Value Focus

Asset Management Industry

Segment Focus

Mutual Funds

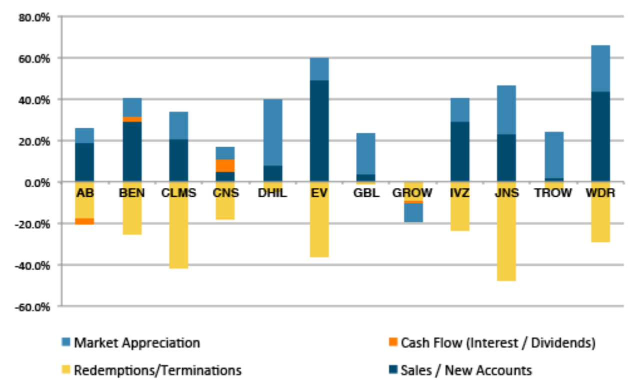
Despite varied results, many publicly traded mutual funds outperformed the broader indices over the last year in a favorable market environment with continued asset flows into equity products. According to Morningstar, US open-ended funds have brought in over $250 billion into their equity and alternative asset products in the last twelve months, partially at the expense of taxable and municipal bond strategies. These dynamics are in line with the historical relationship between asset class returns and retail fund flows, particularly as interest rates and stock indices continue their ascent. Further evidence of this correlation (even within asset classes) is manifested by increased flows into developed market funds over their emerging counterparts in 2013 and early 2014.

Most notably on the upside, Diamond Hill and Waddell & Reed each gained over 70% in the last year on particularly strong gains in AUM and earnings. Not all publicly traded mutual fund providers fared so well – US Global and Eaton Vance lost value in an upward trending market as USG reduced its dividend in 2013 while EV experienced outflows on several key products over the last few months.

As always, the outlook for these businesses hinges on market performance and asset flows. Any continuation of the recent momentum on both these fronts would certainly be a boon for mutual fund providers (who continue to benefit from the rise in equity prices and overall investor confidence levels). Another market downturn, on the other hand, would likely precipitate asset flows out of equities and into fixed income or money market funds with lower fees to their sponsors.

AUM Flows

Fiscal 2013



Independent of market conditions, ETFs continue to pose a threat as investors have extracted $81 billion from traditional mutual funds while pouring $772 billion into ETFs over the last five years, according to Matt Hougan of ETF.com. Despite recent inflows, investors increasingly prefer the transparency and tax efficiency of ETF products over mutual funds. Recent innovations like commission free and currency hedged ETFs are expected to widen the gap in the coming years. Until mutual funds can justify their higher fees with alpha, this trend is not likely to reverse course.

Market Review
First Quarter 2014

Most publicly traded asset managers endured a relatively choppy first quarter after a solid year for AUM growth and margin expansion. The continued overhang of Fed tapering and a steep market rally hastened asset flows out of bonds into equities on the back half of the year, compounding the growth in AUM and revenue as stock funds tend to charge higher management fees relative to fixed income products. SNL Financial's index of US-based asset managers corrected in early 2014 on January's decline before picking back up with the market and overall investor sentiment.

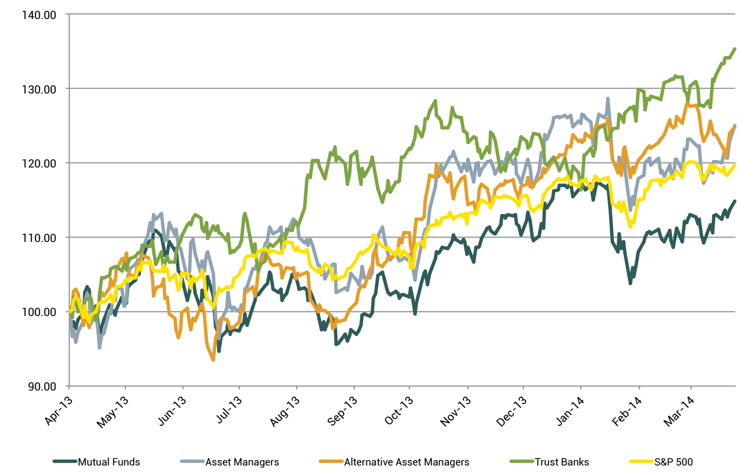
Interestingly, only the mutual fund sector of asset managers has underperformed the S&P 500 over the last year, perhaps because of the recent aforementioned challenges they're facing with the rise of ETFs and other passively managed alternatives to active investing. Trust bank stocks, on the other hand, have had a solid run over this period, with interest rates ticking up, after significantly underperforming other classes of asset managers and market indices since the financial crisis. These disparate returns for different sectors of the same industry is unlikely to persist over the long run but does illustrate the market's varying perspectives on these businesses over time.

