

Trends in Investment Banking - 1997 to 1999

April 2000



Freeman & Co.

About Freeman & Co.

Welcome to Freeman & Co.'s report on trends in the investment banking industry. We want to provide our clients, friends and future clients with data that will support their views and will identify trends that they may have missed.

Freeman & Co. provides in-depth management consulting and strategic advisory services to the financial services industry worldwide, in the areas of:

- *Strategic Consulting*
- *Performance Improvement Consulting*
- *Strategic Advisory and M&A Services*
- *Compensation and Incentive Plans*

We encourage you to share your thoughts and look forward to hearing from you.

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I. Introduction

II. Market Overview

III. Product Trends

IV. Industry Trends

V. Cost Trends

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I. Introduction

- Freeman & Co. research shows that recent trends in investment banking have shifted sources of profitability for firms.
- In the last few years, the major trends in investment banking have been:
 - Growth in equity business, particularly IPOs;
 - Increase in European mergers and acquisitions;
 - Dominance of “new-economy” sectors, such as Technology and Telecom.
- The winners in the market have been the bulge bracket investment banks and highly focused boutiques.
- The growth of investment banking and research costs is exceeding growth in revenues, especially for second tier major bracket and boutique investment banks.

I. Introduction

*Rigorous focus on costs, strategy and execution
will be necessary to maintain profitability.*

I. Introduction

II. Market Overview

III. Product Trends

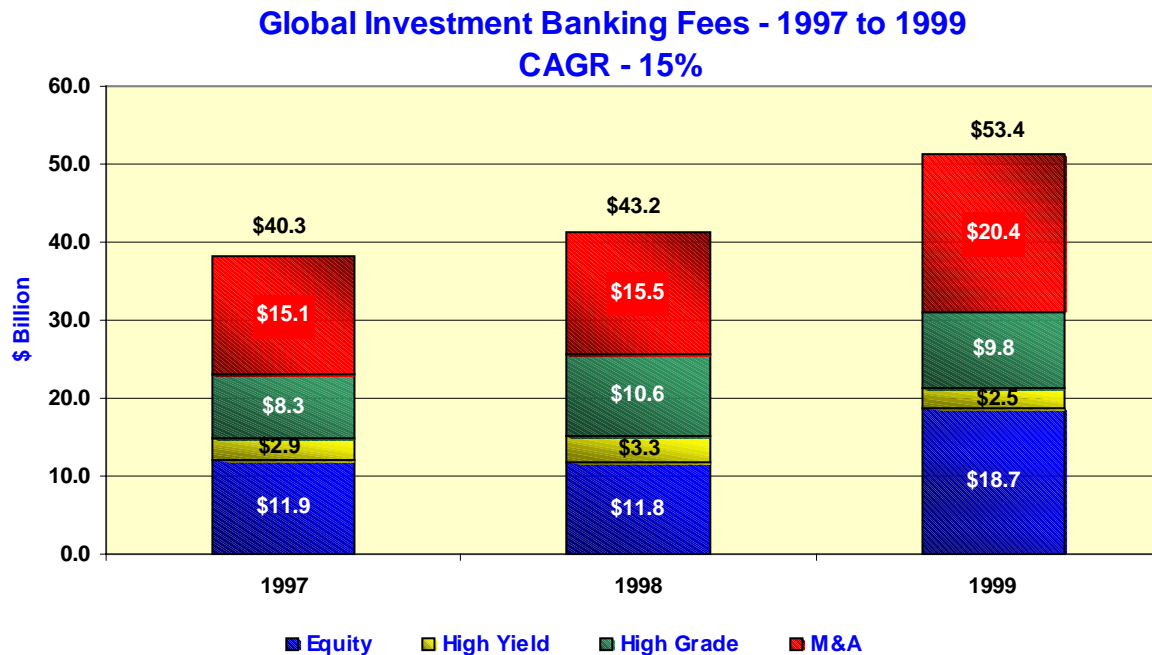
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II. Market Overview

- Global investment banking fees from 1997 to 1999 grew at an annual rate of 15%.
- This growth is driven mainly by equity underwriting and M&A.



Source: Thomson Financial Securities Data, Freeman & Co. estimates

II. Market Overview

- Over the last decade, the leading investment banks have remained relatively unchanged.

Leading Global Underwriters - All Products* (Ranked by fees)

