# Accelerating Consolidation in a Maturing Alternatives Industry

*Continued Market Consolidation as BlackRock Announces Acquisition of Global Infrastructure Partners*

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## Introduction

Following this morning's announcement of BlackRock's $12.5Bn pending acquisition of Global Infrastructure Partners ("GIP"), we are revisiting themes from our recent piece, The Next Chapter for Private Markets, and how these fit into the broader alternatives M&A landscape. In that piece, we highlighted three big challenges that sponsors will face in the next decade or more. These included:

- *The challenge of declining fragmentation*: As large managers diversify into multi-solutions providers, it is becoming more challenging to stay small. The avenues for organic growth are becoming narrower as many large limited partners seek an integrated solution for their capital allocation needs.

- *The challenge of eroding beta*: After three-decades of secular interest rate contraction, we believe the so-called "era of cheap money" is over. A rising tide will no longer lift all boats, and alternative investors increasingly think in terms of capturing share from competitors. Similarly, relative outperformance attributable to an alternative managers' skill and franchise is becoming more important versus beta-driven "absolute returns".

- *The challenge of mega-cap competition*: As fragmentation declines in a beta-starved environment, we expect mergers and acquisitions to transform the alternative asset management industry. Whether via horizontal acquisitions (acquiring new strategies and investment product capabilities) or vertical integration (acquiring insurance businesses and distribution platforms), the largest firms are buying their way into new markets.

These challenges all point to two overlapping imperatives in the maturing alternatives industry: (1) Gain product scale in markets where a manager has a "right to win"; and (2) Diversify and enhance fee income to maintain talent and support organic and inorganic growth.

Several recently announced or rumored transactions reflect this imperative. For example, today's announced acquisition of GIP by Blackrock highlights all three of these trends in the context of a horizontal acquisition. GIP is being subsumed into a mega-cap asset manager with a stated desire to grow its private markets footprint. Within BlackRock, GIP should benefit from improved retail distribution, enhanced product formation, and scaled capital to source large global infrastructure projects, while positioning BlackRock as an emerging multi-solution alternatives provider to large institutional inestors.

Consider also Brookfield's acquisition of DWS to gain diversifying exposure to the secondaries market. This acquisition was concurrent with Brookfield's spin out of its broader asset management business. Why did Brookfield do this? Brookfield is already a scaled investment franchise, but public investors value a stable, diversified management fee and carry base. As Brookfield separates its standalone asset management business from its broader direct investing business, the public market is better able to value Brookfield's diverse business lines.

TPG's acquisition of Angelo Gordon is another example: This transaction represented both a scaling and diversifying opportunity for TPG, key factors for the valuation of a recently listed manager.

Finally, consider Apollo's numerous bolt-on acquisitions and joint ventures with small managers. These deals certainly don't move the needle for Apollo's overall asset base or fee profile. Put differently, they don't meaningfully grow scale for a business with over $600Bn of AUM. But they do provide important diversification: Small joint ventures represent a form of outsourced R&D as Apollo incubates new, niche strategies.

Throughout this piece, we are going to review the recent trends in private markets M&A, discuss how they fit into a broader asset management valuation and scaling paradigm, and discuss the recent GIP / BlackRock transaction in this framework. We'll conclude by reflecting on what this may mean for all but the largest sponsors who are looking for actionable advice to navigate a consolidating market.

