VALUE FOCUS

Asset Management Industry

SEGMENT FOCUS
Alternative Asset Managers

2015

Q1: Mutual Funds
Q2: Traditional Asset Managers
Q3: Alternative Asset Managers
Q4: Trust Banks

VALUE FOCUS

Asset Management Industry

Segment Focus

Alternative Asset Managers

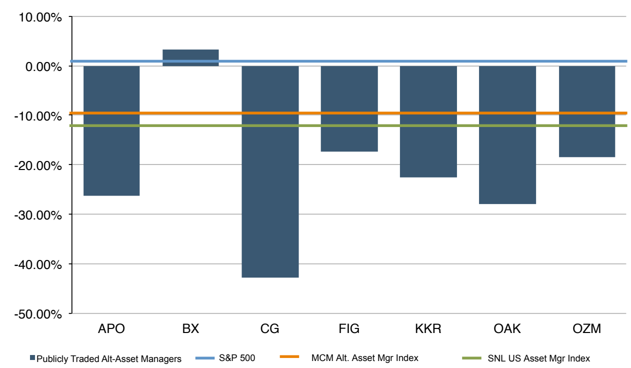
A particularly rocky quarter for the equity markets precipitated huge market cap losses for most of the publicly traded hedge funds and PE firms. The lone bright spot and only sector component to generate a positive return over the last year is Blackstone, which benefited from strong performance fees on its portfolio company investments earlier this year. Still, the stock is down over 20% since its peak in May, which shows just how volatile the industry can be, particularly during times of market distress (a recent post, "**Rough Quarter for the RIA Industry**," from our new blog, *RIA Valuation Insights*, discusses the impact of the recent downturn on asset manager shares – **http://mer.cr/1MbyO6g**).

With over $300 billion in AUM, Blackstone's size is both a blessing and a curse. On the one hand, a large AUM base affords it the opportunity to invest in a multitude of asset classes and industries to enhance its risk/return profile with a diverse product offering. But, size can be a drag on performance and cut into carried interest fees if the underlying fund's stature trumps viable investment opportunities. Still, some of this risk is mitigated by the added stability of higher management fees from a larger asset base. And the market doesn't seem to mind this trade-off as AUM fees represent a relatively stable source of income to complement unpredictable and often inconsistent returns from carried interest.

Stocks of publicly traded PE firms have typically displayed more volatility than traditional money managers, and building larger funds with longer investment horizons may be one way to temper this disparity. Diversifying fund offerings beyond LBOs and into other asset classes such as hedge funds and real estate also helps. Sector analyst Marc Irizarry at Goldman Sachs notes, "All of these firms… have done a lot to diversify their businesses or to position themselves to grow assets on a more sustainable basis." Indeed alt manager shares have outperformed the RIA index as a whole over the last year, albeit by a fairly small margin.

Stock Price Performance

For the Twelve Months Ended September 30, 2015



Source: SNL Financial

Much of the divergence in financial and investment performance within the alternative asset manager sector can be explained by timing. A *Bloomberg News* piece in *Financial Advisor* expounds, "buyout firms' earnings rarely follow a linear path because they are driven by the lumpy timing of exits as well as the "mark-to-market" valuations of fund holdings, which are vulnerable to market swings and required each quarter under accounting rules." The economic cycles and gyrations in the stock market since the financial crisis have compounded this volatility as many of the deals that were struck at the last buyout peak of 2005 to 2007 have taken longer to exit at profitable levels, so their shareholders have yet to witness a full fund cycle while these businesses have been publicly traded.

Irizarry elaborates, "[alternative asset managers] are still 'show-me' stories in the eyes of the market. There's some reluctance on the part of investors to ascribe higher valuations on these managers until they see how sustainable these businesses really are."

