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Alts Boutique Buys Shop for Convertible Push

by Scott Johnson

SSI Investment Management, a Beverly Hills-based alternatives boutique specializing in market neutral and convertible arbitrage strategies, has acquired a local rival that bought its independence from Merrill Lynch and First Republic Bank in late 2007. Los Angeles-based Frolely Revy Investment Management brings along an institutional asset base of \$450 million and a convertible securities strategy that may be poised for recovery in 2009.

Terms of the deal, which closed earlier this month, were not made public, but the principals of Frolely Revy received an ownership stake in the combined firm. Both sides say the deal strengthens the investment research and marketing of their existing strategies.



Amy Jo Gottfurcht
Chairman
and CEO
SSI Investment
Management

“We felt that Frolely Revy’s long-only product offering would fit beautifully within our product line,” says SSI chairman and CEO Amy Jo Gottfurcht. “We could not have found a better fit in terms of the experience base, a solid performance record and professionals that would fit culturally with SSI.”

Frolely Revy says the move allows it to expand despite difficult market conditions. “We’re looking for ways to strengthen our product offerings,” says senior v.p. Andrea Revy O’Connell, who was CEO, president and a portfolio manager of the firm her father, Thomas Revy, co-founded in 1975. “It’s hard in this environment to be a single-style firm. We wanted to fill out what’s available to our clients.”

Discussions with SSI began roughly a year ago. “I didn’t want to shop us around,” says O’Connell. “It’s for more than financial or business reasons. I wanted a firm where the culture was the right fit.”

That would suggest the boutique began looking for a buyer not long after winning its independence from First Republic in September 2007. Frolely Revy had been autonomous for most of its existence but was purchased by First Republic in May 2002 for \$18.5 million in stock and cash, plus additional payments. At that time, Frolely Revy had \$2.2 billion in assets, which it grew to \$4.4 billion in 2004.

Assets began to slide after that, as convertible securities fell out of favor, but the real trauma came when Merrill Lynch purchased First Republic in 2007. Frolely Revy resigned \$600 million of high-net-worth assets on its own around that time due to scale issues, but terminations after the Merrill buy helped to reduce the firm’s base from about \$3 billion to \$800 million. “That announcement created a lot of damage to my client base,” says O’Connell. “It was good news and bad news. The bad news was that we lost assets; the good news was that we were able to buy ourselves back as a result.”



Andrea Revy O’Connell
Senior VP
SSI Investment
Management

The firm was not able to recover any of the assets it lost in the Merrill acquisition. “I look at it through perfect hindsight at this point, and I’m not sure what would have happened to us as a small firm buried in the Merrill Lynch and now the Bank of America organization,” says O’Connell. “I’m not sure if we would exist.”

The most recent transition has been smooth, in part because SSI and Frolely Revy already had a close relationship, says Gottfurcht. The firms have lost professionals to one another in the past, hold some clients in common and share a history as Southern California boutiques. SSI was founded in 1973 by Gottfurcht's husband, John.

All seven of Frolely Revy's investment professionals, including lead institutional portfolio manager Ravi Malik, will move to SSI this week, along with two associates in operations and marketing. The firm's COO, Ann Houlihan, will move to SSI temporarily but is not expected to stay on. SSI had 29 employees prior to the deal, including 13 investment professionals.

"Given our relative asset sizes and revenue streams, it probably makes more sense to put ourselves together, rationalize on marketing and operations and keep the investment teams intact," O'Connell says.

Added to SSI's existing asset base of \$700 million, the combined operation manages roughly \$1.2 billion for institutional investors across strategies that include equity and blended market neutral, hedged convertible income, 130/30 and portable alpha. SSI has seen about \$50 million in asset inflows in the last three months, which Gottfurcht attributes to the firm's conservative approach. "I think people really are going to start looking at risk much more carefully," she says. Frolely Revy's team will continue to manage traditional convertible securities while serving on the investment committee overseeing SSI's products.

SSI says consultants have praised the acquisition in private discussions. "The acquisition of Frolely Revy adds intellectual capacity and additional strategy capabilities," says Emily Colella, SSI's marketing manager and senior v.p. for institutional client service. "Frolely Revy has been held in very high regard by both the institutional and consultant communities."

Convertible securities – typically fixed income instruments that can be exchanged for a predetermined amount of common stock – can fit into either the equity or fixed income buckets of an investor's portfolio. In theory, says O'Connell, such strategies are expected to absorb about half of the equity market's downside while capturing two-thirds of its upside.

Forced selling by investors amid last year's liquidity crunch shook the market for convertibles. The Merrill Lynch all-qualities convertibles index fell by roughly 50% from May to late November of last year, and a recovery has been slow.

But some in the space expect a strong rebound in 2009. Calamos Asset Management founder John Calamos released a white paper in December underscoring a "very rare opportunity" in an extremely undervalued market for convertibles. Frolely Revy agrees with that outlook and says it has already begun to see demand pick up, although asset flows still lag the increased volume of Requests for Proposals.

"More people are interested in learning about convertibles because the opportunity looked so clear at the end of last year," says O'Connell. "The biggest hurdle I'm actually facing is that a lot of pension funds and other clients are a bit frozen up because they don't want to realize the losses in other parts of their portfolios to do the reallocation."

Meanwhile, Frolely Revy co-founder George Frolely joined GAMCO Investors in late February as a consultant to that firm's convertible strategies, with some role in marketing and sales. Frolely stopped managing assets with Frolely Revy in 2005 but had remained as chairman.