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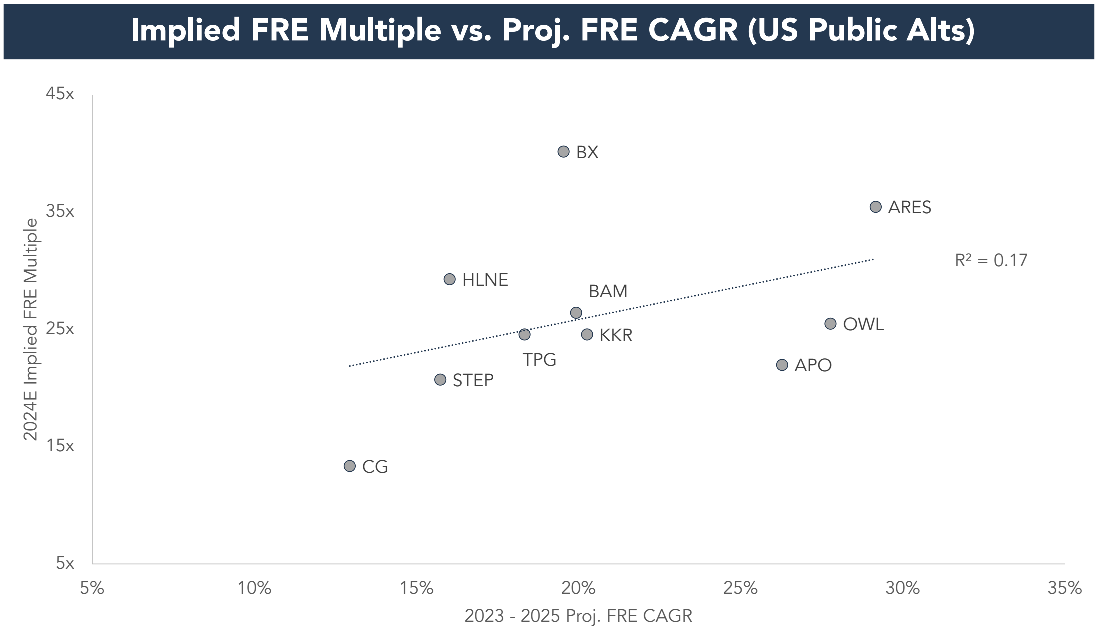
## The Case for M&A

All but the most niche asset managers need to gain scale and diversify their fee income to survive in the rapidly maturing alternatives market. This is as true for large public managers like BlackRock and Apollo (natural consolidators) as it is for smaller firms with specialized product capabilities (natural consolidatees). To frame this emerging M&A environment, we first want to provide some context on why these two factors – scale and diversification – matter so much. We'll then discuss the broader consolidation environment.

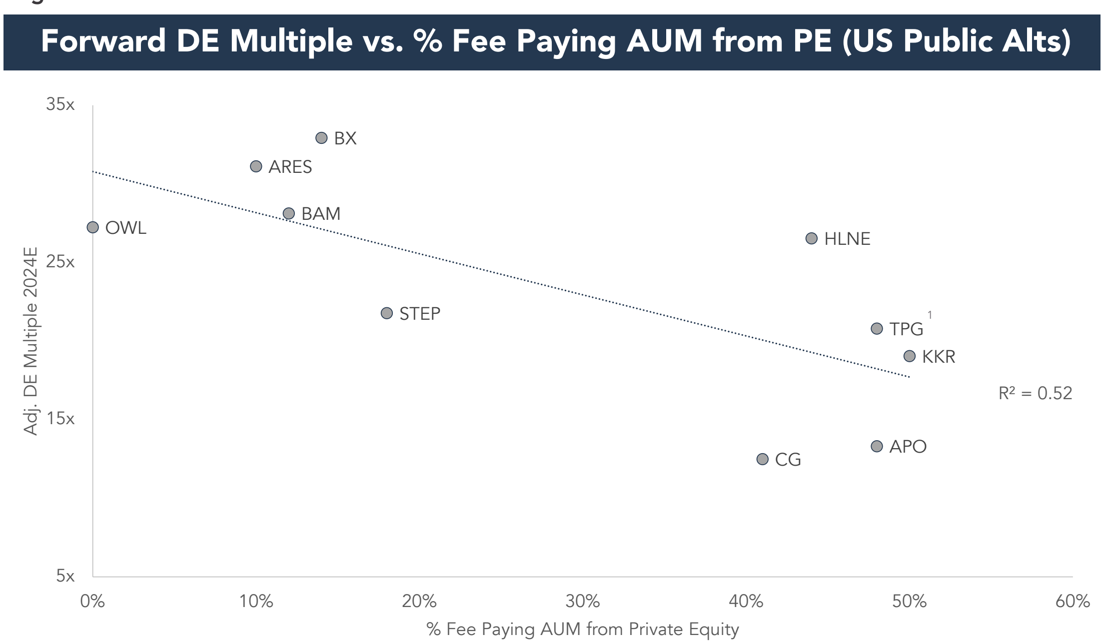
We covered the case for gaining scale in our recent piece, The Next Chapter for Private Markets, but scale alone is insufficient. In Figure 1, we show the value public investors assign to alternative managers' management fee streams ("Implied FRE Multiple") vs. managers' fee growth. Growth is clearly an important value driver. But why does Blackstone, which grows more slowly than Ares, Blue Owl and Apollo, trade at a premium to those stocks? This is because large, monoline asset managers, particularly those focused on more volatile strategies (i.e., private equity / buyout), often see their fee streams more heavily discounted than managers who generate stable, long-term and diversified management fees and carried interest. Figure 2 highlights this: It illustrates the stronger correlation between the percentage of fee-paying AUM from *non*-private equity strategies vs. the overall equity market multiple of these businesses ("DE Multiple").