Smaller asset managers also outperformed their larger brethren over the last year. Still, it's important to remember that our smallest sector of asset managers (AUM under $10 billion) is the least diversified and therefore most susceptible to company-specific events. Such strength is more attributable to DHIL's (~80% of the market-weighted index) outsized gain in market value (previously discussed) rather than any indication of investor preference towards smaller RIAs.

With AUM balances still hovering around peak levels for most equity managers, ongoing management fees and profitability have never been higher, and valuations have risen accordingly. Barring any sort of market correction or shift in asset flows back to fixed income or money market funds, the sector's future appears bright to many, and buyers are starting to take notice.

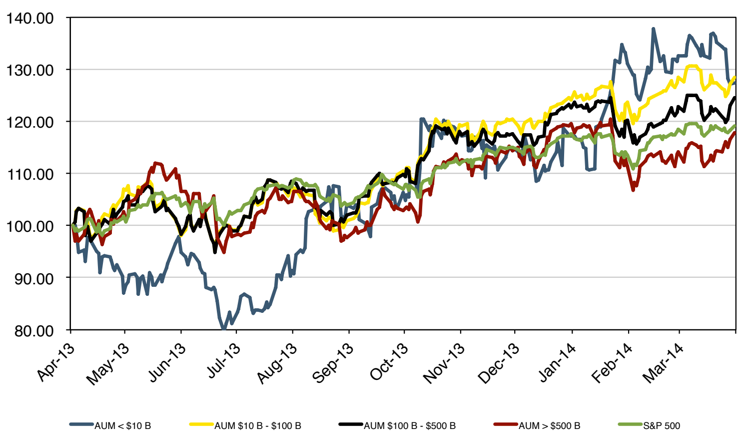
Asset Managers Index

Breakdown by Type



Asset Managers Index

Breakdown by Size



M&A Review
First Quarter 2014

Despite a relatively anemic M&A market for most segments of asset managers since the financial crisis, there were some noteworthy money manager deals thus far in 2014:

- Tri-State Capital Holding's acquisition of Chartwell Investment Partners ($7.5 billion in AUM) on January 7, 2014 for total consideration of $60 million (cash plus earn-out) or 0.80% of AUM or 7x estimated ongoing EBITDA (Initial consideration of $45 million is 7.5x adjusted 2013 EBITDA).
- Dexia SA completed its sale of Dexia Asset Management (~$100 billion AUM) to New York Life Investments for $512 million (0.51% of AUM) on February 3rd.
- Manning & Napier (ticker: MN) announced on April 10th that it will acquire the business and operations of 2100 Xenon Group, an alternative manager that specializes in managed futures and global macro strategies.
- Northwestern Mutual is reported to be mulling the sale of its 93% interest in Russell Investments, which has approximately $250 billion under management. Such a transaction could mark the sector's largest deal since BlackRock's $13 billion purchase of Barclays Global Investors (~$1.5 trillion in AUM).

Stock market volatility since the financial crisis is thought to be a major headwind for M&A in the sector as earnings performance and AUM balances sway with equity prices. Still, many believe the industry is ripe for consolidation following the dearth in deal making over the last few years and aging ownership demographics. So far in 2014, the 23 US asset manager deals reported in the first quarter marked the highest number since the fiscal cliff motivated transactions of over a year ago.

