Freeman & Co. LLC

Asset Management Industry

Drivers of Consolidation

October 2000

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Europe is no longer a distant continent for the spate of acquirers or for us. Freeman & Co. is proud to announce its strategic investment in Sector Analysis Ltd., a UK firm specializing in researching the European asset management industry. Their core product, *European Investor Focus*, analyzes demand for investment products across eight countries and six types of institutions. We think the research product is unique and is a valuable strategic planning and marketing resource to firms targeting Europe. We welcome Magnus Spence and his team to Freeman & Co. and believe it will be a great partnership for our clients who more frequently operate on both sides of the Atlantic.

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Investment Banking	E-Investment Banking: Evolution or Revolution?	October 1999

We would like to thank our clients and friends for their continued support of our work. We encourage you to share your thoughts with us and look forward to working with you to develop and build your firms.

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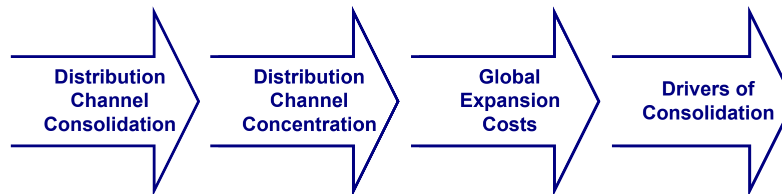
Introduction



Consolidation in the asset management industry has accelerated as firms face uncertain revenue growth, rising compensation and infrastructure costs and increased competition in traditional distribution channels. This report examines recent activity in the industry and focuses on three key drivers of this consolidation: distribution channel consolidation, distribution channel concentration and the cost of global expansion.

Consolidation

The asset management industry has just finished an unprecedented M&A deal boom on a global scale representing over $28 billion in deal value and $1 trillion in asset under management. This increases the pressure on firms that have not expanded globally or that lack the resources to do so. Strong balance sheet companies in banking and insurance should continue to acquire firms. Ideal targets will be firms with scale and assets over $20 billion, but that lack the resources to be global competitors.

As the big deals have closed, the small deals have suffered. Many of the traditional buyers of smaller firms (AUM less than $5 billion) have changed course or have been bought themselves. Buyers of multiple firms such as UAM, Nvest, Phoenix Investment Partners, Conning and US Trust have ceased acquisitions, at least temporarily.

Concentration

Competition continues to increase and firms are being threatened by consolidation and concentration in distribution channels. As more retail brokerage firms sell to larger rivals, asset managers will lose product shelf space. We expect this consolidation to move to other third party channels as technology costs rise along with customers' expectations of service.

Distribution channel consolidation is adding to the concentration in distribution channels already led by firms like Charles Schwab, Fidelity and the Wirehouses. These participants are becoming more influential as they control larger asset pools and are raising the costs for product distribution. They control a greater percentage of mutual funds; are disintermediating independent advisors; and are developing innovations such as exchange traded funds and folios that threaten traditional asset managers' share of wallet.

Global Expansion

Global M&A has jumped as firms realize the cost and time of building de novo foreign operations. The cost of gaining distribution overseas requires scale and capital beyond what many firms can support. The 'build vs. buy' analysis favored 'buy' this year.

Firms have looked for larger deals involving critical mass companies that can expand global reach by offering access to new markets, clients or distribution channels. For large firms, the measures of success will continue to rise as Chase, Fidelity, Merrill Lynch, Charles Schwab and Putnam (Marsh & McLellan) expand globally and increase capital expenditures in technology, customer service systems and new innovations.

Introduction

Drivers of Consolidation

We believe the industry will continue to be filled with thousands of firms providing a wide range of products and services, but most of these will be small boutiques without the resources and/or willingness to expand. The largest firms will increase pressure on mid-sized firms, which lack the resources to expand in all product, distribution or geographic areas. Costs for developing new businesses (products, distribution channels, and geographic regions) will continue to rise due to compensation, technology and customer service demands.

Although we do not expect the pace of large M&A deals to continue, we do expect M&A deal activity to remain strong, particularly US-Europe deals, for the following reasons:

- Expansion into new global markets requires a large scale business and deep capital resources
- Building de novo foreign operations takes longer than required
- Overseas growth rates are expected to be higher than in the US
- Mid- and large-sized firms are experiencing rising costs for domestic product distribution
- Firms are being disintermediated from their clients by traditional and new competitors
- New products continue to challenge incumbents and existing product offerings
- Only a small number of firms are growing net new assets

The number of deals in the first half of 2000 was unimpressive, but other measures exceeded all activity in the previous 18 months: assets under management exceeded $1 trillion and total deal value exceeded $28 billion.

Table 1: Number & Type of Global Transactions

Year	Acquisition	Alliance	Distribution	IPO	JV	MBO	Total
1996	45	2			2	1	50
1997	90	7	3	2	17	1	120
1998	103	10	21	2	28	2	166
1999	114	21	11	3	27	3	179
1H 2000	52	12	5	1	10	2	82
Total	**404**	**52**	**40**	**8**	**84**	**9**	**597**

Source: Freeman & Co.

