It takes star power to make backers open their wallets

By Mike Foster
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Contrary to popular opinion, it is quite possible to raise finance to start a boutique, even in worsening market conditions. But only rock stars need apply.

Backers are offering relatively generous terms to cover the costs of increasingly onerous regulatory requirements, but only if they believe in the talent they're bankrolling.

James Barham, global head of distribution at listed boutique River and Mercantile, said: "Regulation is tougher. It's more intensive – much more about understanding client needs."

Jean Keller, chief executive of Quaero Capital, a Swiss multi-boutique, is more pessimistic: "As regulatory and structural costs of starting a new business increase, new entrants are being actively discouraged."

These days, it takes a brave rock star to shoulder the cost of self-funding a boutique on their own, **given it can cost £5 million to get a simple operation off the ground**, incorporating the raising of enough capital to cover three years of running costs.

Paddy Morrissey, chairman of asset management at recruitment consultant Sheffield Haworth, said: "Outstanding managers should not have a problem raising finance, provided they structure their businesses the right way."

Alan Bartlett is a seasoned backer of boutiques at Goodhart Partners. He said: “Compliance is more expensive than in the past, but the demand for talent is still strong.”

Richard Watkins, chief executive of placement agent Liability Solutions, said: “Seeding hedge funds is tough these days. But traditional boutiques don’t suffer from crowded trades. They are still good businesses to back.”

Boutiques can still find it easy to raise backing because of the fat returns they generate. Cedar Rock, the boutique managed by former Morgan Stanley manager Andy Brown, is exceptional in achieving an operating profit margin of 95% in the year to October 2015. Out of the proceeds, its shareholders collected dividends of £29 million over the period. Cedar Rock failed to return calls.

Average margins in the asset management sector are 35%. But margins at successful boutiques can be significantly higher than 50% – although asset management business-experts caution that smaller firms structured as partnerships often don't list their working partners' pay as an expense, which can lead to apparently outsized margins.

According to firms' reports for their most recent financial years, UK-listed multi-style boutique Jupiter Fund Management offers a margin of 51%. Ardevora, led by Jeremy Lang and William Pattison, has 78%.

Lindsell Train has 63%. Trinity Street Asset Management, run by former GLG manager Richard Bruce, achieves 75%. Longview Partners, backed by Northill Capital, boasts 86%.

So does Stephen Butt’s low-profile Silchester International, often seen as the doyen of the UK boutique world along with its six affiliates. In the year to March 2015, its pre-tax profits totalled £139 million, liberating remuneration worth £49.1 million for its team. Silchester declined to comment.

As well as fat margins and the possibility of a longer-term takeover, boutiques can please their backers with a break into profit in their first year. A person familiar with Hosking Partners, founded by steam train fanatic Jeremy Hosking, said it started to move into profit a year after inception in October 2013, after capturing $1 billion. It now manages $5 billion.

Pacific Current Group, another multi-boutique operator that is the owner of Goodhart Partners and London alternatives specialist Northern Lights, has a more varied record. But its boutiques have seen an annualised growth in assets ranging between 11% and 54% over five years, according to a company statement.

How can mere mortals attract enough backing to become rock stars? For starters, there are no shortcuts. They need to display a steady career history and single-minded determination to generate returns from their chosen style.

According to Sheffield Howarth's Morrissey, the performance of managers at previous employers needs to be top decile over one, three, five and seven years, although some top-quartile appearances need not be a deal-breaker. Clients can even tolerate fourth-quartile performance periods, assuming managers stick to the style which has served them well over the years.

Hosking's value-driven approach has been eclipsed by growth styles since his boutique launched. But investors are remaining loyal, reassured by his role as a key contributor to performance at his previous firm, Marathon Asset Management, whose global equity fund has made an average 7.8% a year, on average, during the 10 years to March 31, 2016, against 4.1% from the MSCI World index, according to Marathon's website.

Success in protecting investments against loss is increasingly important to clients, according to Diana Mackay, chief executive of data provider Mackay Williams, which monitors the views of fund selectors. She says Carmignac became France's most successful manager by protecting the wealth of its clients during market downturns in its early years.

Diversified strategies have fuelled the growth of bond boutiques, traditionally handled by large firms, such as Bruno Crastes' H2O, Silchester associate Colchester Global Investors, led by Ian Sims, and TwentyFour Asset Management. Vontobel bought 60% of the TwentyFour business in March 2015 for a price likely to value it at close to £100 million, seven years from inception.