The outlook for asset manager M&A therefore remains positive in light of recent market dynamics. With so many AUM and profit levels near all-time highs, sellers may finally be able to recover the value drained by the financial crisis and then some. The sector's recent growth and prospect for continued asset flows into equities may entice prospective acquirers. The lack of an impending tax deadline and subsequent spill-over effect may portend lower year-over-year transaction numbers in the sector, but the long-term outlook remains robust.

	Ticker	Price / Trailing EPS	Price / Forward EPS	Total Capital / AUM	Total Capital / EBITDA
TRADITIONAL ASSET MANAGERS					
Affiliated Managers Group, Inc.	AMG	29.19	14.43	2.14%	10.22
BlackRock, Inc.	BLK	17.93	14.40	1.35%	13.03
Legg Mason, Inc.	LM	17.93	16.95	0.97%	13.03
Pzena Investment Management, Inc.	PZN	23.76	16.08	2.78%	14.12
Westwood Holdings Group, Inc.	WHG	26.25	nm	2.65%	17.30
Group Median		**23.76**	**15.25**	**2.14%**	**13.03**
MUTUAL FUNDS					
AllianceBerstein Investments, Inc.	AB	14.69	12.57	nm	12.97
Calamos Asset Management, Inc.	CLMS	13.64	20.40	1.27%	nm
Cohen & Steers, Inc.	CNS	26.15	19.50	3.81%	15.89
GAMCO Investors, Inc.	GBL	16.52	13.89	4.41%	10.64
INVESCO Ltd.	IVZ	18.02	12.59	2.69%	13.88
Franklin Resources, Inc.	BEN	15.03	12.75	4.05%	10.79
Diamond Hill Investment Group, Inc.	DHIL	17.59	nm	3.26%	11.07
Eaton Vance Corp.	EV	21.63	13.98	2.06%	11.91
Hennessy Advisors, Inc,	HNNA	12.60	nm	2.25%	9.51
Manning & Napier, Inc.	MN	nm	12.16	0.43%	nm
T. Rowe Price Group, Inc.	TROW	20.41	16.08	3.01%	11.63
U.S. Global Investors, Inc.	GROW	nm	nm	5.60%	nm
Waddell & Reed Financial, Inc.	WDR	23.61	16.11	4.86%	14.70
Federated Investors, Inc.	FII	19.22	15.20	0.90%	11.89
Virtus Investment Partners, Inc.	VRTS	nm	nm	5.60%	9.54
Janus Capital Group Inc.	JNS	16.97	12.38	1.46%	nm
Group Median		**17.59**	**13.93**	**3.01%**	**11.76**
ALTERNATIVE ASSET MANAGERS					
Apollo Global Management, LLC	APO	7.01	9.20	10.74%	6.75
Brookfield Asset Management, Inc.	BAM.A	14.54	nm	nm	9.04
Blackstone Group L.P.	BX	15.36	8.82	6.55%	nm
Carlye Group, L.P,	CG	16.27	9.85	0.87%	7.01
Fortress Investment Group LLC	FIG	8.73	6.90	4.08%	4.44
Kohlberg Kravis Roberts & Co.	KKR	9.77	8.00	8.89%	nm
Oaktree Capital Group, LLC	OAK	8.62	11.10	nm	nm
Och-Ziff Capital Mgmt Group LLC	OZM	7.86	7.54	nm	6.89
Group Median		**9.25**	**8.82**	**6.55%**	**6.89**
TRUST BANKS					
Northern Trust Corporation	NTRS	20.93	16.25	nm	nm
Bank of New York Mellon Corporation	BK	19.47	12.46	nm	nm
State Street Corporation	STT	14.27	11.61	nm	nm
Group Median		**19.47**	**12.46**	**nm**	**nm**
OVERALL MEDIAN		**16.97**	**12.67**	**2.78%**	**11.35**

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Value Focus Asset Management Industry

Segment Focus: Mutual Funds

First Quarter 2014 Market Overview

First Quarter 2014 M&A Review

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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