The remainder of the report reviews the recent deal activity and its trends, and then analyzes key drivers of consolidation including: distribution channel consolidation and concentration, global expansion costs and distribution competition in the US mutual fund market.

For more information about Freeman & Co., or its London-based research group Sector Analysis, and our services for asset management firms, investment banks, and other financial companies please contact Eric Weber at (212) 830-6162 or eweber@freeman-co.com; or Jim Freeman at (212) 830-6177 or jfreeman@freeman-co.com.

I. Asset Management Activity

Big Deals Drive the Industry

The first half of 2000 experienced the largest deal activity as measured by assets and deal value. We have highlighted fifteen noteworthy deals that were announced this year, representing almost $28 billion in deal proceeds and $900 billion in assets. We chose these because they illustrate the drive to gain global distribution and scale.

Cross-border activity should continue to stay strong as macroeconomic trends create a global industry. We continue to believe the majority of this activity will be centered around European-US relationships as US firms seek distribution in Europe and European firms search to import product skills and to gain access to the US. The rising cost of product distribution and global expansion will force firms to combine or seek partners. For example, most firms developed relationships in Japan in preparation for deregulation, however, we believe few firms are profitable in Japan currently.

Table 2: Fifteen (15) Noteworthy Deals in 2000

#	Date	Acquirer	Country	Target	Country	Entity Value $MM	Total Deal AUM ($MM)
1	Jun-00	Caisse de Depot et Placement	France	Nvest	US	2,200	134,000
2	Jun-00	Old Mutual Plc	UK	United Asset Management	US	2,230	185,000
3	Jun-00	Liberty Financial Cos	US	Wanger Asset Management	US	365	8,800
4	Jun-00	Alliance Capital Management	US	Sanford C. Bernstein Inc.	US	3,500	86,000
5	Jun-00	BankAmerica	US	Marisco Capital Management	US	1,900	15,000
6	May-00	Amvescap Plc	UK	Trimark Financial Corp	Canada	1,800	16,500
7	May-00	Unicredito Italiano SpA	Italy	Pioneer Group Inc.	US	1,200	24,400
8	May-00	Legg Mason	US	Perigee Inc	Canada	211	14,900
9	May-00	KBC Bancassurance Holding	Belgium	Ulster Bank Investment	Ireland	94	7,210
10	Apr-00	T Rowe Price	US	Robert Fleming Holdings Ltd.	UK	1,560	43,000
11	Apr-00	Chase Manhattan Bank	US	Robert Fleming Holdings Ltd.	UK	7,700	140,000
12	Mar-00	Nationwide Financial Services	US	Gartmore Investment	UK	1,640	95,000
13	Mar-00	Metropolitan Life Insurance	US	Conning Corporation	US	175	39,800
14	Feb-00	Colonial	Australia	Stewart Ivory & Co.	Scotland	116	1,862
15	Jan-00	Charles Schwab	US	U.S. Trust	US	2,700	86,100
					Total	**27,391**	**897,572**
					Average	**1,826**	**59,838**

Source: Freeman & Co., SEC filings, company reports

With deal activity, however, comes the opportunity for success and failure. Not all of these transactions or firm strategies will meet their intended goals: United Asset Management (UAM) has over 50 affiliates each with its own management and viewpoints -- combined success with these groups may elude Old Mutual as well; Schwab may experience channel conflict, as its important independent registered advisor channel is threatened by the products and services of US Trust.

I. Asset Management Activity

Big Deals Drive the Industry

This year has been unique because of (1) the size of the M&A deals and (2) the number of cross-border deals. First, the total assets purchased during the first half 2000 exceeded the annual amount in any of the last five years (see Tables 4 and 5). Second, ten of the fifteen noteworthy deals we have highlighted were cross border.

Europe continues to present opportunities for US firms, and we expect to see Europeans continue their purchase of US firms to gain product manufacturing expertise. European interest by most US firms has developed since the introduction of the Euro, which is paving the way for harmonization of regulations, tax policies and retirement systems. However local culture and tolerance for risk drives demand for products in individual countries, and companies entering new markets will need country specific knowledge to be successful.

