retail; and Self-Managed Superannuation Funds. The largest such segment, SMSFs, comprises from one to four members who act as their own trustees and exercise more control over selection and management of their fund's investments than other segments, with assistance from a financial advisor. The retail segment

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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 Ltd

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

Berkshire Global Advisors LLP Member, FINRA / SIPC

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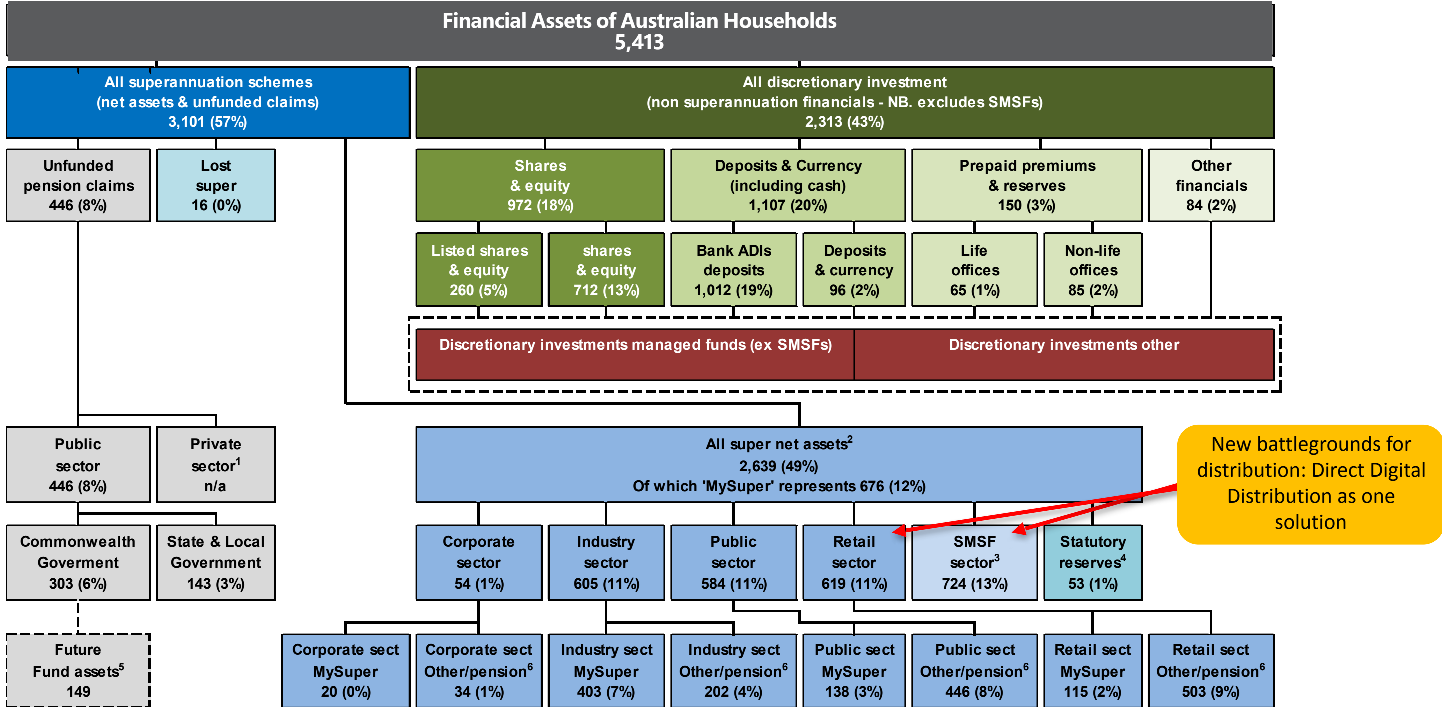
involves publicly offered funds that members join through employer-sponsored groups or via third parties such as advisors. The three main segments not including SMSFs, contain from three dozen collective funds to more than 100. SMSFs, with its small groups, has nearly 600,000 funds.