The vast majority of boutiques, however, market their skills as proprietary long-term equity investors, taking their cue from consultant Willis Towers Watson, whose preferred long-term strategies have beaten the index by 2.1 percentage points over 11 years.

Equity boutiques that rise above the noise of the market perform particularly well. According to a report published by the Kensington & Chelsea Pension Fund, Longview Partners beat the index by an annualised 7.1 percentage points over five years to March 31, 2016.

Cedar Rock has excelled by investing in companies with a strong business franchise, as has Independent Franchise Partners. Each draws on the successful investment technique originally developed at Morgan Stanley.

Terry Smith's Fundsmith uses a related approach. Since inception in 2011, it has generated an annualised 17.6%, or 7.8 percentage points ahead of benchmark, according to its website.

Consultants at Stamford Associates, Willis Towers Watson and Mercer confirm they are willing to give business to rock stars with a well-defined strategy at an early stage, producing enough income to reduce their need for third-party finance. One consultant said: "We all love a great manager. But if they are great, they need to limit their capacity and we'll all be fighting for business, so we are prepared to move early."

Another way to step up inflows is by signing up for “white label” strategies offered by wealth advisers like Pictet and Julius Baer. GAM has taken advantage of a range of third-party strategies of late. A GAM spokeswoman said THS Partners had run strategies for the Swiss firm since 1983, managed £1.8 billion and ended up being bought by GAM this April.

Online wholesale platforms can raise a great deal more money, given their ability to stimulate the interest of fund selectors and rating agencies across the world, reducing the need for boutiques to fund local marketing personnel.

It can be hard to stand out in a crowd, even with a hot message. But rock stars who develop excellence in operations and marketing can make the grade. The classic example is Woodford Investment Management, whose chief executive Craig Newman joined forces with Neil Woodford to pull in £14 billion from Stamford Associates and online platforms. Woodford’s strong online presence, enthusiastically supported by Hargreaves Lansdown, has kept clients loyal and won more business.

Sanditon Asset Management, run by Julie Dean, Tim Russell and Chris Rice, manages £600 million. According to chief executive Rupert Tyer, it got off the ground by launching an investment trust whose fees financed new funds. Tyer added: “Self-belief is very important in the boutique-building business.”

Closed-end investment trusts are sometimes used as boutique building blocks, because they bring talented mangers permanent capital. Troy Asset Management, for example, has a mandate to manage Personal Assets and Troy Income & Growth. Phoenix Asset Management has just taken over Aurora Investment Trust. Value-driven investment trust North Atlantic Smaller Companies Investment Trust, whose share price has risen 115% in five years, is central to Christopher Mills’ Harwood Capital boutique.

Occasionally, boutiques seek listings for their businesses to raise finance, despite the risk of unwelcome publicity when rock stars happen to fall off stage. Exposure to investment banking advisers can also lead to some boutiques deciding to over-diversify, rather than staying true to their style – a frequent cause of problems.

Jupiter, Ashmore and Polar Capital are larger listed businesses that retain a boutique mentality. Smaller listed boutiques include Gervais Williams’s Miton Group and Liontrust.

Boutiques that want third-party funding more often try to associate themselves with wealthy investors, despite their reputation for driving a hard bargain. Lord Jacob Rothschild; Johann Rupert; Jon Moulton; Michael Spencer, chief executive of dealer broker Icap; and Sir Brian Souter, co-founder of Stagecoach, have all backed investment businesses.

Sir John Beckwith is backer to River & Mercantile and former backer to Liontrust. Italian pharmaceuticals billionaire Ernesto Bertarelli has diversified his family fortune into asset management by backing Northill Capital, Longview's parent. Majedie Asset Management won early backing from the Barlow family. Polar Capital Holdings is backed by the Cayzer family. The March family of Spain owns one of the country's specialist managers.

Lord Weinstock's family office funded the launch of Troy Asset Management, named after his 1979 Epsom Derby winner. Like Weinstock, its founder Sebastian Lyon plays it safe. Managers who fail to find wealthy backers are drawn to the likes of Pacific Currents, Quaero and the NewAlpha Asset Management platform managed by French manager La Française, which has typically bought a 15% to 25% stake in boutiques and aims to be rewarded with a 70% slice of dividends after managers collect their profit share.

Partnership with Silchester would be a particularly attractive option for rock stars who want to team up with Butt, but managers say it is hard to move into his charmed circle.

Goodhart chief executive Bartlett says players find it harder to fund themselves when their capacity is limited. The firm has backed several managers like these taking a stake of between 20% to 30% after offering them operational, compliance and marketing support. "There's no point us being greedy. They would only resent it."