Expansion, not survival, will drive M&A: report

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By Marc Hogan

Over the next 12 months, buyers seeking growth will supplant sellers motivated by stress or distress as the primary drivers of mergers and acquisitions in the global asset management industry. That is according to a new report by Jefferies Putnam Lovell.

Many transactions in the first half of the year involved either large banks and insurers divesting to further protect their capital positions, or small companies selling in the interest of survival.

Assuming global markets recover from their March lows, these motivations will give way to more traditional M&A catalysts, such as product diversification and distribution, Jefferies Putnam Lovell says.

Nirav Hathi, a managing director at Jefferies Putnam Lovell, points to three deals that have occurred already in the second half of the year.

Bank of New York Mellon has unveiled a £235m deal to acquire Insight Investment Management from Lloyd's Banking Group. Australia's Macquarie recently announced it was to buy US insurer Lincoln National's Delaware Investments unit for $428m (€303m).

And in late July, Citigroup agreed to sell Japanese asset management unit Nikko Asset Management to Sumitomo Trust & Banking.

"The common thread is obviously that all these businesses are owned by banks which are in some sort of disarray," Mr Hathi says. "The difference is that this time around all the banks managed to get the deals done." The sellers' asset management businesses were of "significant strategic value" to their acquirers, Mr Hathi notes.

"[Independent asset managers] look at these transactions as quite unique opportunities to acquire businesses," he says. "We see this continuing as the equity markets stabilise and the asset management earnings become predictable."

Deal volume fell by one third in the first half of 2009, compared with the year-earlier period, to 73 announced transactions, according to the Jefferies Putnam Lovell report. Excluding BlackRock's $13.5bn acquisition of Barclays Global Investors, deal values fell by 93 per cent to the lowest half-year total in at least 10 years.

Several of these transactions were big divestiture, merger and minority-stake deals involving bank- and insurance-owned asset managers.

In addition to the BlackRock-BGI deal, three other transactions took place involving asset managers with $100bn or more in assets under management or contract: Société Générale's merger with Crédit Agricole, Swiss Re's sale of insurance asset manager Conning to Aquiline Capital Partners and Mitsui Life Insurance's sale of its stake in Sumitomo Mitsui Asset Management to three other banks and insurers.

However, the lion's share of transactions in the first half of the year were small. Nearly 75 per cent of sellers during the period managed less than $3bn in client assets – a record – according to the report.

Many small firms were forced to sell to survive. Jefferies Putnam Lovell cites the sale of $2.1bn private equity fund-of-funds manager HJR Capital to Capital Dynamics following reports that HRJ could not raise enough capital from limited partners to fulfil its commitments to underlying fund managers.

Deal volumes are likely to rise, albeit perhaps only slightly, in the next 12 months. Divestitures will remain a catalyst for transactions and will represent the vast majority of assets under management changing hands through M&A, according to the report.

Ray Soudah, founder of M&A boutique Millenium Associates, has a somewhat different outlook. He says he does not expect the number of transactions to increase over the next 12 months.

"There has been a recovery in profitability during the past few months, which has brought people from the red into the black," Mr Soudah says. "There is less pressure to consolidate, whether you are a buyer or whether you are a seller. There is no reason for people to buy each other at higher prices just because the market feels better."

Within stable to lower deal volume, though, Mr Soudah says he expects large banking and insurance groups to continue to deal away their asset management units, as their capital needs and long-term forecasts remain challenging. He also predicts an increase in the number of mergers, as opposed to acquisitions, noting that such transactions make sense as a cost-saving measure regardless of the market environment.

Benjamin Poor, director at Cerulli Associates, says he agrees with the Jefferies Putnam Lovell report that more traditional deal catalysts will replace the panic sales of the past nine months. But he cautions against expecting a sharp increase in the number of transactions.

Mr Poor says: "You also have wonder about whether deals that didn't get done at fire-sale prices will get done at higher prices. For instance, if Vanguard didn't offer top dollar for iShares previously, why would they offer top dollar for a lesser business now, when valuations have increased and would-be sellers have stabilised?"

He further notes that asset management does not lend itself to M&A particularly easily.

While increased scale can help reduce costs, mergers may lead to other costs that are difficult to measure, resulting from culture clashes or unwanted departures. For actively managed products, team and manager lift-outs will probably be more common than outright acquisitions, he says.