accelerando observer

M&A in asset management - curse or blessing? Revisited October 2021

Large, medium and small scale M&A activity is undeniably back in asset management town and many industry outlooks predict further, in some cases even dramatic consolidation. However, mergers do not provide immediate solutions nor superiority per se and the M&A track record in asset management is certainly not rich in success stories. This paper addresses some prominent recent asset manager mergers and looks beyond the obvious. While it cannot replace a sector study it will provide an informed wrap up, including our at times rather contrarian views and convictions.

In November 2020, a *Financial Times* article headlined that merger mania was sweeping the asset management industry, quoting the investment bank Piper Sandler, a much respected reference for M&A in the asset and wealth management sector, that by 2030 only about 50% of investment houses will still exist. The prediction has certainly sent some shockwaves across the industry. Yes, the asset management sector, in particular in Europe, remains simply too fragmented, with too many funds and also too many asset managers with subpar scale or insufficient distribution power. The case for further consolidation and excess capital are certainly there. Nonetheless, we consider the forecast mentioned above to be exaggerated and also name some clear counter arguments in this paper.

Last year alone, announced M&A deals in the asset and wealth management sector rose to USD 38.9 billion (versus USD 13.6 billion in 2019), setting a new record since the global financial crisis. Nine deals involved price tags of more than USD 1 billion, including Morgan Stanley's acquisition of Eaton Vance for USD 7 billion or Franklin Templeton's USD 4.5 billion acquisition of Legg Mason. 2021 is also on course to set a new record, not only in terms of total deal volume, but also in terms of the number of smaller deal transactions, as recently highlighted by Refinitiv research. The *Financial Times* recently quoted Amin Rajan, CEO of Create Research, as saying that "the marriage season is heating up. The asset management industry is now gripped by merger mania. The question is whether any of the deals will deliver for shareholders." Well, he is certainly touching a pain point here. The M&A track record in asset management is not exactly rich in success stories. In fact, asset management M&A is complex, full of pitfalls, conflict potential, legacy issues and key people risks.

To get a better understanding of the drivers behind acquisitions, we tend to break down M&A deals into different types: the usual, scale driven ones, the distribution led deals and proposition led deals. Often we find combinations in one deal. Also, on a regular basis we conclude differently than the official communication of the involved groups.

Some recent deals under the spot light

Let's kick off with the acquisition of NN IP by Goldman Sachs Asset Management. The media quoted Goldman's CEO as saying that "everything that NN does, we already do, and this is adding and accelerating our growth." So, is it a scale driven deal? Well, the deal will double Goldman European assets to become one of largest fund managers in Europe. Many industry experts also expressed the view that NN IP's ESG credentials have been of major appeal to Goldman. However, spending EUR 1.7 billion for that? Well, we don't think so. *Ignites Europe* quoted us in August as saying that "while NN's ESG capabilities are certainly an asset, the main drivers of the deal are NN IP's distribution platform and its parent company's insurance assets." The acquisition was a real bargain for Goldman with a very low valuation on NN IP's AuM. Further on, NN Group, including the insurance assets, will become a client of Goldman within a 10 year strategic partnership. In consequence, in our humble view, this is a much more distribution led deal, at extremely attractive valuations, with some scale and also proposition elements. All in all, a very smart deal indeed. The only thing which concerns us is the aspect of cultural integration and related conflict potential - ultra high performance Wall Street culture meeting a Dutch asset management and insurance culture. By no means do we want to discredit Dutch or NN IP's working culture at all, but matching it with this type of Wall Street culture can be extremely challenging. In particular, as experience shows, that integration of two very different businesses and cultures is best done fast and also somewhat ruthlessly.

Other rather serial examples of the multi-faceted benefits of buying cheap and securing further distribution channels are a number of Amundi's acquisitions. In January 2020, Amundi, Europe's largest asset manager, snapped up Sabadell Asset Management, comfortably doubling its AuM in Spain to EUR 43 billion. In addition, and potentially even more importantly, the deal is also part of a 10 year strategic partnership, which resulted in Amundi selling its funds via Sabadell's network of 1.900 Spanish branches. On a much larger scale, Amundi sealed a similar 10 year distribution deal with Unicredit when Amundi purchased Pioneer in 2016. Interestingly, according to Bloomberg news from last month, 5 years on, UniCredit now intends to negotiate better terms in the distribution agreement with the aim of achieving a lower guaranteed sales objective of Amundi products being sold to Unicredit's HNWI unit.

In April this year, Columbia Threadneedle bought the European investment arm of BMO Financial Group of Canada for USD 845 million in cash, equivalent ***to*** 0.7% of BMO's European assets, a relatively modest valuation. The acquisition was much less about scale, but much more driven by product and expertise diversification, as well as strengthening regional and channel distribution, where we can see clear benefits.

