THE CAMBRIDGE COMMENTARY

A Review of M&A Activity in the Investment Management Industry During 2017

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780 Third Avenue, 7th Floor, New York, NY 10017
(212) 826-8290
www.cambintl.com

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John H. Temple
President
(212) 829-8292
jtemple@cambintl.com

David W. Abbott
Managing Director
(212) 826-8293
dabbott@cambintl.com

Richard H. Haywood, Jr.
Managing Director
(212) 826-8294
rhaywood@cambintl.com

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(212) 826-8290
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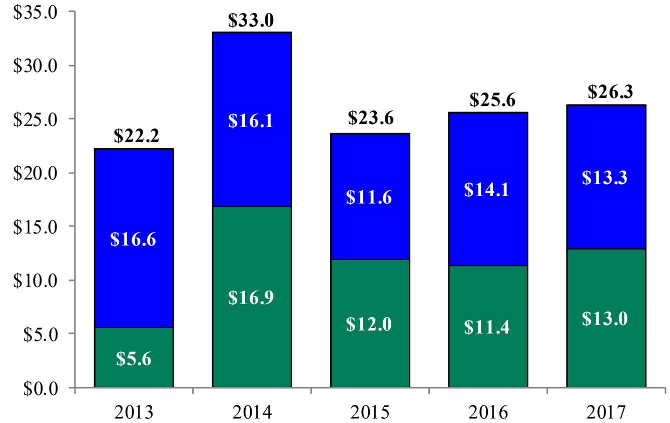
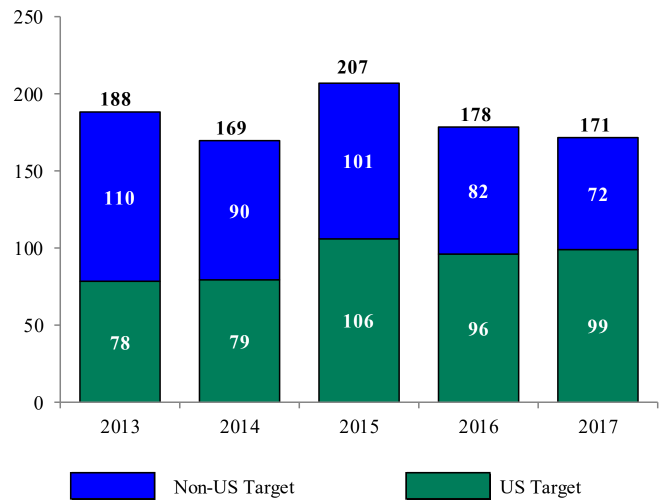
Strong equity markets and synchronized growth in major economies characterized 2017. International[1] and US[2] equities had total returns of 25.0% and 21.8% respectively in the year. This favorable economic climate helped mitigate but did not reverse the secular headwinds being faced by the asset management industry globally. Of these, the shift to passive management and concomitant fee pressure among active managers remains the most severe, but rapid changes in the regulatory environment and the inevitable increase in regulatory costs have also played a part.

Not surprisingly, therefore, 2017 transactional activity, which was broadly comparable to the last few years, continued to be driven by consolidation, both in asset management and, for somewhat different reasons, in wealth management. Indeed, seven of the top ten transactions reflected a consolidation theme, even more than the five out of ten in 2016, with the Standard Life – Aberdeen Asset Management merger leading the way. Bank divestitures continued to be a theme particularly outside the US, with sales by Banco BPM in Italy, ANZ and Westpac in Australia, Citigroup in Mexico and Société Générale in China. Themes of consolidation and divestiture attract private equity so it was not surprising that 2017 was another strong year for private equity purchases, accounting for about 20% of global transaction volume and three of the top ten – Stone Point Capital and KKR acquiring Focus Financial Partners, TA Associates' buyout of Old Mutual Wealth's Single Strategy Business,

Annual Transaction Volume[3]
($ in billions)



Annual Transaction Count[3]



[1] MSCI EAFE ND
[2] S&P 500 TR

[3] Transactions involving managers with more than $200 million under management

Top Ten Investment Management Transactions of 2017

(All amounts in US$)

