Legg CEO Targets M&A to Plug Product Holes

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By Morgan M. Davis

Joe Sullivan, CEO of Legg Mason, has identified some gaps in the firm's product lineup and is actively looking to acquire new managers to add to its multi-boutique roster. In particular, Legg is seeking to add global equities, alternatives and "solutions"-based capabilities, he says.

"[Acquisitions are] an inorganic way to accelerate our organic growth," says Sullivan, emphasizing that any acquired boutiques would not be a grab for assets, but instead fill in products and talent that are missing from Legg Mason. "Client demand continues to evolve," he says. "We are more active in the M&A space than we've been in years."

The "solutions"-driven strategies Sullivan is seeking are "synonymous with customization," he says. While the firm does have some such capabilities, like the customized solutions options at ClearBridge Investments, it needs broader and deeper products to meet client demand, he says. Institutional clients want highly customized products and multi-asset class options, says Sullivan. Indeed, "solutions" -oriented strategies like liability driven investments (LDI) or volatility management have been drawing significant interest from institutions.

Of the three identified growth areas, alternatives will take the longest time to develop, says Sullivan. But, as Legg Mason considers potential acquisitions, it will have to shake out which areas of client interest are fads and which are core changes to pursue, says Sullivan

Expanding equities offerings is also a priority as investor interest diversifies, says Sullivan. "We need to add capabilities in non-U.S. equities," he says.

Acquisitions for Legg Mason won't necessarily mean new affiliates, says **Thomas Hoops,** head of business development. "We'll have fewer but larger affiliates," he says. Instead of a standalone boutique, Legg Mason may opt to "bolt on" an acquired firm to a current affiliate. Legg has already done this once when it bought hedge fund firm **Fauchier Partners** at the end of 2012 and integrated it with Permal **Group**.

Acquiring new, standalone boutiques also remains an option, says Hoops.

Sullivan has been an active proponent of growth for the Baltimore-based firm since he officially took on his role as CEO in February 2013. After joining Legg, he immediately began discussing the potential for acquisitions as the asset manager seeks to diversify its product offerings.

Legg Mason suffered heavy blows in the financial crisis, and has since struggled to regain investor confidence. The firm, which had $680 billion in assets under management at the end of January, had more than $1 trillion in assets under management at the end of September 2007. Legg suffered another recent setback when its $442 billion fixed income shop, Western Asset Management, was hit with SEC sanctions on charges related to a coding error.

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To stem the tide of outflows, Sullivan has aggressively pushed for growth. Last month he hired Hoops from Wells Fargo **Asset Management** for the newly created head of business development position, as reported. Hoops, who reports directly to Sullivan, oversees the product capabilities of the Legg Mason affiliates, determining where the firm is lacking, and driving the acquisition strategy, for both boutiques and talent, as well as global product development for new and current affiliates. “It’s trying to connect all of the constituencies in helping lead and drive growth and development,” from the top-down while monitoring client and market interests, Hoops says of his role.

The multi-boutique model is “optimal,” says Sullivan. “It’s getting increasingly difficult for small asset managers to compete,” he says. This presents an opportunity for parent companies, like Legg Mason, to bring in highly specialized managers. The parent can offer support through distribution, access to new markets and seed capital to continue building products, says Sullivan. In turn, the boutiques can focus on investments. Legg Mason has almost $400 million in seed capital to invest in upgrading current franchises at any given time, he says. But Sullivan only intends to expand so far. Unlike the Affiliated Managers Group (AMG), which also has a multi-boutique structure, Legg is “not looking to have 15 … affiliates,” says Sullivan. Legg Mason plans to maintain fewer, larger shops, he says.

Firms including New York Life, BNY Mellon and Nuveen Investments have similar multi-boutique models. The multi-boutique model has become one of the most preferred structures for asset managers, says **Jillian Rudman**, CEO of strategic consultancy J Rudman & Associates. Having specialized shops diversifies the parent manager’s business and expands its reach into new markets, she says. The boutiques benefit as they need the scale to sustain their business while focusing on what they do best, she says. “They get to be part of a large, stable business,” says Rudman.

Acquiring boutiques diversifies business risk, and can often better align interests with clients as they have high equity ownership and a strong focus on the investment process, says Rudman. But acquisitions aren’t always smooth sailing. They can be complex, and parent firms can risk overlapping capabilities between shops, as well as key person risk, says Rudman.

Acquisitions can’t be forced, and having a good cultural fit is important, agrees Sullivan. “You can’t fall in love with an acquisition,” he says. “Nothing’s perfect.”

Merger and acquisition activity throughout the industry is on the rise, says **Kevin McKeon**, director at recruiting firm Sheffield Haworth. “If you have a gap in your platform … organically it’s going to take four to six years” just to be seriously considered by investors, he says. Asset managers are looking to grow through acquisition across the board, not necessarily just a manager looking into an asset class it doesn’t currently have, like a fixed income shop looking for equities, says McKeon.

Adding acquisitions to existing affiliates, as Hoops mentioned, can be very difficult, says McKeon. “The ones that require more attention are the ones … where the firms have acquired an entity and put it into an affiliate," he says. While two firms may invest in the same asset classes, the cultures and personalities of the investment teams may be very different, he says.

Sullivan is positive on his outlook for his firm. Legg's assets have been crawling upward, with assets under management at $680 billion at the end of January, up from $656 billion at the end of September 2013. The firm had nearly $649 billion in assets at the end of December 2012. "We're clearly in a position of growing momentum," he says.

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