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Worst Time to Sell Funds Since '02 Hurts Lehman Plans

By Sree Vidya Bhaktavatsalam and Jason Kelly

Aug. 22 (Bloomberg) -- Lehman Brothers Holdings Inc., the fourth-largest U.S. securities firm, is exploring the sale of all or part of its asset-management unit to raise money. So are Wachovia Corp., the fourth-largest U.S. bank, and regional lenders Fifth Third Bancorp and National City Corp.

Their timing couldn't be worse as prices for fund companies have fallen to the lowest in six years.

Lehman, based in New York, and the banks may be forced to sell in the buyer's market because they are under pressure from regulators and rating firms to replenish capital drained by a combined $38.2 billion of asset writedowns and credit losses since last year. They already have raised $36.4 billion in equity and preferred shares, limiting their capacity to sell more stock as additional losses loom.

``There's been carnage, so you're going to see panic sales to raise capital,'' Benjamin Phillips, a Boston-based partner at consulting firm Casey Quirk & Associates, said in an interview.

The market's weakness can be measured by the ratio of stock prices to earnings of publicly traded asset managers such as BlackRock Inc. and Legg Mason Inc. A basket of 50 companies worldwide traded at an average of 11 times earnings in the second quarter, meaning investors were willing to pay $11 for each $1 of operating profit. That's down from 17.7 times in the second quarter of 2003, according to data compiled by the Putnam Lovell unit of New York-based Jefferies Group Inc.

Lowest Valuation

It's the lowest valuation for the group since 2002, driven by a 17 percent decline in world stock prices since Jan. 1, as tracked by the MSCI World Index. Also dragging prices lower has been a selloff of publicly traded hedge funds, buyout firms and managers based outside of the U.S.

Lehman rose 69 cents, or 5 percent, to $14.41 in New York Stock Exchange composite trading at $:15 p.m., after a Reuters report today that Korea Development Bank is open to an acquisition of the securities firm. The shares have declined 78 percent this year.

Lehman has contacted potential bidders including Blackstone Group LP, the world's largest buyout firm, and Washington-based Carlyle Group to gauge their interest in the asset-management unit, which oversees $277 billion including funds run by Neuberger Berman LLC, three people familiar with the matter said Aug. 19.

Early Money Manager

The company purchased Neuberger Berman for $3.2 billion in 2003, when it had about $64 billion in assets. Neuberger, started in 1939 to serve wealthy clients, was among the first money managers to offer so-called no-load mutual funds, which don't charge transaction fees. Estimates on the value of the business by four analysts range from $6.5 billion to $13 billion.

Randy Whitestone, a Lehman spokesman, declined to comment.

Wachovia, based in Charlotte, North Carolina, may divest businesses that it doesn't consider essential, Chief Executive Officer Robert Steel said July 21. Candidates include Evergreen Investments, which manages $246 billion, analyst Brad Hintz of Sanford C. Bernstein & Co. in New York said July 28.

Fifth Third Bancorp and National City Corp., both based in Ohio, are exploring the sale of their investment units, according to people familiar with the matter. Fifth Third Asset Management has $22 billion, while National City's Allegiant Asset Management unit oversees $29 billion.

Fifth Third's Debra DeCourcy and National City's Kelly Wagner Amen declined to comment.

`Core Business'

``Wachovia is committed to the asset-management business,'' said Laura Fay, a spokeswoman for Evergreen. The Boston-based firm ``remains a core business for Wachovia.''

The wave of potential sellers, combined with a lack of interest among buyers from within the fund industry, may deflate prices even more, said Erika Cramer, a partner Silver Lane Advisors LLC in New York, which provides advice on asset- management transactions.

``Multiples have come down from their highs and at the same time buyers are being shown a lot more assets,'' Cramer said. ``Buyers can be a lot more selective,'' she said.

New York-based BlackRock, the largest publicly traded U.S. money manager, has a very ``high bar'' to do a new transaction following its acquisition of Merrill Lynch & Co.'s fund unit in 2006, CEO Laurence Fink said during a conference call last month.

At Baltimore-based Legg Mason, which acquired Citigroup Inc.'s money-management unit in 2005, the ``near-term'' priority is to support money funds and existing products, CEO Mark Fetting said July 25.