Target	AUM ($bn)	% Acq'd	Purchaser	Amount Paid ($mn)	Strategic Rationale
Aberdeen Asset Management *Aberdeen, UK*	383.6	100%	Standard Life	4,670	Coming off several years of outflows caused by the industry's shift to passive investments and overexposure to emerging markets, Aberdeen combines with Standard Life in a no-premium merger to form Europe's second largest asset manager.
Fortress Investment Group *New York, NY*	69.6	100%	SoftBank Group	3,300	In a bold move typical of Chairman Masayoshi Son, SoftBank extends its interests into asset management by offering a 39% premium to buy Fortress Investment Group.
Focus Financial Partners *New York, NY*	110.0e	70%e	Stone Point Capital and KKR	1,400e	The success of Focus Financial Partners' consolidation of private wealth management firms is demonstrated by the $2 billion valuation achieved in its third refinancing by private equity.
Guggenheim Investments' ETF Business *New York, NY*	36.7	100%	Invesco	1,200	Invesco pays up for Guggenheim's ETF business, 60% of whose assets are in smart beta products, reinforcing its market position as second in smart beta and fourth in the global ETF business.
Aletti Gestielle *Milan, Italy*	21.1	100%	Anima Holding	810	Banco BPM, formed from the merger of Banco Popolare and Banca Popolare di Milano at the beginning of 2017, sells its asset management business to Anima, an independent asset manager in which it holds a 14.3% stake.
Old Mutual Global Investors' Single Strategy Business *London, UK*	34.3	100%	TA Associates and Management	800	Old Mutual's plan to liquidate takes another step forward with the divestiture to private equity of the Single Strategy business of Old Mutual Wealth, led by famed investor, Richard Buxton.
OnePath Pensions and Investments *Sydney, Australia*	18.7	100%	IOOF Holdings	770	The unusually named IOOF (originally International Order of Odd Fellows) becomes Australia's second largest wealth advisor as Australia and New Zealand Banking Group exits the wealth management business.
Sentry Investments *Toronto, Canada*	15.0	100%	CI Financial	615	CI Financial underscores its position as the leading independent asset manager in the Canadian market by acquiring Sentry Investments, one of the largest independent fund groups left in Canada.
ETF Securities' Exchange Traded Commodities *London, UK*	17.6	100%	WisdomTree	610	WisdomTree moves up to ninth in the global ETF ranking with this acquisition of Europe's leader in exchange traded commodities.
Riverstone Holdings *New York, NY*	27.2	12%e	Petershill Fund (Goldman Sachs)	500e	Goldman Sachs's Petershill Fund continues its push into private equity by buying a slice of this successful energy-focused private investment platform.

e: Indicates estimate

and the Petershill Fund's minority investment in private equity manager, Riverstone Holdings.

Acquisitions to build market share in passives, and in smart beta in particular, resulted in three major transactions, two of which were also cross-border purchases by US managers, Invesco and WisdomTree, of European firms. Meanwhile, cross-border activity by foreign managers buying into US asset management was up substantially, with SoftBank, HNA and Nippon Life making big investments.

Last but by no means least was the continuing – and accelerating – consolidation seen in private wealth management during the year. This was particularly true in the US where a combination of factors resulted in a record number of independent RIAs selling to consolidators, other RIAs and regional and community banks.

ALL EYES ON A HIGHLAND FLING

In the biggest transaction of 2017, Standard Life and Aberdeen Asset Management, both based in Edinburgh, combined to form the second largest asset manager in Europe. Mimicking the Henderson – Janus deal announced the previous year, no premium was paid and the merged group is headed by co-CEOs, one drawn from each company. As with Henderson – Janus, incremental revenue synergies through complementary investment capabilities and greater global distribution, and reduced unit costs through increased scale were cited as the principal strategic benefits.

Nevertheless, the combination was widely viewed as defensive as both firms had suffered recent outflows – Standard Life's flagship Global Absolute Return Strategy had suffered poor performance while Aberdeen was overexposed to poorly-performing emerging markets. Cost savings are projected at £200 million annually, which is 10.9% of the combined cost base.