In a reflection of where product demand is heading of late, four of the five fastest-growing asset classes in the year through March 2019 involved alternative categories with the fifth being socially responsible investing. As the super program gets ever larger, the more likely it is that funds will be forced to



Notes:
1. Unfunded pension claims excludes liabilites of unfunded pension claims for private sector employer defined benefit and hybrid schemes
The ABS 'Australian National Accounts, financial accounts', do not provision for household private sector employer unfunded pension claims
2. Difference between ABS and APRA data for superannuation pension schemes is due to different reference universes and ABS data, includes provisions for some liabilities (eg. tax, creditors, borrowings)
3. 'SMSF sector' includes APRA small funds and APRA Approved Deposit Funds (ADFs)
4. 'Statutory reserves' includes immediate annuities and regular premium products through life offices
5. Future Fund provisions for unfunded Commonwealth superannuation liabilities. Legislation stipulates that money may not be withdrawn from the Fund until 2020
6. 'Other/pension' includes non MySuper accumulation assets and retirement assets

Source: ABS National Accounts: Financial Accounts (Cat 5232.0, Tables 20, 36, 39, 43); APRA Quarterly Superannuation Performance; ATO SMSF Quarterly Statistics

Among the large funds regulated by the Australian Prudential Regulatory Authority (APRA) — which oversees 85% of total assets in funds with more than A$10 billion — the largest 10 account for 47% of assets. The leading fund is **AustralianSuper** with A$140 billion in AUM, 2.2 million members and 280,000 employers. AustralianSuper offers various investment options, including Balanced, which counts 90% of AustralianSuper members as investors and delivered an average annual return of 7.3% in the 10 years through June 2018. Balanced invests both directly and via fund managers, with domestic and global equities making up 56% of assets; a variety of alternatives 25%; and fixed income and cash 19%.

The Australian asset management industry itself is competitive with some 1,000 managers. The top-10 include a mix of global and domestic firms that account for 42% of domestically sourced AUM. **State Street Global Advisors** is No. 1 with a 5.8% share. The next 10 firms hold a 17% share, leaving about 40% of the market up for grabs among firms with shares of about 1% or less.

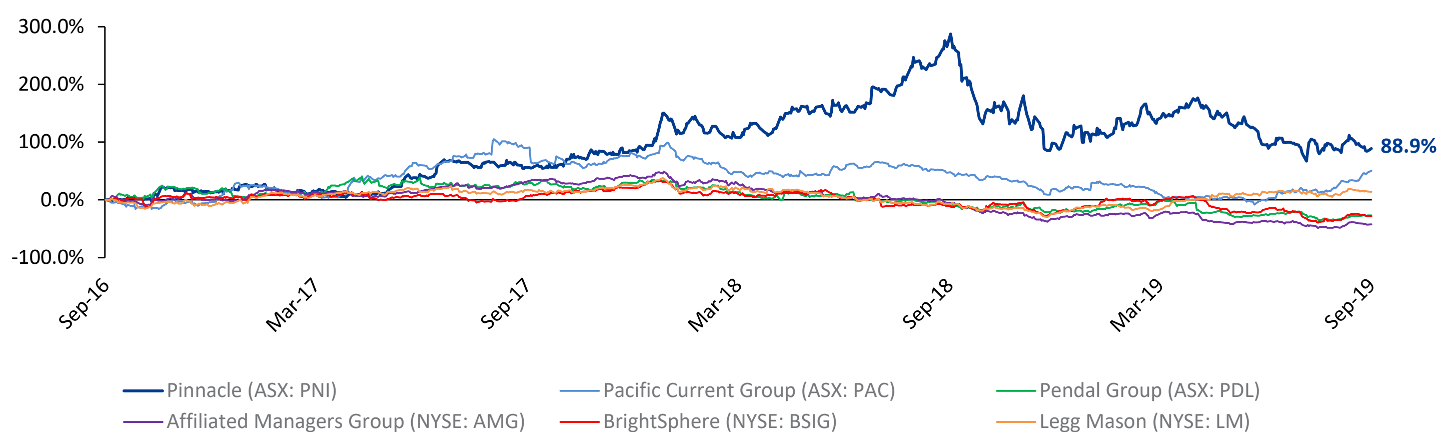
seek more investments outside Australia, given the country's relatively small size. That should create opportunities for managers with global products.

Although the superannuation program drives most of the growth in Australia's asset management industry, it isn't the only factor. A sophisticated insurance industry and the retail market are also significant. Within the retail market, Australia has the third-largest number of high net worth individuals in Asia-Pacific after Japan and China, according to Capgemini. The country also led the world in 2018 in net inflow of HNWIs (12,000) for the fourth consecutive year, according to researcher New World Wealth. Property consultant Knight Frank projects that Australia's population of HNWIs will climb 18% in the five years through 2023 while ultra-HNWIs (at least $30 million in investible assets) will jump 20%, aided by wealthy immigrants from Asia.