**Figure 1**




Source: Goldman Sachs Global Investment Research. As of January 2024.

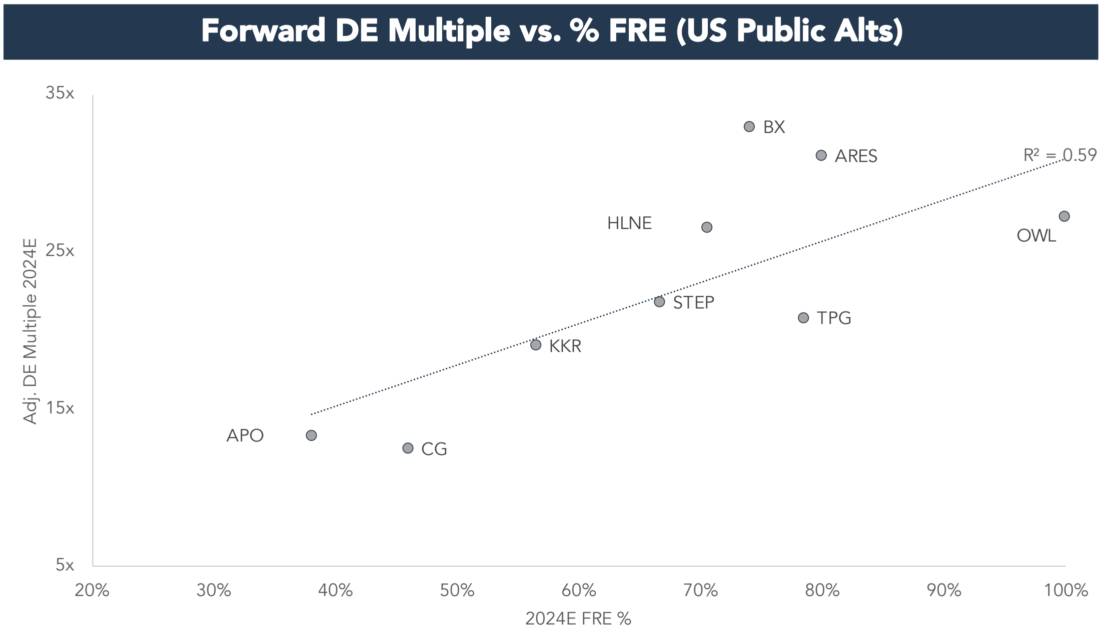
**Figure 2**




Source: Goldman Sachs Global Investment Research. As of January 2024. (1) TPG pro forma for full-year Angelo Gordon.

Finally, the market also cares about the composition of asset managers' earnings, not just their product diversity or scale. Asset managers who generate more managmeent fees than carry tend to trade at a premium to those who generate more non-recurring carry than management fees. Management fees – especially from diverse products – tend to be stable and long-dated (this is the same reason, for example, why a water utility trades at a lower cost of capital than a high-growth software business). To illustrate this, in Figure 3 we show the relationship between alternative managers' DE Multiple relative to their management fee composition ("FRE %").

