ASSET MANAGEMENT INDUSTRY

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SEGMENT FOCUS: ALTERNATIVE ASSET MANAGERS

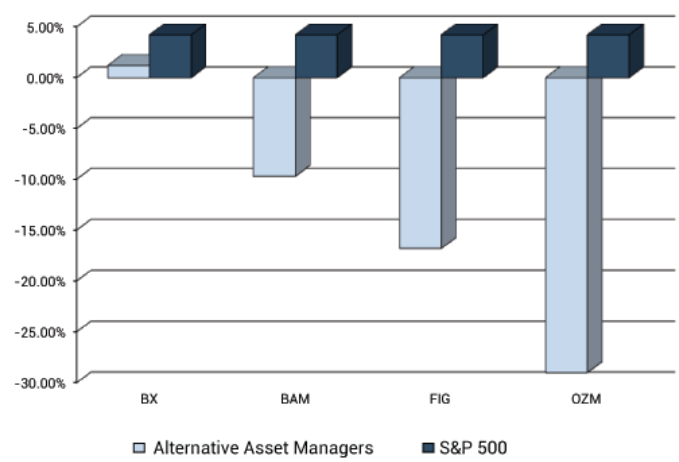
Once the darlings of Wall Street, hedge funds and other alternative asset classes have struggled to recover AUM post Lehman, as dissatisfied investors are still reluctant to pay higher fees and have their cash locked up for months, or even years, at a time. Hedge funds, for example, underperformed absolute return managers by 19% in 2008 and 7% through August of this year, according to data provider Hedge Fund Research. As a result, many high net worth investors seem to be seeking alternatives that do not amplify returns with leverage or tie up their funds in underperforming asset classes.

Indicative of the sector's recent hardships, all four components in our index of alternative asset managers have underperformed the S&P over the last 12 months. The publicly traded hedge funds, Och-Ziff and Fortress, have led the downward charge, as these high beta businesses continue to consistently post losses.

Still, with the recent uptick in the global equity markets, there is some room for optimism. As of this writing, October 2011 had already wiped out the previous month's losses, which saw hedge funds slide 2.6% in September compared to the S&P's 7.2% decline, as measured by Merrill Lynch's Investable Hedge Funds index. Analysts at Merrill also noted that several hedge funds and managed futures funds have recently moved to shorting stocks and increasing positions in gold, suggesting a departure from the buy low, sell high concept, which may concern their underlying investors.

Private equity firms haven't fared much better in this environment, as an anemic IPO market and contraction in leveraged loan financing have precluded any momentum gained from rising stock valuations in 2010. These trends have also trumped a recent uptick in fund allocations to private equity and other alternative investments, as wealth managers seek asset classes with relatively low correlation to the equity markets and higher returns than those currently offered by fixed income and cash positions.

TOTAL RETURNS FOR 12 MONTHS ENDED 09/30/11



Still, more cautious advisors are skeptical of the perceived lower correlation between the private and public equity markets. Iaian Scouller of Oriel Securities notes, "The biggest danger to the sector is that you get a fall in [public] equity markets, and realizations go on hold."[1]

Tom Becket of PSigma Investment Management elaborates, "I think there are some interesting opportunities in private equity, but you need to think about the outlook for 2012 and 2013. We're becoming increasingly concerned that we might be coming to the end of a positive business cycle. I would regard private equity as a very high risk right now."[2]