Following the announcement of the Henderson – Janus merger by only a few months, the Standard Life – Aberdeen announcement caused a frenzy of merger discussions in boardrooms around the industry. Active managers, both independent and institutionally owned, were forced to confront the prospect of rapid consolidation in the industry as a response to the shift to passive investing. After all, if the famously independent CEO of Aberdeen Asset Management, Martin Gilbert, was prepared to accept a no-premium merger, surely every asset manager should reconsider its competitive position. The results of all these discussions, though, have been less than impressive, with no further significant combinations announced to date. One reason is undoubtedly the difficulty in finding a dance partner sufficiently complementary that cost savings might be expected to exceed revenue losses, but another has been the steadily advancing equity markets which have helped to mask continuing outflows from active managers. Indeed, Standard Life Aberdeen's first trading statement shows no slow-down in the heavy outflows of the prior year.

PASSIVE CONTINUES TO MAKE INROADS

It is not necessary to look further than Vanguard's expected net inflows of $350 billion in 2017 for confirmation that passive management continues to make inroads. Driven by reasons of cost and risk control, it is not a trend we expect to reverse anytime soon.

In retail markets, BlackRock's iShares, Vanguard and State Street are estimated to have 71% of the global ETF market between them, and pricing on market cap weighted index funds has become brutal. For example, iShares Core S&P Total US Stock Market ETF now has an expense ratio of just three basis points. As a result, other managers are left with the unenviable dilemma of whether to compete in this rapidly growing but scale-driven business or to focus on making their active management business as passive-proof as possible.

For Invesco, given its early bet on ETFs through its 2006 purchase of PowerShares, the answer was to be expected: buying a European firm, Source, with $18 billion of specialist ETFs, and a US firm, Guggenheim Investments' ETF business with $36.7 billion under management. These purchases confirmed Invesco's position as the fourth largest provider of ETFs globally, although its market share remains a modest 4.6%. More importantly, however, both Invesco's purchases focused on factor-based, or smart beta, ETFs where pricing is higher, and where Invesco's resulting 19.9% market share is within sight of iShares' market leading 21.0%.

For WisdomTree, the largest specialist sponsor of exchange traded products, there also could only be one answer so its acquisition of Europe's leading exchange traded commodities business owned by ETF Securities was no surprise, particularly given its reluctance to trade lower fees for market share in the US market.

These investments did not come cheap: Invesco had to pay $1.2 billion, or close to 20 times run-rate operating income, for the Guggenheim ETF business while WisdomTree paid $611 million, or 15.7 times run-rate margins, for its European exchange traded commodities business.

These valuations may have seemed too rich for Franklin Resources which, as an active manager that has suffered four years of outflows, capitulated late in 2017 by launching 16 of its own single-country ETFs at nine basis point expense ratios. Meanwhile, Legal & General Investment Management, already a heavyweight in passive investing with a $430 billion index business, also entered the ETF business for the first time with the acquisition of ETF Securities' exchange traded platform called Canvas.

HARD ASSETS ARE FLAVOR OF THE YEAR

For active managers looking for segments of the market resistant to passive substitution, hard assets have been an important place to be, particularly given the projected anemic returns for stocks and bonds. Given this, BNY Mellon's sale of $9 billion AUM real estate and infrastructure manager, CenterSquare Investment Management, to Lovell Minnick Partners and management, may seem inconsistent except that it was not an exit but rather a rationalization, eliminating overlapping capabilities in its multi-boutique structure.

2017 also saw BlackRock acquire the First Reserve Energy Infrastructure Funds, and Blackstone and Brookfield acquire energy infrastructure managers, Harvest Fund Advisors and Center Coast Capital Advisors, respectively. Another MLP manager, Tortoise Investments, was purchased by Lovell Minnick Partners, marking its second investment in hard asset managers in 2017, and providing the seller, Mariner Holdings, with a handsome profit to reinvest in the expansion of its Mariner Wealth Advisors business. In Australia, Westpac sold the international business of global infrastructure manager, Hastings Management, to London-based Northill Capital.

Likewise, the number and volume of real estate manager transactions increased substantially. In Europe, Patrizia Immobilien, a publicly-traded real estate manager, made three acquisitions almost doubling its assets under management to €38.3 billion. Principal Global Investors also acquired a pan-European real estate manager, Internos Global Investors. In the US, Aon Group purchased 75% of Townsend Group and Columbia-Threadneedle (Ameriprise) acquired Lionstone Partners.

Minority private equity investments in alternative managers continued unabated in 2017 with Dyal Capital Partners (Neuberger Berman) and Petershill Fund (Goldman Sachs) making three such investments apiece.