**Figure 3**

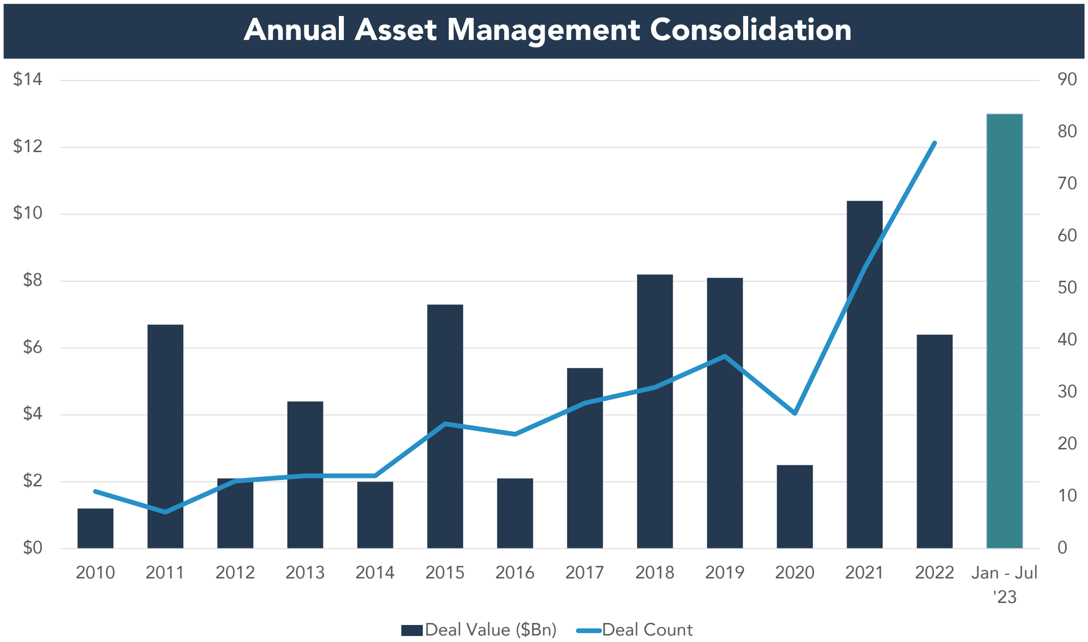



Source: Goldman Sachs Global Investment Research. As of January 2024.

*To summarize, growth, scale, and diversification – when paired with consistent investment performance – drive the valuation of alternative asset managers*. Given these factors, it's not surprising that asset management M&A volumes have increased meaningfully in recent years. ***In fact, while the broader M&A markets dropped to their lowest levels in over a decade, consolidating transactions increased in value by 6.5x in the past decade.*** These included several landmark deals by recently public managers: Brookfield / DWS[1]; TPG / Angelo Gordon; Bridgepoint / Energy Capital.

[1] While Brookfield is not recently public, it did recently restructure its public entity by distributing its asset management business to its shareholders.

**Figure 4**




Source: Pitchbook. As of July 2023.

Recent M&A activity can be seen through a horizontal-build or vertical-integration framework. Horizontal build includes acquiring new product capabilities and entering new markets. Vertical integration includes acquiring new services capabilities, such as insurance liability books and distribution platforms.

- *Horizontal build*: The increase in volumes shows that both traditional (legacy) managers and rapidly scaling alternatives platforms are racing to grow and diversify their businesses. Traditional asset managers are seeking to enter the highly lucrative alternatives space to stabilize their asset base and fee streams (long-only managers typically trade at a lower market multiple, given the less sticky / shorter duration of their capital bases). Meanwhile, alternatives managers are seeking *diversifying adjacencies* to position their platforms as "one-stop-shop" solutions providers to limited partners. Figure 5 highlights some of the recently completed transactions by both traditional and alternative asset managers:

Figure 5

**Transactions by Buyer Rationale**

| Traditional Asset Manager Acquiring Alts Capabilities | | Alternative Managers Expanding Product Lines | |
|---|---|---|---|
| Acquiror | Target | Acquiror | Target |
| AB | CarVal Investors | Oaktree | 17Capital |
| nuveen | Arcmont Asset Management | EQT | BPEA Baring Private Equity Asia |
| PGIM | Deerpath Capital | TPG | Angelo Gordon |
| T.RowePrice | OHA Oak Hill Advisors | General Atlantic | Iron Park Capital |
| Franklin Templeton | Lexington Partners | | |

Source: Arctos Market Research.

