

# **INVESTMENT MANAGEMENT**

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## **Industry Review**

# **2003**

**BERKSHIRE CAPITAL CORPORATION**



# **BERKSHIRE CAPITAL CORPORATION**

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# AGAIN, THE NUMBERS GO SOUTH

If year one of the bear market involved denial and year two acceptance, capitulation may sum up 2002, as global stock markets tumbled in unison for the third year in a row. In the U.S., the last time this occurred the country was nearing the end of the worst economic calamity in its history—the Great Depression.

This time around, the depression has been psychological in nature and, as in 2001, investors sought security in safer instruments. By the second quarter, bond and money market funds worldwide had accumulated enough assets (\$5.4 trillion) to overtake equity funds (\$4.8 trillion), according to data from the Investment Company Institute (ICI).

In the U.S., taxable bond funds added \$110 billion in fresh cash between January and October, while equity funds experienced \$27 billion in net withdrawals, including five consecutive months of outflows, according to the ICI. U.S. equity funds also posted their worst quarterly performance in 15 years during the July through September period, dropping by an average of more than 17%. In Canada, mutual funds weren't doing any better, experiencing net monthly redemptions through most of the year.

The story in Europe was similar. In the first half of the year in Germany, equity funds attracted less than half the money they did during the same period in 2001, according to the Association of German Mutual Fund Companies. By the third quarter, Scottish money managers had just 54% of their assets in equities, the lowest percentage since the Scottish Financial Enterprise began keeping records in 1989. Meanwhile, the announcement last September that Germany's Neuer Markt stock exchange would be closed underlined the beating Europe's investors have taken since 2000. Opened in 1997, the market was designed to be a European NASDAQ and was an important symbol of the Continent's emerging equity culture. Ultimately, a string of scandals, bankruptcies and the collapse of the tech bubble undid the market—and provided one more reason for European investors to run for cover.

Ongoing scandals at major companies and questions about financial transparency in general continued to impact investor confidence worldwide. Money managers who four years earlier had invested in stocks built on pipe dreams were suddenly poring over the financial

statements of blue chips seeking hidden bombshells. Even the iconic **General Electric** came under scrutiny. In March, **Pimco's** Bill Gross, a mythical figure himself in the bond world, questioned the quality of GE's financial reporting and its use of "near hedge fund leverage" in tapping the commercial paper market. (In another sign of the times, in the third quarter, the Pimco Total Return bond fund eclipsed Fidelity Magellan to become the second-largest mutual fund.)

Concerns about profits also weighed on investors. By November, GE joined a growing chorus in corporate America by cutting earnings guidance for both 2002 and 2003. The company, which recorded double-digit earnings gains for nine consecutive years through 2001, chopped its growth target for 2002 by more than half to 7%, while this year's number was broadly placed between 3% and 13%.

*BusinessWeek* reported that its index of U.S. corporate earnings was flat in the third quarter, once it had stripped out all the special charges from both 2001 and 2002. Meanwhile, when Standard & Poor's applied its new "core earnings" criteria (omitting pension earnings and expensing stock options, among other changes) to previously reported S&P 500 company results in the year through June 2002, the number was 31% lower. For the full year 2002, Thomson First Call estimates that operating earnings growth will come in around 2% for the S&P 500.

As a result, end-of-year valuations continued to appear pricey by historical standards, at 22 and 29 times trailing earnings for the Dow and S&P 500, respectively, though early Thomson estimates for 2003 placed earnings growth at 14%.

DOWN, DOWN, DOWN				
Performances of Key Stock Indices				
	2000	2001	2002	% OFF RECORD HIGH (HIGH MONTH/YEAR)
DJIA	-6%	-7%	-17%	-29% (1/00)
S&P 500	-10	-13	-23	-42 (3/00)
NASDAQ	-39	-21	-32	-74 (3/00)
FTSE 100	-10	-16	-25	-43 (12/99)
DAX	-8	-20	-44	-64 (3/00)
Nikkei 225	-27	-24	-19	-78 (12/89)

SLUGGISH ENGINES			
GDP Growth			
	2001	2002*	2003*
U.S.	0.3%	2.3%	2.6%
Euro Area	1.5	0.8	1.8
Japan	-0.3	0.0	0.8

\*Projected  
Source: World Bank

In Europe, the bear market has pushed stock valuations closer to historic norms than in the U.S., but corporate profits and economic growth are also weaker: the Euro area is expected to post GDP growth of just 0.8% in 2002 and less than 2% this year (compared with 2.3% and 2.6%, respectively, in the U.S.). This pall was reflected in a year-end UBS-Gallup survey, which found 58% of individual investors in Europe to be pessimistic about the region's economic prospects in 2003.

Germany in particular has been struggling with virtually flat growth on top of the negligible gain it posted in 2001. Just as importantly, there appears to be no silver lining for Europe's largest economy: both the German service and industrial sectors were hurting, bankruptcies were at the highest level since World War II, and unemployment was over 8% and climbing. With an uncharacteristically high budget deficit of nearly 4% of GDP, Germany also found itself chastised for exceeding EU spending caps. The result: the one-time poster child of Europe began to invite comparisons to another model-turned-laggard, Japan.

Grappling with its second straight year of negative or flat economic growth and a financial system that has been on a deathwatch for years, in November the Japanese government actually gave the nation's banks until March 2003 to shore up their balance sheets or face the threat of nationalization. But given the government's record for shrinking away from genuine economic reform, most observers are taking a wait-and-see attitude toward this latest salvo. The stock market continued to offer a good barometer of sentiment, as the Nikkei 225 in November hit its lowest level since 1983.

### KEY NUMBERS KEEP DROPPING

Three other key barometers of economic activity—mergers and acquisitions, IPOs and venture capital funding—continued to decline last year. Worldwide

## FEWER DEALS, FEWER DOLLARS

### Worldwide M&A Activity

Number of announced deals	2001	2002
<b>WORLDWIDE</b>	29,970	25,100
<b>U.S.</b>	7,680	6,860
<b>FINANCE &amp; INSURANCE SECTOR (WORLDWIDE)</b>	2,848	2,478
<b>\$1 BILLION-PLUS DEALS (WORLDWIDE)</b>	305	251
Value (\$ billions)	2001	2002
<b>WORLDWIDE</b>	\$1,701	\$1,231
<b>U.S.</b>	\$771	\$458
<b>FINANCE &amp; INSURANCE SECTOR (WORLDWIDE)</b>	\$414	\$236
<b>\$1 BILLION-PLUS DEALS (WORLDWIDE)</b>	\$1,100	\$695

Sources: Thomson Financial (Worldwide, U.S.); Dealogic (Finance, \$1b-plus)

M&A value, which dropped by half between 2000 and 2001, fell another 28% to \$1.2 trillion in 2002, according to Thomson Financial, with Europe proving a more active arena than the U.S. for the first time in 11 years. The number of deals dropped by 16% in 2002, on top of a 22% decline in 2001.