Broader Appeal

Federated Investors Inc., the fourth-largest U.S. manager of money-market mutual funds, has bought stock and bond-fund managers to appeal to a larger group of investors. In July, the Pittsburgh-based company agreed to buy two funds from David Tice, who is known for his bearish outlook on the stock market.

The company is on the lookout for more acquisitions, said Joe Machi, a director who coordinates mergers and acquisitions at Federated.

``These are very good times, very busy times,'' he said.

Affiliated Managers Group Inc., based in Beverly, Massachusetts, bought stakes in two money managers last month, including Bank of New York Mellon Corp.'s Gannett Welsh & Kotler. Affiliated Managers, which owns stakes in more than two dozen fund companies, will look for ``high-performing, independently managed boutique'' firms, CEO Sean Healey said in an interview.

Close Look

Private-equity firms will take a close look at the fund managers up for sale, analysts said. Buyout firms and other financial buyers participated in transactions of money managers with $116 billion in assets during the first half of 2008, including the June acquisition of American Airlines' mutual-fund unit by TPG Inc. and Pharos Capital Group LLC. That compares with $492 billion in assets in the first half of 2007, a record for leveraged buyouts.

KKR & Co. LP, based in New York, bought a $1.25 billion stake in Legg Mason to help the firm replenish capital as the money manager struggled with subprime-linked losses.

In November, Chicago-based Madison Dearborn Partners LLC completed its $5.75 billion acquisition of Nuveen Investments Inc., also of Chicago, in the largest buyout of an asset manager.

``This is a very attractive business for private-equity firms,'' Burton Greenwald, a mutual-fund consultant in Philadelphia, said in an interview. ``Financing an asset manager with a dependable stream of income will be easier for them.''

Lehman Options

Lehman Chief Executive Officer Richard Fuld is weighing options ahead of third-quarter results next month that may include writedowns estimated by JPMorgan Chase & Co. at as much as $4 billion. The sale isn't Lehman's first choice, and may not appease its critics, JPMorgan analyst Kenneth Worthington wrote in a note to clients Aug. 18.

``We don't think the investors and rating agencies would welcome this divestiture, which brings a steady cash flow, diversification and a lower compensation ratio,'' wrote Worthington, who rates Lehman shares ``neutral.''

Merrill Lynch in July abandoned an effort to sell its 49 percent stake in BlackRock, surprising analysts who had said that investment bank would divest the holding to raise capital. Instead, Merrill Lynch extended an agreement to distribute BlackRock's funds.

Lehman wants to sell 20 percent of its more than $60 billion of ``distressed'' assets in the third quarter, Merrill Lynch analyst Guy Moszkowski in New York, said in a July 28 note to clients.

Blackstone's Angle

Neuberger Berman, which manages more than $120 billion, is the largest piece of Lehman's asset-management business. The company runs $54 billion in money-market funds and $39 billion in private equity and hedge funds. Investment management accounted for a quarter of Lehman's revenue of $2.8 billion in the six months ended May 31. Lehman owns stakes in hedge-fund managers such as D.E. Shaw & Co., which is not included in any potential sale.

Some of the potential private-equity buyers may consider buying a stake as an investment through one of its funds in its traditional leveraged buyout combining cash and debt, said the people familiar with the situation, who declined to be named because the discussions are private.

Blackstone, run by Stephen Schwarzman, may consider incorporating Lehman's business into its unit that manages hedge funds and funds-of-funds, according to a person familiar with the New York-based firm's thinking.

The so-called marketable asset management unit, overseen by Blackstone vice chairman J. Tomilson Hill, has grown to be Blackstone's largest, with assets under management of $52.1 billion as of June 30, up 59 percent from the same period a year earlier.

Diversification of Businesses

Blackstone is expanding its non-private equity businesses to compensate for a lack of LBOs. The firm earlier this year bought GSO Capital Partners LP, a hedge-fund firm, to widen its investments in distressed debt. KKR is expanding its asset- management business with the hiring of William Sonneborn from TCW Group Inc.

``Combining traditional asset management with private equity allows the asset managers to diversify,'' said Randal Stephenson, a senior managing director at New York-based Pali Capital. ``It's all money being invested, but the time horizons and the return horizons are different.''

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