Investor money has been flowing into the private debt asset class ever since bank credit dried up following the Global Financial Crisis and transactions involving these specialist managers have now also risen, even as the average management fee has dropped to a decade low. In the largest such transaction, British Columbia Investment Management, acquired a majority stake in Hayfin Capital Management, the $8.8 billion AUM London-based private debt manager, from its initial private equity and institutional investors. Meanwhile, Marshall Wace also achieved a partial exit, merging its transatlantic private debt business, MW Eaglewood, into Pollen Street Capital. Private equity was not just exiting, however, as Dyal Capital Partners made minority investments in TPG Sixth Street Partners and Atalaya Capital Management. Strategic buyers of private debt included LGT Capital Partners buying European Capital Fund Management and Aegon acquiring 25% of Dynamic Credit.

ASIAN BUYERS COME TO THE FORE IN THE US

Among technology investors, Masayoshi Son of SoftBank and its $100 billion Vision Fund are legendary, investing at a breakneck pace in companies that are expected to underpin the global shifts to be brought on by artificial intelligence and the Internet of Things. However, Masa's ambition is not limited to tech investments as he also has long-term plans to become one of the world's biggest asset managers. Given this, SoftBank's purchase of publicly-traded alternatives manager, Fortress Investment Group, for a 39% premium to the pre-announcement price does not look so surprising. It is certainly a huge win for Fortress shareholders, who have seen its share price decline from an IPO price of $35 in early 2007 to about $5 in the last few years on the back of a disappointing recovery from the Global Financial Crisis by its private equity and hedge funds. As a footnote, Fortress's traditional fixed income manager, Logan Circle Partners, used the change in control as an opportunity to find a new home for itself at MetLife. While Logan Circle had tripled in size in the seven years of Fortress ownership, there was little commonality between the businesses or their objectives. As part of MetLife, where 80% of assets under management are internal, Logan Circle can significantly enhance the scale and competitiveness of the Group's third party institutional business.

By contrast to Masa's rapid-fire approach to acquisitions, Nippon Life's purchase of a minority stake in TCW was a model of caution. Beginning in July 2014, Nippon Life had gradually expanded its strategic involvement with TCW by delegating general account assets to TCW to manage and by selling TCW products through Nippon's domestic Japanese investment management arm, Nissay Asset Management. In that context, a purchase of only 24.75% seems like a small next step but it does achieve two other objectives – enabling management to become the largest shareholder bloc in TCW while allowing private equity investor, Carlyle, to reduce its ownership from 60% to 31.2%. It also highlights the success of TCW's 2010 acquisition of $23 billion AUM fixed income manager, MetWest, for $300 million, a price we estimated at the time was about five times revenues, in conjunction with the forced exit of TCW's CIO, Jeffrey Gundlach. Today, that price looks cheap with 83% of TCW's $192 billion being in US fixed income assets and both its CEO, David Lippman, and its fixed income CIO, Tad Rivelle, coming from MetWest.

While Japanese institutions have long been buyers of stakes in US asset managers, albeit not usually at the level seen in 2017, Chinese buyers are a more recent phenomenon. Foreshadowed by Huatai Securities purchase of AssetMark in 2016, there were four such investments announced in 2017. Two of the purchases were announced by the controversial Chinese conglomerate, HNA, taking a two-step 24.9% stake in OM Asset Management and, together with RON Transatlantic, agreeing to buy Anthony Scaramucci's 45% stake in his fund-of-hedge-fund, SkyBridge Capital (the latter deal is in limbo, awaiting approval of the Committee on Foreign Investment in the United States).

HNA has been at the forefront of Chinese conglomerate offshore purchasers, announcing 80 deals totaling more than $40 billion in under three years. However, lenders have become nervous that this expansion has been too rapid and that the Group may be overleveraged. These concerns are exacerbated by an opaque ownership and corporate structure. Chinese regulators have also taken steps to slow the rapid growth of these conglomerates on concerns that they could pose a systemic risk to China's economy.

The third largest contingent after Japanese and Chinese buyers of US managers was the Canadians. Apart from US manager purchases by CIBC and Brookfield Asset Management discussed elsewhere in this letter, publicly-traded Guardian Capital purchased 70% of Alta Capital Management in Salt Lake City. Alta manages $3.2 billion of US equity and balanced mandates for a similar client profile as Guardian in Canada, namely retail wrap intermediaries, institutions and private clients.

