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Taking the LONG VIEW

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on the future of Federated
Investors with acquisition**

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Chris Donahue bets big on the future of
Federated Investors with acquisition

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J Christopher “Chris” Donahue’s long-term view paid off when Federated Investors Inc. acquired a majority interest in Hermes Investment Management in July 2018 for approximately \$340 million.

“This has been a big deal for us,” says Donahue, president and CEO. “One of the things that’s really exciting about it is that we were working on this deal for almost six years. The analysts had thrown in the towel on me, saying, ‘Yeah, you guys are never going to do anything.’”

Hermes is a London-based pioneer of investment strategies that consider environmental, social and governance criteria, with around 400 employees. It was created by a British pension plan, BTPS, which retains 30 percent ownership with the option to sell the residual to Federated after three years.

“We made offers, and then finally they were ready and that’s why it happened. So, this took a lot of patience and perseverance,” he says, adding had Federated been able to buy its majority interest five years ago, the price would have been lower, but it was still a fair deal.

It’s unusual for a public company to have the patience to wait six years to close a deal. However, Federated has an AB stock structure, with the voting stock controlled by the original families. Analysts can comment, but they don’t influence operations, enabling the company to accomplish a long-term, sustainable investment.

The combined companies had annual revenue of \$1.135 billion last year with about \$460 billion in assets, and while Federated was the larger business, with about 1,500 employees, Donahue calls it a reverse

transformation. He plans to incorporate Hermes’ investment strategy and international footprint into the Pittsburgh-based investment management company.

“Usually the person doing the buying transforms what was bought. We’re going to do it exactly the reverse,” says Donahue, whose father started the company with two high school friends.

The acquisition is one of the biggest in Federated’s 64-year history. Of its 60 mergers and acquisitions, all but a few were asset roll-ups, including the purchase of \$14 billion in assets from PNC Financial Services, which was announced in May.

“There really was no overlap of investment management between our companies. This is not one of those deals where you misuse the word synergy,” Donahue says. “To investment analysts, synergy means dead people. To us, synergy means that you have complementary investment managements that can advance the ball for the future.”

Take the long view

Donahue — who took over as CEO in 1998 — says when doing a merger, one of the first things the investing community looks at is how much money will be saved by cutting expenses. With Hermes, Federated didn’t plan to cut any expenses.

“We’ve told the Street this year that we’re going to invest at least \$5 million more this year in various marketing of our Hermes products over here in the U.S.,” Donahue says. “That is certainly not going to be a positive for current earnings, but we wouldn’t make that bet if we didn’t think it was a good bet for longer-term earnings.”

So far, the integration has gone well. Hermes’ data

are being added to Federated portfolio manager work stations as quickly as possible, and Federated is hiring to create a U.S. department that will serve active owners who are interested in socially responsible investing.

In addition, three new funds have been rolled out with three more expected this year, Hermes investment expertise has been presented to Federated's institutional clients and Hermes products are being added to small managed accounts.

Federated's London staff has moved over to Hermes' office, and Hermes will be putting people in Federated's Frankfurt office. The two operations in Dublin remain up in the air until Brexit is decided.

"We bought Hermes last summer, knowing full well that nobody knew what was going to happen with Brexit," Donahue says.

Again, that signals a commitment to long-term decision-making, he says. It was the right thing to do, no matter what.

Two peas in a cultural pod

In Donahue's experience, an acquisition's



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success comes from the cultural fit and the business model.

"You get those two things right, nine out of 11 times, you're going to do fine," Donahue says.

It also requires perseverance, patience and an ability to stoop to conquer.

While it's not always easy to gauge the cultural fit before the deal goes through, it is crucial to do so.

"You can't buy a suit, figuring that you're going to lose weight and go fit into it. It just doesn't work," he says.

Federated had five years of cultural due diligence with Hermes, and Donahue says they found similarities across the board. Federated has always had a culture that allows individuals dignity, where each employee has the ability to paint

their own picture.

"They have to stay on the canvas because we have compliance rules, and we've got other canvases and other painters, but it shows that we support your creativity, knowledge and understanding of what you can do," Donahue says.

The first time Federated met with Hermes executives, he says, they used the same example to describe how they saw themselves. The two companies also emphasize sustainable investing. With Federated, that means seeking investment performance excellence by keeping fiduciary duty front and center; for Hermes, that translates into a focus on environmental, social and governance criteria.

The people also were similar.

"If you took our head of HR and put her over in London, and took their head of HR and put him over here, you wouldn't be able to tell the difference," Donahue says.

The overlap between bonus plans, hiring practices, etc., is not 100 percent, but it is a thing of beauty, he says.

The end of an era

While the Hermes acquisition is setting up the future for Federated, on another level, the company has gone through an ending.

Donahue's father, John F. Donahue, died in 2017, and another co-founder, Richard B. Fisher, died in 2018. Both men's sons are on the executive team, indicative of how the first generation set up succession.

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“So, yes, it is the changing of an era, but one of my responsibilities is to maintain and enhance the culture,” Donahue says.

The painting on canvas analogy originally came from the founders; it was just how they looked at things, he says. They also wanted everybody to enjoy coming to work.

“If you enjoy coming to work, you have gratitude. Because if you have gratitude in your heart, you will have joy,” Donahue says. “On the other hand, if you feel entitled, then you will not be satisfied. You’ll be frustrated, angry or worse.”

Donahue’s influence has come from realizing that when people are unhappy, first look at whether it’s worth changing the structure. If not, then that person’s life work should be somewhere else.

“Then at least by the subtraction method, you end up with a lot of people who enjoy coming to work,” he says.

The company also continually looks at succession. Each year, the board reviews all of the major departments and articulates succession plans for each. That might mean one individual, a group of individuals or looking out to other parts



of the company. With Donahue’s job, a handful of people on the executive staff have been identified as people who could take over if he’s hit by a bus tomorrow, Donahue says.

“We have to look at this. It’s part of your fiduciary duty, and our board is very, very attentive to it, as are our executives,” he says. “Then, this methodology is passed down through so that you’re always looking at ‘OK, who could do this?’”

Two years ago, for example, Federated’s head of sales retired. The company replaced him from a pool of five A-plus candidates in the company’s salesforce of 190.

“We are not infallible, and we do not live forever. These are two very important points,” Donahue says. ●

Views are as of March 29, 2019, and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

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50271 (6/19)

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NAME:

J. Christopher “Chris” Donahue

TITLE:

President and CEO

COMPANY:

Federated Investors Inc.

Born: Roswell, New Mexico, at Maxwell Air Force Base

Education: History degree from Princeton University, law degree from the University of Pittsburgh

What was your first job, and what did you learn from it?

My first job was buying a snow machine and trying to make money, shoveling snow in Pittsburgh. My father lent the majority of the money. I think the machine was \$100; my sister put in \$20 and I put in \$10. This was during the snow season. We started making a few payments.

The next year, there was no snow, and my father foreclosed the loan. He took back the snow machine. We paid the labor first, so I had made more than \$10. But my sister Kathy was only an investor; she lost everything. We were probably 12 or 13.

You come from a big family, right? Nine sisters and three brothers. Mom and dad had 84 grandchildren. In February, triplets were born, so mom now has 130 great grandchildren. My grandchildren are ninth-generation Pittsburgh, and by the way, there are 38 of those. At the family reunion last year, we had 240 of 256 show up.

How are you involved with the community?

I’m on the board and executive committee of the Allegheny Conference on Community Development. I’m also on the board of the World Affairs Council of Pittsburgh, Saint Vincent College and the Lumen Institute.