The value and number of IPOs worldwide also declined markedly for the second straight year, off 36% and 18%, respectively, according to Dealogic. (Between mid-August and mid-October 2002, there wasn't one IPO in the U.S.) With the M&A and IPO markets in the doldrums, VC funding in the U.S. in the first three quarters dropped to \$5.5 billion, from \$30.3 billion during the same period in 2001, data from Thomson Venture Economics shows. In 2000, a record \$97 billion was raised, as investors sought to capitalize on the tech bubble.

The asset management industry both mirrored and bucked the larger trends. The value of deals dropped sharply for the second consecutive year, to \$10.3 billion—down 34% from 2001 and far off the record \$36.4 billion in 2000. For the first time in recent memory, there was not one billion-dollar deal, and a total of \$5 billion was spent for the top 10 deals in 2002, compared with \$10.5 billion in 2001 and \$23 billion in 2000. Only one of the 10 largest deals last year involved two U.S. operations—**U.S. Bancorp's** \$715 million acquisition of **State Street Corp.'s** corporate trust business. In all industries, the level of \$1 billion-plus deals also dropped significantly, with the value of such transactions off 37% and deal numbers down 18%.

While the sharp drop in value in the asset management industry reflected an unwillingness on the part of buyers to make major commitments during a period of uncertainty, it was also indicative of the weakness plaguing many financial services firms. At the same time, the number of deals (143) set a new record, as firms made smaller strategic acquisitions that added expertise, assets

## A RETURN TO DOUBLE-DIGIT GROWTH?

### S&P 500 Earnings Per Share, Thomson First Call

#### Projections

2002	EPS	% CHG. vs. '01	2003	EPS	% CHG. vs. '02
1Q	\$11.29	-11.5%	1Q	\$12.30	+11.9%
2Q	12.35	+1.4	2Q	13.32	+11.2
*3Q	12.15	+6.9	3Q	13.51	+17.1
*4Q	12.42	+14.6	4Q	N/A	
*2002	47.34	+2.0	2003	52.80	+13.7

\* 3Q & 4Q '02 are estimates; estimates & projections based on sell-side analyst consensus, as of Dec. 20, 2002.

% change does not correspond fully to previous year's earnings due to changes in S&P components.

Source: Thomson First Call

or distribution in a sector or geographic area. This marked the second consecutive year that the number of asset management deals grew against the backdrop of the larger negative M&A picture. And while none of the elevated multiples of 2000 were in evidence, valuations also held steady—in part reflecting the deals that did not get done.

### SMALLER DEALS PREVAIL

**John Hancock's** moves in 2002 are a good example of the cautious but strategic approach buyers took as the company completed two small acquisitions for U.S. mutual funds (the U.S. Global Leaders Growth Fund of **Yeager, Wood & Marshall** and the Pzena Focused Value Fund of **Pzena Investment Management**), with an eye toward leveraging its vast distribution network to expand sales of both. In another small deal typical of 2002, **Putnam Investments** acquired a leading European high yield bond specialist, **New Flag Asset Management**, to complement its already significant U.S. business in that area.

The flurry of deals for hedge fund managers also played into this strategic tack-on trend, as firms sought either to enhance existing alternative investment operations or to gain a foothold in a growing area. **Unicredito Italiano, Gartmore Group** and **Robeco Groep** were all active in this arena, along with a host of other firms. In fact, the largest transaction in the asset management industry involved two hedge fund companies—**Man Group's** \$833 million acquisition of **RMF Investment Group** (see story, p. 10). **Deutsche Bank's** \$490 million acquisition of **RREEF** was another major example of the effort by asset managers to diversify their alternative investment offerings, with RREEF adding U.S. real estate assets to the German bank's European portfolio.

The wealth management business remained attractive to buyers, as transaction numbers hit 50 for the first time. Small deals predominated, with **Bank of Montreal (Harris Private Bank), Mellon Financial Corp.** and **Bank of New York** each making two acquisitions to extend their geographic reach. In the institutional sector, the deal numbers reached 56, though average transaction value dropped below the \$100 million mark for the first time since 1996. Two transatlantic deals—**Northern Trust Corp.'s** acquisition of **Deutsche Bank's** European index business and **Bank of Ireland's** purchase of 61% of **Iridian Asset Management**, a Connecticut-based equity manager with \$11 billion in AUM—were among the largest institutional transactions.

While equity markets and asset managers struggled worldwide, companies continued expanding into new territory in search of opportunity, as the 43 cross border deals kept pace with past years. Value did drop from 2001, however, to \$4.3 billion. Again, a big part of the story in 2002 was the absence of mega-deals. By comparison, in 2000 and 2001, a total of seven cross border deals of \$1 billion or more took place.

Not surprisingly, given the general weakness in the sector, mutual fund transactions dropped in number and value to levels last seen in the early 1990s (with the exception of 1998, a notably quiet year). Canada, which has witnessed increasing consolidation of its mutual fund industry, was an exception, as **Sun Life Financial Services** took a 30% stake in **C.I. Fund Management** and **National Bank of Canada** acquired **Altamira Investment Services**. The Sun Life transaction involves an M&A

structure that may become more prevalent, as the Toronto-based firm exchanged its mutual fund operations for shares. CI also gains access to Sun Life's large sales force. South of the border, the U.S. was remarkably quiet, with the market characterized by very small deals.



After three years of negative stock market returns, history would suggest a turnaround in 2003, and during October and November, the U.S. market did generate a strong comeback that faded in December. At the same time, with economic activity sluggish at best in Europe and Japan, and the prospects for the U.S. appearing to flip-flop with each new set of economic indicators, the catalysts for a reversal in sentiment are not apparent.

Moreover, at the time of this writing, the potential for war with Iraq remains another drag on sentiment. If war does come and is decided quickly—and if Iraqis greet Americans as liberators rather than invaders, much as in Afghanistan—the war could prove the confidence-boosting event that diverts money flows back into equities. But a difficult invasion or an uncertain middle ground short of war could lead to another equity sell-off or provide investors and businesses with another reason to sit on their hands.

In mapping their future and assessing their appetite for transactions, asset managers will weigh such near-term concerns against longer-term opportunities—and none looms larger than the hordes of graying baby boomers who need to accelerate their savings and investment for retirement (particularly in light of the hit to their nest eggs

INVESTMENT MANAGEMENT TRANSACTIONS					
	1998	1999	2000	2001	2002
Majority Equity	81	85	121	118	119
Minority Equity	13	15	4	4	16
Management Buyout	3	3	1	8	8
<b>TOTAL</b>	97	103	126	130	143
Value of All Transactions (\$b)	7.1	17.0	36.4	15.6	10.3
AUM Changing Hands (\$b)	430	562	1,405	830	548

*Source: Berkshire Capital Corporation*

of late). The front edge of that very formidable group—those born in 1946—will start retiring this decade.

In the U.S., the pressure from this voting bloc, not to mention budgetary reality, will in the years ahead presumably drive a flurry of legislative initiatives providing for greater retirement savings incentives. In a

largely ignored November speech, a U.S. Treasury official underscored the daunting nature of this problem by noting that the federal government faced a \$20 trillion future gap between promised retiree benefits, including health care, and projected revenues.