Interestingly, given the importance of management fee earnings and predictable, diverse incentive fee income (vs. more volatile or episodic earnings from, say, buyout funds), credit, infrastructure, and secondaries have been especially attractive targets. Indeed, *nearly 50% of all acquisitions involving alternative asset managers since 2021 have involved a manager whose flagship strategy is secondaries, credit, or infrastructure.* This "land grab" for managers with scaled capabilities in these strategies has left few independent firms of scale remaining, which should continue to drive scarcity value and further M&A activity in the near to-medium term.

- *Vertical Integration*: Another driver behind recent record alternatives M&A volumes is the need to unlock or expand distribution capabilities. Once a manager achieves "one-stop-shop" status through product expansion, growth is often a function of distribution and capital base. Can a manager sell existing products to new channels (e.g., retail distribution platforms)? Can a firm originate sufficient deal flow to satisfy permanent capital sources (e.g., insurance platforms)?

  Similar to the horizontal "land grab" for alternative investing capabilities, vertical integration is leading to fierce competition for capabilities and talent in distribution, in addition to demand for insurance platforms. The largest alternative platforms – notably Apollo (Athene) and KKR (Global Atlantic) – are using insurance sales forces to expand distribution while also effectively securing perpetual demand for their products. Meanwhile, FS Investments acquired Portfolio Advisors and Apollo acquired Griffin Capital to scale their distribution capabilities.

Figure 6 shows the accelerating insurance AUM of alternatives managers, which they have gained either via outright acquisitions (Apollo / Athene) or strategic relationships (Blackstone / Corebridge).

Figure 6

**Select Insurance-Related Transactions and Minority Investments**

Alternative Asset Managers Acquiring Insurance Capabilities

| Alternative Manager | Insurance Partner | AUM ($Bn) |
|---|---|---|
| APOLLO | Athene | ~$250 |
| APOLLO | Athora | ~$50 |
| ARES | Aspida | ~$8 |
| CARLYLE | Fortitude | ~$78 |
| Blackstone | Corebridge; Resolution; Everlake; F&G | ~$120 |
| KKR | Global Atlantic | ~$155 |

Source: Morgan Stanley.

In summary, we believe that well executed M&A, paired with continued investment performance, can meaningfully accelerate the growth trajectory and franchise value of an asset management business. These activities also provide a "halo-effect" on the broader business: The diversification premium highlighted earlier applies not just to the value of acquired products, but also elevates the franchise value of existing products. As evidenced by accelerated M&A activity in recent years, firms that can leverage M&A create a flywheel effect: Diversification begets a more stable earnings base; a more stable earnings base begets a higher franchise value; a higher franchise value gives managers the "currency" with which to acquire more managers; and a diverse franchise attracts a broader limited partner base in search of integrated solutions providers.

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### The GIP / BlackRock Transaction

As mentioned, BlackRock announced a $12.5Bn acquisition of GIP this morning. GIP is a $100Bn+ infrastructure investor, the largest independent infrastructure manager globally. Its 400 employees and 40+ portfolio companies span real infrastructure assets in the transportation, energy, digital, water and waste sectors. Investments include airports at

Gatwick, Edinburgh and Sydney; large data centers; Suez water and waste; and ports and rail lines, among others.

We view this transaction in the framework discussed earlier. Infrastructure managers have been a thematic consolidation target for larger managers. They benefit from specialized investment capabilities and relationships; persistent secular tailwinds driven by government deficits and the "green transition"; and long-term capital bases with stable management fees.

For BlackRock, the acquisition case is clear: BlackRock has ~$140Bn of illiquid alternative assets today, and this transaction grows illiquid alternative AUM by nearly 80%. Further, BlackRock has $900Bn+ of retail AUM (~$40Bn alternative retail) and a large distribution team to syndicate that product. Plugging GIP into this distribution network will elevate GIP's capital formation capabilities, particularly for "core"-like (stabilized), cash-flowing infrastructure products that are more suitable for retail clients. The acquisition will effectively triple BlackRock's existing infrastructure assets, and – according to BlackRock management – will do so with limited overlap in their underlying investor bases, expanding both business' overall investor TAM. In a growing infrastructure market where scale is necessary to compete for the largest public-private partnerships, BlackRock's backing should also elevate GIP's sourcing competitive positioning.