For all the success of the nation's asset management industry and superannuation program, the last couple of years have seen a fallout from scandals primarily involving the nation's four major banks but also smaller financial advisors. An

investigation by the Australian Royal Commission revealed numerous instances of fraudulent and unethical practices in the financial services industry, including the superannuation program. "There is a developing super fund 'zeitgeist' focused on radically increasing member value," wrote Willis Towers Watson about the post-Commission super program. "The model to do this will involve considerably more engagement and more scale and efficiency in the system."

As regulatory and fee pressures increase, analysts expect super fund consolidation to accelerate. "Last year [2018], we predicted that the number of [APRA] funds would halve over the next decade, but we now believe this will be nearer to five years to ten," KPMG wrote this year. "Greater regulatory obligations, plus issues such as continued increases in operating costs and ongoing uplift in churn out of funds [are] placing further pressure on many fund's business models [and] driving consolidation." There have been several examples this year, including industry funds **MTAA Super** and **Tasplan**, which concluded a memorandum of understanding in July to investigate a merger that would create a national super fund with A$22.5 billion in AUM. "We anticipate that the increased scale will deliver efficiencies that can be passed on to members by way of product and service improvements, competitive fees and returns," the two companies said.



The same pressures driving super fund mergers are likely to fuel M&A activity among asset managers themselves, with a universe of perhaps 200 mid-market firms (about A$500 million in AUM) as potential targets. At the same time, pure asset managers are likely to benefit as the bank-driven integrated model breaks down and the market becomes more fragmented. Last year, **Commonwealth Bank of Australia** (ASX: CBA) started the process of major bank asset and wealth management divestitures by selling its global asset management business to **Mitsubishi UFJ Financial** (NYSE: MUFJ) for A $4.1 billion, a deal that closed in August of this year. This year, CBA and another of the big four banks, **Westpac Banking Corp.** (ASX: WBC), both sold their financial advisory businesses to domestic firms.

Mitsubishi gained A$210 billion in AUM from CBA, extending its Japanese-dependent business into Australia as well as Europe. Australia, comprising 57% of the acquired assets, now accounts for 12% of Mitsubishi's total AUM. Mitsubishi paid 12.4 times EBITDA, which the firm acknowledged was higher than the 10 to 11 times valuations on other publicly traded asset managers in Australia at the time. But Mitsubishi called the price "quite reasonable," pointing to the nation's "substantial market growth potential."

Publicly traded Australian asset managers often trade at higher multiples than their counterparts in other markets, including the U.S., for two reasons: One is supply and demand, owing to the limited number of pure-play publicly traded Australian managers; the second, and likely more important one, is the industry's projected growth, thanks to the superannuation system. Those valuations can have an impact on the expectations of privately held firms that dip their toes into the seller's marketplace.

In a second cross border deal this year involving a major bank divesture, Canadian asset management giant **CI Financial** (TSX: CIX) acquired **National Australia Bank**'s (ASX: NAB) 49% stake in local quantitative fund manager **Redpoint Investment Management** (management retained the rest). CIF cut the deal through its Australian subsidiary, **GSFM**, which was acquired in 2016 and has more than A$7 billion in AUM. Established in 2011 by several seasoned industry executives, Redpoint has A$10 billion in AUM in funds focused on Australian industrials and global infrastructure, as well as strategies for institutions and financial advisors. "We see demand in the Australian market for quantitative solutions," said GSFM, "and Redpoint brings a highly credible and experienced team to provide such strategies." GSFM operates as a distributor for seven other asset managers offering differentiated strategies, including diversified U.S. fund manager **Payden & Rygel** and hedge fund **Man Group** (LSE: EMG). For Redpoint, the deal provides an opportunity for expansion via GSFM's "focused and specialist distribution capability."

A third cross border deal with another large buyer took place in late 2017: **Natixis**' (PA: KN) A$155 million purchase of a 52% stake in **Investors Mutual Ltd.** An established Australian equities value manager, IML had A$9.1 billion in AUM at the time and joined its new parent's multi-affiliate network. In

various communications, Natixis said IML offered "expertise in Australian equities" and "additional exposure to the Australian retirement savings markets." Additionally, the French firm said the deal "marks an important step" in its "ambition to expand" in the larger Asia-Pacific region, calling the area "critical" to its growth.