In Continental Europe, where private pensions are far less common, the need for reform is even greater, given the region's slower economic and population growth, the heavy pension burden placed on governments—and the tendency of the region's politicians to shelve the issue. But the problem isn't just confined to the wealthiest industrialized nations. The issue has also entered the radar screen in Central and Eastern Europe, as well as in China, where those over 60 will double to 20% of the population during the next 10 years—and where international asset managers have been traveling to offer governments advice and counsel.

The current difficulties notwithstanding, the graying of the world's population, combined with the greater sophistication and wealth of the world's people, continue to make asset management one of the most attractive areas of the financial services industry. As a result, in our view, the renewal of more ambitious buying and selling activity is inevitable, only awaiting some clearer signs of economic recovery and investor confidence.

Other factors that we believe are likely to impact the asset management industry in the near term include:

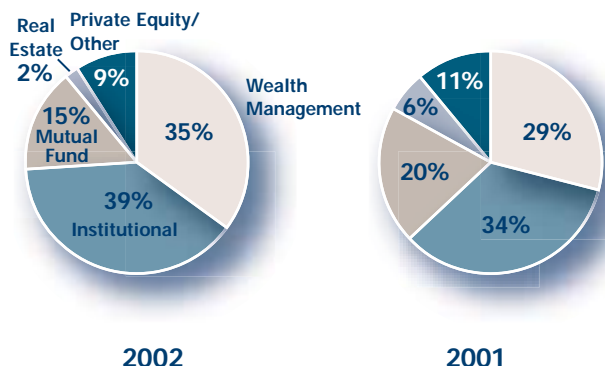
- Increasing pressure among large players to consolidate operations, with a focus on divestitures and partnerships.
- Large overcapacity of production in Europe will not be eliminated easily, a situation that will make the prospect of alliances possibly more appealing.
- Large overcapacity in the mutual fund arena will begin to shake out through mergers, divestitures and partnerships.
- Increased pressure on fees in institutional money management will cause some players to rethink strategies and reduce costs.
- The proliferation of hedge funds will reverse course, with many such funds shutting down. Hedge fund transactions will continue, but deals will depend on the continuation of excess returns, with the top firms and managers faring best.
- The wealth management sector will grow increasingly competitive and overcapacity may result in more partnering arrangements.♦

**H. Bruce McEver**  
Chairman

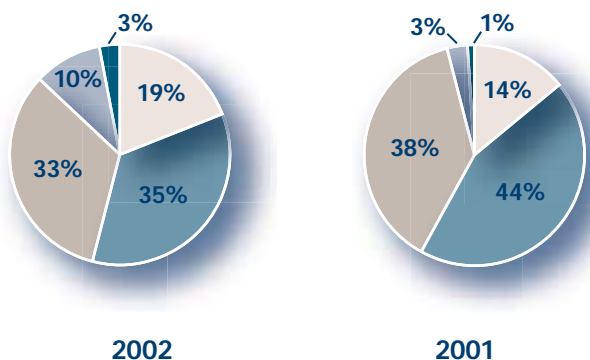
**R. Bruce Cameron**  
President

## WHO'S SELLING?

### Number of Transactions by Sector as % of Total



### Value of Transactions by Sector as % of Total



## WHO'S BUYING?

### Number of Transactions

	1998	1999	2000	2001	2002
Bank	25	26	41	45	49
Institutional	10	10	15	12	17
Mutual Fund	3	6	17	9	15
Wealth Manager	1	1	12	5	15
Insurance Co.	17	18	14	14	15
Securities Firm	8	13	15	13	11
MBO	3	3	1	8	8
Financial	16	16	2	8	5
Trust Company	5	4	5	5	2
Real Estate Manager	4	1	0	4	1
Other	5	5	4	7	5
<b>TOTAL</b>	<b>97</b>	<b>103</b>	<b>126</b>	<b>130</b>	<b>143</b>

Source: Berkshire Capital Corporation

## WEALTH MANAGEMENT

In a continuation of the trend from 2001, transactions in the high net worth market maintained a brisk pace in 2002, with a record 50 deals. The value of those deals, at \$2 billion, was on par with 2001, though down considerably from the peak years of 1999 and 2000. And while valuations for most deals did remain level with 2001, buyers were less likely to pay the material portion of consideration up front. The more gilded names—which three years ago could fetch 15-to-20 times EBITDA—actually experienced the biggest drops in valuations.

Still, the steady deal numbers in 2001 and 2002 underline the ongoing attractiveness of a business that can generate high margins, provide loyal customers and tap into an enormous pool of assets: the combined wealth of those with financial assets of at least \$1 million is \$26.2 trillion worldwide, according to Merrill Lynch & Co. and Cap Gemini Ernst & Young, or four times the total amount invested in U.S. mutual funds.

As wealth managers seek to increase their penetration of this market, even the acquisition of a small firm provides an effective complement to organic growth in a business where the pickup of a handful of plum customers can be significant. Moreover, many smaller players are eager to embrace their larger brethren, which can offer the financial muscle, access to technology and broader menu of investments and services required to attract and retain customers. For example, with stocks no longer a sure thing, asset allocation services and alternative investments are of particular interest to high net worth clients.

Along these lines, some single- or multi-family offices have also taken tentative steps toward selling or creating partnerships with larger institutions. These high-end offices, which are typically started as advisors for one family or a group of families, often take on other clients, providing additional returns for the original families. The problem: the bear market has placed some of these families in the unaccustomed position of having to pump capital back into the offices, at the same time that their own assets may be declining—leading them to reconsider the value of ownership. With estimates of anywhere from 5,000 to 10,000 such offices worldwide, observers believe consolidation is inevitable.

The largest deals in 2002 were in fact fairly modest, at around \$100 million. By comparison, **Legg Mason's** \$682 million acquisition of **Private Capital Management** led the sector in 2001 (a deal that could reach \$1.4 billion if growth targets are met), while **Charles Schwab's** \$2.7 billion purchase of **U.S. Trust** topped the list in 2000. Banks, the traditional leaders in this sector, dominated activity again last year, as brokerages and mutual fund companies steered clear, focused as they were on their core businesses.

The **Bank of New York** was a notable player, with two acquisitions last March and April that extended its reach in New England and boosted its BNY Asset Management group's AUM by nearly \$6 billion, to \$73 billion, after two years of minimal growth. The larger of the two acquisitions—and one of the largest wealth management deals of the year—involved Boston-based **Gannett Welsh & Kotler**. Founded in 1974, GWK is a fixed income specialist with \$5 billion in AUM, including a large and fast-growing municipal bond separately managed accounts business.

BNY's second acquisition was of **Beacon Fiduciary Advisors**, another Boston-area firm that manages \$700 million for 350 individuals. In explaining the sale, Beacon President Fredrick Schultz highlighted the research, products and technical support the bank would offer his firm, adding: "We believe that this union will provide our clients with an added expertise that would otherwise be unavailable to a firm of our size." BNY's moves were typical of activity in the sector, with buyers seeking strategic acquisitions to fill either a geographic or product niche.