Market Overview
Third Quarter 2015

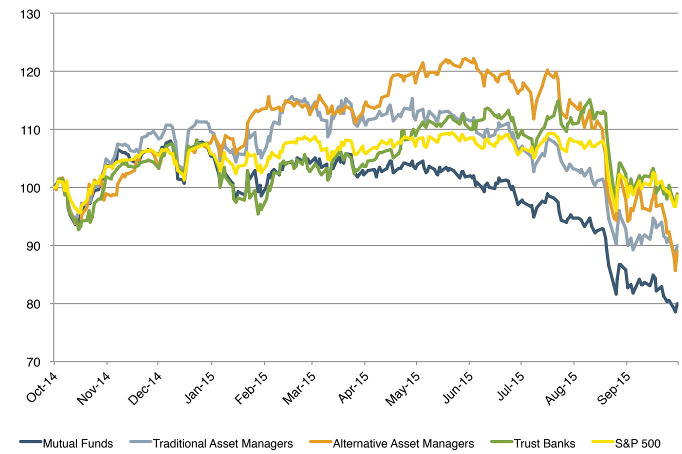
Q3 was an especially bad quarter for asset managers, with the group losing over $40 billion in market capitalization during a six week skid. Given the sector's run since the last financial crisis, many suggest this was overdue and only pulls RIA valuation levels closer to their historic norms. The multiple contraction reflects lower AUM balances and the anticipation of reduced fees on a more modest asset base.

The most recent sell-off brings the industry to the brink of a bear market despite the S&P being down only 10% or so over the last few months. Such underperformance is not surprising for a business tethered to market conditions and investor sentiment. The market is acknowledging that revenue for equity managers is directly tied to index movements and earnings often vary more than management fees due to the presence of fixed costs. Combining these dynamics with some multiple contraction reveals the market's rationale for discounting these businesses in recent weeks.

The outlook also remains uncertain and will ultimately be determined by market movements and asset flows. We're neither smart enough nor dumb enough to predict future market movements and will defer that to the experts. As for asset flows, fee-richer active funds are losing ground to indexes and alternative products despite typically outperforming more passive strategies during market downturns. Overall, asset flows to riskier products (active or passive) are unlikely to improve until the recent volatility declines to more normal levels.

Asset Managers Index

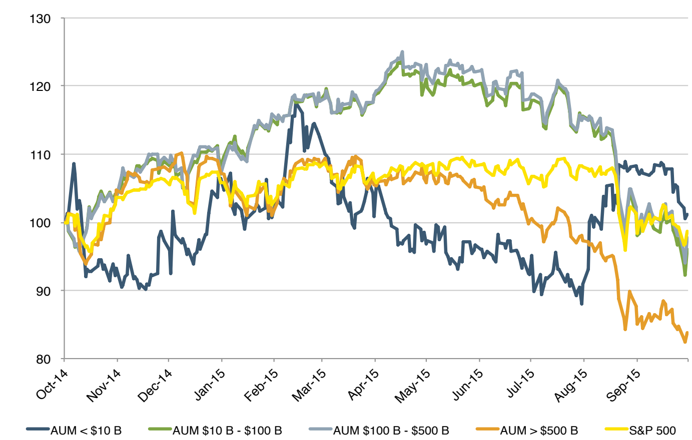
Breakdown by Type



Source: SNL Financial

Asset Managers Index

Breakdown by Size



Source: SNL Financial

What We're Reading

Erik Hirsch on Private Equity
McKinsey & Company: Aly Jeddy and Bryce Klempner
http://mer.cr/1LmcDth

The Decline and Fall of Fund Managers
WSJ's MoneyBeat: Jason Zweig
http://mer.cr/212Fqyp

We Know What Your DGF Did Last Summer
Financial News: Mark Cobley
http://mer.cr/1WZ1SJp
(subscription required)

M&A Review
Third Quarter 2015

Despite the recent setback in the markets, RIA transaction activity posted solid gains for Q3 and into the month of October. We caution against reading too much into this since transaction value is often not reported, though it is promising that the number of deals has increased fairly consistently over the last year. The fourth quarter looks to continue this trend with Hellman & Friedman's recent purchase of Edelman Financial (covered in the recent post, "**Monday Morning Quarterback: Edelman sells for $800 million (!)**," from our new blog, *RIA Valuation Insights* – **http://mer.cr/1NkNKSC**).

