



# Renewed appetite - Alts manager M&A heats up

**Alternative Investments**

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# Alternative asset management M&A activity heating up

With the continued “bar-belling” of investor portfolios and strong demand for alternative strategies in the current low-growth, low-yield environment, we see renewed appetite for deal-making involving alternative asset managers. Over the next 12–24 months, an uptick is expected in Mergers and Acquisitions activity across a wide range of transaction types, from minority stake sales to large-scale M&A. Consolidation and strategic partnerships will allow alternative investment (AI) firms to offer a more diverse range of products and strategies to investors, provide access to new distribution channels, and facilitate succession planning and the ability to retain top talent.

But, as the appeal of M&A grows, it is important for buyers to keep top of mind both the unique and sometimes fickle nature of the business they are acquiring as well as the management team they are investing in. Conducting a comprehensive due diligence review of both the manager and its funds under management, and structuring deal terms that take these factors into consideration, can greatly limit the risk of the deal and preserve the value a buyer expects from the transaction.



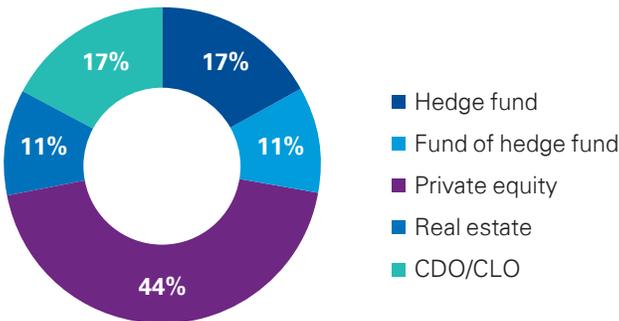
## Diverse deals

Driven by steady inflows from institutional and retail investors seeking risk-adjusted and uncorrelated returns, asset managers are showing a keen interest in expanding into alternative strategies. As one of the fastest-growing, yet highly fragmented segments of the asset management industry, we see M&A involving alternative managers gaining momentum after a period of relatively flat deal activity in recent years. Looking ahead, expected deals include:

- Platform acquisitions by alternative managers seeking to offer an expanded product line-up;
- Minority stake sales to private equity (PE) and long-term institutional investors;
- Cross-border acquisitions and strategic partnerships; and
- Acquisitions by traditional asset managers seeking to fill product gaps and market alternative strategies to retail investors.

Following a dip in M&A activity in 2015 due in part to some of the headwinds facing the hedge fund sector, deal activity in the alternative asset management industry bounced back to more normalized levels in 2016 with 48 transactions. Deal momentum continues in 2017 as M&A activity is off to a hot start with 18 transactions in the first quarter alone, according to preliminary data from Sandler O’Neill + Partners.

## Alternative asset manager deals by target type (YTD 3/31/17)

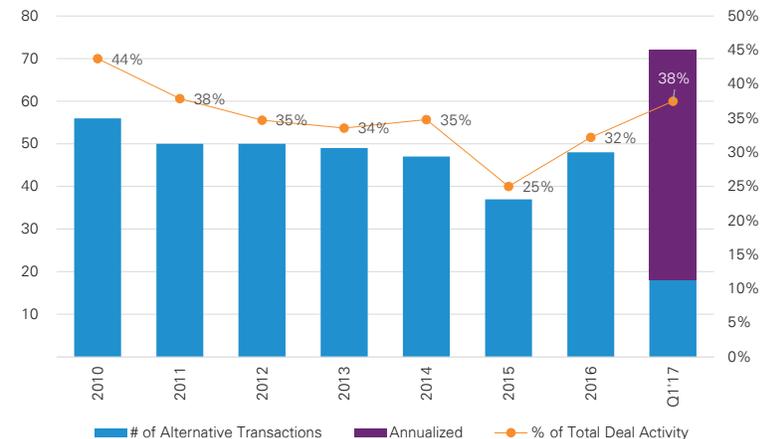


“When we boil it all down, the main issue we see is fit. Do the people and cultures fit? Do the strategies meet the needs of my investors? Am I adding complementary distribution channels? Does the combined platform deliver scale? Those are elements that really matter.”

**Brian Seidler**  
Managing Director, KPMG Deal Advisory

In the pie chart below, we see PE deals are most popular in Q1 2017, driven in large part by continued demand for illiquid alternative strategies by traditional managers, large institutional investors, and specialist funds targeting minority stakes in managers. Following these charts are factors that may have a material impact on M&A activity going forward.

## Aggregate alternative asset manager deals (as of 3/31/17)



Data source: Sandler O’Neill + Partners (used with permission)

## Key factors that may continue to fuel M&A activity

### Search for size, scale, distribution

In the desire to diversify, AI firms will seek to increase scale, offering an array of alts products and strategies. PE firms may expand into adjacent asset classes such as real estate, infrastructure, and hedge funds. AI firms may broaden their search for strategic partners that can provide distribution and support asset-gathering efforts, particularly in overseas markets as they look to expand their global footprint.