**Harris Private Bank** of Chicago made two acquisitions, as parent **Bank of Montreal** continued to expand its U.S. operations. The higher-profile deal involved the \$30 million purchase of "certain assets" of **myCFO**, which will provide Harris with new bases in California, Denver and Atlanta. Started in 1999 by Netscape founder James Clark and based in Silicon Valley, myCFO promised to merge the traditions of private banking with the convenience of the Internet. A board and client list that includes such luminaries as Kleiner Perkins venture capitalist John Doerr and Cisco CEO John Chambers added to the firm's attractiveness. In practice, however, myCFO has turned out to be a fairly traditional firm that has managed to attract very wealthy clients (\$5.7 billion in AUM and an average account size of some \$50 million), while failing to establish a profitable business.

The second acquisition, of Seattle-based **Northwestern Trust**, brought an additional \$3 billion in AUM to Harris, along with clients in 15 states, including those in the coveted Northwest. Gilles Ouellette, president and CEO of Bank of Montreal's Private Client Group, said the acquisition was part of the bank's strategy "to expand our integrated suite of wealth management products and services across the United States in fast-growing, urban areas, building on the strong Harris brand." In total, the two deals boosted Harris' AUM to around \$26 billion.

There were several other smaller acquisitions made by banks on behalf of their wealth management subsidiaries. **Mellon Financial Corp.**, in the midst of its transition to becoming a broader investment management firm, acquired two companies within the space of two weeks last spring. The first target was Cleveland's **Weber Fulton & Felman** (AUM: \$800 million), which

bolstered the office Mellon had set up in the city two years earlier. “This move,” said David Lamere, vice chairman and president of Mellon’s Private Wealth Management Group, “is in keeping with Mellon’s strategy of strengthening and expanding our private wealth management business in key regions across the country.”

In the second deal, Mellon extended its European reach, acquiring the U.K.’s **Henderson Private Asset Management** (AUM: \$1.4 billion) for \$27 million. That acquisition was made by Mellon’s U.K.-based asset management subsidiary, **Newton Investment Management Ltd.**, acquired in 1998. The Henderson acquisition increases Newton’s AUM to \$7.4 billion for private clients and charities.

Legg Mason remained active last year, with its Cincinnati-based wealth manager **Bartlett & Co.** picking up a small nearby regional player—**Wallington Asset Management** (AUM: \$187 million) of Indianapolis. **Wells Fargo & Co.** enhanced its private banking operations in the San Francisco area with the purchase of **Nelson Capital Management**, a Palo Alto firm with 400 clients, some \$578 million in AUM and a specialty in socially responsible investing.

**Northern Trust Corp.**, which has generally relied on its own resources for expansion in wealth management, entered the hot Atlanta market through the acquisition of **Legacy South, Inc.**, a 6-year-old firm with just a handful of employees but 120 clients and \$300 million in AUM. Mark Stevens, president of Personal Financial Services for Northern Trust, said the deal “continues our nationwide strategy of expanding into affluent markets that have excellent growth opportunities for our business.” The Chicago financial services firm also has a large wealth management business in adjoining Florida.

Among European firms, the number of deals with a wealth management component dropped to a handful, with the most notable transaction involving

**ABN AMRO**, one of the top 10 private banks worldwide (AUM: \$114 billion). In September, the bank announced it had signed a letter of intent to acquire Germany’s venerable **Delbruck & Co.** With 3,500 clients, Delbruck will nearly double ABN AMRO’s existing client list in Europe’s most competitive and alluring wealth market. ABN AMRO’s Jan Peter Schmittmann, head of the bank’s Private Clients and New Growth Markets units, said, “With this acquisition, we clearly strengthen our position in the most attractive growth market in private banking in Europe.”

Another major European wealth manager, **BNP Paribas**, expanded its high net worth business in Spain with the acquisition of **J.P. Morgan Chase’s** Spanish private banking and asset management business (AUM: \$750 million). ♦

## INSTITUTIONAL ADVISORS

As in other parts of the asset management business, the institutional side witnessed smaller deals but continuing activity. There were 56 transactions in 2002, up from 44 in 2001 and 50 in 2000. But value declined 50% from 2001 to \$3.6 billion and was far below the extraordinary \$17 billion in 2000. With the average deal value dropping well below \$100 million, the sector reverted to levels last seen in 1996 (though excluding \$1 billion-plus transactions, average deal value in 2002 was also on par with the late 1990s).

In a year when institutions took a decidedly cautious approach to equities, an equally guarded attitude by buyers in the sector wasn’t surprising. In particular, the steady stream of well-heeled players that had been entering the market each year to make billion-dollar deals—such as **AMVESCAP**, **Alliance Capital Management**, **Allianz**, **Old Mutual** and **Société Générale**—dried up in 2002. On the other end of the scale, there were numerous deals for solid institutional firms with \$2 billion to \$5 billion in AUM, although many such companies that were actively seeking new homes came up against a lack of interest from buyers if performance, overhead or product lines didn’t measure up. In the \$10 billion to \$20 billion AUM tier, asset managers were generally holding their own and chose to stay put in an environment where few buyers were predisposed to pay top dollar.

The sector’s biggest transaction, measured by transfer of assets (\$120 billion), involved **Northern Trust Corp.’s** \$260 million acquisition of **Deutsche Bank’s** index business. Although indexing is a low-margin affair, the deal did provide Northern Trust with much greater scale, making it one of the three largest U.S. institutional index managers. Stephen Timbers, president of Northern Trust Global Investments, said the deal allows the company to “expand our international and enhanced index offerings significantly.” The divestiture fits with Deutsche Bank’s efforts to focus on active asset

### WEALTH MANAGEMENT TRANSACTIONS

	1998	1999*	2000**	2001	2002
Number of Transactions	25	33 (31)	44 (43)	41	50
Combined Value (\$m)	592	4,079 (1,574)	6,727 (4,027)	2,166	1,975
Total Seller AUM (\$b)	22	95 (26)	186 (100)	53	63
Average Deal Size (\$m)	24	124 (57)	153 (94)	53	39
Average Seller AUM (\$m)	875	2,888 (850)	4,223 (2,321)	1,300	1,254

\* Numbers in parentheses exclude the UBS - GAM and Swiss Life - Banca del Gottardo deals

\*\* Numbers in parentheses exclude the Schwab - U.S. Trust deal

Source: Berkshire Capital Corporation

management. A second noteworthy transatlantic deal involved **Bank of Ireland's** \$171 million purchase of 61% of **Iridian Asset Management**, a Connecticut firm (*for more details, see p. 11*).

But the largest transaction by value, and the most intriguing institutional deals taking place in general in 2002, were in the hedge fund area. Facing an unyielding bear market, asset managers have shown increasing interest in these vehicles as one means for improving performance. For example, following the record \$31 billion that hedge funds attracted in 2001, research released in early 2002 by Deutsche Banc Alex. Brown revealed that 98% of the 168 institutions it surveyed had made hedge fund or absolute return investments, while 57% said they were redirecting assets to alternative investments.