An example of a pure scale deal, with some specialist proposition elements, has certainly been Morgan Stanley's purchase of Eaton Vance. Morgan Stanley bought Eaton Vance for an equity value of approximately USD 7 billion in October last year. The price was not cheap, but Morgan Stanley's CEO James Gorman stated to the media that "the way you get deals done is you offer a fair price for a great business. You don't get great businesses cheap." A quote well worth thinking about. Anyway, the deal almost doubled Morgan Stanley Investment Management (MSIM) AuM to USD 1.2 trillion. Interestingly, both businesses were performing remarkably well before the deal announcement. According to a presentation from Morgan Stanley at that time, MSIM had an organic growth rate of 21% for the 14 quarters to the end of Q2 2020, while Eaton Vance featured organic growth of 19%, compared to an industry average of -3% for other active managers. In essence, unlike in many other deals, two pretty healthy businesses were combined. Also, there wasn't an ETF driver in the deal, as neither MSIM nor Eaton Vance had any real footprint in this space. However, Eaton Vance's affiliate Parametric, which is a big player in the direct indexing space, may well have been a major attraction to MSIM. Also, Eaton Vance's ESG specialist Calvert, although much smaller than Parametric, adds value to the MSIM proposition. Although there is still quite some overlap in core strategies, the deal has the potential to create a very powerful player in the industry in our view. Stay tuned.

Shortly before, in February 2020, Franklin Resource, the owner of Franklin Templeton, announced the takeover of Legg Mason for USD 4.5 billion - a relatively cheap price - in a deal that created a firm with USD 1.5 trillion in assets globally. Interestingly, Legg Mason had more AuM than Franklin, but Franklin has been, in spite of heavy outflows in recent years, financially much healthier than Legg Mason with remarkable cash reserves. Similar to Morgan Stanley / Eaton Vance, the Franklin / Legg Mason deal was about scale, combined with proposition enhancements. Further on, the asset distribution mix was also attractive. Franklin managed predominantly retail assets, whilst most assets from Legg Mason derived from institutional investors. Nonetheless, the deal has been and remains complex and carries risks, which are mainly centred around Legg Mason's affiliates concept, which includes brand names like WesternAsset, ClearBridge, Brandywine and Martin Currie. Affiliate concepts can be beautiful in theory, but in practice we witness a lot of challenges and (distribution) disputes between the affiliate and the parent company. An affiliate concept being sold and integrated is even more challenging. Time will tell.

Another really big one could be the alleged merger of Invesco and State Street Global Advisors, as suggested in a report in *The Wall Street Journal* last month, in September 2021. If the potential merger were to go ahead, it would be a very significant deal too, creating a USD 4.3 trillion asset manager. On the upside, it would create an even more significant ETF player in the U.S. - beefing up SSGA's ETF market share to a combined 21%., way ahead of the number 4 ETF provider Schwab, with a market share 3.7%, according to *Bloomberg Intelligence* calculations. In Europe, the combined ETF business would move up to be ranked 4th, behind BlackRock, DWS, and the yet to be combined entity of Amundi and Lyxor. *Ignites Europe* quoted us as saying that "integration can be a nightmare, in particular when we talk about this size of deal. Also, and very importantly, both aren't the healthiest asset management businesses around. Both firms have been struggling for quite a while. Invesco in particular has been experiencing multi-billion outflows and its business has been much harmed." The potential deal would certainly provide ETF scale, but apart from that, the proposed deal doesn't convince us and we struggle to see real solutions to the existing problems in both firms. On a side note, Invesco already made four acquisitions in the last 15 years, including Oppenheimer Funds, the ETF provider Source and the ETF business of Guggenheim Investments.

A much smaller scale deal which caught our interest recently was the announcement that Oddo BHF Asset Management is to buy French value boutique Metropole Gestion last month, in a deal of proposition and regional distribution expansion. The merger may enable Oddo BHF AM to sell its funds in the UK as well as in the US, where Metropole is already present. Meanwhile, Metropole would benefit from Oddo's strong European distribution network, particularly in France, Germany and Switzerland.

However, as stated earlier, the M&A track record is mixed at best. Back in 2009, BlackRock clearly provided the blue print for large scale mergers in asset management when it acquired Barclays Global Investors and created the world's largest money manager. Also the Amundi acquisition of Pioneer Investments is widely consider as a role model deal. The deal also feature an appealing distribution channel mix with around 73% of Amundi's assets having come from institutional investors and 74% of Pioneer's AuM owned by retail investors.

But apart from that, most other prominent mergers haven't (fully) paid off yet. Let's take two prominent deals from 2017 for instance: Aberdeen / Standard and Janus / Henderson. In both cases, investor type ratios were almost identical. In terms of geographic asset origin the Janus / Henderson tie-up showed a lot more benefits in comparison to Aberdeen / Standard. While Aberdeen / Standard, now called abrdn, still struggles to turn around fund outflows, Janus Henderson, managed a remarkable comeback into net positive flow territories and is now widely perceived as one integrated firm.

