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BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES

Valuing Asset Managers

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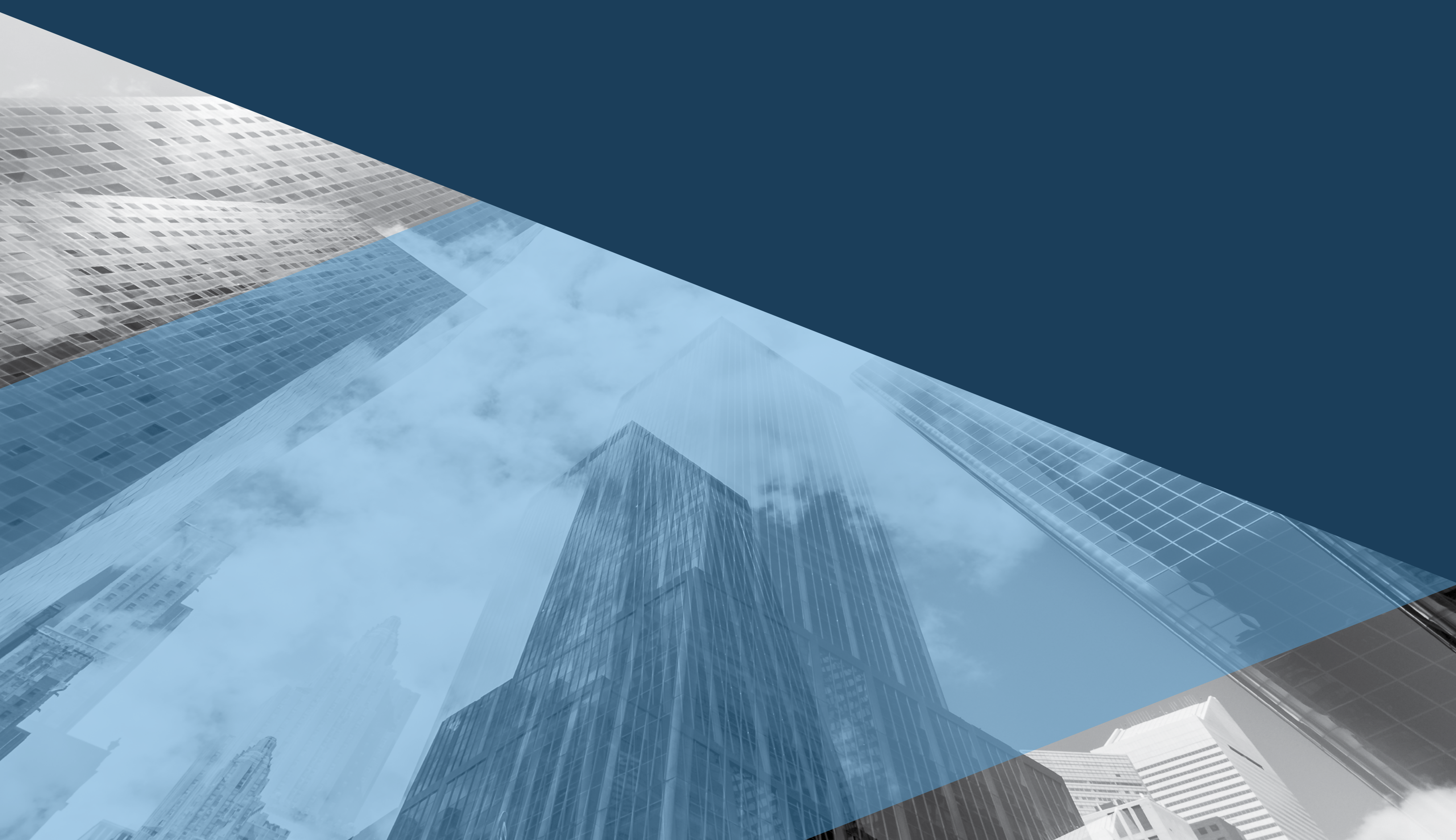


Understanding the value of an asset management business requires some appreciation for what is simple and what is complex.

On one level, a business with almost no balance sheet, a recurring revenue stream, and an expense base that mainly consists of personnel costs could not be more straightforward. At the same time, investment management firms exist in a narrow space between client allocations and the capital markets. They depend on revenue streams that rarely carry contractual obligations and valuable staff members who often are not subject to employment agreements. In essence, RIAs may be both highly profitable and prospectively ephemeral. Balancing the risks and opportunities of a particular investment management firm is fundamental to developing a valuation.