More generally in cross-border activity, the number and volume of transactions inwards into the US was similar to 2016 at 15 and an estimated $4.9 billion whereas outward cross-border transactions increased substantially to 13 and an estimated $3.0 billion, a level last seen in 2014. The WisdomTree and Invesco European ETF business purchases accounted for one-third of this volume with TA Associates' purchase of the single strategy business of Old Mutual Wealth and BlackRock's purchase of the asset management business of Citibank's Mexico subsidiary, Citibanamex, accounting for much of the remainder. BlackRock has stated its ambition to become a full solutions provider in key markets around the world and this transaction is a big step forward in that direction in Mexico.

BANKS CONTINUE TO EXIT ASSET MANAGEMENT

With the exception of the Canadians, banks globally have been steadily exiting the asset management business ever since the Global Financial Crisis, and 2017 was no exception. Many of these divestitures were to competitors seeking consolidation savings. In Italy, the third largest bank, Banco BPM, sold its mutual fund group, Aletti Gestielle, to Italy's largest independent asset manager, Anima, in which Banco BPM already had a 14.3% minority shareholding. Down-under, Australia and New Zealand Banking Group (ANZ) sold its advice-led wealth management business, OnePath Pensions and Investments, to Melbourne-based IOOF confirming IOOF's number two spot behind AMP in this segment of the market. In both cases, the selling banks have entered into long-term distribution agreements with the buyers. Also in Australia, Westpac sold another 19% of BT

Investment Management to institutional investors, leaving it with just 10% that it intends to sell in the second half of 2018, and also sold part of its infrastructure business. In Mexico, as previously discussed, Citigroup's subsidiary, Citibanamex, sold its asset management business while in China, Société Générale sold its 49% ownership in Fortune SG to a private equity buyer, Warburg Pincus. In the US, UMB Financial reversed course and sold its Scout and Reams investment boutiques, having tried unsuccessfully to stem outflows for several years. They will be combined into Raymond James' Carillon Tower Advisors.

CONSOLIDATION ACCELERATES IN US PRIVATE WEALTH

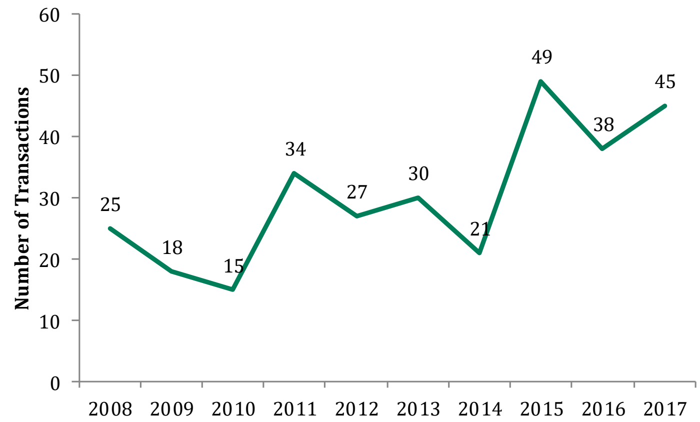
The pace of consolidation in the US private wealth management sector continued to accelerate in 2017. Whether this was primarily a cyclical phenomenon as the industry entered the ninth year of a bull market, or a secular trend driven by demographics, technological change and the introduction of the DOL's fiduciary rule, is not clear but, either way, the number of transactions has been rising fast. A third explanation is that the consolidation pick-up is being driven by the acquisitiveness of a single company, Focus Financial Partners. Its website reported eight acquisitions during the year while its affiliates reported a further ten, accounting in aggregate for 40% of all US wealth management transactions. While most of these acquisitions are in the one to three billion AUM range (with affiliate acquisitions generally smaller), the acquisition of SCS Financial, an ultra-high net worth firm in Boston, stands out as an anomaly with its $16.5 billion under management. The connection turns out to be private equity firm, Stone Point Capital, which had purchased a minority stake in SCS in 2012 and then together with KKR, announced the purchase of a majority of Focus Financial Partners in 2017, just a month before Focus itself announced the purchase of SCS. Perhaps the best indication of the success Focus is enjoying can be seen in the $2 billion valuation it achieved in its latest refinancing by private equity.

