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Is now the time to buy money managers?

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The volume of mergers and acquisitions has decreased significantly when compared to only a year ago. At that time, many potential buyers were attracted to an extremely bullish outlook for both the stock market and the wealth management industry. A number of global groups even announced that asset management would be a core business and planned to grow this area by a mixture of aggressive organic and external efforts (i.e., acquisitions, mergers, joint ventures). The strong demand often fuelled heavy competition when bidding on a potential target putting companies willing to sell in a very favourable position.

Now, only 12 months later, the industry faces quite a different situation where the attractiveness of certain money managers has visibly fallen, at least as reflected in their listed stock prices. The cause of this is quite clear. Uncertainty about the world economy has left financial institutions nervous to make additional acquisitions. Extremely poor financial performance has forced large global players to chop staff and reorganize in defensive moves to plug bleeding from the bottom line. Many have thrown strategy out of the window and are completely distracted by day-to-day events. Further, the short-term outlook for the money management industry has been thought to be dim. Falling stock markets has made clients more cautious reducing their trading activity resulting in fewer trades and thus significantly reduced transaction revenues. Even worse, the lower value of clients' assets has resulted in lower asset management, safekeeping and custody income as fees are often based on the level of assets under management/administration. In contrast to revenues, costs are primarily fixed, even though the potential reduction in bonus payments will smooth somewhat the effect of lower revenues. With industry cost/income ratios significantly rising, potential money manager acquirers have significantly discounted the value of the firms and thus are offering lower prices, more stringent deferred payment structures, and less favourable overall contract conditions as their way to try and take advantage of the apparent "cheap" opportunities. The end result has been fewer acquisitions as sellers' expectations for price have not shifted as quickly as buyers' unwillingness to pay historic premiums.

Financial institutions are left asking themselves - is this the time to buy or sit on the sidelines and see what happens next? Most institutions will be left waiting and wondering while strategic thinkers will aggressively seize the opportunity and begin buying again. This can be seen in companies such as Citigroup that are reportedly scouring the market for strategic links. Why are they moving now - because they can see long-term opportunities through the short-term fog. For example, looking at the specific situation in Europe the long-term effects driving the growth of the Industry have not been affected by any fundamental change. The pension systems in many European countries have not been healed overnight and it is not expected that this problem can be solved easily in the near future and thus making private provisions for pension as necessary as one year before. The European community and integration has not come to a stop so did not stop the need for a further consolidation in the European banking industry. One thing, which has (unfortunately) changed are the returns to be earned on the stock markets. In the last couple of years the returns of the stock markets have been quite favourable. Nevertheless, the history has shown that a period of extraordinary stock market returns can not be sustained over a long period and that over a long-term period stock market returns are more in the range of 8%-10% per year (over a 5-year period the S&P 500 had an annual growth rate of 9.28%) than in the range they were in 1999-2000. In this respect, the reduction of stock market returns we are facing right now can be seen as a correction of the long-term trend towards the average. However, this correction should not influence the valuation of money managers to a large extent as the valuation is and was based on a long-term view of the perspectives and should not rely on rather short-term excessive growth rates. This is reflected in the fact that the P/E multiples of the few publicly traded private banks in Switzerland and elsewhere have been only slightly reduced when comparing to the situation 1 year ago.

Also, the long-term attractiveness of clients has not been reduced along with stock market returns. This is quite the contrary as the burst of the bubble has shown clients that no investment advisor has a magic bullet that allows forecasting the future precisely. Clients begin to see that a relationship with their investment advisor should not be aiming at short-term profit maximisation by entering into too much risk but should be based on a profound analysis of the long-term risk-return-preference. Only a person who has a long-term and deep relationship with the client can do this analysis. Therefore sticky private clients are even less likely to change their banking relationship in order to follow a Guru promising heaven on earth. The potential for closer relationship should offer enhanced opportunities for financial institutions to generate even higher profits with lower client turnover. Once the markets stabilize over the next 18-24 months, trading volumes should rise with asset values and thus income.

Further, the cost structure for money managers is also trending positive in the long-term. Firms have slowly been adjusting compensation schemes to be more bonus oriented. The recent downturn will surely lead to additional changes. Further, the days of the star money manager receiving gigantic packages are dwindling. Firms are moving towards open architectures lowering the value of product managers – in fact, commoditizing money managers while gaining a tighter hold on the client. Therefore, there is strong downward pressure on the compensation structure of money managers for the long-term.

As one thinks about the long-term for money managers, it becomes evident that the short-term tells a very different story from the long-term. The basic long-term fundamentals for the industry are sound – good industry growth prospects, sticky clients, healthy margins, restructuring cost structure. All the factors above clearly show that even though the short-term value driver of the asset management industry has suffered recently, the long-term outlook is stable.

Buyers with a long-term strategy will be more capable of evaluating the long-term value of a given money manager and thus be able to take this opportunity to grow their business at favourable terms. In any case a transaction should only be made after serious evaluation of the target and if the acquisition fits the long-term strategy. The smart acquirers will never regret paying fair prices for sustainable businesses.

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Note to Editors

MilleniumAssociates AG is headquartered in Switzerland, the heart of the Wealth Management Industry. The firm specialises in advising on Merger and Acquisitions and strategy consulting with emphasis on private banking, family offices, asset/fund management and other Wealth Management businesses including life insurance. As a Swiss-based corporation, MilleniumAssociates AG is not part of an integrated investment house and the firm is therefore uniquely positioned to offer independent pure advice in order to maximise shareholder value for its clients.

The company currently has numerous well-experienced specialists who have managed in the past, amongst other important deals, the acquisition of **Global Asset Management**, with about CHF 20 billion assets under management, by UBS AG, and have participated in the acquisition of Brinson Partners by former Swiss Bank Corporation. In the fourth quarter 2000, MilleniumAssociates advised Credit Suisse on the purchase of **JO Hambro Investment Management**, a premier UK investment manager and hedge fund manager for high net worth individuals, with assets under management of circa CHF 4 billion. In the family office segment, the firm in mid-2001 advised on the deal between Chicago-based **Frye-Louis Capital Management**, Inc. and Swiss-based Credit Suisse, resulting in the latter's acquisition of a strategic HNWI business platform and CHF 2.5 billion in private client portfolios in the USA. The team has experienced participating in numerous transactions in the past few years covering key aspects including origination, valuation, due diligence and contract negotiations.

MilleniumAssociates' fully dedicated team of specialists are involved in numerous active Wealth Management advisory projects with assignments supporting clients with expanding global strategies as well as those seeking to determine their ideal strategic options including partnerships and alliances. The firm recently stated that it intended to donate at least one percent of annual gross profits to charity.

For further information call:

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