Notably, the deal benefits from high alignment, an important consideration for GIP's limited partners. Of the $12.5Bn consideration, 75% is in common stock, with a significant long-term deferral. GIP's leadership group will collectively be a top-5 BlackRock shareholder, which should support both sides' incentives to integrate the businesses effectively. Further, incentive fees and GP commitments in existing GIP funds are carved out of the deal, leaving those economics in the hands of the GIP team itself, a positive for alignment with GIP's limited partners.

Finally, the deal should support BlackRock's overall franchise value. BlackRock has struggled to achieve its long-term ~5% growth goals via its traditional asset management businesses; high-growth alternative infrastructure should benefit the overall equity story. Unaffected for the transaction, BlackRock trades at a ~20x forward PE multiple, and it appears to be paying a slightly discounted market multiple for GIP's underlying management fee base (estimated to be in the mid-to-high 20s range). The transaction will have a transformational impact on BlackRock's management fee base from illiquid alternative assets (with some estimates projecting a doubling of this fee base). As discussed earlier in this piece, a growing long-term management fee base should benefit from a higher multiple than BlackRock's overall business.

Below, we present takeaways for limited partners and sponsors. We present a framework that contextualizes the GIP / BlackRock transaction within Arctos' sponsor "levels" framework. We believe this transaction elevates GIP (a "level 8" firm that didn't have a standalone path to becoming a "level 10" firm) within BlackRock (firmly entrenching it as a "level 10 firm"). More on that below.

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**Takeaways for Limited Partners and Sponsors**

For limited partners, consolidation is a double-edged sword. On the one hand, it will allow consolidatees to layer into larger platforms that can support their operations and capital raising, freeing investment teams to focus on generating returns for investors. Further, the largest LPs may benefit from a broader set of integrated solutions offerings to efficiently allocate capital across their risk-return spectrum. Still, limited partners should scrutinize these transactions closely, particularly with respect to incentives: Are their GPs motivated to generate continued outperformance, or simply gather assets to boost fee earnings?

For sponsors, we expect M&A in this space to accelerate as managers face the three challenges outlined in the introduction – *declining fragmentation, eroding beta, and mega-cap competition* – along with the increasing urgency of achieving scale and diversification.

In particular, we expect the following:

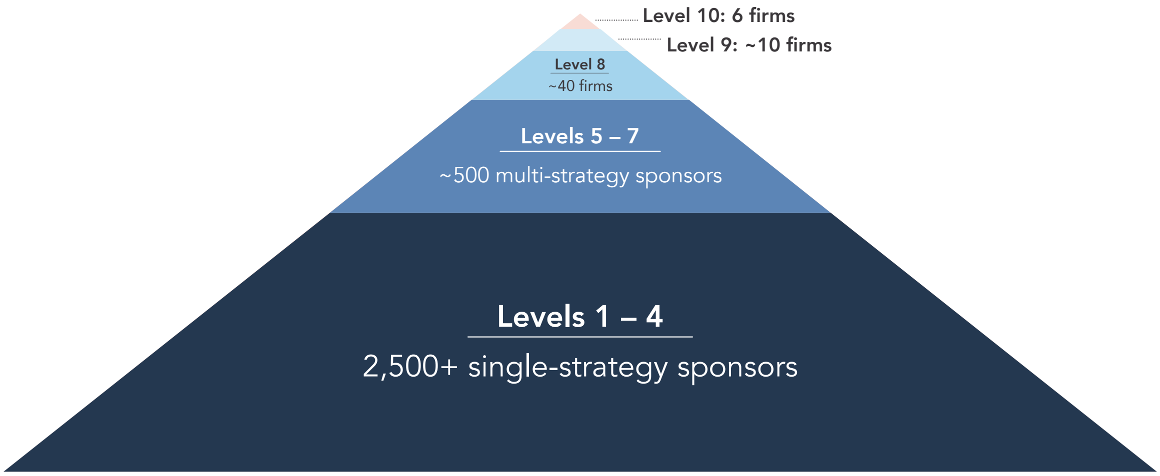
- The largest public sponsors to accelerate acquisitions that enable them to broaden out and access retail;

- A major push from top sponsors, though not necessarily the largest, to acquire the diversifying adjacencies they need to access public markets cost of capital in order to have a right to win. (Both of these would be predicted by the three big challenges.)