On its surface, asset management is the business model dreams are made of. A few skilled people in one office can make millions providing a sophisticated and straightforward service. Billing simply requires deducting fees from client accounts, and the upward drift of the markets propels revenue growth. Looked at from the inside out, however, it is a fiercely competitive industry in which one is judged unforgivingly by the numbers. Profit margins can be huge but can evaporate in two quarters of a bear market. Revenue growth, in fact, is driven by relationships between owners, employees, and clients.

On one level, all registered investment advisors ("RIAs") are alike, as there are significant similarities across the industry between development of fee income and the composition of the expense base. But look a level deeper, and differences emerge. Some firms manage assets for individual clients, others for institutional. Some employ a value strategy; others are growth-oriented. Some focus on equities; others focus on fixed income; others still on any number of alternative strategies. Some manage funds through a mutual fund vehicle, others through Separately Managed Accounts ("SMAs"), others through Exchange Traded Funds ("ETFs"), and so on. Each of these distinct characteristics has implications for the value of the firm in the marketplace.

Industry Overview

Asset management firms offer investment products or strategies designed to provide investors with exposure to a specified sector or asset class, often with the objective of delivering favorable investment performance relative to designated benchmarks. Clients of asset managers are typically high net-worth individuals or institutional investors such as pension plans, foundations, endowments, banks, and insurance companies. Asset managers offer advisory services to clients through investment vehicles such as ETFs, mutual funds, and SMAs.

Asset management firms are a subset of the broader RIA industry. The investment offerings and objectives of asset managers differ from the advisory services of other types of RIAs, such as wealth managers, turnkey asset management platforms (TAMPs), hedge funds, and hybrids (RIAs that are also broker/dealers).

The table below shows the number of RIAs by service offered. The total number presented below exceeds total RIAs because the rows are not mutually exclusive, and RIAs often offer more than one service.

Advisory Service	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Portfolio management	10,439	10,695	10,118	10,130	10,337	10,916	11,376	11,598	12,110	12,651	12,923	13,368	14,278	14,859	15,037
Financial planning	4,664	4,803	4,194	3,526	3,651	3,910	4,200	4,391	4,777	5,224	5,452	5,783	6,310	6,651	6,772
Adviser selection	3,531	3,603	3,283	3,074	3,183	3,321	3,473	3,533	3,667	3,850	3,945	4,065	4,266	4,430	4,485
Pension consulting	1,996	2,108	1,946	1,786	1,819	1,949	2,080	2,222	2,404	2,617	2,731	2,884	3,108	3,255	3,284
Other	2,874	2,977	2,220	2,008	2,020	2,070	2,107	2,114	2,165	2,210	2,270	2,314	2,405	2,456	2,458
Educational workshops	1	33	483	580	671	775	892	966	1,059	1,192	1,259	1,339	1,426	1,465	1,511
Publications	757	794	770	672	668	689	713	722	739	770	767	762	792	796	800
Market timing	145	148	127	89	76	70	60	63	55	55	55	48	49	51	49
Rating/pricing services	48	47	43	43	44	41	43	42	39	41	39	37	35	37	32

Source: SEC Investment Adviser Statistics - Form ADV Data, period ending December 2023 - May 15, 2024

Revenue Model

The most common revenue model used by asset management firms is charging fees which are calculated based on a percentage of their clients' assets under management ("AUM"). Generally, the amount of such fees is outlined in an investment management agreement between the client and the asset management firm and may be negotiated on a client-by-client basis. Revenue for firms using this pricing model is tied to the amount of AUM and the overall blended fee level (expressed as a percentage of AUM).

In some cases, asset management firms may charge performance-based fees, the amount of which is tied to the investment performance of managed assets. Such fees are relatively more common in alternative asset classes than equities or fixed income.

The fee level charged by asset management firms is influenced by many factors, including the following:

1. **Asset class**. Fee levels charged by asset management firms tend to vary based on the asset class focus of the firm. In general, fee levels are higher for asset classes that are more specialized or require a greater degree of investment analysis relative to the size of the asset class. Broadly speaking, fee levels in the industry tend to be higher for alternative asset management firms, lower for fixed income-oriented firms, and somewhere in the middle for equity focused firms. Within the equity asset class, fee levels tend to be higher for investment products focused on smaller market capitalization stocks.

2. **Management style.** Actively managed investment products tend to have higher fee levels than passively managed investment products in similar asset classes, which reflects the higher cost of delivering the active strategies compared to passive.