We have also seen another consolidator, HighTower Holding, become a more significant purchaser of RIAs as a result of its planned shift away from an initial strategy of primarily funding breakaway broker teams. In April, it made its largest purchase to date, acquiring WealthTrust, a holding company with ten underlying managers and $6.4 billion under management, bringing its total AUM to $46 billion. Later in the year, HighTower sold a minority stake to private equity firm, Thomas H. Lee Partners, providing liquidity to some early investors and advisers and providing fuel for further growth.

2017 saw the creation of aggregator, Wealth Partners Capital Group, a spin-off from AMG Wealth Partners. WPCG launched with the acquisition of minority stakes in EP Wealth Advisors and MAI Advisors, and the receipt of AMG's minority interest in Forbes Family Trust. Wealth Partners will use these three firms as platforms for future acquisitions of smaller firms.

Excluding the private equity refinancings of Focus Financial and HighTower, there were two other notable private wealth transactions in the US. In July, CIBC and its US wealth management division, Atlantic Trust, announced the acquisition of Geneva Advisors in Chicago for up to $200 million – this following the completion of CIBC's purchase of The Private Bank, also in Chicago, the month before. In addition to building local market share, a consolidating acquisition like this expands the acquiror's product and service offering which can offset pressure to cut fees. The other notable transaction was the recapitalization of Rockefeller & Co. as Rockefeller Capital Management under the leadership of Gregory Fleming and financed by the private equity fund of hedge fund manager, Viking Global Investors. Greg, most recently President of Morgan Stanley Wealth and Asset Management, has ambitions to grow Rockefeller from $16.2 billion of assets under management and advisement to over $100 billion in five years.

Number of US Wealth Management Transactions*



**Traditional RIAs with at least $200 million of primarily high-net-worth separate account portfolios under management*

On a smaller scale, regional and community banks continued to be buyers of RIAs in their footprint with purchases by Associated Banc-Corp, Fifth Third, First Midwest, Meridian Bank and Peapack-Gladstone Financial.

All this buying interest in private wealth RIAs has inevitably had an impact on pricing and we have seen a marked firming of multiples being paid in this segment of the market – as much as a 20% increase for larger firms.

OUTLOOK FOR 2018

The US asset management industry has had a huge lift in the fourteen months since the Presidential election with market prices up over 40%[4]. Undoubtedly a large part can be attributed to the expectation of the corporate tax cuts which became a reality on December 20 with the President's signing of the Tax Cuts and Jobs Act. After such a run, in the ninth year of a bull market, it is difficult not to be concerned about what comes next, especially given signs of frothiness exemplified by frenzied cryptocurrency buying, Renaissance art selling for $450 million or, for market watchers, growth beating value by 16.6 percentage points[5] while the yield curve continues to flatten.

From a transactional perspective, however, 2017 was not a frothy year, being very much in line with preceding years. This reflects buyer caution in the face of industry headwinds and the difficulty in getting asset management consolidations to pencil out. This is likely to remain true in 2018, whether markets rise or fall. Divestitures are likely to continue, providing opportunities for full integration consolidations or for multi-boutique or private equity purchases when full integration is not practicable. Such is the case with the expected sale of £28 billion AUM Hermes Investment Management in the UK by BT Pension Scheme where the press reported four bidders in mid-December. This transaction, together with an expected IPO of Deutsche Bank's asset management business, will likely be two of the biggest deals of 2018.

Targeted acquisitions of smart beta firms, of managers able to outperform their index, and of active managers sheltered from the shift to passive will remain of interest. Transactional activity in non-traditional asset classes such as infrastructure, real estate, private debt and private equity will remain strong, and, possibly, we may even see increasing interest in hedge fund managers who recovered in 2017 from a long period of underperformance.

In private wealth, where client stickiness makes integration much easier to execute and where regulatory changes in the US and Europe are driving consolidation, we anticipate the number of transactions to increase steadily. Private equity appetite for this segment has been whetted by prior successes on both sides of the pond so there will likely be no shortage of capital to roll up the industry.

Our best wishes to you all for a prosperous 2018.

[4] *Dow Jones US Asset Manager Index*

[5] *Russell 1000 Growth less Russell 1000 Value in 2017*