The institutional deal market received a hint of this interest in July 2001, when **OppenheimerFunds** announced its acquisition of **Tremont Advisers Inc.**, a global hedge fund advisory and investment firm. By 2002, that initial spark had blossomed into courtships worldwide. The year's blockbuster deal—and the largest transaction in the asset management industry—involved two major European hedge fund players, as **Man Group** acquired **RMF Investment Group** for \$833 million (*see story, p. 10*). There were several other smaller but interesting cross border institutional deals involving hedge funds, including **Robeco Groep's** acquisition of **Sage Capital Management** and **Gartmore Group's** purchase of **Riverview International** (*for more details on these deals, see p. 11*).

Major financial firms are also gaining access to the institutional hedge fund business via minority shareholdings in small but ambitious companies. **Nikko Cordial Securities**, Japan's No. 3 brokerage house, bought an undisclosed stake in New York's **Asset Alliance Corp.**, a holding company that has \$4.5 billion in AUM through its interests in 14 alternative investment managers. For Asset Alliance, the deal offers an infusion of capital and opportunities for global expansion, while Nikko Cordial (the former Nikko Securities) diversifies its product line.

Within the U.K., **Threadneedle Asset Management** (AUM: \$68 billion) took a minority stake in **Attica Asset Management**, a small hedge fund company formed in 1999 that serves both institutional and high net worth clients. The deal's logic is familiar: a stake in the hedge fund universe for Threadneedle (a subsidiary of **Zurich Financial Services**), and access to the resources of a larger partner for Attica. "We believe that the market-

place for Attica's products is one of the most attractive segments in the asset management industry," said Threadneedle Chief Executive Simon Davies.

Bermuda-based reinsurance specialist **XL Capital Ltd.**, which has been actively seeking investments in specialized asset managers, acquired minority stakes in two small New York-based firms: **OneCapital Management Partners**, an alternative investment firm; and **Stanfield Capital** and **Stanfield Global**, which manage structured credit products and a \$3 billion investment-grade securities conduit, respectively. In November 2001, XL had also invested in **FrontPoint Partners** of Connecticut, another small alternative asset manager.

Ironically, just as these deals were being done, the demand for hedge funds began to soften, with institutions growing ever more conservative in their investment strategies. Cash inflows to hedge funds dropped by more than \$800 million between the first

and second quarters of 2002, to \$4.6 billion, according to Tass Research. This has led industry observers to predict a major shakeout in a field still dominated by "mom-and-pop" firms—a situation that could make for interesting acquisition plays in the years ahead.

The fast-growing Mexican private pension fund market, started up in 1997 and now sporting 25 million participants, was another notable center of activity in 2002. The **Principal Financial Group**, which manages pension funds in a number of countries, made two acquisitions, buying **Zurich Afore** (owned by Zurich Financial Services) in March and then reaching agreement in November to acquire **Afore Tepeyac** for \$58 million.

Combined with its pre-existing business in Mexico, the deals give Principal \$1.3 billion in AUM and make it the fourth-largest player in this market, by number of customers. Norman Sorensen, president of Principal International, called the second deal "an important step in our strategy to be a leader in the retirement services industry in the Mexican market and in the rest of Latin America." (Meanwhile, Principal sold off its Australian mutual fund business. *See p. 9*.)

In a third transaction, **Prudential Financial Inc.** paid \$128 million for a 50% interest in **IXE Grupo's Afore XXI**, the country's ninth-largest pension fund manager (AUM: \$1.6 billion). In addition, **Citigroup's** Mexican subsidiary, **Grupo Financiero Banamex**, bought out the 48% interest of **AEGON NV** in their joint life insurance and pension businesses, for \$1.2 billion.

INSTITUTIONAL ADVISOR TRANSACTIONS					
	1998	1999	2000	2001	2002
Number of Transactions	56	38	50	44	56
Combined Value (\$b)	5.7	4.1	17.0	7.3	3.6
Total Seller AUM (\$b)	388	178	890	593	294
Average Deal Size (\$m)	102	107	340	169	65
Average Seller AUM (\$b)	6.9	4.7	17.8	13.8	5.2

*Source: Berkshire Capital Corporation*

In general, companies have been paying healthy multiples to buy stakes in the *afores*, as the country's pension managers are known.

Among U.S.-based firms, the year is summed up by noting that two of the more significant institutional transactions involved targets with AUM only in the \$6 billion to \$7 billion range. In one, **John Nuveen Company** acquired **NWQ Asset Management**, a value manager that is one of the dozen-plus affiliates Old Mutual has sold since its 2000 purchase of **United Asset Management**. As part of the \$140 million deal, Nuveen also entered into an alliance through which Old Mutual affiliates will sub-advise products sponsored and distributed by Nuveen. In the other deal, **Berger Financial Group** acquired **Enhanced Investment Technologies**, a 15-year-old large-cap firm with a quantitative investment strategy relating to stock price movements.♦

## MUTUAL FUNDS

The mutual fund industry, once the care-free route to wealth and success for both customers and suppliers, remained stuck in reverse in 2002, a circumstance that generated an ongoing series of grim statistics. In the third quarter, U.S. equity funds suffered their worst performance in 15 years (down 17.5%); in July, they set a record for monthly outflows (\$53 billion); and by October, they had racked up their fifth consecutive month of outflows—the first time that has happened since the Investment Company Institute started tracking such data in 1990.

The toll showed up in the poor performance of many publicly traded asset managers. The experience of **Alliance Capital** was typical of the sector. Its AUM dropped by 12% in the year through September, to \$369 billion, and in the third quarter, revenues and net operating earnings declined by 10% and 31%, respectively. The stock was doing even worse, sinking 43% in the first nine months of 2002. In providing the company's guidance for flat growth in 2003, Chairman and CEO Bruce Calvert summed up the industry's predicament by saying, "We're trying to watch every nickel."

This discouraging environment was also reflected in the number and value of mutual fund transactions, which declined markedly for the second consecutive year. One key factor in the decline in deal value was the absence of the world's major financial firms, which appeared reluctant to make significant bets in a

down market. Additionally, for the second year in a row, the largest transactions took place outside the U.S., with the leading deal carrying a price tag of around \$650 million.

Within the U.S., where half the deals took place, activity was decidedly low-key. Take **John Hancock Financial Services**. It made two strategic but small deals in buying the U.S. Global Leaders Growth Fund of **Yeager, Wood & Marshall** and the Pzena Focused Value Fund (AUM: \$22 million) of **Pzena Investment Management**. As part of the arrangement, Hancock left management in place to run both funds while leveraging its strength as a packager and distributor.

In the case of Global Leaders Growth (now sold under the Hancock name), Hancock was able to acquire a fund with a solid track record and \$109 million in AUM for a nominal initial cost. The seller's payoff is built around the continuation of the sub-advisory fee, which has grown as a result of the 250% increase in AUM since Hancock acquired it. "As part of our strategic plan to grow assets, we seek to acquire top-performing mutual funds that complement our existing product lines," said Maureen Ford, chairman and CEO of John Hancock Funds.

