Investment Management and Real Estate

Building scale through acquisition

An extract from European IMRE News March 2009

PricewaterhouseCoopers

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The changing landscape for participants in Europe's investment management sector is forcing businesses to adapt and this may result in a drive for scale.

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The short-term outlook for the asset management sector remains uncertain and asset managers are confronted with pressure from market volatility, withdrawals from retail investment funds and institutional business becoming less profitable as clients reallocate funds from equities and alternatives into lower margin cash and fixed income. Furthermore, the sector generally and the hedge fund industry in particular are suffering from reputational damage, capital scarcity and the threat of increased regulatory intervention. These pressures have been reflected in the share prices of listed fund managers. For example, the weighted average share price decrease of the largest 10 UK asset managers (by market capitalisation at 1st January 2008) was 50% during the 2008 calendar year, compared to a 30% fall in the FTSE All-Share Index.

The response of many asset managers has been, and is likely to continue to be, a reduction in costs. Several have announced headcount reductions and others have announced mergers at the fund level. Research from Morningstar highlights that there was a sharp increase in share class closures/mergers from 1,482 in 2006 to 4,538 in 2008.[9]

A further option for businesses will be to search for scale at the house level which may benefit organisations from both a cost reduction and a capital perspective. Larger asset managers may, therefore, think this is a good time to acquire smaller counterparts.

Emerging opportunities

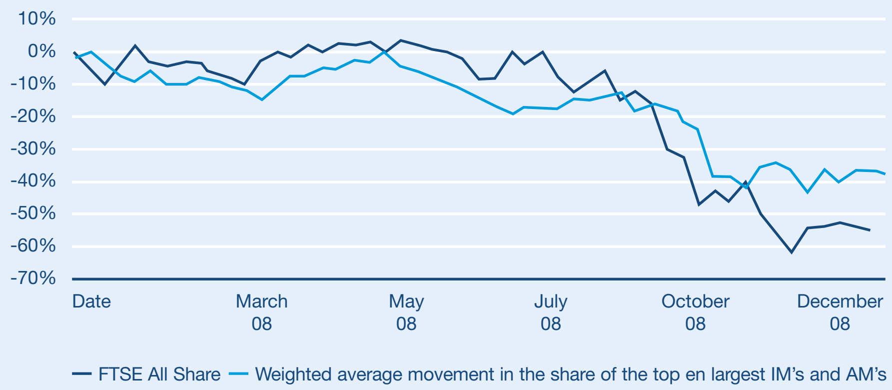
With prices for asset managers at low levels, opportunistic financial buyers with capital to invest may view this as the right time to buy and there has been some evidence of this trend developing. For example, GLG Partners acquired SocGen's UK asset management business in December 2008 for an undisclosed sum. A number of questions remain for private equity houses interested in the sector including the critical question of talent management which deterred some buyers in the past.

The year 2008 was punctuated by two events which may be indicative of further emerging trends in the sector:

Distressed sales – New Star, the UK listed fund manager, announced a capital restructuring on 3rd December 2008 "that will result in £240 million of its £260 million of gross debt being converted into equity".[10] The restructuring resulted in the banking consortium of HBOS, Lloyds TSB, HSBC, RBS and National Australia Bank effectively

9 Source: Morningstar research 12 January 2009
10 Source: New Star press release 3 December 2008

Weighted average movement of the largest 10 listed UK investment and asset managers (by market cap as at 1 January 2008)



Source: PricewaterhouseCoopers analysis

owning a 75% stake of New Star's enlarged fully diluted ordinary share capital. The banking consortium is rumoured to be searching for a new buyer for the business. It is possible that other asset managers, particularly those with a high degree of leverage, may also be required to renegotiate or restructure the terms of their debt and this could give rise to distressed sales.

Sale of captive investment businesses representing attractive capital-raising options for large financial services groups – Aberdeen Asset Management announced on 31st December 2008 that it had acquired parts of Credit Suisse's Global Investors business for £250 million (subject to shareholder and regulatory approvals). Credit Suisse's exit continued a trend seen in the United States where large financial services groups have sold fund management units to raise capital. US examples have included Citigroup swapping its asset management unit for Legg Mason's brokerage operations (2005); Northwestern Mutual selling its Mason Street Funds to American Century and Federated Investors (2006); and AmSouth Bancorp selling its fund unit to Pioneer Investments (2005). Other large financial services groups are likely to be considering doing the same as they look to focus on their core businesses.

In the medium to long term the outlook for the sector remains strong as the demographic of an increasing proportion of elderly people in Western Europe and a large under-developed market in Eastern Europe will create growth. Therefore, with asset prices at historical lows many will view this as an exciting time to acquire an asset management business for the longer term.

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Investment Management and Real Estate contacts

IMRE News is produced by experts in their particular field at PricewaterhouseCoopers, to address important issues affecting the investment management industry. If you would like to discuss any aspect of this document, please speak to your usual contact at PricewaterhouseCoopers or one of those listed on these pages.

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