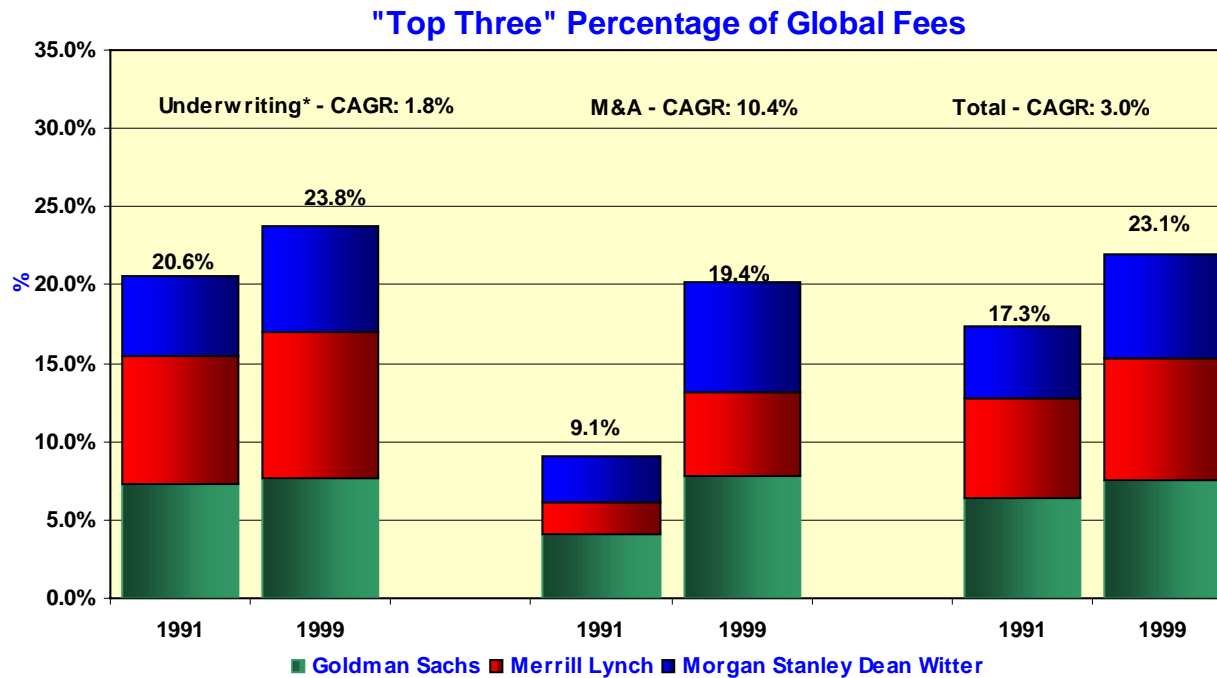
Rank	1991	1999
1	Merrill Lynch	Merrill Lynch
2	Goldman, Sachs	Goldman, Sachs
3	Smith Barney Inc.	Morgan Stanley Dean Witter
4	Morgan Stanley	Salomon Smith Barney
5	CS First Boston	Credit Suisse First Boston
6	Lehman Brothers	Donaldson Lufkin & Jenrette
7	PaineWebber	Deutsche Banc Alex Brown
8	SG Warburg	Warburg Dillon Read
9	Alex. Brown & Sons	JP Morgan
10	Bear Stearns	Lehman Brothers

Source: Thomson Financial Securities Data, Freeman & Co. estimates

* Equity and Equity-linked, High Yield and High Grade

II. Market Overview

- The “Top Three” investment banks - Goldman Sachs, Merrill Lynch and Morgan Stanley Dean Witter - have greatly increased their dominance.



Source: Thomson Financial Securities Data, Freeman & Co. estimates

*Equity and Equity-linked, High Yield and High Grade

II. Market Overview

■ Observations:

- The leading investment banks continue to increase their market share in a fast growing market.
- An “oligopoly” has emerged, with the top firms getting stronger and capturing a larger proportion of fees.
- Continued success in investment banking will require substantial capital and a broad range of products and services.
- A prolonged market downturn will push marginal players out.

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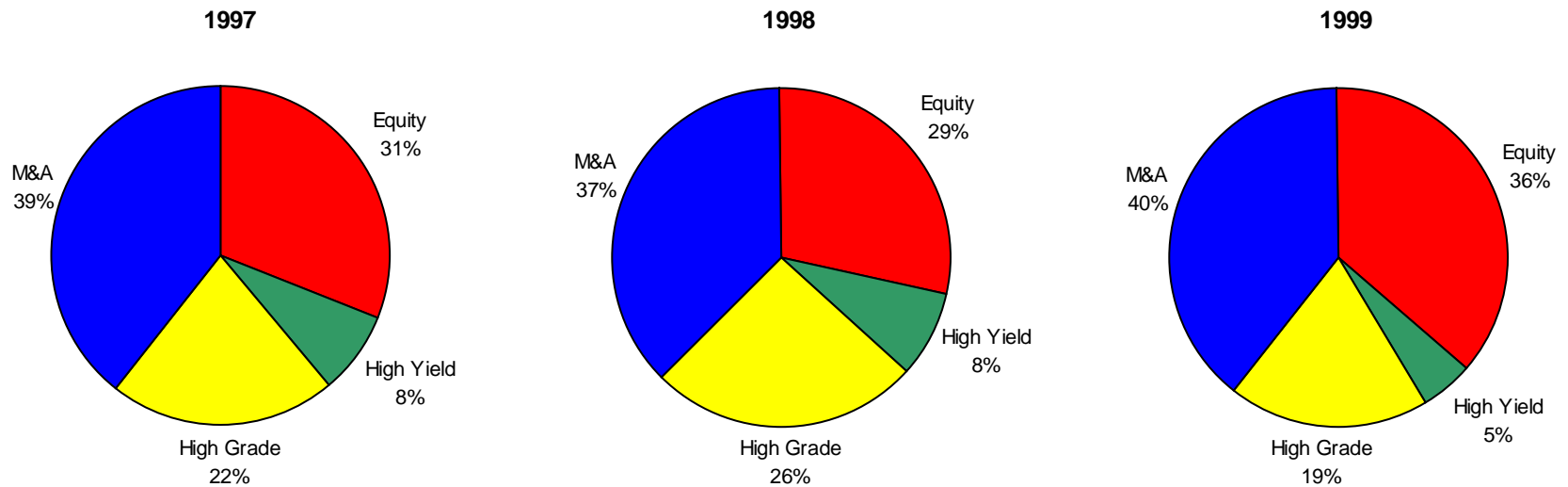
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III. Product Trends

- Recent fee growth has come from two main sources: equity underwriting and M&A.
- High yield and high grade have declined as fee sources.