Table 3: Recent Deal Pricing

#	Acquirer	Target	Entity Value $MM	Total Deal AUM ($MM)	EV[1] Multiple of EBITDA	EV[1] Multiple of Revenue	EV[1] Multiple of AUM
1	Caisse de Depot et Placement	Nvest	2,200	134,000	12.2x	3.4x	1.6%
2	Old Mutual Plc	United Asset Management	2,230	185,000	7.4x	2.5x	1.2%
3	Liberty Financial Cos	Wanger Asset Management	365	8,800		5.5x	4.1%
4	Alliance Capital Management	Sanford C. Bernstein Inc.	3,500	86,000			4.1%
5	BankAmerica	Marisco Capital Management	1,900	15,000			12.7%
6	Amvescap Plc	Trimark Financial Corp	1,800	16,500	9.0x	4.9x	10.9%
7	Unicredito Italiano SpA	Pioneer Group Inc.	1,200	24,400	24.4x	4.8x	4.9%
8	Legg Mason	Perigee Inc	211	14,900	11.9x	7.2x	1.4%
9	KBC Bancassurance Holding	Ulster Bank Investment	94	7,210			1.3%
10	T Rowe Price	Robert Fleming Holdings Ltd.	1,560	43,000			3.6%
11	Chase Manhattan Bank	Robert Fleming Holdings Ltd.	7,700	140,000		6.3x	5.5%
12	Nationwide Financial Services	Gartmore Investment	1,640	95,000		4.3x	1.7%
13	Metropolitan Life Insurance	Conning Corporation	175	39,800	7.0x	1.9x	0.4%
14	Colonial	Stewart Ivory & Co.	116	1,862			6.2%
15	Charles Schwab	U.S. Trust	2,700	86,100	17.8x	5.0x	3.1%
		Total	**27,391**	**897,572**			
		Average	**1,826**	**59,838**	**12.8x**	**4.6x**	**4.2%**

Source: Freeman & Co., SEC filings

[1]EV is Enterprise Value; multiples calculated on trailing twelve months

However in the mutual fund industry, much of this standardization began as far back as 1985 when the Council for the Economic Communities introduced its UCITS Directive, allowing for cross-border marketing of fund products. Obviously, cross-border currency risk inhibited the UCITS from reaching the scale of the $4.6 trillion mutual fund industry in the US but other factors inhibited development. Not all countries have been supportive of UCITS, many firms lacked access to distribution channels in other countries and firms did not have the resources to build pan-European retail distribution systems themselves. Although change presents opportunities, many firms will face difficulties.

II. Activity by Region

Buyers and Sellers

The most notable feature of regional activity in the first half of 2000 is that total assets for the six month period exceeded last year's ***annual*** total by 53%. This measure exemplifies the explosion of deal activity.

The gold rush to Japan in 1998 and 1999 has ended as firms begin the hard work of making their partnerships profitable. As the financial landscape in Japan continues to change, we expect firms to quietly dissolve partnerships that fail to deliver the expected results. Some partnerships such as JP Morgan/Dai-Ichi Kangyo Bank are being dismantled due to changes with the parent organizations.

Table 4: Acquired Assets ($MM) by Seller Region

Region 1	1997	1998	1999	1H 2000	Total
Africa		34,910			34,910
Asia	21,840	68,982	82,244	7,332	180,398
Canada	9,000	11,600	8,304	31,409	60,313
Europe	194,595	126,422	160,057	417,677	898,751
South America	312	8,285	19,062	2,122	29,781
US	525,875	228,560	414,419	585,563	1,754,417
Total	**751,622**	**478,759**	**684,086**	**1,044,103**	**2,958,570**

Source: Freeman & Co.

US sellers were led by United Asset Management ($185B AUM), Nvest ($134B), US Trust ($86B) and Sanford C. Bernstein ($86B) representing 85% of total US company assets acquired. In Europe, the top deals were Robert Fleming ($140B), Gartmore ($95B) and T.Rowe Price buying its JV stake from Flemings ($43B). In the increasing trend towards building global management and distribution capabilities, five of these seven deals were US-Europe cross-border.

In the acquirer's universe, US and European firms, as noted above, dominated the landscape as they tried to build franchises in both the new and old worlds. Many firms, having devoted 1998 and 1999 to preparing for the Japanese big bang, have turned their attention to Europe.

Table 5: Acquired Assets ($MM) by Buyer Region

Region	1997	1998	1999	1H 2000	Total
Africa	1,000	54,860			55,860
Asia	6,140	31,164	45,528	4,994	87,826
Canada		13,893	8,359	9.4	22,261
Europe	229,645	134,503	463,226	501,915	1,329,289
South America	12		662	122	796
US	514,825	244,339	166,311	537,062	1,462,537
Total	**751,622**	**478,759**	**684,086**	**1,044,103**	**2,958,570**

Source: Freeman & Co. Note: Old Mutual plc is classified as a European firm

The European marketplace should develop into a quasi-single marketplace as the European Commission develops reforms such as its defined contribution initiative: "Towards a single market for supplementary pensions". US firms may be able to capitalize on their experience with defined benefit and contribution plan sponsors, however in most cases they will need local partners for distribution, country expertise or cost sharing. Gains will take longer than expected.

III. US Activity

Size of US Activity - Death of the Small Deal

One big shift in deal activity was the 48% annualized decrease in the number of US firms acquired. This change is even greater when the size of deals is examined: deals involving more than $10B AUM were up 250% annualized compared to 1999, while the number of deals with less than $10B AUM fell 72%.