1 Ross, Alice. "Investors Cautioned on Private Equity." *Financial Times*, July 8, 2011.

2 *Ibid.*

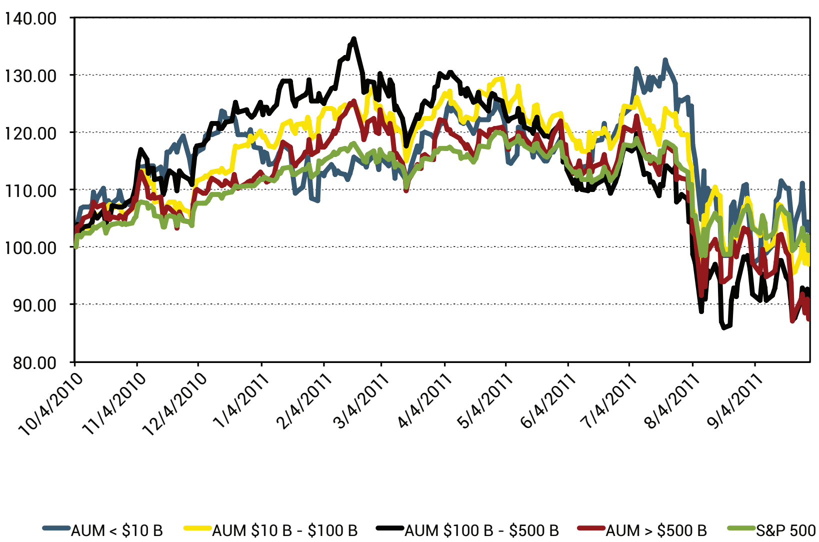
Market Overview: 2011 Q3

Publicly traded asset managers lost a quarter of their market value in the 3rd quarter of 2011, nearly doubling the loss of the major indices over the same time period. For businesses whose top lines are tied to market performance and have operating leverage in their cost structure, this disparity is not so alarming. What is somewhat surprising is that the traditionally more conservative trust banks have underperformed all of its peer sectors over the last 12 months, as indicated by the adjacent graphs. The combination of a near-zero federal funds rate and stock market correction has eroded trust banks' lending margins and curtailed the revenue they receive from managing and administering client assets, precipitating a significant decline in their share prices over the last two quarters.

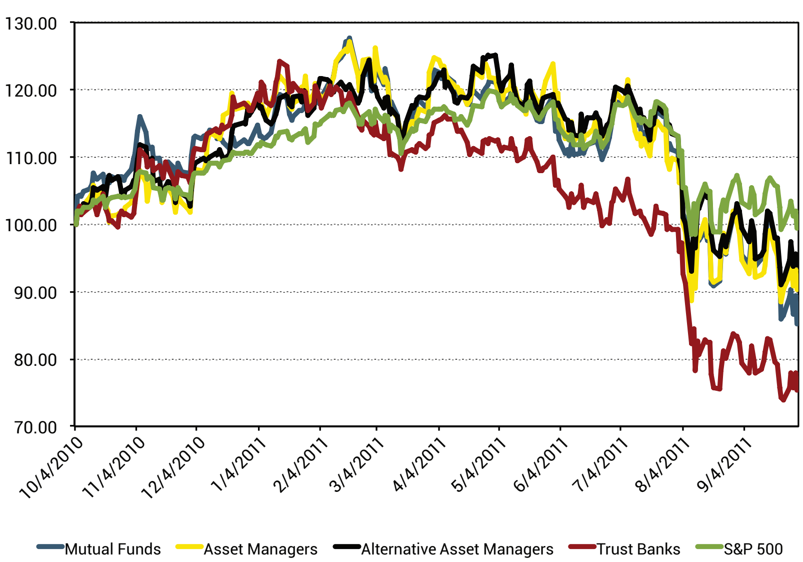
Another interesting trend in recent quarters is smaller, publicly traded asset managers' outperforming their larger counterparts in terms of share prices and total returns. The basis for this phenomenon is not immediately obvious, but can probably be attributed to higher customer retention rates for smaller money managers during market downturns, as they can often be more responsive to client concerns with fewer assets and relationships to manage. Still, such a divergence represents somewhat of an anomaly for publicly traded companies in the same line of business and is unlikely to persist in the foreseeable future.

The recent decline in share prices for publicly traded asset managers suggests the outlook for this sector is pretty grim, at least compared to expectations in previous quarters. However, most of the major indexes are trading at 12x to 13x historical earnings and any reversion to the mean could precipitate a significant recovery in asset manager valuations. Otherwise, look for additional client redemptions and contracting AUM balances if the markets continue to slide or exhibit the level of volatility observed in recent months.

ASSET MANAGERS INDEX :: BREAKDOWN BY SIZE



ASSET MANAGERS INDEX :: BREAKDOWN BY TYPE



Mergers & Acquisitions Review: 2011 Q3

In a relatively weak domestic M&A market, asset management transactions have held up reasonably well thus far in 2011 with 44 deals and $38 billion in acquired AUM through the first three quarters, down only slightly from the corresponding figures reported in 2010. In a recently published article from *AdvisorOne*, David Devoe of Schwab Advisor Services attributes the recent strength in RIA acquisitions to the following four trends:[1]

1. **Demographics of the principals.** The average age of RIA business owners is 54 and almost 30% are at least 60 years old.

2. **The proliferation of consolidators**. The growing number of firms that make acquisitions a key part of their business model is giving M&A a boost.