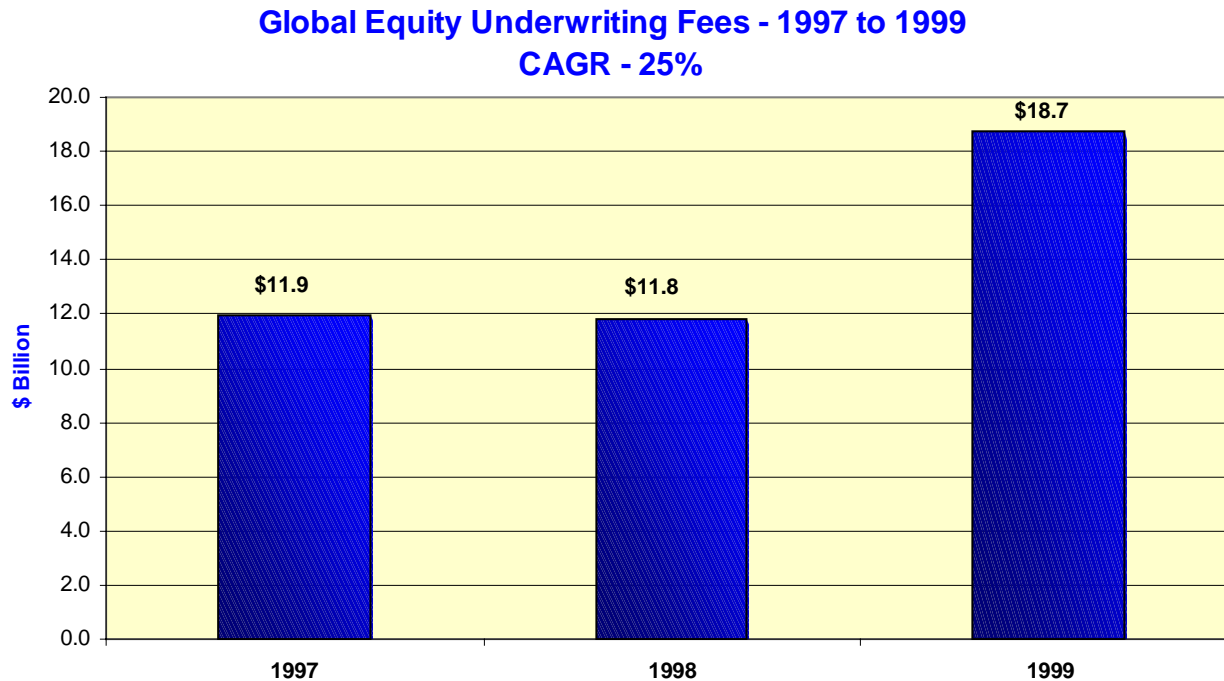
Investment Banking Fees by Product



Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

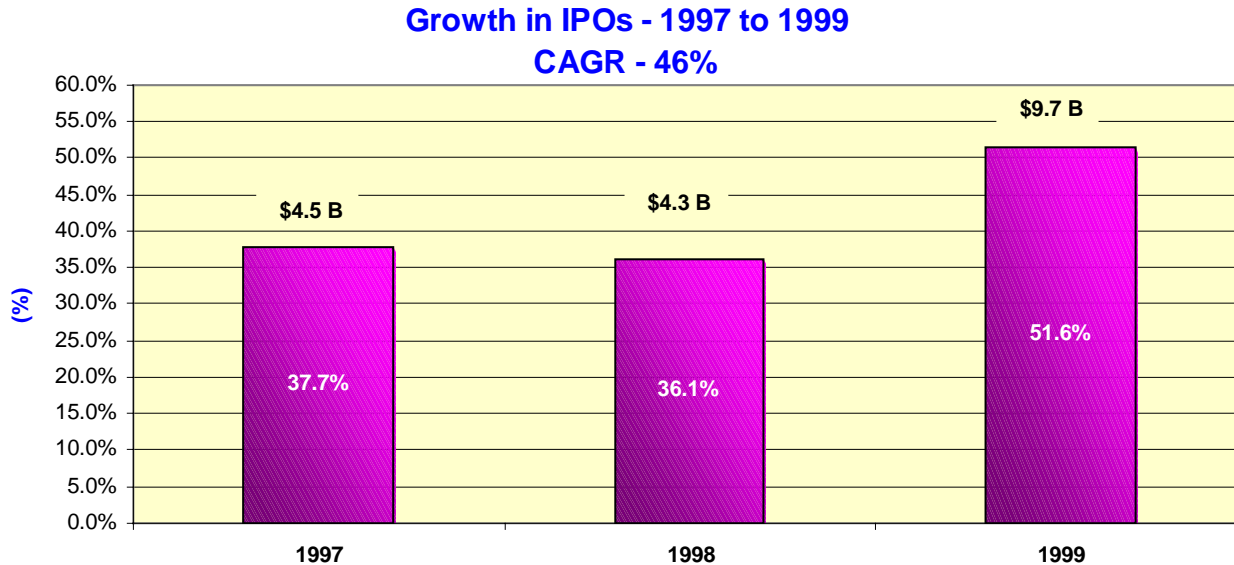
- Equity underwriting has been driving the growth in investment banking fees, with a three-year CAGR of 25%.



Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

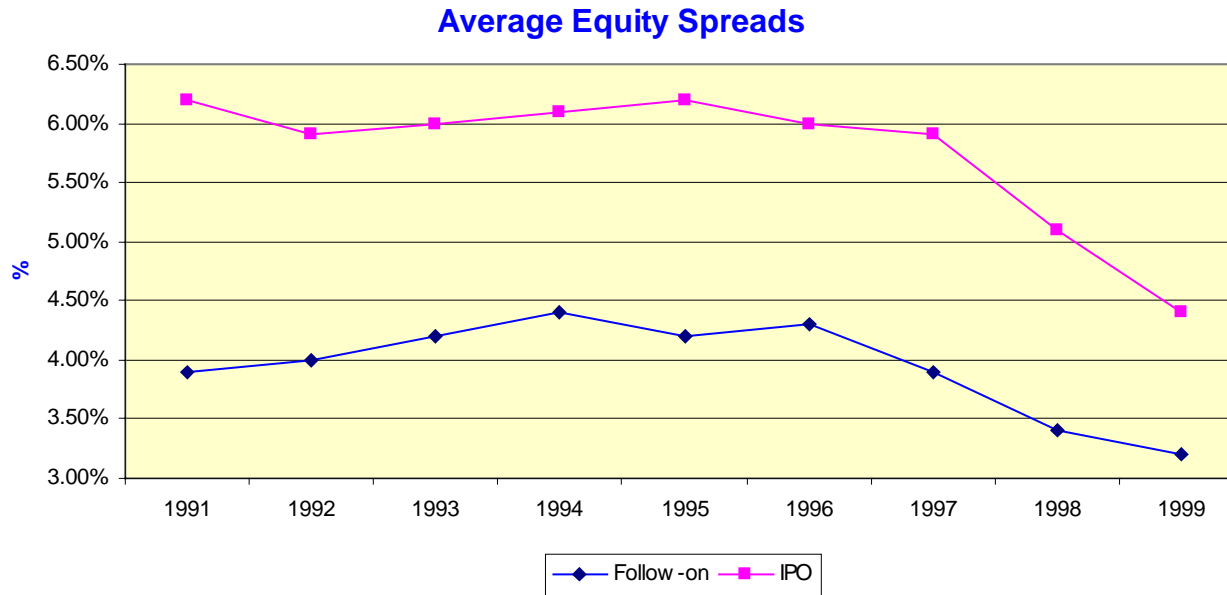
- The increase in equity revenue in 1999 has come mainly from IPO's.



Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

- However, the spreads for both IPOs and follow-on offerings have been dropping.



Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

- Leadership in equity underwriting has not changed much in the last decade.

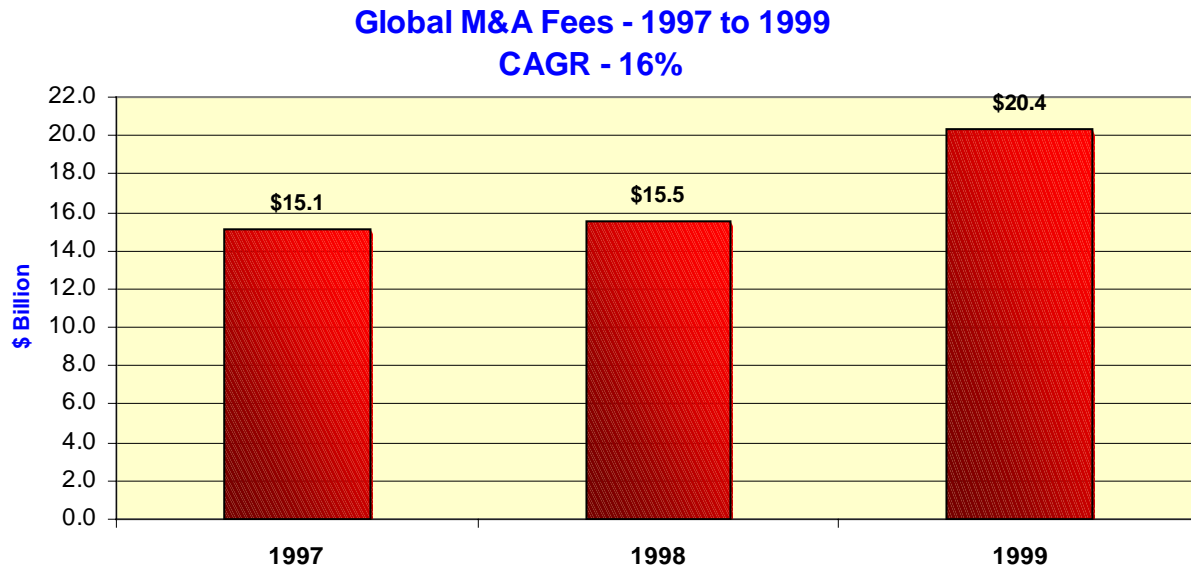
Leading Global Equity Underwriters (Ranked by fees)

Rank	1991	1999
1	Merrill Lynch	Goldman, Sachs
2	Goldman, Sachs	Merrill Lynch
3	Morgan Stanley	Morgan Stanley Dean Witter
4	Lehman Brothers	Credit Suisse First Boston
5	Smith Barney	Salomon Smith Barney
6	CS First Boston	Deutsche Banc Alex Brown
7	PaineWebber	Donaldson Lufkin & Jenrette
8	Donaldson Lufkin & Jenrette	Warburg Dillon Read
9	Alex. Brown & Sons	Lehman Brothers
10	JP Morgan	Dresdner Kleinwort Benson

Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

- M&A fees have also grown, with a three-year CAGR of 16%.