Part of the drop in small deals can be attributed to the drop in acquisitions by holding companies – acquisitions by the top ten (10) buyers of firms averaged 15.5 acquisitions annually from 1996-1999 (see F&Co. *Moving from Client Ownership Focus,* March 2000 p. 11). These same firms acquired only two US companies in the first half of 2000, with Legg Mason and AMG each buying one firm.

Table 6: US Firms Acquired by Size of AUM

Transaction Type	1996	1997	1998	1999	1H 2000	Total	% of Total
<$500MM	13	12	18	16	3	62	28%
$500MM - $5B	16	31	19	30	3	99	45%
$5B-$10B	4	9	5	6	1	25	11%
>$10B	8	8	5	4	7	32	15%
Total	**41**	**60**	**47**	**56**	**14**	**218**	**100%**

Source: Freeman & Co. Note: Excludes Consulting/Data Providers

As these firms suffered acquisition indigestion and UAM sold to a foreign firm, it led us to question the viability of the Affiliated Mangers Group business model. The back-end payments for AMG's initial acquisitions should begin to be paid in 2001 or 2002; with the availability of investment manager start-up capital from CalPERS and others, we question why a key employee with access to the customer base would stay for 8% of the equity of a subsidiary versus the chance to start a new firm and own 25%, 33%, 50% or 100%. While all start-ups will not be as successful as Marisco Capital Management (sold for $1.9 billion to Bank of America), the US is filled with 7,000 small money mangers for a reason: barriers to entry are low for boutiques, margins are high, operating costs excluding compensation are low and revenue growth rates compound with the underlying assets. The expensive part of the business has been distribution and it is getting more expensive as channels consolidate. The Wirehouses, Charles Schwab, Fidelity and others will become more important distributors for boutique investment firms and will command higher economics for their distribution systems.

Table 7: Number & Type of US Firms Acquired

Type	1996	1997	1998	1999	1 H 2000	Total
Alternative Investments			1	2		3
Boutique	24	34	25	30	5	118
Commercial Bank				1		1
Consolidator	1				1	2
Consulting/Data Provider	1	3	8	6	4	22
Diversified Asset Manager	7	11	6	9	4	37
Global Investment Bank	1		1	1		3
Institutional	1	5	4	2		12
Insurance	1				2	3
Investment Bank/Brokerage			1	1		2
Mutual Fund	2	1				3
Private Bank/Private Client	3	8	4	6	1	22
Private Equity/LBO/VC		1	1			2
Real Estate		1	3	2		6
Trust Company			1	2	1	4
Total	**41**	**64**	**55**	**62**	**18**	**240**

Source: Freeman & Co.

IV. European Activity

Conquering the Old and New Worlds

Activity in Europe was up 30% annually in the first half of 2000, reflecting the rising interest in Europe due to four main factors: implementation of the single currency in 1999, potential high growth in pension and mutual fund assets, renewed focus after preparation for Japan's Big Bang and a maturing US market.

Table 8: Number & Type of Transactions in Europe
(either firm European-based)

Year	Acquisition	Alliance	Distribution	JV	MBO	Total
1996	7	1	0	2	0	10
1997	21	3	0	8	0	32
1998	32	3	4	12	1	52
1999	34	5	7	14	0	60
1H 2000	27	3	3	5	1	39
Total	**121**	**15**	**14**	**41**	**2**	**193**

Source: Freeman & Co.

One catalyst for the development of a Pan-European market will be US investment banking business models based on Pan-European coverage of industry sectors, not country models. These firms will work to create a single capital market to underwrite large corporate bond and equity issues. An example is the European bond market, which has been growing at 16% since 1996, but represents only 5% of GDP compared to 29% in the US (see F&Co. *Investment Banking in Europe*, September 2000). Pan-European models will move from the corporate issuers and underwriters to the investors, who will continue to open to Pan-European investing as they are offered more products issued across Europe. This should create a larger, more profitable investment management business and an opportunity for strong market participants.

The number and type of firms gaining distribution shows that it is an expensive process, undertaken by firms with deep resources and strong capital bases. Commercial banks, diversified asset managers, insurance companies and investment banks lead the market entry statistics. Small firms such as boutiques and private client firms do not have the resources to enter Europe; many will remain national firms or be acquired as larger firms continue using 'buy' market entry strategies.