The two acquisitions made in 2002 by **Strong Financial Corp.** were similar. In the first, the privately held Wisconsin company (AUM: \$38 billion) purchased **Rockhaven Asset Management** to capture two funds, including the \$35-million Rockhaven Premier Dividend Fund, as well as the firm's investment team. For Rockhaven, the appeal was simple, as noted by its president, Chris Wiles: "We are going to get distribution." In November, Strong announced that it had agreed to acquire a fixed income fund from **State Street Research & Management Co.** The State Street Research Tax-Exempt Fund (AUM: \$287 million) is expected to be wrapped into an existing Strong municipal bond fund.

As in 2001, Canada was a center of activity and further consolidation, accounting for two of the largest deals in the mutual funds sector. These included the 30% stake **Sun Life Financial Services** (AUM: \$225 billion) acquired in **C.I. Fund Management** (AUM: \$17 billion). The shares-for-assets swap, valued at \$652 million, created the nation's fourth-largest mutual fund company and joins CI's brand name and fund expertise with the largest insurance sales force in Canada. Two years ago, CI failed in its bid to take over Canadian fund giant **Mackenzie Financial Corp.**, which was acquired

### MUTUAL FUND TRANSACTIONS

	1998	1999	2000	2001	2002
Number of Transactions	8	28	29	26	22
Combined Value (\$m)	238	8,335	12,022	5,921	3,400
Total Seller AUM (\$b)	8	275	323	154	132
Average Deal Size (\$m)	30	298	415	228	155
Average Seller AUM (\$b)	1.1	9.8	11.1	5.9	6.0

Source: Berkshire Capital Corporation

for \$2.7 billion by **Investors Group Inc.** in 2001. Sun Life, which has pursued an aggressive diversification strategy since demutualizing in 2000, also owns **MFS Investment Management** in the U.S.

In the second major acquisition, **National Bank of Canada** bought **Altamira Investment Services** for \$320 million (including assumption of debt), in the process doubling its mutual funds AUM to \$6.8 billion and becoming the nation's 14th-largest mutual fund player. The deal did raise some eyebrows, as National Bank paid the equivalent of 9.5% of AUM for a company with an aggressive investment style that had lost one-third of its AUM between 2000 and the time of the deal last June. But noting that there were "fewer and fewer opportunities of this size," Real Raymond, National Bank's president and CEO, said the transaction "represents an excellent opportunity to participate in industry consolidation and to achieve the critical mass required for further expansion."

Meanwhile, **Mackenzie Financial** sold off its U.S. mutual fund subsidiary, **Mackenzie Investment Management** (AUM: \$2.1 billion), to mutual fund manager **Waddell & Reed Financial** (AUM: \$29 billion) of Kansas, for \$74 million. Mackenzie Investment manages the Ivy family of funds and is sub-advisor for the Universal Funds family of its former parent.

There were several deals of note outside North America, including a London-based one in which **Friends Ivory & Sime** acquired the asset management business of **Royal & Sun Alliance**. The \$350 million transaction makes FIS one of the 10 largest investment companies in the U.K. by more than doubling its AUM to \$104 billion. Citing this increased scale, Howard Carter, CEO of FIS, called the transaction "transformational" and said it would enable the firm "to deliver the level and consistency of long-term performance which our clients deserve." Soon after, FIS rebranded itself as **ISIS Asset Management**; it remains listed on the London Stock Exchange (67%-owned by **Friends Provident plc**).

In Australia, **Westpac Banking Corp.**, cash-rich after the sale of its finance subsidiary in early 2002, made three domestic acquisitions between April and August that significantly expanded its capabilities in fund management—a \$370 billion industry made all the more attractive by the country's compulsory private pension scheme. The two key deals—for **BT Financial Group** and **Rothschild Australia Asset Management**—more than doubled Westpac's retail funds under management to around \$17 billion, vaulting it into a strong No. 4 position in that category.

The larger of the two transactions involved BT Financial Group, a \$550 million deal that provides Westpac with a solid brand name and wrap account business. Meanwhile, for seller **Principal Financial Group**, based in Iowa, the deal was something of a bitter pill, as

it had acquired the business only three years earlier for more than \$1 billion. However, the consolidation of the industry and the rapid change in distribution methods had made it difficult for BT to compete.

The \$180 million acquisition of **Rothschild Australia** gave Westpac a large advisory infrastructure and an international network of alliances with firms such as **Putnam Investments** and **Grosvenor Capital Management**. The third and smallest deal involved the \$20 million purchase of 51% of **Hastings Funds Management** (AUM: \$1.1 billion), a hedge fund manager. Although these acquisitions have made Westpac a far stronger competitor, observers believe the bank faces a formidable near-term task integrating the businesses. ♦

## CROSS BORDER

Globalization in the asset management industry proved to be alive and well in 2002, if the sheer number of cross border deals is taken into account, as 43 were transacted. But the diminished deal value—off 39% from 2001—provided a truer picture of sentiment, and the once-common billion-dollar deal disappeared altogether.

There were 23 deals involving a U.S. buyer or seller, with the transactions about evenly split between the two and the value significantly below the \$100 million mark on average. In a continuation of the trend that began in 2001, European firms steered closer to home in considering targets, though a number did make the journey across the Atlantic, if with less fanfare. During the height of the bull market, Europeans made headlines with the premiums they paid for access to American consumers and asset management know-how—and even in 2001, European firms pulled off two separate billion-dollar U.S. deals.

Within Europe, the deals in 2002 were also small in scale, with the exception of **Man Group's** \$833 million acquisition of **RMF Investment Group** (see story, p.10). In addition to the sluggish macroeconomic conditions and the bear market, this new sobriety reflected

### CROSS BORDER TRANSACTIONS

U.S. - Int'l	1998	1999	2000	2001	2002
No. of Deals	18	23	23	17	23
Value (\$b)	1.3	7.4	13.8	5.9	1.7
<b>Two Int'l Firms</b>					
No. of Deals	12	15	21	18	20
Value (\$b)	2.2	3.5	4.8	1.1	2.6
<b>TOTAL</b>					
No. of Deals	30	38	44	35	43
Value (\$b)	3.5	10.9	18.6	7.0	4.3

Source: Berkshire Capital Corporation

an additional factor: the battering taken by Europe's nascent equity-ownership culture. While observers remain confident that this culture is ingrained enough in the U.S. to survive the bear market, three straight years of negative returns are likely to spook Europe's less adventurous investors for some time to come.

This has caused banks and financial firms to reconsider exactly how much money can be made near-term in fee-based investment services. In 2001, Deutsche Bank estimates that European investors put three times as much cash into money markets as in equity funds, and the flight to safety was no less pronounced in 2002. In the first half of the year in Germany, for example, equity funds attracted less than half the money they did during the same period in 2001, according to the Association of German Mutual Fund Companies.