### Succession planning

Rather than wind down their funds after a successful investing career, managers are seeking to build a firm with a lasting legacy. A sale transaction (including minority stake sales) can help enable generational transition and broaden the ownership structure. Concurrently, such action can provide a mechanism to attract and retain the “next generation” of fund managers.

### Convergence with traditional asset classes

In the coming years, asset managers that have traditionally focused on the “long-only” segment of the market may turn to M&A as a tool to acquire alpha generation skills and to capitalize on the growing “retailization” of alternative strategies—the increasing availability of liquid alternative investments to retail investors through registered investment (mutual) funds and retirement accounts.

## Motivation

Whether they were large, high-profile deals or smaller-scale transactions, it is important to understand the strategic rationale and motivations of buyers and sellers. Managers who made the decision to align with new partners share a commonality in motivations that we see carrying on in deals to come.

### Seller motivations

- Succession planning
- Access to new distribution channels
- Growth capital
- Competitive and fee pressures
- Monetize franchise value
- Retain control
- Infrastructure investment



### Buyer motivations

- Expansion into new products and strategies
- Talent acquisition
- Economies of scale/optimize operational leverage
- Broaden geographic footprint
- Grow wallet share
- Financial returns

# Actions for success: AI deals require enhanced due diligence

Though there is never a “sure thing” in doing any deal, and no checklist is ever complete, our experience in advising on AI M&A deals leads us to offer a few ideas to consider in an attempt to limit risk and preserve value:

- At its core, asset management is a “people” business and HR issues pose significant post-deal execution risks.
  - Acquirers should pay particular attention to assessing the quality and depth of the target’s management team—including investment and noninvestment personnel.
  - While sometimes difficult to ascertain, close attention should be paid to whether a merger will work culturally.
  - Though sometimes described as a “soft” aspect of a deal, cultural compatibility can often make or break a union.
  - Buyers also will need to understand employee incentives and the manager’s ability to retain top talent after the deal closes. While key personnel risk is inherent in many AI firms, it can become magnified in smaller managers where there may be heavy reliance on a “star” fund manager and limited bench strength.
- Due diligence must include a comprehensive quantitative and qualitative assessment of the manager’s investment strategy and track record, including an analysis of where and how returns are generated.
- AI managers tend to carry greater headline and reputational risk, especially in this time when the regulatory spotlight is bright and regulatory prosecutions seem commonplace. Acquirers should ensure that any investment firm being considered for an acquisition has a robust operations platform and risk and control environment.
- Buyers also need to understand the “stickiness” of investor relationships, the overall level and mix of AUM, and the composition and sustainability of earnings.
- In structuring the deal, pay close attention to details involving employment agreements with individuals deemed critical to the ongoing business and their post-closing compensation arrangements. Here are some considerations:
  - The acquisitions of AI managers are fundamentally about acquiring people, investment know-how, and client relationships. Therefore, employment agreements with individuals deemed to be critical to the ongoing business and their post-closing compensation arrangements need to be addressed prior to the signing of any definitive contracts. Long-term retention and incentives can take the form of an earn-out, management equity stakes, or other incentive plans to align buyer and seller objectives. Earn-out mechanisms, which result in future payouts if certain performance thresholds are achieved (e.g., EBITDA or revenue targets), have become a common feature of transactions involving AI firms and are typically used to mitigate valuation uncertainties and motivate key executives after the deal closes.
  - Acquirers should also, if possible, seek contractual protections relating to the retention of client relationships and assets. It is common for transaction agreements to consider and incorporate a closing condition relating to the client consent process, enumerating a minimum amount of required AUM or run-rate revenues (RRR) as of the closing date, and/or a purchase price adjustment mechanism based on changes in the amount or type of AUM or RRR (in some cases excluding the impact of market movements) at closing as compared to a specified preclosing date.

In addition to this checklist, of course, there are other issues specific to M&A in the AI industry that KPMG’s transactions professionals manage with clients on a routine basis.



## About the contributor



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Brian is a managing director in KPMG's Financial Services Deal Advisory practice based in New York. Brian has over 17 years of experience serving clients in the investment management industry with extensive experience in providing due diligence, structuring, and deal advisory services to both strategic and private equity investors. He has led numerous client engagements across the asset management sector, including mergers, acquisitions, and divestitures of both traditional and alternative managers in transactions ranging in size from \$10 million to \$5 billion. Brian has been a guest speaker and quoted in several leading industry publications regarding his outlook on industry consolidation, transaction valuations, and deal-related issues facing buyers and sellers of investment management firms.

# How KPMG can help

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From initial planning to postdeal operations, we are with you every step of the way.

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