Table 9: Number & Type of Firms Gaining Distribution in Europe

Type	1996	1997	1998	1999	1H 2000	Total	% of Total
Boutique	0	0	2	3	2	7	4%
Commercial Bank	2	12	14	18	8	54	28%
Consolidator	1	1	0	1	0	3	2%
Consulting/Data Provider	0	2	1	1	3	7	4%
Diversified Asset Manager	3	7	15	12	11	48	25%
Global Investment Bank	3	5	6	11	3	28	15%
Insurance	1	3	10	8	9	31	16%
Investment Bank/Brokerage	0	0	2	3	1	6	3%
Pension Fund	0	0	0	2	0	2	1%
Private Bank/Private Client	0	1	1	1	1	4	2%
Private Equity/LBO/VC	0	1	0	0	0	1	1%
Real Estate	0	0	1	0	0	1	1%
Trust Company	0	0	0	0	1	1	1%
Total	**10**	**32**	**52**	**60**	**39**	**193**	**100%**

Source: Freeman & Co.

V. Distribution Trends

Distribution Channel Consolidation

Asset management firms have been profitable during the 90's, and they have required relatively little capital expenditures compared to other industries. For example, fully-scaled asset management firms have had pre-tax margins in the 30-40% range recently (see Table 17), even firms that are ranked #100 in total assets under management. We tried to compare this to margins and capital expenditures in the US steel industry, but could not find the #100 US steel manufacturer as it ceased to exist, probably long ago.

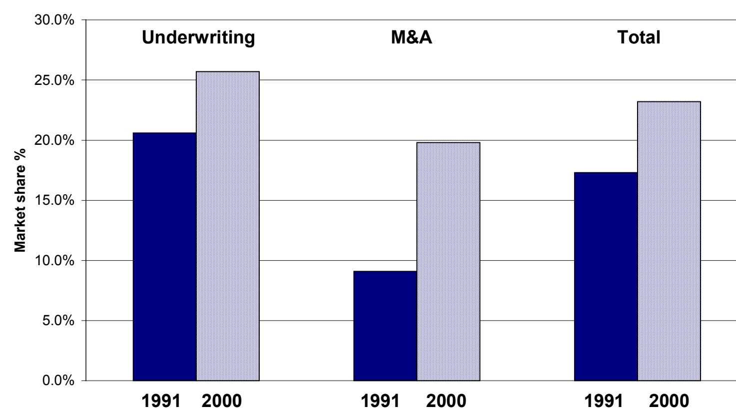
Compensation costs, capital expenditures, technology and systems costs are rising, while the cost of building distribution remains extremely high. Although firms have enjoyed strong profitability recently, three forces are increasingly threatening the independent asset management firm:

1. consolidation of firms that distribute its products,
2. product innovation by brokerage firms, and
3. pricing pressure from new products.

In our March 2000 report we identified that Charles Schwab controls approximately 4-5% of mutual fund assets through its OneSource and related programs (see F&Co. *Moving from Client Ownership Focus,* March 2000, page 15). Fidelity manages approximately 14% of the long-term US mutual fund assets (see Table 15), and controls an additional 4% through its open architecture fund platform. Although overlaps exist between these groups, collectively they control the distribution or management of 20% of mutual fund assets in the US. These 'superfirms' should continue to increase the asset base they control due to their investment in building new distribution channels and technologies. Smaller firms that lack the capital to build these channels will be forced into a wholesale distribution or a niche product provider role.

In addition to the increase in market share of the largest firms, other distribution sources are vanishing as firms consolidate. The brokerage and investment banking business is experiencing a rapid consolidation brought about by a few key trends. The Bulge Bracket is increasing its market share in underwriting and M&A advisory fees and the 'Big 3' of these (Goldman Sachs, Morgan Stanley and Merrill Lynch) control approximately 23% of global fees in these services.

Table 10: Top 3 Investment Banks' Global Fees Market Share



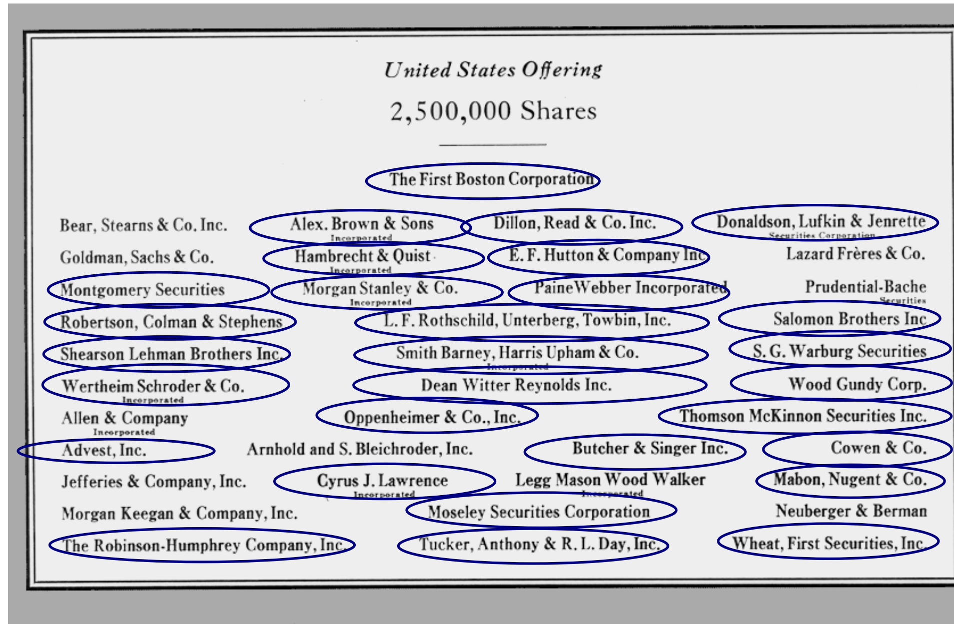
Source: Thomson Financial Data, Freeman & Co. estimates
Top 3: Goldman Sachs, Morgan Stanley Dean Witter, Merrill Lynch