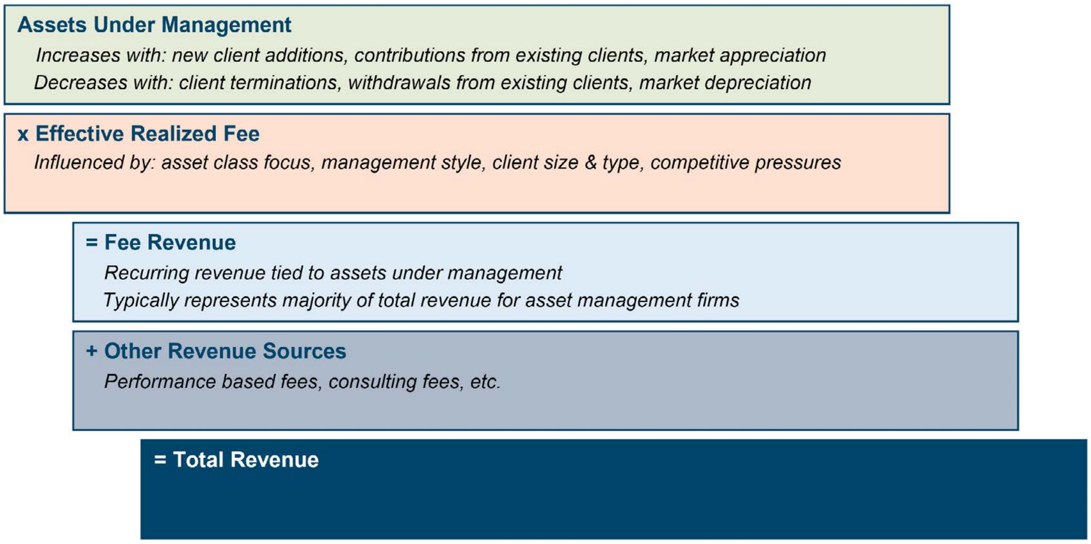
3. **Client size and type.** Larger clients may have greater negotiating power and thus may be able to negotiate higher fees. Institutional clients frequently have more negotiating power than retail clients given their typically larger size and greater capacity to conduct manager due diligence and compare fees across managers. Additionally, many asset management firms employ a tiered fee structure under which the marginal fee level declines as the amount of client assets increases.

4. **Competitive pressures.** Asset management is a highly competitive industry, and pricing is one of the key factors that can influence a client's decision to invest with a particular firm. A firm's ability to attract and retain clients is impacted by the competitiveness of its fee schedules relative to the fee schedules offered by competitors for similar investment products. In asset classes where significant competition exists, a firm's pricing power may be limited. Conversely, in certain niche asset classes where relatively little competition exists, firms may have greater pricing power and ability to charge higher fees.

The fee levels agreed to by the client and asset management firm are typically assessed against the market value of client assets at regular intervals, most frequently on a quarterly basis. The value of client AUM—and the fee base for the asset management firm—increases with new client additions, contributions from existing clients, and appreciation in the market value of client assets. Conversely, assets under management decrease when clients terminate accounts, withdrawal assets, or the market value of client assets declines.

The figure below summarizes the factors influencing revenue for a typical asset management firm.

Illustrative Asset Management Revenue Model

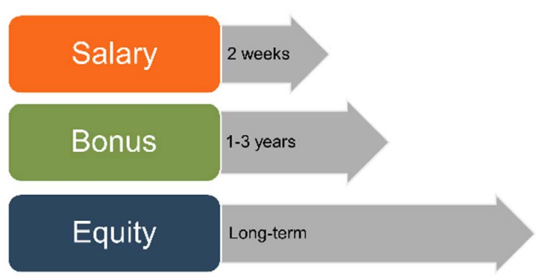


Cost Structure

The asset management business model relies on highly skilled labor to provide investment analysis, strategies, and products. As such, compensation expenses typically represent the largest component of operating expenses for asset management firms. Given the importance of attracting and retaining skilled employees, compensation structure is a significant consideration for industry participants. Compensation structures vary from firm to firm, but typically include the following components:

1. **Base salary / Benefits**. Base compensation is fixed in nature and is paid regardless of firm or employee performance over the short term. On its own, base salary provides little incentive for employees to grow the value of the business over time.