For many firms that in prior years had been actively extending their geographic reach via acquisitions, this mix of market and business woes forced a reversal or halt of strategy. **Commerzbank** was the most notable example,

### CROSS BORDER TRANSACTIONS BY DOMICILE AND TYPE

SELLER	BUYER				
		U.S.- Int'l	Int'l- U.S.	Int'l- Int'l	TOTAL
<b>2002</b>					
Institutional		7	6	8	21
Personal/Trust		2	3	8	13
Mutual Funds		2	1	2	5
Real Estate		1	1	0	2
Other		0	0	2	2
<b>TOTAL</b>		<b>12</b>	<b>11</b>	<b>20</b>	<b>43</b>
		U.S.- Int'l	Int'l- U.S.	Int'l- Int'l	TOTAL
<b>2001</b>					
Institutional		5	2	5	12
Mutual Funds		2	2	7	11
Personal/Trust		2	0	3	5
Real Estate		2	0	0	2
Other		0	2	3	5
<b>TOTAL</b>		<b>11</b>	<b>6</b>	<b>18</b>	<b>35</b>

Source: Berkshire Capital Corporation

as it sought to rein in costs and tighten its focus by selling off its fund management businesses outside Germany. In November, the troubled bank finally struck a deal with **Wells Fargo** for the sale of \$4.9 billion of the institutional and retail assets of its major U.S. holding, **Montgomery Asset Management**. Although terms were not disclosed, observers put the price at around 1% to 1.5% of AUM, or approximately \$50 million to \$75 million—far off the \$250 million Commerzbank paid for the firm in 1997.

The bank also sold off two smaller holdings during the year: a 34% stake in Monaco's largest asset manager, **Compagnie Monegasque de Banque**; and a 60% stake to management in Boston's **Martingale Asset Management**. Commerzbank's U.K. holding, **Jupiter**, which manages around \$14 billion in funds, remained on the sale block, as supply exceeded demand in the M&A market.

At the same time, plenty of firms were on the lookout for opportunities to add assets, money management

## As markets continue to slide, a hedge play stands out

In a year when many investors appeared early on to relinquish any hope for generating positive returns in the stock market, it seems appropriate that the largest asset management deal involved two hedge fund companies. **Man Group PLC's** \$833 million acquisition of Switzerland's **RMF Investment Group** created perhaps the world's largest hedge fund manager out of two groups that were already formidable players on their own. Announced in May, the cash-and-share transaction nearly doubled Man's AUM to \$20 billion, and appeared to underline the determination of Chairman Harvey McGrath to turn the publicly traded London-based company into the "Fidelity of the hedge fund world."

Although adding those assets didn't come cheap—Man paid around 21 times pre-tax earnings and nearly 10% of AUM—some observers saw strategic merit to the deal. One reason was fit: RMF, a fund of hedge funds manager, balances Man's primary focus in the high net worth retail market by adding an institutional business in Europe. Institutions, which hold just a tiny percentage of all hedge funds, remain an enormous and coveted untapped market for the industry.

In addition, the 10-year-old Swiss firm has been a growth machine, with AUM increasing from \$458 million to \$8.5 billion between 1998 and the time of the acquisition. RMF has particularly strong relationships with **Swiss Life** and the **Credit Suisse**

**Group**, which combined account for a majority of the company's AUM.

While Man-RMF was the marquee transaction in 2002, there were 13 other hedge fund deals—just as the industry's cash spigot began to close a bit. Hedge fund inflows of \$17 billion in the first nine months of 2002 were down from \$22 billion during the same period in 2001, as investors sought the comfort of bonds and money markets. Although Man's U.S. operation, Man-Glenwood, suffered a loss in September due to the collapse of one of the hedge funds in its portfolio, the company's overall AUM rose 19% in the half-year through September, excluding the RMF contribution.♦

expertise or new markets. In addition to the Man Group-RMF deal, there were a number of other interesting if lower-profile hedge fund transactions. **UniCredito Italiano**, which stepped into the spotlight three years ago with a \$1.3 billion acquisition of Boston's **Pioneer Group**, acquired London's **Momentum Asset Management**, a longtime alternative asset manager (AUM: \$1.5 billion). The \$110 million deal was done through UniCredito's Pioneer Global Asset Management unit, which touted the purchase as part of its "plans to expand aggressively into the fast-growing alternative investments arena."

**Gartmore Group** of the U.K. also added some expertise in the hedge fund area, acquiring U.S.-based **Riverview International**, a fund of hedge funds manager for institutions, with \$350 million in AUM. In business only since 1999, Riverview has a strong track record, with its key Market Neutral fund providing 13% annualized returns since inception and low volatility. Several months after the June transaction, the renamed **Gartmore Riverview** said it planned to raise more than \$1 billion selling hedge funds to European institutions. With more than \$3 billion in hedge fund AUM prior to the acquisition, Gartmore already had a significant institutional business in this area.

**Robeco Groep**, an aggressive Dutch asset manager, followed up on its 2001 purchase of fund manager and institutional advisor **Harbor Capital Advisors** by making two additional U.S. acquisitions, including one for a small fund of hedge funds manager, **Sage Capital Management**. A New York-based institutional and high net worth firm, Sage has \$300 million in AUM. Robeco also took a 60% stake in **Boston Partners** (AUM: \$9 billion), an institutional manager started up in 1995. (Domestically, Robeco acquired 49% of **Transtrend**, a Dutch hedge fund manager with \$310 million in AUM.) Robeco's stated objective is to become one of the top 15 European asset managers by 2006 (current AUM: \$100 billion), with a "substantial presence" in Europe and the U.S., achieved partly via acquisitions.

**Bank of Ireland** underlined its commitment to the U.S. market by acquiring 61% of Connecticut-based **Iridian Asset Management** for \$171 million, through its Bank of Ireland Asset Management arm (AUM: \$52 billion). The bank, which has the option to acquire the rest of the company in the future, began talking to Iridian in the summer of 2001 and completed the deal in May of 2002. An institutional firm focused on mid- and large-cap equities, Iridian was founded in 1996 and had amassed \$11 billion in AUM by the time of the acquisition.

Both companies said the deal provided them with the scale necessary to accelerate growth. Said Willie Cotter, chief executive for Bank of Ireland Asset Management: "While Iridian has concentrated primarily on the foundation, endowment and corporate sectors to date, our focus will be on using our marketing and dis-

tribution capability to help them develop a presence in other attractive segments of the institutional U.S. market and other markets internationally."

In the most prominent deal involving a U.S. company buying a European asset manager, **Northern Trust Corp.** acquired **Deutsche Bank's** global index businesses for \$260 million. For Northern Trust, the deal added \$120 billion in AUM and placed it among the top three U.S. institutional index managers. For Deutsche Bank, the divestiture was in keeping with its efforts to reorganize its business around active asset management. Deutsche, another German bank in the midst of a difficult year, was busy shedding both financial and non-financial assets, including its interest in a tire manufacturer, Continental.