3. **Private equity's recent interest in the asset manager space**. Devoe notes that "In 2011, we've seen the private equity firms invest more aggressively than they have in the past. What's interesting about this trend is that it underscores the power of the independent model as investors continue to put their money into this part of the industry." Devoe points to three recent minority interest acquisitions of asset managers by private equity firms including Carlyle's purchase of Avalon Advisors, Warburg's investment in the Mutual Fund Store, and Rosemont's stake in Westmount Asset Management.

4. **Growing sophistication.** RIA principals are becoming much more strategic in the fundamentals of M&A and how they can use it to achieve their goals. Potential synergies and cost cutting can be very profitable if you can build AUM with minimal client attrition, but this can be difficult to execute in practice.

MARKET MULTIPLES AS OF 09/30/11

	Ticker	Price / Trailing EPS	Price / Forward EPS	Total Capital / AUM	Total Capital / EBITDA
ASSET MANAGERS					
Affiliated Managers Group, Inc.	AMG	22.82	9.88	1.51%	7.67
BlackRock, Inc.	BLK	12.05	10.69	0.90%	8.60
Legg Mason, Inc.	LM	14.61	10.58	0.82%	9.45
Pzena Investment Management, Inc.	PZN	8.41	8.00	1.33%	5.30
Westwood Holdings Group, Inc.	WHG	18.58	nm	1.94%	12.59
Group Median		14.61	10.23	1.33%	8.60
MUTUAL FUNDS					
AllianceBerstein Investments, Inc.	AB	10.50	9.35	nm	8.81
Calamos Asset Management, Inc.	CLMS	9.44	9.72	0.79%	1.71
Cohen & Steers, Inc.	CNS	23.00	14.38	2.80%	14.51
GAMCO Investors, Inc.	GBL	12.54	11.03	3.62%	8.83
Epoch Holding Corporation	EPHC	14.59	11.60	1.86%	10.47
INVESCO Ltd.	IVZ	10.62	8.16	2.27%	14.66
Franklin Resources, Inc.	BEN	11.40	10.07	3.16%	8.00
Diamond Hill Investment Group, Inc.	DHIL	12.90	nm	2.27%	8.44
Eaton Vance Corp.	EV	12.65	11.14	1.81%	7.68
T. Rowe Price Group, Inc.	TROW	16.82	14.05	2.35%	9.52
U.S. Global Investors, Inc.	GROW	13.29	nm	4.01%	8.48
Waddell & Reed Financial, Inc.	WDR	11.80	9.81	2.55%	7.53
Federated Investors, Inc.	FII	10.96	10.43	0.63%	7.04
Janus Capital Group Inc.	JNS	6.12	8.00	1.06%	4.88
Group Median		12.17	10.25	2.27%	8.46
ALTERNATIVE ASSET MANAGERS					
Och-Ziff Capital Mgmt Group LLC	OZM	nm	5.57	34.9%	nm
Brookfield Asset Management, Inc.	BAM	7.59	23.35	nm	7.07
Blackstone Group L.P.	BX	nm	6.14	3.6%	nm
Fortress Investment Group LLC	FIG	nm	4.70	3.4%	nm
Group Median		7.59	5.86	3.6%	7.07
TRUST BANKS					
Northern Trust Corporation	NTRS	13.94	11.51	nm	nm
Bank of New York Mellon Corporation	BK	8.65	7.59	nm	nm
State Street Corporation	STT	10.15	8.04	nm	nm
Group Median		10.15	8.04	nm	nm
OVERALL MEDIAN		12.05	9.88	2.27%	8.46

Still, deal pricing remains soft and recent market conditions might spook potential investors who could see their own AUM tumble by 20% or more year-to-date by Halloween. With falling equity prices and asset manager valuations, would-be sellers are also less likely to approach the bargaining table and part with their businesses for potentially 30% less than they could have received a few months ago. Transaction pricing and M&A activity are highly correlated to investor sentiment and overall bullishness, particularly for asset managers, so continued deterioration in the global equity markets could debilitate the recent strength we've seen in RIA deal flow.

1 Hanson, Joyce. "RIA M&A Deals Near Last Year's Record: Schwab Advisor Services." *AdvisorOne*, Oct. 10, 2011.

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VALUE FOCUS » ASSET MANAGEMENT INDUSTRY

Segment Focus: Alternative Asset Managers

Third Quarter 2011 Market Overview

Third Quarter 2011 M&A Review

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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. To see past issues of **Value Focus**, visit www.mercercapital.com under the Knowledge Center section of our website.

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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