Tumbles in the Asset Management Industry - Again. T Rowe Price Acquires Oak Hill Advisors

Introduction

On the 28th of October Oak Hill Advisors (OHA), an American credit manager, announced that it had reached an agreement with T Rowe Price, the US asset manager, to be acquired for $4.2bn in cash and shares. T Rowe Price's CEO, Bill Stromberg, said that this takeover is a chance to pursue development prospects in private credit as more institutions and wealthy individuals seek exposure to the industry.

T Rowe Price will pay up to $4.2bn for 100% of OHA's equity, with $3.3bn payable at closing, 74% in cash and 26% in T Rowe Price common stock. A further $900mln will be paid in cash if certain business milestones are met beginning in 2025. The takeover represents the Baltimore-based company's most expensive deal to date. The deal will accelerate the asset manager's expansion into the alternative investment market and complement its existing global platform. The acquisition is expected to close in the fourth quarter, pending regulatory approval.

T Rowe Price

T Rowe Price, founded in 1937, is a global investment management firm based in Baltimore. As of 2020, the firm had more than $1.6tn in assets under management and $6.2bn in yearly revenues, making it one of the largest active asset managers in the world. It provides an array of mutual funds, sub-advisory services, separate account management, record keeping, and related services for individuals and institutions.

The company is focused on active management after strategically deciding against a major initiative in passive investment. In addition, the firm provides several advanced investment planning and counselling tools. T Rowe Price's risk-aware, disciplined investment approach emphasizes diversification, consistency in style, and basic research. The company's global client base includes many of the world's leading corporations, public retirement plans, foundations, endowments, financial intermediaries, and sovereign entities, with institutional assets accounting for over 50% of the firm's total assets under management.

Oak Hill Advisors

Oak Hill Advisors, founded in 1987, is a leading alternative independent investment firm, headquartered in New York, with primary offices in, among others, London, Sydney, and Hong Kong. The firm has approximately $52bn under management across performing and distressed credit-related investments all over the world, with a focus on North America and Europe. Its key sectors include high yield credit, leveraged loans, structured products, distressed investment, and private credit markets. Oak Hill Advisors aim at investing actively across a range of asset classes to maximise risk-adjusted returns and capture changing relative value through the market cycle. It has raised $19.4bn in capital since January 2020, arguably thanks to its strong performance, global institutional customer base, and a favourable business environment.

Asset Management Industry

The asset management business has emerged from the worldwide pandemic in a strong position, with assets expected to expand by 11% in 2020, reaching $103trn by the end of the year. Retail portfolios, which account for 41% of global assets at $42trn, gained 11% in 2020, while institutional investments rose at a similar rate to reach $61trn, or 59% of the global market.

Private markets have had a particularly impressive run within the universe of alternatives. Global assets are concentrated in private equity, real estate, private finance, infrastructure, and natural resources, with assets under management (AuM) growing at a rate of around 12% per year to almost $8trn by September 2020.

The world's largest asset management market, North America, had another year of double-digit growth in 2020, with AUM rising 12% to $49trn. Europe (10%), Asia-Pacific (11%), and the Middle East and Africa (11%) all saw considerable growth; however, profitability was static in contrast to 2019, with operating profits hovering around 34% of net revenues due to cost and charge reduction.

Implications for the Asset Management Industry

T Rowe’s acquisition of Oak Hill Advisors comes at a time when asset managers are looking for methods to increase their profitability. It is the result of tough competition and lower costs, as more often clients shift to passive investment opportunities. According to Morgan Stanley, the whole industry, which includes private credit, private equity, and infrastructure, increased to $7.4trn by the end of 2020 and is predicted to reach $13trn by the end of 2025.

Money managers have stepped in as lenders to fill the hole left by banks in the aftermath of the 2008 financial crisis, and thus private-credit investment has drastically risen over the last decade. Bond fund returns have been harmed by ultralow interest rates, prompting investors to seek greater yields in the private debt markets. As conventional managers have failed to keep up with the stock market's surge, investors have poured more money into low-cost index funds.

