

Improved IPO market could jump-start PE interest in asset managers

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By Mindi Westhoff

Though the credit crunch and lackluster IPO market in 2009 may have stunted private equity investments in asset managers, observers say industry consolidation and, at the same time, the rise of both independent wealth management firms and registered investment advisers should provide opportunities for investments in 2010.

Citing the limited access to the equity markets and the general financial distress that characterized most of 2009, Asset Management Finance Corp. President John McAvoy said some of his company's competitors struggled with their fundraising goals. As for Asset Management Finance, a unit of Credit Suisse Group AG, the company managed to weather the storm, he said, completing four deals in December 2009.

Asset Management Finance recently led a \$100 million equity financing to wealth management company HighTower Advisors LLC, and Asset Management Finance Chief Investment Officer Rob Jakacki told SNL that two of the company's four December 2009 transactions involved wealth management firms.

"There are pretty powerful macro factors that are causing the best brokers at the wire houses to want to leave," Jakacki said. "We think one of the more interesting areas in addition to our core of asset management is investment in wealth management."

In addition to diversifying horizontally through investments in wealth management along with asset management, Circle Peak Capital President and CEO R. Adam Smith said opportunities exist for venture-backed firms to help asset managers grow vertically with a broader range of products and services. With few examples of private equity deals that successfully diversify asset managers' business lines, Smith said firms are likely more keen on expanding asset managers' core activities than attempting to offer new services.

From a valuation standpoint, Smith said RIAs also offer an attractive opportunity for private equity investors.

"Smaller partnerships that might need expansion capital or growth capital or want to pursue tuck-in acquisitions or hiring within those organizations, they need capital, and they're more affordable these days than they were historically," Smith said.

Because typical investment management transactions hover at about 8x to 10x cash flow, and banks of late have been lending closer to 2x cash flow, Convergent Capital Management President and CEO Rick Adler said a lot of pressure has been placed on venture-backed companies. But with a lower-priced transaction in the RIA or wealth advisory space, Adler said private equity firms stand a much better chance of getting a deal done.

"On higher-priced to medium-priced transactions, it would be a very difficult environment for the private equity players to compete with strategic players," he said. "With a majority partner that spells their last name B-A-N-K, it makes it a lot easier."

But access to funds isn't the only thing holding private equity back from investing in larger asset management companies, McAvoy said. Despite fairly high margins and relatively stable growth, McAvoy said investments in asset managers do not always carry with them a clear exit strategy for private equity groups.

Though the slow market for initial public offerings does not affect Asset Management Finance as a long-term investor, Jakacki said the lack of leveraged financing available for buyouts exacerbates the lack of an exit strategy that venture-backed firms see when looking at the midsize asset management industry in particular.

Adler added that, while not every firm is oriented that way, some private equity players feel more comfortable partnering with an investment manager with a second transaction in mind, and the IPO market's return could signal a resurgence in that activity.

"Assuming the IPO market comes back this year, how many of the companies that come public are going to be private equity spinouts or recaps? A lot of them," Adler said. "When a private equity sponsor does not have the potential exit of an IPO, then the fundamentals of the company, its growth rate and profitability, are much more important."

A recent survey of capital markets executives from accounting and consulting company BDO Seidman LLP indicated that 46% of respondents expect financial services IPO activity to increase in 2010, with 35% of them expecting offerings to remain flat from 2009.

As to the sources of IPOs in general, 39% of investment bankers who responded cited private equity portfolios, while 22% said IPOs would come from spinoffs and divestitures and 21% expect them to stem from venture capital portfolios.

Although some may see it as a challenge for private equity firms, Smith said he views both the asset management and wealth management businesses as compelling longer-term investments given the continued fragmentation in the space and opportunities to improve human capital. Without more examples of strategic sales of private-equity-backed asset management companies, Smith said there has not been enough time on the clock to make a case against the space.

"I don't think the story is written on that yet," Smith said. "If the performance and the scale and the value proposition is there, I think the strategic buyers are willing to pay full price for growth or unique asset pools." *i*