V. Distribution Trends

Distribution Channel Consolidation

The success of the Bulge Bracket investment bank has put tremendous pressure on other investment banking firms to remain competitive. The cost of revenue-producing human capital has been increasing at approximately 30% per year for the past three years (see F&Co. *Technology Slowdown*, May 2000), increasing the pressure and cost of firms retaining their best employees. The result has been continuing consolidation in the investment banking and brokerage business.

Table 11: Brokerage Acquisitions since 1987 Tombstone



United States Offering

2,500,000 Shares

The First Boston Corporation

Bear, Stearns & Co. Inc. Alex. Brown & Sons Incorporated Dillon, Read & Co. Inc. Donaldson, Lufkin & Jenrette Securities Corporation
Goldman, Sachs & Co. Hambrecht & Quist Incorporated E. F. Hutton & Company Inc. Lazard Frères & Co.
Montgomery Securities Morgan Stanley & Co. Incorporated PaineWebber Incorporated Prudential-Bache Securities
Robertson, Colman & Stephens L. F. Rothschild, Unterberg, Towbin, Inc. Salomon Brothers Inc
Shearson Lehman Brothers Inc. Smith Barney, Harris Upham & Co. Incorporated S. G. Warburg Securities
Wertheim Schroder & Co. Incorporated Dean Witter Reynolds Inc. Wood Gundy Corp.
Allen & Company Incorporated Oppenheimer & Co., Inc. Thomson McKinnon Securities Inc.
Advest, Inc. Arnhold and S. Bleichroder, Inc. Butcher & Singer Inc. Cowen & Co.
Jefferies & Company, Inc. Cyrus J. Lawrence Incorporated Legg Mason Wood Walker Incorporated Mabon, Nugent & Co.
Morgan Keegan & Company, Inc. Moseley Securities Corporation Neuberger & Berman
The Robinson-Humphrey Company, Inc. Tucker, Anthony & R. L. Day, Inc. Wheat, First Securities, Inc.

Source: Freeman & Co. research

The resulting impact on asset management firms is that their distribution partners are vanishing through mergers. With limited shelf space for investment products, some asset managers will lose access. Combinations will force businesses within the organizations (private client, private banking, retail brokerage, etc.) to review the number of products they distribute and rationalize the number of firms with whom they do business. Firms will get bumped from wrap programs, select advisor lists and other pre-screened programs -- increasing the cost and competition for distribution.

Table 12: Select Brokerage Acquisitions 2000

Acquirer	Target	Retail Registered Reps.	Retail Accounts
PaineWebber	JC Bradford	1,000	350,000
UBS	PaineWebber	7,000	3,200,000
MONY	Advest	500	300,000
RBC	Dain Raucher	1,300	600,000
First Union	First Albany	250	95,000
First Union	JW Genesis	200	20,000
CSFB	DLJ	375	
Chase	JP Morgan	130	
Total		**10,755**	**4,565,000**

Source: SIA Yearbook, 1999-2000; Freeman & Co. research

V. Distribution Trends

US Mutual Fund Distribution

In the US, the long-term mutual fund business continues to expand at a 20% annual growth rate fueled by capital market returns. However, the trend toward lower sales charges or less transparent sales charges continues. Since 1997, the no-load channel has had total AUM growth twice (22.1% CAGR) the rate of the front-load channel (10.3% CAGR). Back-end load products have had strong growth (19.9% CAGR), as less transparent fee products are an easier sell to retail clients in intermediary channels.

Table 13: Long-Term Mutual Fund Assets by Pricing Structure
1Q1998 – 2Q2000

	No Load	Front Load	Back End	Hybrid	Total
CAGR%	22.1%	10.3%	19.9%	5.5%	17.4%
2Q00 $B	$2,444.8	$1,550.9	$613.5	$16.0	$4,625.2
1Q98 $B	$1,558.8	$1,243.2	$408.0	$14.2	$3,224.3
2Q00 % of total	53%	34%	13%	0%	100%
1Q98 % of total	48%	39%	13%	0%	100%

Source: Morningstar, Freeman & Co.
Note: Does not count products with waived loads for certain distribution channels

Fees for distribution and other services will either fall or their structuring will conceal the true costs to customers. We expect wholesalers to create pricing structures that appear like no-load funds to the consumer, but generate commission revenue in other ways. The Internet will continue to pressure fees for many commodity products and services, including certain distribution components of the asset management industry as has happened with retail brokerage commissions.