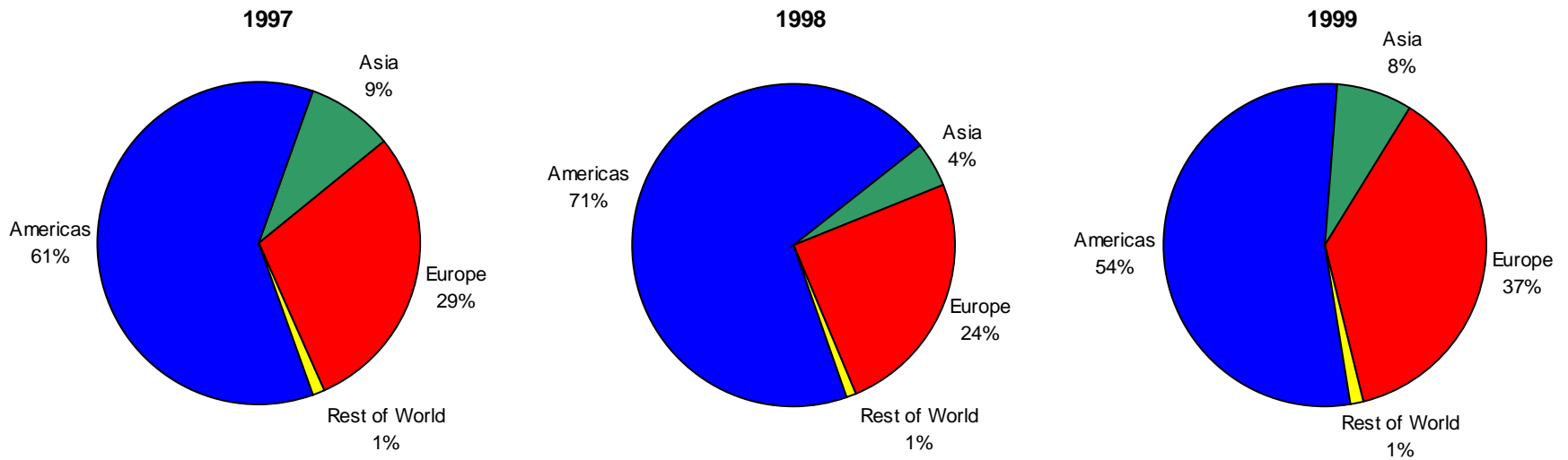


Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

- The increase in M&A fees has come mainly from Europe, although the Americas still remain the most significant fee-paying region.

M&A Fees by Region



Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

- During the last decade, M&A leadership in Europe has shifted from European firms to the US investment banks.

Leading European M&A Advisors (Ranked by fees)

Rank	1991	1999
1	SG Warburg	Goldman, Sachs
2	Lazard Houses	Morgan Stanley Dean Witter
3	Schroder Group	Warburg Dillon Read
4	Goldman, Sachs	Merrill Lynch
5	Deutsche Bank	JP Morgan
6	Rothschild Group	Rothschild Group
7	ING Barings	Lazard Houses
8	BZW/Barclays	Credit Suisse First Boston
9	CS First Boston	Dresdner Kleinwort Benson
10	Banque Paribas	Lehman Brothers

Source: Thomson Financial Securities Data, Freeman & Co. estimates

III. Product Trends

■ Observations

- Equity underwritings, especially IPOs, are driving the growth in investment banking revenues.
- M&A fee growth is also healthy, especially in Europe.
- US investment banks are gaining leadership in the European marketplace.

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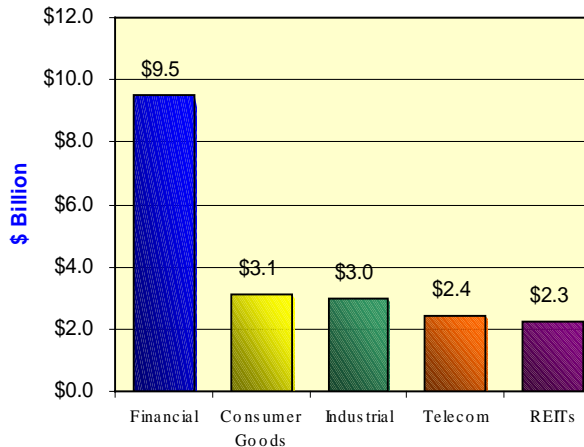
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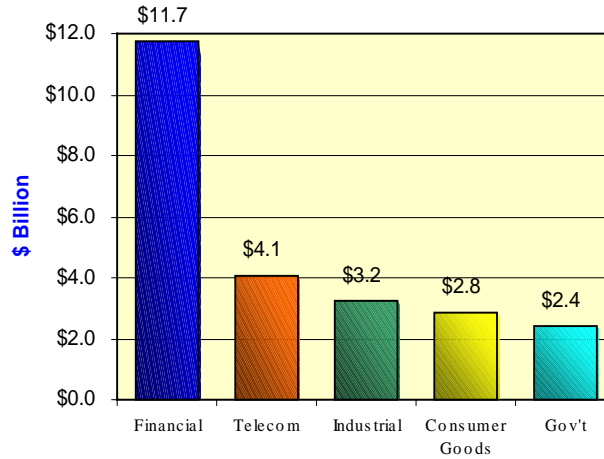
- During the last three years there has been a shift in industry focus from the “old-economy” toward the “new-economy” industries.
- Technology and Telecom are spearheading this growth, with a CAGR of 89% and 68% respectively.
- The Financial sector has consistently been the largest revenue generating sector.