In a second deal involving a U.S. buyer—and in a decidedly more adventurous arena—**Putnam Investments** acquired **New Flag Asset Management**, a leading high yield bond specialist based in London and in business for only four years. Putnam already manages \$11 billion in high yield assets in the U.S., but New Flag is expected to aid its efforts to develop global expertise in this area.♦

## ALTERNATIVE INVESTMENTS

### REAL ESTATE

The real estate sector remained reasonably active in 2002, with three transactions, including one sizable deal, and a few rumored deals that could take place in 2003. Indeed, for asset managers chastened by three years of negative equity returns, real estate began to take on a greater luster.

**Deutsche Bank's** \$490 million acquisition of **RREEF** was the most notable transaction in 2002, with the Chicago-based firm adding \$16.2 billion to Deutsche's pre-existing real estate AUM of more than \$20 billion, primarily in Europe. The pricing, equivalent to 3% of AUM, provided a strong inducement to RREEF management, as did the benefits of teaming up with a major global player. For its money, Deutsche gained a significant presence in U.S. real estate

### REAL ESTATE TRANSACTIONS

	1998	1999	2000	2001	2002
Number of Transactions	8	4	1	8	3
Combined Value (\$m)	567	507	N/A	427	1,022
Total Seller AUM (\$b)	11.7	13.6	2.0	19.3	22.8
Average Deal Size (\$m)	71	127	N/A	53	341
Average Seller AUM (\$b)	1.5	11.0	2.0	2.4	7.6

Source: Berkshire Capital Corporation

while meeting a strategic goal of enhancing the bank's active asset management capabilities.

Soon after the deal closed, Deutsche's **Scudder** mutual fund unit, acquired in 2001, teamed up with RREEF to offer the closed-end Scudder RREEF Real Estate Fund on the American Stock Exchange. In a sign of prevailing investor sentiment, it marked the 13th such fund to have registered for an IPO through October, compared with three in all of 2001.

There was one other transatlantic deal in 2002, involving **Prudential Real Estate Investors'** acquisition of Munich-based **TMW Immobilien AG**. (Prudential also acquired the **TMW Real Estate Group** of Atlanta as part of the same transaction.) Prudential touted the European deal as strengthening its "position as a global asset manager." TMW Immobilien managed total assets of \$6.6 billion in Europe, while PREI had worldwide AUM of \$15.5 billion.

Within Europe, insurer **Fortis AG** paid \$470 million to acquire **Bernheim Comofi**, a deal that included **Bernheim Asset Management**, the market leader in Belgian third-party real estate asset management, with some \$1.5 billion in AUM. Fortis AG's real estate arm managed a portfolio of about \$3 billion prior to the deal. The transaction also wrapped in Bernheim Comofi's large pan-European car-park business. Bernheim was owned by **Security Capital Group** of the U.S., which was itself acquired by **GE Capital** in 2002; Fortis AG is owned by the Dutch-Belgian financial services firm of the same name.

## HEDGE FUNDS

As with real estate, the hedge fund arena drew investors seeking a partial remedy for the bear market. There were 14 transactions involving such firms in 2002, with fund of hedge funds groups accounting for eight of the deals, and deal value exceeded the cumulative total for the previous four years. **Man Group's** \$833 million acquisition of **RMF Investment Group**, a teaming of two European hedge fund companies, was both the largest hedge fund deal and the largest transaction in the asset management industry in 2002 (*see story, p. 10*). The other hedge fund deals in 2002 were much smaller, as befits an industry characterized by small shops run by a handful of managers.

**Mellon Financial Corp.**'s acquisition in June of **HBV Capital Management** was a typical example of a large financial firm filling a niche and a respected hedge fund player gaining financial muscle and distribution. HBV, founded in 1999, has a good institutional client base, a fast-growing business (AUM: \$530 million), and a single-manager strategy that complements Mellon's fund of hedge

funds business. "HBV deepens the level of investment expertise we offer our clients, enabling us to meet their demand for sophisticated investments that reduce portfolio risk and volatility," said Ronald O'Hanley, president of Mellon Institutional Asset Management. Based in New York and London, HBV was renamed **Mellon HBV Alternative Strategies**.

**Wilmington Trust Corp.**'s investment in Baltimore's **Camden Partners** (AUM: \$200 million) was indicative of the interest among wealth managers in expanding their menu of alternative investments, with Camden providing hedge fund and private equity plays. For Camden, the link to a larger firm offers its clients services in areas such as tax and estate planning. As with many of the alternative investment deals featuring a large, publicly traded buyer, the cost was not significant enough to require disclosure. (*For more information about other hedge fund deals, see the Cross Border and Institutional sections.*)

## PRIVATE EQUITY/VENTURE CAPITAL

The venture capital business continued to hobble along in 2002, following its worst performance on record in 2001, when U.S. venture capital funds recorded an average 28% decline. VC-related M&A and IPO activity sank sharply in the U.S. for the second year in a row. In the third quarter, \$1.8 billion was spent on acquisitions, compared with \$3.7 billion in 2001 and \$7.9 billion in 2000, according to Thomson Venture Economics and the National Venture Capital Association. (The high-water mark was \$26.4 billion in the second quarter of 2000.) Fund-raising commitments showed a similar decline, with only 113 VC funds raising a total of \$5.5 billion in the first nine months of 2002, compared with 277 and \$30.3 billion during the same period in 2001. In all of 2000, \$97 billion was raised through 632 funds.

Not surprisingly, companies began selling off large stakes in their VC portfolios, exiting the business altogether or curbing investment. As just two prominent examples, **Hewlett-Packard** hired **CSFB** to sell off its portfolio of investments in 46 companies, while **General Electric** announced its intention to shutter its GE Equity group during the next few years. **Lucent Technologies**, facing a range of woes, sold 80% of its New Ventures Group to **Coller Capital**, a London-based private equity firm.

Meanwhile, buyout firms worldwide are estimated to have some \$100 billion available to invest and no shortage of targets to consider.♦

### HEDGE FUND TRANSACTIONS

	1998	1999	2000	2001	2002
Number of Transactions	4	3	4	6	14
Combined Value (\$m)	170	56	326	88	1,033
Total Seller AUM (\$m)	3,900	675	3,070	14,535	16,648
Average Deal Size (\$m)	43	19	81	15	74
Average Seller AUM (\$m)	975	225	768	2,423	1,189

Source: Berkshire Capital Corporation

## ABOUT BERKSHIRE CAPITAL CORPORATION

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**B**erkshire Capital Corporation was founded in 1983 to advise clients on strategic business analysis and the initiation and execution of successful mergers, acquisitions, divestitures, joint ventures and other alliances in the financial services industry. For 20 years, the firm has helped its investment banking clients achieve individual and specific strategic objectives with successful long-term results. As the first investment bank to target the asset management and securities industry sectors exclusively, the firm has acquired deep senior-level industry contacts, developed proprietary deal databases and gained a perspective on the financial services industry during a period of consolidation, growth and market turbulence. A recognized leader in the field, Berkshire Capital has advised buyers and sellers on over 150 completed transactions. The firm has also completed more than 120 independent valuation/strategic advisory assignments. Headquartered in New York City, with regional offices in Philadelphia and Denver, a subsidiary in London and advisers in Amsterdam and Frankfurt, Berkshire Capital offers a broad geographic coverage of the financial services industry.

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