In February 2020, Jupiter snapped up Merian Global investors. The combined group announced EUR 78 billion in AuM, creating the second-biggest retail fund manager in the UK. However, in our view, it was a rather a defensive move towards scale effects and some product / talent diversification, but not about major distribution benefits due to too much overlap. The purchase price of GBP 390 million for GBP 22 billion in Merian AuM was certainly attractive to Jupiter, in particular if we consider that Merian was valued at GBP 600 million when Merian performed its management buy-out back in 2017. Nonetheless, in spite of the merger, Jupiter is becoming increasingly vulnerable to a takeover bid after posting a 5th consecutive quarter of net outflows according to an article from *Ignites Europe* this month. However, it must also be mentioned that the level of outflows have slowed down in comparison with previous quarters and a lot of things appear to be changing at Jupiter.

The race for specialist acquisitions

Apart from the deals addressed beforehand, we witness many smaller, more specialist acquisitions, almost exclusively driven by enhancing proposition and expertise. Last month, Franklin Templeton announced the acquisition of O'Shaughnessy Asset Management, a quantitative asset manager which oversees roughly EUR 5.5 billion in assets. Also in September, BNP Paribas bought a majority stake in the Dutch credit specialist Dynamic Credit Group. In June, JP Morgan Asset Management acquired the forest management and timberland investing company Campbell Global. The list of recent specialist acquisitions could be extended considerably. The hottest spaces in specialist acquisitions are without any doubt ESG and private assets currently, but talent is scarce and the number of specialist managers willing to sell out is very limited. In fact, in this area it isn't a buyers, but rather a seller's market with ever climbing price tags. Of course there is no shortage of available private equity monies, nor asset manager's excess capital, but most specialist boutique managers have deliberately chosen their independence versus large organizations with all constraints involved. The extremely high current demand carries the risk ***of triggering*** subpar, rather than real leader acquisitions. But then again, a certain amount of money can change many minds.

Going vertical again?

Another trend which is gathering momentum again is vertically integrated M&A activity - asset managers buying into distribution channels. In the more recent past, we have seen reverse cases, with wealth managers becoming fund managers (e.g. SJP in the UK or Edward Jones in the U.S.). This year, however, more and more asset managers started to purchase significant stakes in wealth management platforms, distributors and also fintech. M&G Investments or abrdn made and announced some respective deals recently. Goldman / NN IP and some Amundi deals of course also have major vertical elements in them. Although JP Morgan AM wasn't the buyer, it will certainly benefit from JP Morgan Chase's acquisition of the UK digital wealth management platform Nutmeg in June this year. Also remember in this context, already in 2020, JP Morgan AM teamed up with Nutmeg to create an exclusive range of investment portfolios. With an ever shrinking universe of large European wholesalers, also largely M&A driven, and tighter bottlenecks in access and shelf space, more and more asset managers are thinking aloud about buying their own distribution channels. On the other hand, major banks have rediscovered their appetite for asset management businesses. Watch this space.

Asset managers are also increasingly acquiring technology providers - partly in scary dimensions. BlackRock, at least in our humble opinion, is already a major technology player. Fidelity is on its way, also with massive technology related budgets. Moreover, although smaller scale examples can be found aplenty, large scale technology capabilities will drive winners further - and faster - and may well reshape the entire landscape.

What now?

As stated earlier, we don't believe in some rather doom and gloom forecasts which predict that very large parts of the industry will be wiped out, as mentioned at the beginning of the paper. The asset management industry is in a much healthier state than many industry headlines may suggest.

Profit margins remain rather rich, in particular in Europe. Asset managers in Europe posted an average operating margin of 30% over the past 5 years. However, this is an average ratio with many asset managers posting much higher numbers, in particular when it comes to unlisted, independent fund houses. In spite of the rather comfortable profit margins, acquiring specialist boutiques or buying out teams might take on greater urgency for many larger European asset managers in need of sharpening their proposition. Also, optimizing distribution footprints, both regionally and on an investor segment basis, remains a key challenge for many European asset managers. On a global basis, we expect large, mainly very large managers to continue to consolidate through further acquisitions. This is not necessarily because of scale and alleged cost saving potential, but largely proposition driven to enable much broader conversations and touch points with very large, predominantly institutional clients - kind of following BlackRock or Amundi.

All in all, it may not be as dramatic as initially stated, but without a doubt, the asset manager landscape will look quite different in the not-so-distant future.

accelerando associates is a leading European fund distribution consultant providing bespoke strategic advice and research to asset management firms worldwide. accelerando, founded in 2004, has offices in Frankfurt, Germany, and in Valencia, Spain. www.accelerando-intelligence.com

Follow us on LinkedIn: https://www.linkedin.com/company/accelerando-associates