Similar to Natixis, some American and European firms view Australia as a stable beachhead from which to penetrate the larger Asian region, in addition to the value it holds as a single market. Among Asian-based firms, interest has been lower but is more likely to zero in on the Australian market alone, although Mitsubishi's acquisition provided a mix of markets.

In the wealth space, there are some 26,000 advisors and 2,200 licensed advisory firms registered with the Australian Securities and Investment Commission. While the share of advisors in groups with more than 100 advisors is 55%, that number is down 10 percentage points since 2016, according to the Financial Services Council, with the concurrent rise in the percentage of small to mid-size firms highlighting the growth of boutiques. In The Deal's 2018 list of Australia's top financial advisors, 60% were not aligned with a major bank or insurer, leading the magazine to observe, "If the list has an overarching theme this year, it is the genuine arrival of boutique operators in financial advice."

As the banks divest their wealth arms and the industry becomes more fragmented, the type of smaller and mid-size players cited by The Deal are expected to make additional gains. On top of that, the wealth industry is also shifting from a product-driven commission model to more of an open-architecture and professional fee-based service, while regulators have added new and tougher standards for advisor certification.

A report this year from Australia's **Crestone Wealth Management** underlines the need among wealthy individuals for sound advice, with the firm pointing out that HNWIs "aren't necessarily as sophisticated as supposed." As an important example, Crestone cites the narrow focus in the portfolios of many HNWIs and ultra-HNWIs on cash, Australian equities and direct residential property. "This lack of diversification poses significant risks to both groups' wealth," Crestone writes, noting that three-quarters of those interviewed said they would consider investing in other asset classes "if they understood the different types available."

The changing wealth marketplace is likely to generate M&A activity as well as demand from companies for capital for aggregation and other purposes. One high-profile firm drawn by the market opportunity is wealth aggregator **Focus Financial Partners** (NASDAQ: FOCS). The New York firm has been cutting deals in Australia since 2016 as it slowly expands outside the U.S. This year, it acquired an ultra-HNWIs firm, Melbourne-based **Escala Partners**.

Focus Chairman and CEO Rudy Adolf told analysts in May that the Australian wealth model has been "fundamentally turned upside down" by the Royal Commission, creating "a tremendous white space that, quite frankly, pushed the traditional players out of the market." He cited six-year-old Escala as representative of a growing list of "innovative [and] nimble" firms, saying Focus hopes to turn its new partner into a "platform for other firms in Australia." **Financial Professionals** of Brisbane is Focus' second partner firm in Australia.

In an interview with *The Deal* last year, Escala investment advisor and partner Ben James said most of the firm's clients "come to us as a result of a liquidity event — they have usually been in an environment of risk such as managing their business and selling it. As a result, they are more likely to be looking for capital protection, income generation or compounded growth than continuing with an aggressive growth profile."

In a second cross border wealth deal this year that included an investment banking component, Canada's **Canaccord Genuity Group** (TSX: CF) significantly extended its Australian wealth business by paying A$25 million for **Patersons Securities** of Melbourne. CGG also plans to implement an equity incentive program for "key" Patersons employees. Patersons has more than A$13 billion in assets, 100 investment advisors and offices across the country. CGG said the deal "marks the beginning of a new chapter for our Australian business as we systematically expand our presence with a leading wealth management business." ▲

Berkshire have been serving clients in Australia since 2010 and in 2017 opened our second international office in Sydney, New South Wales.
For any Australia and New Zealand related inquires please contact:

Nelson Lam
Principal and Executive Director
+61 402 336 228
nlam@berkshireglobal.com

www.berkshireglobal.com

Berkshire Global Advisors LP
527 Madison Avenue, 3rd Floor
New York, New York 10022
United States
Tel: +1 212 207 1000

Berkshire Global Advisors Ltd.
11 Haymarket
London, SW1Y 4BP
United Kingdom
Tel: +44 20 7828 2828

Berkshire Global Advisors Pty Ltd.
Level 18, 1 Castlereagh Street
Sydney, NSW 2000
Australia
Tel: +61 402 336 228