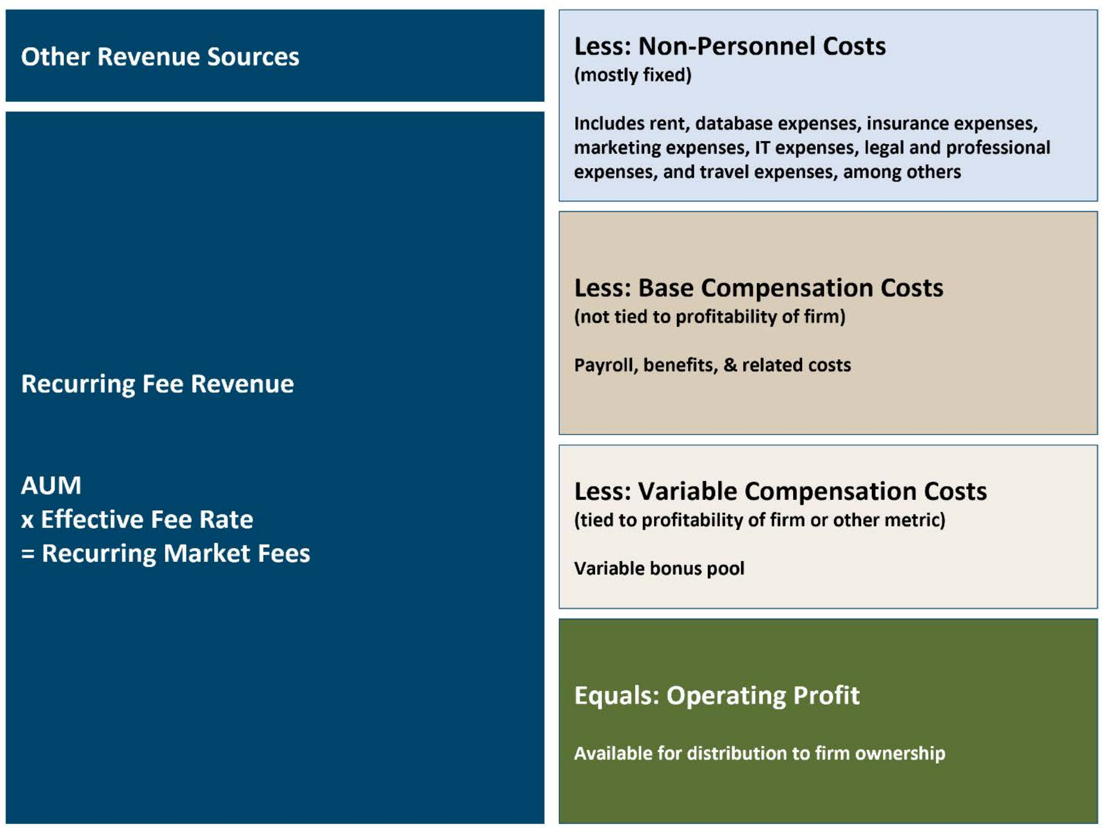
2. **Variable Compensation / Bonus.** In theory, variable compensation can be tied to any metric the firm chooses. The amount of variable compensation paid to employees varies as a function of the chosen metric(s). Variable compensation is also called at-risk compensation because all or part of it can be forfeited if target thresholds are not met. Variable compensation is most often paid out on an annual basis. Variable compensation provides a means to incentivize employees to grow the profitability of the business over the medium term (1-3 years).



3. **Equity compensation.** Equity incentives serve an important function by aligning the interests of employees with those of the company and its shareholders. While base salary and annual variable compensation serve as short- or medium-term incentives, equity incentives serve to motivate employees to grow the value of the business over a longer time and play an important role in increasing an employee's ties to the firm and promoting retention.

Non-compensation operating expenses typically represent a relatively small portion of the firm's overall costs. Non-compensation expenses for asset management firms often include rent, database expenses, insurance costs, distribution expenses, marketing expenses, IT costs, legal and professional fees, and travel expenses, among others. In most cases, the amount of non-compensation costs is not directly tied to the amount of AUM, revenue, or profitability of the firm.