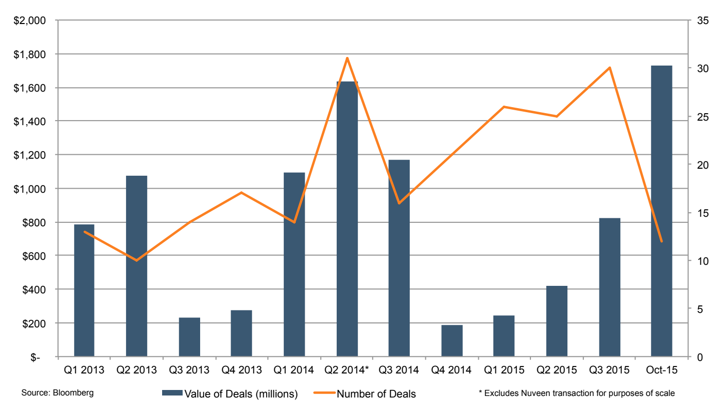
The quarter-end multiples for the public RIAs reveals that pricing remains firm but not egregious, a conducive environment for continued transaction activity in the sector. Prospective buyers will also be intrigued by many of these businesses now trading at a 30% discount to their 52 week high.

Placing the recent uptick in its larger historical context reveals a lull in deal making after the active 2006 to 2009 period that culminated in BlackRock's purchase of Barclay's asset manager business.

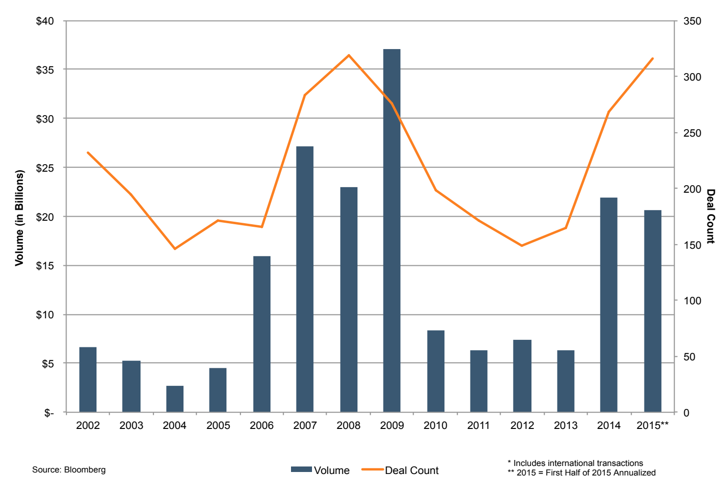
The sector's ability to shrug off the most recent correction is a testament to its resiliency in the face of declining management fees and impending regulatory changes (covered in the recent post, "**What are you afraid of this Halloween? FinCEN**," from our new blog, *RIA Valuation Insights* – **http://mer.cr/1GD8TrC**). Despite the recent uptick, we believe the backlog for deal making remains fairly robust given the four year pause in transactions from 2009 to 2013 and the aging demographics of many investment management firms. The real threat to deal making would be a longer, more pronounced downturn in the equity markets that would crater AUM levels and investor confidence. We note the decline in transaction activity following the financial crisis of 2008 and 2009 as indicative of what another bear market could do to M&A trends.

The outlook for deal making is therefore more nuanced and dependent on market conditions. The market's stabilization since the last correction has clearly boded well for sector M&A, and the future appears bright – as long as security pricing holds up. Another significant setback would likely curtail the recent momentum and valuation levels.

Announced RIA Acquisitions Since 2013



Asset Manager M&A Since 2002*



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Asset Manager Multiples by Sector

