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INVESTORS WEIGH UP MERRILL'S DEAL WITH BLACKROCK

Investors weigh up Merrill's deal with BlackRock

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BlackRock's \$9.3bn deal to take over the huge investment assets of Merrill Lynch Investment Management – for many years the largest mutual fund manager in the land – continues a trend for the largest financial institutions to cede control of fund management activities to specialist fund managers.

It follows on the heels of Citigroup's \$3.7bn sale of its fund management assets to Legg Mason, which had a similar logic, and the recent deal now represents both the most money paid in a fund management transaction and the greatest amount of assets under management to change hands in one deal.

Most industry watchers say that the move – which will create one of the world's biggest money managers, with \$1,000bn in assets – will be advantageous to investors. "The primary benefit is that your funds are now going to be under the umbrella of a well-balanced investment firm," says Daniel Seivert, managing partner of 3C Financial Partners, a Los Angeles-based investment bank and strategic consulting business. "Merrill Lynch does a lot of things, whereas BlackRock is focused on just investment management. It is that concentration and focus that has made it so successful."

Many others agree that pure-purpose asset managers – such as BlackRock and Legg Mason – do a better job as money managers than investment banks. Historically, they have been able to deliver higher returns to fund investors and they offer higher margins to their shareholders.

Specialized managers appear better able to attract and keep talent, and provide an environment conducive to generating returns above the index. BlackRock has done very well as an asset manager, with consistently high returns that have brought a flood of new money. Its performance has outpaced that of Merrill Lynch.

As Mr Seivert puts it: "Portfolio managers are more attracted to working for a pure play investment management group with 4,500 employees as opposed to a Mother Merrill that has 50,000 employees. Focus and specialization are appealing."

The deal will also expand and diversify BlackRock's offerings. BlackRock, which has traditionally focused on bonds, will become the largest active fixed-income manager in the world, as well as dramatically increasing its equity management and overseas business.

This could have an added benefit. When fund groups merge it is common for several of the mutual funds to be merged to avoid duplication – a process that can be confusing and messy for investors. But in this case there is not a great deal of overlap and BlackRock has said it does not expect to merge funds.

Some in the industry have speculated that the merger will be the catalyst that finally brings alternative investments to mainstream investors. As of December 2005 BlackRock had \$25bn of its \$453bn in assets under management invested in its alternative investments unit, including hedge funds, funds of hedge funds, structured products, real estate products, private mezzanine debt and private equity funds.

But David Hayward, director of alternative investment research at Financial Research Corporation, the Boston-based data company, says that is not necessarily a given. "The products are very lucrative but also very complicated," he says. "Whether this merger will help alternative investment move close to Main Street will depend on the distribution network Merrill brings."

Darlene DeRemer, partner at Grail Partners, a speciality M&A advisory group, also predicts Merrill-BlackRock will not bring hedge funds closer to Main Street, although the deal may make it even easier for the wealthy to buy alternative investments. "We've already seen a growing use of hedge in the institutional market and this will give BlackRock a better foothold. In the longer term it could bring more hedge [funds] to high net worth clients."

So the merger seems to make strategic sense for the companies involved without raising any fears for their clients. There are, however, some reasons for caution. Acquiring companies have struggled to absorb their purchases, with frequent cultural clashes and little sign of the synergies trumpeted at the time of the merger. Merrill's own acquisition of Mercury in 1997 was a mixed bag. Deutsche Bank's 2001 acquisition of Zurich Scudder is not seen as greatly successful.

The most successful have been those – such as most of Legg Mason's purchases, and Allianz's purchase of Pimco – where the acquirer leaves its new business to continue undisturbed. That is not the case with BlackRock, which intends to take control of MLIM.

BlackRock, which made its name as an institutional bond manager, now has several new challenges: to manage hundreds of billions of dollars in equities; to become a retail manager as well as an institutional manager; and to absorb a very large organisation into its own infrastructure.

Sonya Morris, an analyst at Morningstar, suggests investors in Merrill Lynch funds sit tight for the time being but keep a close eye on relative performance and on any changes in management or strategy.

And there may be bad news for investors on prices. Whatever else the deal means, Mr Seivert suggests you should not expect fees and other charges to drop. "It's a luxury of the investment management industry that once you're a larger firm with a cachet brand, you don't have to cut prices."

ABOUT ECHELON PARTNERS

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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