Illustrative Asset Management Cost Structure



Investment Focus

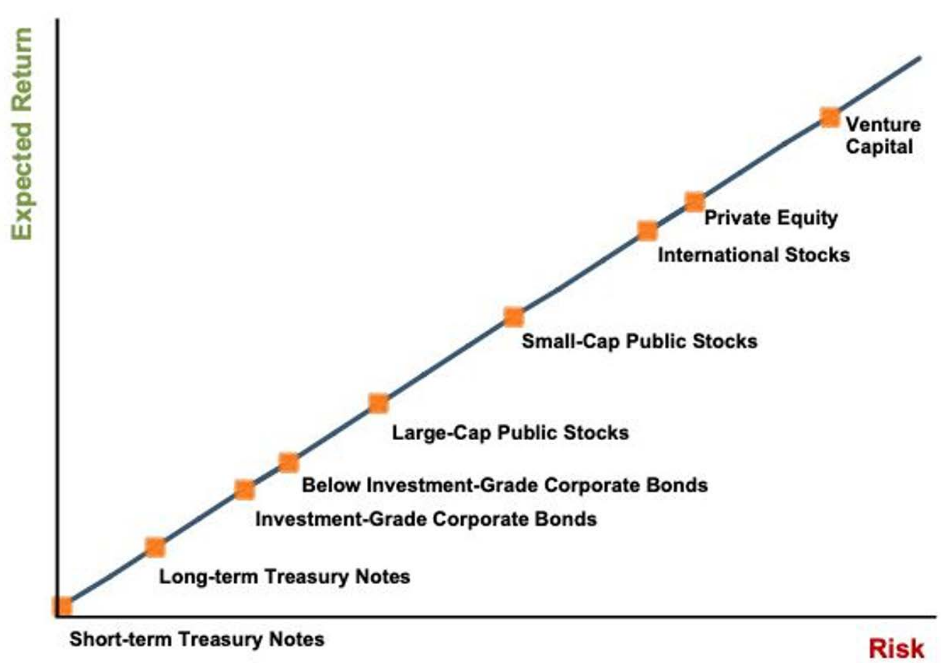
Asset management firms may focus on one or more asset classes, or may focus on specific niches within asset classes, including the following:

- Equities (may be further classified based on market capitalization, value vs growth, geography, etc.)
- Fixed income (may be further classified based on duration, risk profile, tax attributes, etc.)
- Real estate (further classified into commercial, residential, multifamily, industrial, office, etc.)
- Alternative investments (includes private equity, hedge funds, commodities, derivatives, etc.)
- Cash and cash equivalents (short term cash management)

Asset classes may differ with respect to liquidity, size, efficiency, information availability, and other factors. From an investor perspective, different asset classes fill different roles with respect to expected risk and return. As the graphic below demonstrates, riskier asset classes are typically associated with higher expected returns (investors demand higher expected returns as compensation for greater risk).

Generally, investments in riskier asset classes produce higher realized returns over long time periods. However, shorter term performance can be volatile. As the chart below suggests, the relative performance of various asset classes can differ significantly from year to year.

Investors Choose from a Menu of Investment Alternatives



Asset classes can fall in and out of favor with investors based on, among other things, recent performance of the asset class, expectations for future performance of the asset class, and the prevailing macroeconomic environment. Investor sentiment towards an asset management firm's particular asset class focus can be a significant driver of asset flows. Additionally, strong relative performance of an asset class in one year may trigger investors to rebalance their allocations—resulting in outflows for asset classes that have outperformed and inflows for asset classes that have underperformed.

Ranked Annual Total Returns of Key Indexes (2004-2023)