Top Five Industry Sectors by IB Fees

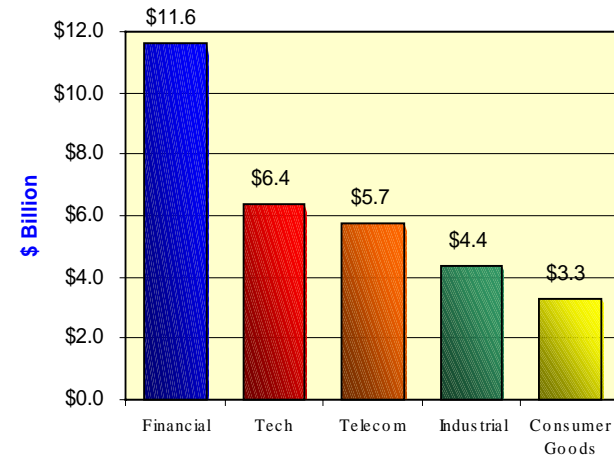
1997



1998



1999

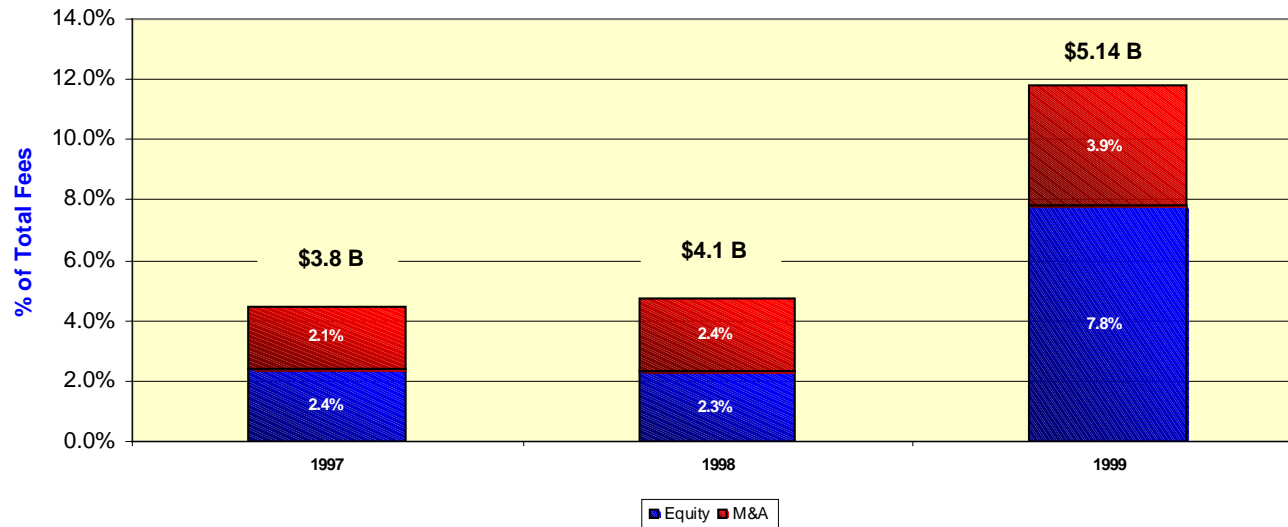


Source: Thomson Financial Securities Data, Freeman & Co. estimates

IV. Industry Trends

- Technology companies have generated an increasing share of overall equity and M&A fees, especially in 1999.

Technology - Equity and M&A Fees as % All Industry Fees
CAGR: 16%



Source: Thomson Financial Securities Data, Freeman & Co. estimates

IV. Industry Trends

- During the last five years, leadership in Technology underwriting has moved from boutique investment banks to the bulge bracket firms.

Leading Technology Equity Underwriters (Ranked by fees)

Rank	1994	1999
1	Robertson Stephens	Morgan Stanley Dean Witter
2	Montgomery Securities	Goldman, Sachs
3	Hambrecht & Quist	Credit Suisse First Boston
4	Alex. Brown & Sons	BancBoston Robertson Stephens
5	Merrill Lynch	Merrill Lynch
6	Lehman Brothers	Chase Hambrecht & Quist
7	Morgan Stanley	Donaldson Lufkin & Jenrette
8	Bear, Stearns	Deutsche Banc Alex Brown
9	Smith Barney	Salomon Smith Barney
10	PaineWebber	Lehman Brothers

Source: Thomson Financial Securities Data, Freeman & Co. estimates

IV. Industry Trends

- Many of the large Technology boutiques have been acquired since 1997.

Target	Acquirer	Date	Value (\$ MM)	Specialty
Alex. Brown & Sons	Bankers Trust	Apr-97	\$2,123	Technology
Cowen & Co.*	Societe Generale	Jun-98	\$615	Technology
Furman Selz	ING Groep	Aug-97	\$600	Media
Hambrecht & Quist	Chase Manhattan Corp	Dec-99	\$1,550	Technology
Montgomery Securities	NationsBank	Jun-97	\$1,300	Technology
Patricof*	Bank of New York	Nov-98	Undisc.	Media
Robertson Stephens*	BankBoston	May-98	\$800	Technology
SoundView*	WIT Capital	Jan-00	\$360	Technology
Volpe, Brown Whelan & Co.	Prudential Securities	Feb-00	\$187	Technology
Wessels, Arnold & Henderson	Dain Rauscher	Mar-98	\$165	Technology

* Advised by Freeman & Co.

IV. Industry Trends

- Some independent and recently established boutique investment banks focusing on the Technology industry have achieved considerable success. For example, **Thomas Weisel Partners**:
 - Generated approximately \$186 million in M&A and underwriting revenues in 1999, its first year of existence.
 - Built an infrastructure of research analysts and investment bankers, with a current headcount of approximately 450 people.
 - Attracted senior management from various leading investment banks.
 - Raised \$100 million of equity-linked capital from Calpers.
 - Raised a \$1.25 billion leveraged buyout fund.
 - Assembled an investor network of about 22 industry-leading private equity strategic partners and an advisory board of 175 CEO's of emerging growth companies.
 - Year 2000 revenue goal: \$400 million.

Source: Investment Dealers Digest, January 24, 2000, Equity Research reports

IV. Industry Trends

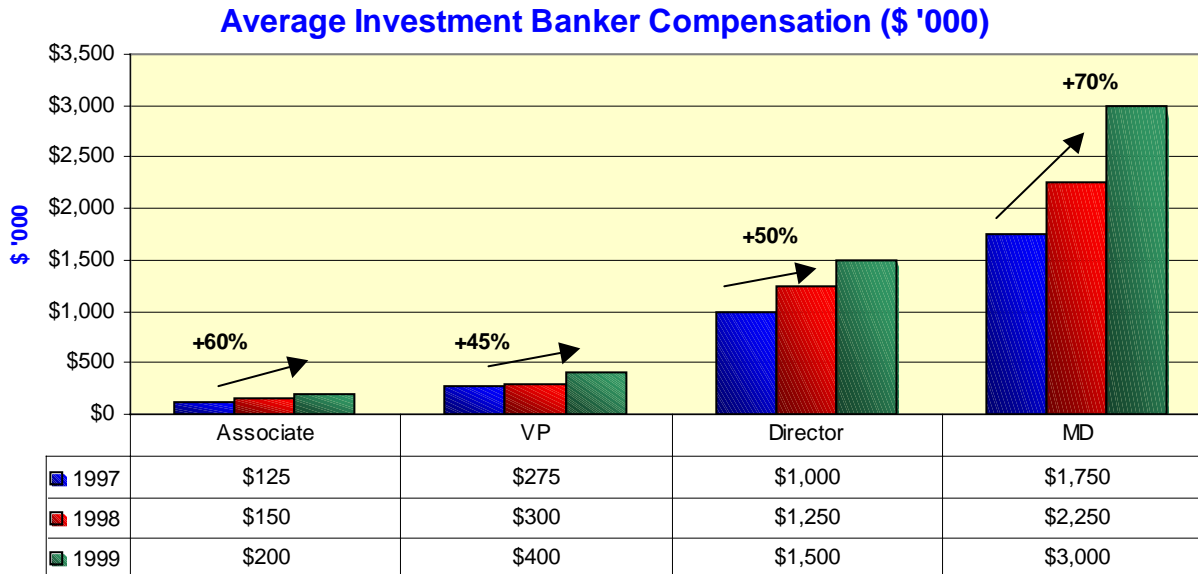
■ Observations:

- Growth in investment banking fees has come predominantly from the “new-economy” industries.
- Technology and Telecom have been the leading industries driving this change.
- The leading underwriters and advisors in these sectors are now the bulge bracket firms.
- Some highly focused boutiques have been able to achieve significant success in the “new-economy” industries since these industries require specific execution strategies.
- Some firms are quietly pursuing a “counter-cyclical” strategy of focusing on “out-of-favor” industries (i.e. Energy, Consumer Products etc.) as an alternative strategy.

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V. Cost Trends

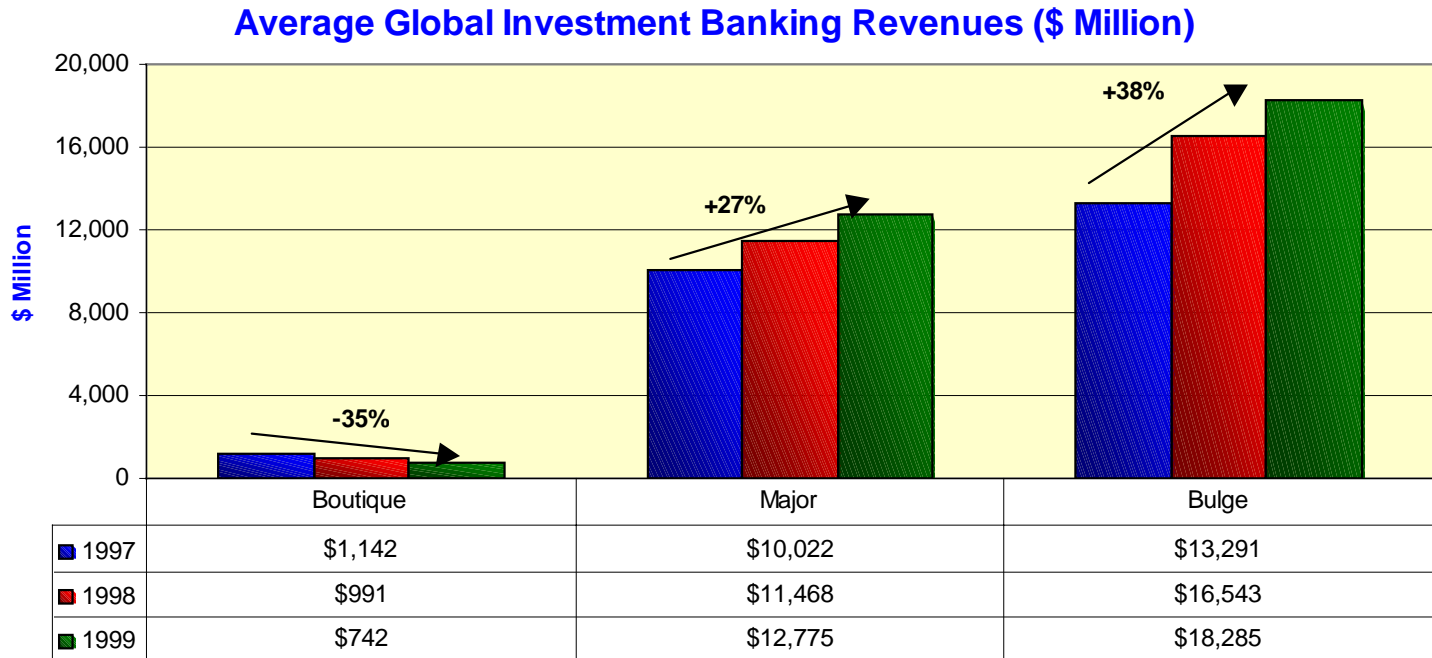
- The costs of investment banking department has gone up considerably. A significant portion of this increase in costs is from competitive compensation.
- Investment banking compensation has reached new heights, with the rain-makers being highly rewarded for generating deal flow.



Source: Executive Search firms, Freeman & Co. estimates

V. Cost Trends

- At the same time, average investment banking revenues have grown moderately for the bulge and major bracket investment banks and declined for the boutique firms.
- Overall growth in revenues has been slower than the growth in costs.