One aspect of the industry that has remained constant through the years is the amount of assets in top performing funds, particularly funds with four- and five-star ratings from Morningstar. This asset concentration directly drives profitability as scale is a huge factor. As shown below, four and five star funds are 5x larger on average than lower rated funds. Firms such as Fidelity, Vanguard, Janus and others who can continue to develop and maintain strong products plus strong distribution channels have a distinct advantage over mid-sized firms.

Table 14: Long-Term Mutual Fund Assets by Morningstar Rating

Morningstar Rating	1998 Q2	1999 Q2	2000 Q2	# of Funds 6/30/00	AUM $B 6/30/00	Avg. AUM $B 6/30/00
4 & 5 Stars	60.0%	62.5%	61.0%	2,731	$2,845	$1.04
Other	40.0%	37.5%	39.0%	8,533	$1,820	$0.21
Total	**100.0%**	**100.0%**	**100.0%**	**11,264**	**$4,666**	**$0.41**

Source: Morningstar, Freeman & Co.

Although many industry participants have pre-tax margins in the 35% range (see Table 17), mid-sized firms will continue to face challenges. Compensation, distribution costs and operating expenses continue to rise for firms while new business opportunities, such as global expansion, require large capital commitments that may strain their resources. Mid-sized firms can continue to exist and maintain healthy margins if they focus on core product and distribution areas. Innovation will remain key for these firms in the product area, and they will need to get closer to their customers in distribution channels. However mid-sized firms will be excluded from the global marketplace. Those firms that attempt expansion and stretch their resources may be the most vulnerable.

V. Distribution Trends

Can firms consistently create top-tier product, and does it matter?
Although mutual fund performance and ratings matter, other factors such as name brand, distribution channels and customer access are key drivers of long-term success. These non-performance elements explain, in part, the disparity between asset and rating concentration as shown below.

Table 15: Top 5 Firm AUM and Rating Concentration 6/30/00

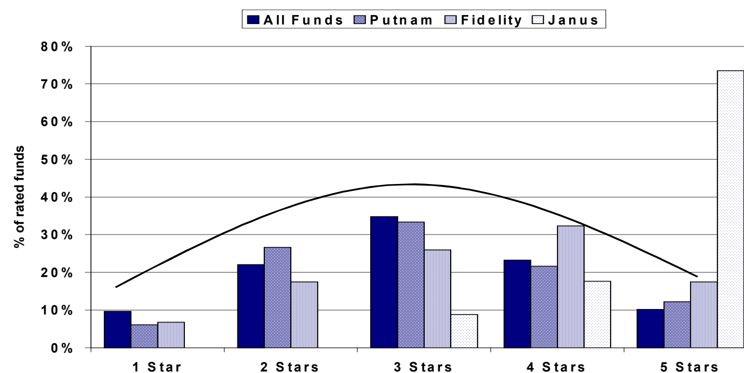
Firm	AUM $B 2Q00	# of 4 & 5 Star Funds	% of Total AUM	% of Total 4 & 5 Stars	Difference
Fidelity	$628,790	117	13.9%	4.3%	9.6%
Vanguard Group	508,425	38	11.2%	1.4%	9.8%
American Funds Group	333,716	15	7.4%	0.5%	6.8%
Putnam Funds	237,428	61	5.2%	2.2%	3.0%
Janus	230,574	40	5.1%	1.5%	3.6%
Top 5 Total	**1,938,933**	**271**	**42.7%**	**9.9%**	**32.8%**
Industry Total	**$4,536,389**	**2,730**	**100.0%**	**100.0%**	**n.a.**

Source: Morningstar, Freeman & Co. Note: Includes multiple share classes

Fidelity and Vanguard have a higher asset market share than top rated fund market share – a testament to their strong brands and distribution channels. Fidelity's difference yields a +9.6% benefit and Vanguard's difference is +9.8%. Fidelity's position is based on its strength in multiple distribution channels; Vanguard's is the leader in retail index funds. Hot funds will provide growth spurts, but solid business development, multiple distribution channels and customer access is the foundation for long-term growth.

Morningstar ratings are distributed on a normalized curve, and a company's ratings should be normally distributed (excluding survivor bias, selection bias, etc.). Firms with good research should skew toward higher rankings; however Janus is skewed abnormally to the right. This is due to its small number of funds and its aggressive growth style. Is this sustainable? Is it a function of being in the right place at the right time? What happens when the aggressive growth style turns? How will this affect asset growth, revenues and earnings? Is reversion to the mean for Janus probable?