We have been increasingly thinking about this with a proprietary framework that uses "levels" to segment and understand the large universe of private markets platforms. A start-up sponsor with no AUM would be level 1. At the top (level 10), you have the largest public sponsors, with international offices and strategies, a diversified product mix across all alts categories, excellent distribution capabilities, and broad or broadening financial services arms (think: new *liabilities* to pair with existing alternative *assets* origination). Our view is that level 10 firms will be active at entrenching their status further – more retail touchpoints, more insurance liabilities, and possibly traditional asset management if those serve to enable the former – and that level 7-9-type firms will be actively seeking public listings or combinations (as in the case of GIP) to achieve level 10 status.

Figure 7.

**Levels of Private Markets Firms (Illustrative)**




Source: Arctos, Preqin. As of January 2024.

But for everyone else, things are less predictable. Growth oriented managers want to reach whatever level at which they can sustainably compete (call this the 'max level'). Diversifying product is clearly important, but some adjacencies are clearly too far afield (would the market value a growth equity GP more if they suddenly acquired a subscale European real estate manager?). The critical question is how to reliably improve competitive positioning and grow fee income without making non-core acquisitions in areas where the GP doesn't have a right to win (i.e., an ability to sustainably harvest alpha).

In our view, an acquisition is worth it if:

- It plays to existing strengths, i.e., combined with current competitive advantages, a GP would have a right to sustainably compete with the capabilities of the target;
- There are strategic and financial synergies, while avoiding dyssynergies (typically in the form of talent loss due to cultural clashes, compensation disputes, or perceived conflicts by limited partners). Synergies may include non-overlapping underlying investor bases that supports cross-sell, complementary sourcing engines, or duplicative operational costs;
- It tackles or capitalizes on the big three challenges, while protecting or enhancing the acquisition target's ability to generate continued alpha.

With the obvious proviso that price and execution are paramount, we believe acquisitions like these should be accretive for the acquiror and serve their twin goals of scale and diversification. We aren't making a judgement call on whether this trend is good or bad for the asset class, but we are highly confident that the trend will continue.

Evaluating fit with existing strengths is harder than it sounds, and it is the critical piece to get right for managers below the highest levels. We have a proprietary framework for evaluating the building blocks of great firms at each level, which in our view can be broken down into partner-level and firm-level competitive advantages ("CAs") across six critical categories. (We may publish framework at a later date.)

We believe that these managers need to ensure that:

- *Whether bought or built, your pattern of CAs must grant you the right to own the new franchise*. By this we mean, if you are a Level 3 mid-market consumer-focused buyout manager, it is important to ask yourself and your firm whether you have the partner- and firm-level CAs to rationalize a proposed acquisition. Is making the necessary enhancements to your CAs to *earn the right* to make the proposed acquisition feasible or realistic? What's a more reliable platform-building step? Can you protect and enhance the target's alpha-generating ability?

- *Targets should be complementary to yours in their pattern of CAs* across their partners or within their firm, while ensuring that a successful culture is not unduly disrupted. This is a fine balance, but ultimately the more successful culture will "win" and the target will integrate. The largest firms are ninjas at nearly everything they do, and are hence large, diverse teams (since no one individual can possibly be good at everything). This ensures that you do not suffer too much from negative dissynergies.

- *Your pattern of CAs (say, in origination or fundraising) should meaningfully enhance the potential of the target.* This ensures you can capitalize on positive synergies.

- *Whether bought or built, you must ensure there's a meaningful probability of alpha generation, driven by historical performance inputs, probabilistic modeling and assessment, and market dynamics.* This is more challenging, but it is both doable and critical. FRE growth and diversification beyond your flagship are positive *outcomes* of a set of carefully cultivated fundamentals that, in our view, ultimately boil down to investment performance in the form of alpha generation. We may one day evolve as an industry to the point where our underlying products are nearly all alpha-neutral, as in the public markets; then differentiation will be in brand, service, product diversity, and distribution alone. But we remain far from that. Investors need a reason to commit to alts, and that reason remains the prospect of alpha.

We believe this framework is a valuable way to think about the lasting consolidation trends highlighted by the GIP / BlackRock combination. As we refine our "Levels" framework, we welcome your insight and thought partnership, and invite you to reach out to your Arctos contacts to discuss this further.