# MoneyVoices: Making Sense of SMith Barney Deal

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Determining whether the Morgan Stanley Smith Barney (MSSB) joint venture is a good deal or not largely depends on which stakeholder group you are a part of. Early on, it's a challenge to see the silver lining for financial advisors, Citi equity holders, clients as well as investment managers, and service providers either working with the two firms or looking to break in. The twin drivers of the joint venture are Citi's desperation and Morgan Stanley's opportunism, not the prospect of a great fit, great synergies or the promise of a better life for the 20,000 advisors and/or the 6.8 MM clients they serve.

**Overview of Stakeholders**


**Clients: No Material Benefits** – This deal is not about the end client. Pricing is not likely to go down and services are not likely to increase. Keep in mind that Morgan Stanley and Smith Barney clients can already tap into a dizzying number of separately managed accounts, mutual funds and exchanged-traded funds. Therefore, no substantial benefit will come to clients from a product access point of view.

**Financial Advisors: Mixed Bag** – This deal is likely to be perceived as yet another agitation to an already very unsettled group. Most financial advisors have been looking for changes to make their jobs easier. Now those advisors will take a back seat as management focuses on merger integration. Lower-end producers may be pushed out while larger producers will likely receive a retention bonus of 100% of gross in exchange for a five year commitment to stay at the firm. Payouts are not likely to change (as that was done just prior to this deal) and internal competition and wrangling will likely be a productivity-reducing distraction.

**Citi Equity Holders: Bad Deal, But Alive** – Management just sold half of the crown jewel at trough-level valuations and is putting it into the hands of an owner that has had significant difficulties growing and managing their own brokerage business over the recent past. We may never know if this is the move that prevented a Lehman Brothers-like collapse, but it is much more likely that the U.S. government's $45 billion investment will have a bigger impact than the $2.7 billion in cash and $10 billion in tax benefits from this joint venture. Perhaps this underscores the desperation of Citi's current position.

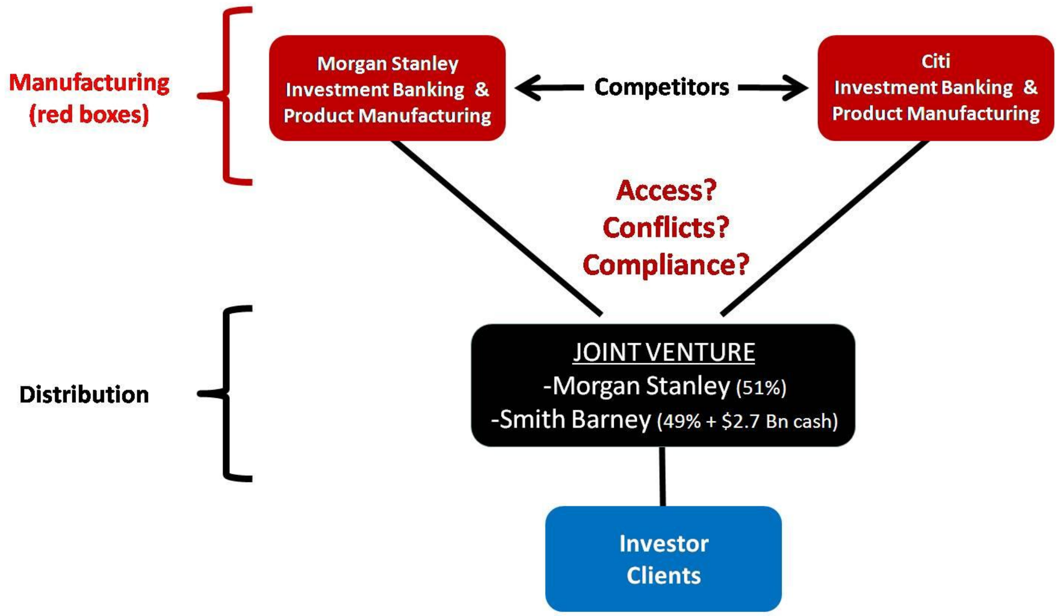
**Morgan Stanley Equity Holders: Potentially Great Deal** – Morgan Stanley just purchased and gained control of the most valued retail force in the securities business. It also secured the option to buy the remaining pieces over the next five years, although the terms of those options remain to be seen. While this is a bet with plenty of risk, it's a bold and opportunistic move from a smaller player that has struggled to forge a clear vision and growth path in this industry.

**Third Party Investment Managers and Other Supplier Partners: Fine Near Term, Trending Worse Over Time**– The initial world order will likely be one of inclusion rather than exclusion. At the headquarters, decisions are likely to be on hold or to come slowly in the coming year. Decreasing the amount of business partners will likely not occur initially. For those not already contracted as a partner, it will be very difficult to gain entry. Now with larger scale and greater power, vendors should expect MSSB will be coming to them with the request to reduce pricing. The already rigorous process of getting past due diligence is likely to become meaningfully more difficult as a result of the recent decline in financial markets not as a result of this joint venture.

Other big picture thoughts to keep in mind.

History has shown us that joint ventures as a business structure are more likely to disappoint than succeed. This is particularly true of large scale ones. At the wirehouses, the retail business is inextricably tied to the manufacturing business, particularly in the areas of munis, research, stock lending, and deal syndication.

Citi and Morgan Stanley are fierce competitors at the investment banking and product manufacturing level. How they are going to share access to the MSSB joint venture will likely prove very challenging on many levels.




Citi and Morgan Stanley have built their brokerage empires in large part through numerous acquisitions of related businesses. Anybody who has been behind the scenes knows that it is a complex and nested operation that has not been integrated but just happens to function. A joint venture will make the necessary clean up less likely and could hamper otherwise realizable synergies from this deal.

While the dismantling of mega financial supermarkets may prove to be the prudent strategy of the day, all should have eyes wide open as we go from supermarkets to supersized. To a large extent, a brokerage firm with 10,000 plus advisors has proven to be an unwieldly business endeavor. As with McDonalds, more of what is unhealthy is likely not a good thing.

| **Morgan Stanley Smith Barney Statistical Overview** | |
|---|---|
| Brokers | 20,000 |
| Branches | 1,000 |
| Assets | $1.7 trillion |
| Revenues | $14.9 billion annual |
| Non-Grid Expenses* | $7.3 billion annual |
| Grid Payouts (est. @ 35% of annual revenue) | $5.96 billion annual |
| Clients | 6,800,000 |

| **Analysis** | |
|---|---|
| Brokers per branch | 20 |
| Revenues per broker | $745,000 annual |
| Clients per broker | 340 |
| Assets per broker | $85 million |
| Non-grid expenses per broker | $366,667 annual |
| Assets per client | $250,000 |

## About ECHELON Partners

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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