Meanwhile, deal-making in asset management has surged as firms seek scale, expand into new growth areas, and reduce costs. According to Dealogic, 160 asset management agreements, worth $25.3bn, have been completed so far this year; last year, there were 208 transactions worth a total of $54bn.

Many prominent asset managers, including BlackRock Inc., Pacific Investment Management Co., and JPMorgan Chase & Co.'s asset-management division, have hired specialized managers to diversify their services and compensate for lower-cost funds cutting into their bottom line. Others, such as Invesco Ltd. and Franklin Resources Inc., have pursued larger, more risky purchases to gain scale and save costs. One could say that consolidation and building up your muscle is the answer to current challenges faced by asset managers.

Deal Structure

T Rowe manages $1.61trn in assets as of September 30th, offering a range of mutual funds, account management, and other advisory services. According to the terms of the deal, T Rowe will acquire 100% of the equity in Oak Hill Advisors (OHA); $3.3bn will be paid out at closure, with around 74% in cash and 26% in T Rowe's common stock, and up to $900mln in cash might be paid out if certain performance milestones are met. The high price reflects the significant demand for private money as well as the fierce rivalry in the market for agreements.

Once the transaction is completed, any outstanding OHA debt will be paid off. Oak Hill Advisors will function as a separate entity inside T. Rowe Price. It will also keep control of its investing approach and personnel. Glenn August, the company's founder, will continue in his current position and is likely to join T. Rowe Price's board of directors and management committee.

Deal Rationale

The acquisition of Oak Hill Advisors is game-changing for T Rowe since the deal marks a shift from being an active asset manager, focused mainly on equity and fixed income, to a more diversified business. Indeed, the acquisition of OHA will enable T Rowe to grow in the alternatives market, one of the most attractive asset classes now. Investors are allocating their money towards passive, ESG, and private markets. Since passive is not a strategic business for the company and it is already building its ESG presence, that leaves private markets which offer attractive yields and solid risk-adjusted returns. The deal marks a change from the usual path of organic growth - it's T Rowe's first relevant acquisition in more than two decades.

The acquisition comes at a time where passive managers, including Vanguard or BlackRock, who offer cheaper alternatives to bond and equity funds, are pushing active firms to find new streams of revenue. Combining an institutional quality manager with a 30-year track record of growth and investment performance in the private markets with T Rowe's global scale is expected to create future growth opportunities. Additionally, private market funds, which lock up client money for years, also could help smooth out revenue swings for asset managers when markets retreat and investors suddenly turn more cautious.

The company remarked that excluding amortization of intangibles and the expense impact of the earnout, the transaction is expected to be accretive to T Rowe Price diluted earnings per share by a low-to-mid single-digit percentage in 2022.

Finally, from the Oak Hills' side, the acquisition is expected to be beneficial, as it gains a competitive advantage - scale. It will allow to seek increased financing and drive differentiated returns across alternative credit markets. T Rowe Price's full range of equity, fixed income, and multi-asset solutions, along with its global footprint, is anticipated to facilitate these benefits of scale, offering greater opportunities for investors, borrowers, and financial sponsors.

Market Reaction and Financial Advisors

T. Rowe Price (NASDAQ: TROW) rose for three days in a row after announcing its $4.2 billion acquisition of Oak Hill Advisors on Thursday, October 28th. The stock advanced by 0.8% on Monday morning, after a rise of 0.7% on Friday and 5.7% on Thursday. T. Rowe Price shares are up 46.8% so far this year, well above the S&P 500 and NASDAQ Composite indices. Notwithstanding the considerable premium paid to acquire OHA, the investors seem to have reacted positively, a sign of belief that the combination of the twos will create value for the stockholders. According to analysts, adding alternative investments to the company's business mix will improve its growth profile.

Evercore served as the financial advisor to the T Rowe Price and Dechert LLP served as the company's legal counsel.

J.P. Morgan Securities LLC and M. Klein & Company served as the financial advisors to Oak Hill, and Paul, Weiss, Rifkind, Wharton & Garrison LLP provided legal counsel.

TAGS: T Rowe, Oak Hill Advisors, Asset, Management, M&A, Stromberg