				Pricing as of September 30, 2015			
	Ticker	9/30/15 Stock Price	% of 52 Week High	Price / Trailing EPS	Price / Forward EPS	Total Capital / AUM	Total Capital / EBITDA
TRADITIONAL ASSET MANAGERS							
Affiliated Managers Group, Inc.	AMG	$170.99	74.14%	18.09	11.63	1.74%	8.27
BlackRock, Inc.	BLK	297.47	77.70%	15.01	13.45	1.15%	10.92
Legg Mason, Inc.	LM	41.61	70.30%	15.01	11.75	0.81%	10.92
Pzena Investment Management, Inc.	PZN	8.90	72.65%	16.79	16.70	2.10%	10.65
Westwood Holdings Group, Inc.	WHG	54.35	79.81%	14.97	nm	2.02%	10.50
Group Median			**74.14%**	**15.01**	**12.60**	**1.74%**	**10.65**
MUTUAL FUNDS							
AllianceBerstein Investments, Inc.	AB	$26.60	81.25%	13.50	12.46	nm	12.20
Calamos Asset Management, Inc.	CLMS	9.48	65.65%	17.24	18.43	0.87%	nm
Cohen & Steers, Inc.	CNS	27.45	58.21%	16.74	13.39	2.49%	9.85
GAMCO Investors, Inc.	GBL	54.90	60.83%	13.79	12.17	3.36%	9.22
INVESCO Ltd.	IVZ	31.23	74.27%	12.96	10.70	2.54%	11.72
Franklin Resources, Inc.	BEN	37.26	62.70%	9.99	10.86	2.90%	7.27
Diamond Hill Investment Group, Inc.	DHIL	186.04	89.01%	16.36	nm	3.78%	10.56
Eaton Vance Corp.	EV	33.42	71.49%	16.30	13.00	1.43%	9.49
Hennessy Advisors, Inc,	HNNA	23.76	95.04%	13.53	nm	2.75%	9.13
Manning & Napier, Inc.	MN	7.36	88.00%	nm	8.18	0.25%	nm
T. Rowe Price Group, Inc.	TROW	69.50	78.41%	14.88	13.67	2.31%	8.22
U.S. Global Investors, Inc.	GROW	1.67	46.39%	nm	nm	3.24%	nm
Waddell & Reed Financial, Inc.	WDR	34.77	67.07%	10.05	10.63	2.57%	6.39
Federated Investors, Inc.	FII	28.90	80.84%	19.40	14.10	0.93%	12.27
Virtus Investment Partners, Inc.	VRTS	13.60	71.67%	nm	nm	3.24%	8.87
Janus Capital Group Inc.	JNS	17.18	66.59%	14.78	11.76	1.58%	nm
Group Median			**71.58%**	**14.78**	**12.31**	**2.54%**	**9.35**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management, LLC	APO	$17.18	66.59%	45.21	7.84	2.97%	9.05
Brookfield Asset Management, Inc.	BAM.A	nm	nm	13.37	24.97	nm	9.68
Blackstone Group L.P.	BX	31.67	71.28%	12.62	8.80	5.87%	nm
Carlye Group, L.P,	CG	16.80	52.70%	11.51	6.11	0.68%	8.20
Fortress Investment Group LLC	FIG	5.55	64.16%	13.88	6.07	2.54%	7.03
Kohlberg Kravis Roberts & Co.	KKR	16.78	67.01%	10.83	6.01	23.08%	nm
Oaktree Capital Group, LLC	OAK	49.50	86.74%	22.00	12.07	15.57%	nm
Och-Ziff Capital Mgmt Group LLC	OZM	8.73	64.71%	11.96	5.98	nm	13.39
Group Median			**66.59%**	**13.00**	**6.98**	**4.42%**	**9.05**
TRUST BANKS							
Northern Trust Corporation	NTRS	$68.16	86.01%	17.66	15.26	nm	nm
Bank of New York Mellon Corporation	BK	39.15	86.14%	15.60	12.23	nm	nm
State Street Corporation	STT	67.21	82.71%	15.93	11.79	nm	nm
Group Median			**86.01%**	**15.93**	**12.23**	**nm**	**nm**
OVERALL MEDIAN			**71.67%**	**14.97**	**11.79**	**2.51%**	**9.58**

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In This Issue

About Value Focus Asset Management Industry

Mercer Capital's Value Focus is a quarterly publication providing perspective on valuation issues pertinent to asset managers, trust companies, and investment consultants. Each issue highlights a market segment: 1st quarter: Mutual Fund Companies, 2nd quarter: Traditional Asset Managers, 3rd quarter: Alternative Asset Managers, and 4th quarter: Trust Banks. View past issues at www.mercercapital.com.

About Mercer Capital

As one of the largest valuation firms in the United States, Mercer Capital provides asset managers, trust companies, and investment consultants with corporate valuation, financial reporting valuation, transaction advisory, portfolio valuation, and related services.

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