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Consolidation trends in the EAM sector

The external asset management ("EAM") sector in Switzerland has remained to some extent less impacted than the banking industry by regulatory costs increases, delaying the consolidation and restructuring process as currently observed between banking institutions. With the forthcoming implementations of FIDLEG and FINIG as well as the impact of automatic exchange of information, we expect increased consolidation in the sector alongside a rise in valuations in the coming years.

EAMs that are looking to commit to the Swiss marketplace for the long term, should consider their strategic options in the market, which can require a business model realignment and/or scale increase to adapt to the "new normal" environment.

We think business model sustainability will be significantly polarized between structured players that are to benefit from the foreseen sector restructuring and the sub-scale players, making the bulk of the market, facing increased challenges. The former are often well underway in the adaptation of their businesses to the tax compliant environment and to the repricing ongoing in the wealth management industry since the introduction of tax compliance measures. The structured players are already equipped to absorb more easily the incoming cost burdens from new regulations. In our view, they have the potential to win market share against market peers and private banks, and generate long term shareholder value as they focus on the more profitable parts of the wealth management value chain.

We believe that such sophisticated and structured market players have logically the potential to benefit the most from the forthcoming consolidation process. In selected European countries, independent asset managers are gaining market share at the expense of the traditional bank-owned wealth managers that are suffering from client's loss of confidence in banking institutions. We also think this trend could be replicated in Switzerland to some extent as well.

On the other hand, smaller EAMs with an eroding client base that lack appropriate expertise and have not adapted revenue models will most likely not be able to maintain a profitable activity on a standalone basis. They will have the option to collaborate with other firms, gradually remit their client relationships to market peers or banking institutions via revenue sharing agreements or wind-down their businesses.

In the M&A space, we generally think that EAMs benefit from a competitive advantage in the acquisition of AuM from peers compared to private banks as they do not need to transfer custody, but only client management agreements. This makes it technically a much smoother process for relationship managers to transfer and retain clients in a transaction.

Transactions specifics

The sharing of support functions amid rising structural back-office costs is a recurring theme within the EAM industry in Switzerland and overseas, with several players having launched cost-sharing platforms in recent years to attempt addressing this challenge. On the other hand, few M&A transactions have actually taken place in Switzerland between market players in order to remediate to the forthcoming rise in operating costs, as opposed to countries such as the UK.
In the UK, a significant amount of independent wealth management transactions took place in the last two years amid the implementation of the Retail Distribution Review ("RDR") directive relating to the regulation of the advisory function for wealth management firms. In Switzerland, we observe that most of the recent transaction activity took place only between small entities with one to two key individuals, primarily for succession reasons, with very few strategic transactions among larger firms only.

We think, the gap in transaction pricing between sellers and acquirers in Switzerland can partly explain the limited amount of transactions in the EAM sector. In today's world, acquirers are significantly underpaying for risks, which are inherent to people businesses like wealth management, but are also exacerbated by uncertain regulatory context. At the same time, sellers are attaching significant value to their profitable, cash-generating captive client base and are not willing to accept significant value discounts that reflect increased regulation and tax regularisation programmes (reduction in AuM). In the case of smaller entities with limited succession planning and/or significant business reliance to one or two key individuals, which makes the bulk of the sector in Switzerland, the value gap is exacerbated and – in our experience - frequently prevents transactions from taking place.

There also is a structural gap in transactions: acquirers consider small EAM transactions more a hiring process rather than an M&A deal, and hence can favour asset type transactions when considering purchasing an entity. On the other hand, sellers are looking to obtain a franchise value for their business and therefore favour share deals.

The other key challenge that we frequently see in the Swiss EAM sector is the complexity and challenge represented by transaction integrations, either in the case of deals between peers or with private banks. Transactions between peers are generally structured in part via paper transactions with previous owners retaining a stake in the combined business, making governance and transaction valuation key transaction challenges. Hence, suitable partners are rare to find for market players looking for M&A opportunities, as cultural and strategic fit are highly critical. This also explains why we see the development of “hybrid” forms of transactions such as revenue sharing agreements rather than traditional M&A transactions that are easier to put in place. Cash transactions are therefore limited as acquirers of businesses are today very wary of retention risks and reluctant to pay 100% cash due to the current inherent risks in the sector.

However, we believe that value can be created through traditional M&A transactions as long as the compatible partner can be found and an adequate transaction structuring is implemented. It can allow not only significant cost savings, but also create momentum for business growth. In addition, revenue synergies can be created through the pooling of complementary front office/ servicing competencies for potential return on asset improvement, which is the main challenge of many market participants today.

In our view, the Swiss wealth management market should continue to hold growth potential, as clients will still be looking to diversify the location of their wealth and receive higher service level. Nevertheless, we believe the number of EAMs in Switzerland to materially decrease in the coming years as the advisory function becomes increasingly regulated. Similar developments can be observed in other neighbouring countries such as Germany and the UK when similar regulations were implemented. The fragmented Swiss EAM market is expected to mature in the years to come to result in the emergence of larger, more sophisticated players concentrating on value proposition and reinforcing their status as credible alternatives to traditional banking players.

Recent Completed Transactions Advised by Deloitte Financial Advisory Switzerland

Lead Financial Advisor to	Lead Financial Advisor to	Financial Advisor to	Lead Financial Advisor to
LGT	valartisgroup	EFG	Israel Discount Bank
On the acquisition of a majority stake in UK based Vestra Wealth	On the disposal of Valartis Bank (Liechtenstein) to Citychamp Watch & Jewellery Group Ltd.	On the acquisition of BSI	On the sale of the Swiss Private Banking business to Hyposwiss Private Bank
vestrawealth	冠城鐘錶珠寶集團有限公司 CITYCHAMP WATCH & JEWELLERY GROUP LIMITED	BSI	HYPOSWISS PRIVATE BANK
2016	2016	2016	2016

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