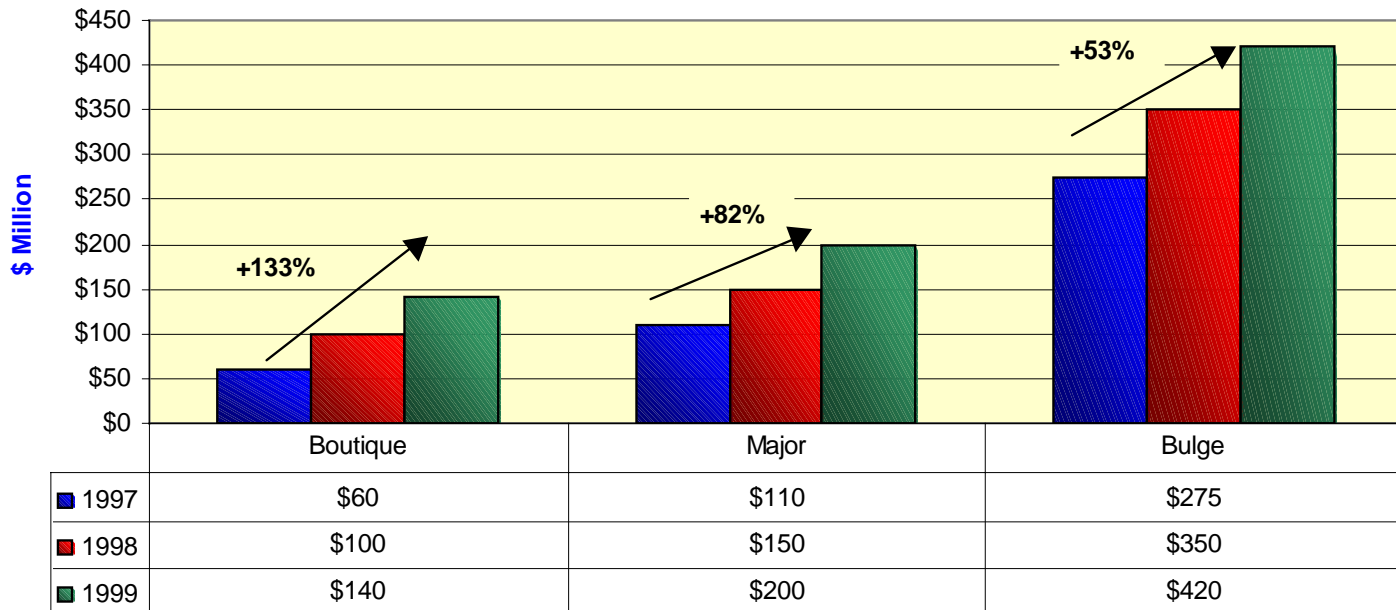


Source: Thomson Financial Securities Data, Freeman & Co. estimates

V. Cost Trends

- The cost of research departments has also increased substantially.
- The costs of smaller firms have increased at a faster pace, due to the higher compensation required to retain key analysts.

Average Cost of Global Research Departments (\$ Million)

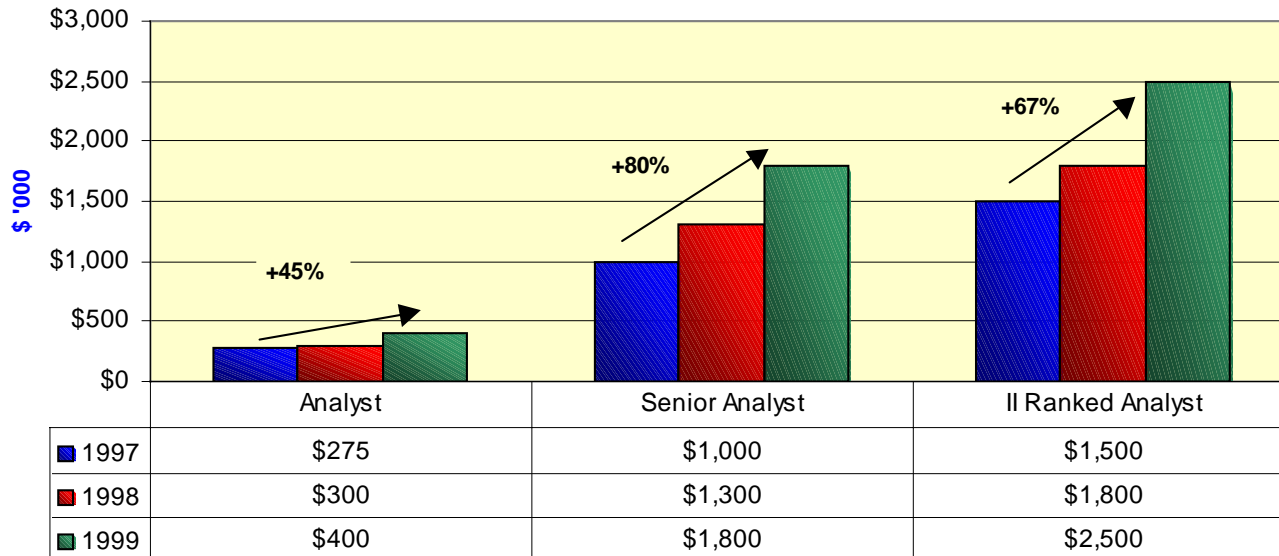


Source: Institutional Investor, Nelson's Directory of Investment Research 1999, Freeman & Co. estimates

V. Cost Trends

- The role of the research analyst has increasingly shifted to generating and marketing investment banking deals. Research is now an, maybe “the”, essential relationship builder.
- The compensation of senior analysts has grown at the fastest rate, as smaller firms have been luring away second-tier analysts from the large firms.

Average Equity Analyst Compensation (\$ '000)



Source: Institutional Investor, Nelson's Directory of Investment Research 1999, Freeman & Co. estimates

V. Cost Trends

■ Observations:

- Costs of investment banking and research departments have increased dramatically.
- The largest increase in compensation has been for rain-makers and senior analysts.
- Growth in costs maybe outpacing the growth in revenues.
- Profit margins for the smaller players are getting squeezed.

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VII. Conclusion

- Investment banking revenues are increasing, driven by growth in equity underwriting and M&A. “New-economy” industries such as Technology and Telecom have been spearheading growth.
- The bulge bracket investment banks are winning an increasing share of the market. Some industry-focused boutiques have also been able to gain market share due to relationships and expertise.
- Investment banking and research costs have grown faster than revenues, especially for the major and boutique investment banks.
- Bulge bracket dominance will continue to erode market share and profitability of marginal players.
- In the event of a market downturn, the small to medium sized investment banks will face downward pressure on profits and market share.

VII. Conclusion

Planning for all market scenarios will be critical for success.