Table 16: Distribution of Rated Funds - 6/30/00



Source: Morningstar, Freeman & Co. Note: Includes multiple share classes

Our point is that long term success is based on a wide range of strong products, multiple distribution channels, close customer contact, innovation and strong financial performance. The obstacles to success are many, and the global capital investment that firms are making continues to increase.

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Table 17: Public Company Financials

	AUM $B	Enterprise Value (EV) [1]	Market Cap $MM	10/5/00 Share Price	Last 12 Months Revenue	Last 12 Months EBITDA [2]	Last 12 Months EBIT [3]	Last 12 Months Core Net Income [4]	EV/ EBITDA	EV/ EBIT	Price/Core Income	Price/ TTM Income
Diversified												
Blackrock (BLK)	177	2,351	2,351	36 13/16	421.5	144.3	126.7	74.1	16.3x	18.6x	31.7x	32.0x
Eaton Vance (EV)	47	1,724	1,695	48 3/16	413.2	249.1	176.8	108.4	6.9x	9.8x	15.6x	15.2x
Federated Investors (FII)	126	3,662	3,212	25 3/8	646.8	275.2	264.2	151.2	13.3x	13.9x	21.2x	22.8x
Franklin Resources (BEN)	233	10,741	10,305	42 5/16	2,321.1	681.6	681.6	490.2	15.8x	15.8x	21.0x	18.6x
Gabelli (GBL)	23	901	851	28 3/4	208.8	80.7	80.0	61.5	11.2x	11.3x	13.8x	32.9x
Neuberger Berman (NEU)	54	3,355	3,270	66 1/2	583.8	245.4	235.2	143.2	13.7x	14.3x	22.8x	22.8x
SEI Investments (SEIC)	72	3,404	3,377	63 5/8	525.4	136.3	119.3	70.9	25.0x	28.5x	47.6x	42.1x
Stilwell (SV)	313	8,767	8,767	39 5/16	1,804.9	862.5	806.3	460.5	10.2x	10.9x	19.0x	16.8x
T Rowe Price (TROW)	179	5,686	5,669	46 7/8	1,161.8	511.9	475.3	298.3	11.1x	12.0x	19.0x	20.5x
Waddell & Reed (WDR)	40	2,838	2,828	34 7/16	447.8	190.8	184.0	105.6	14.9x	15.4x	26.8x	26.5x
Total	***$1,265***	***$43,429***	***$42,325***					***Average***	***13.8x***	***15.0x***	***23.9x***	***25.0x***
								Median	***13.5x***	***14.1x***	***21.1x***	***22.8x***
Insurance												
Alleghany (Y)	46	1,888	1,489	201 7/16	1,444.1	233.4	199.5	149.2	8.1x	9.5x	10.0x	10.0x
Liberty (L)	53	1,750	1,188	24 7/8	731.3	255.8	178.5	102.4	6.8x	9.8x	11.6x	11.6x
John Nuveen (JNC)	60	1,543	1,543	49 7/16	350.6	166.1	156.9	100.0	9.3x	9.8x	15.4x	15.1x
Total	***$159***	***$5,181***	***$4,220***					***Average***	***8.1x***	***9.7x***	***12.3x***	***12.2x***
								Median	***8.1x***	***9.8x***	***11.6x***	***11.6x***
Consolidators												
Affiliated Managers (AMG)	89	1,402	1,174	52 3/8	597.7	270.8	242.4	180.8	8.1x	9.7x	14.0x	14.2x
Total	***$89***	***$1,402***	***$1,174***									
Bank/Trust Companies												
Boston Private Fincl. (BPFH)	4	171	171	14 5/8	46.7	13.6	12.1	8.2	12.6x	14.1x	21.0x	21.0x
Fiduciary Trust (FCNY)	53	282	282	60	183.9	36.5	36.5	21.9	12.0x	12.0x	20.0x	20.0x
Wilmington Trust (WL)	17	1,903	1,735	53 3/4	439.4	188.0	164.8	109.2	10.1x	11.5x	15.9x	15.9x
Total	***$73***	***$2,356***	***$2,188***					***Average***	***11.6x***	***12.5x***	***18.9x***	***19.0x***
								Median	***12.0x***	***12.0x***	***20.0x***	***20.0x***
Limited Partnerships												
Alliance Capital L.P. (AC)	388	9,217	8,785	49 13/16	1,765.9	572.8	569.6	468.8	16.1x	16.2x	18.7x	17.8x
Total	***$388***	***$9,217***	***$8,785***									
Overall												
Total	***$1,975***	***$61,585***	***$58,692***					***Average***	***12.3x***	***13.5x***	***20.3x***	***20.9x***
								Median	***11.6x***	***12.0x***	***19.0x***	***19.3x***

Notes
1 Enterprise Value (EV) includes equity plus long term debt
2 Before tangible depreciation and amortization
3 Excludes extraordinary items and minority interest expense/income
4 Excludes extraordinary items and minority interest expense/income

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