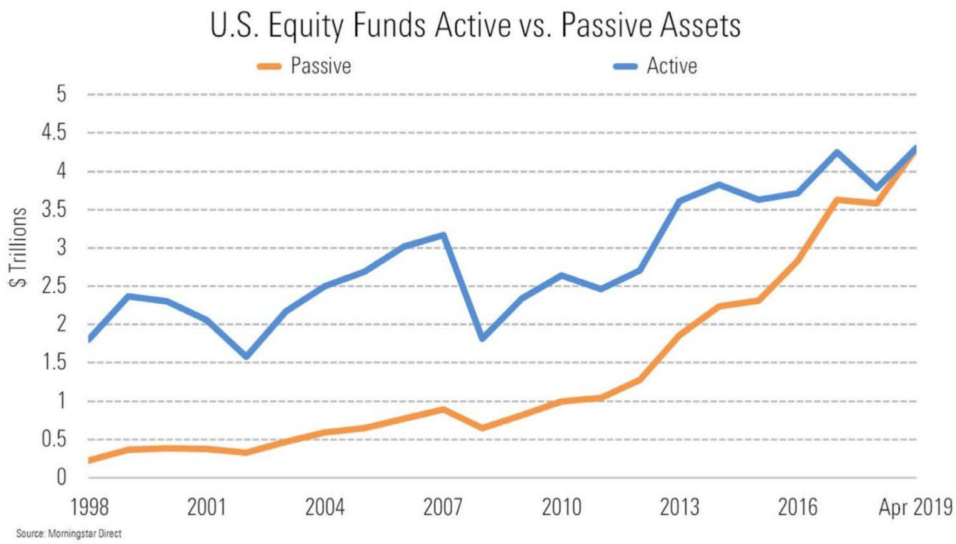
2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Annualised
High yield 14.3%	China equities 54.3%	Cash 1.9%	U.S. equities 31.6%	China equities 29.7%	Commodities 38.5%	Commodities 22%	U.S. equities 27.1%	U.S. equities 25.1%	Europe equities 6.9%	U.S. equities 13.7%
Infrastructure 12.4%	EM equities 37.8%	DM gov. debt -0.4%	Infrastructure 27%	U.S. equities 21.4%	REITs 32.5%	Cash 1.3%	Japan equities 20.8%	China equities 19.7%	Commodities 3.1%	Japan equities 6.5%
U.S. equities 11.6%	Europe equities 26.2%	IG credit -3.5%	Europe equities 24.6%	EM equities 18.7%	U.S. equities 27%	Infrastructure -0.2%	Europe equities 20.7%	Commodities 18.4%	U.S. equities 3%	Europe equities 6.3%
EM equities 11.6%	Japan equities 24.4%	High yield -4.1%	REITs 24.5%	Japan equities 14.9%	Europe equities 17%	High yield -12.7%	High yield 14%	Infrastructure 15.1%	Infrastructure 2.3%	Infrastructure 6.2%
Emerging debt 10.2%	U.S. equities 21.9%	U.S. equities -4.5%	China equities 23.7%	IG credit 10.1%	Infrastructure 11.9%	Europe equities -14.5%	REITs 11.5%	High yield 9.2%	EM equities 1.8%	Commodities 5.3%
Commodities 9.7%	Infrastructure 20.1%	Emerging debt -4.6%	Japan equities 20.1%	DM gov. debt 9.5%	Japan equities 2%	IG credit -16.1%	Emerging debt 10.5%	Japan equities 8.7%	REITs 1.7%	High yield 4.8%
REITs 6.9%	High yield 10.4%	REITs -4.8%	EM equities 18.9%	High yield 7%	High yield 1%	Japan equities -16.3%	EM equities 10.3%	EM equities 8.1%	Japan equities 1.6%	EM equities 4.2%
IG credit 6%	Emerging debt 9.3%	Infrastructure -9.5%	Emerging debt 14.4%	Europe equities 5.9%	Cash 0%	Emerging debt -16.5%	IG credit 10.2%	Emerging debt 5.7%	High yield 1.4%	REITs 3.7%
Japan equities 2.7%	IG credit 9.3%	Commodities -10.7%	High yield 12.6%	Emerging debt 5.9%	Emerging debt -1.5%	DM gov. debt -17.5%	Infrastructure 6.8%	Cash 5.3%	Emerging debt 1.2%	Emerging debt 3.2%
DM gov. debt 1.7%	REITs 8.6%	Japan equities -12.6%	IG credit 11.8%	Cash 0.7%	IG credit -2.1%	U.S. equities -19.5%	Cash 5.1%	REITs 3.9%	China equities 1%	IG credit 2.1%
China equities 1.1%	DM gov. debt 7.3%	EM equities -14.2%	Commodities 11.8%	Infrastructure -5.8%	EM equities -2.2%	EM equities -19.7%	DM gov. debt 4.2%	Europe equities 2.4%	IG credit 0.7%	China equities 1.9%
Cash 0.4%	Commodities 1.7%	Europe equities -14.3%	DM gov. debt 5.6%	REITs -8.1%	DM gov. debt -6.6%	China equities -21.8%	Commodities 0%	IG credit 1.9%	DM gov. debt 0.6%	Cash 1.8%
Europe equities 0.2%	Cash 0.8%	China equities -18.7%	Cash 2.3%	Commodities -9.3%	China equities -21.6%	REITs -23.6%	China equities -11%	DM gov. debt -3.6%	Cash 0.4%	DM gov. debt -0.5%

Key: Equities Bonds Private markets, commodities

Past performance is not a reliable indicator of current or future results. It is not possible to invest directly in an index.
Sources: BlackRock Investment Institute, with data from LSEG Datastream, 14 February2025.
Notes: The table shows annual index total returns (income or dividends reinvested) in U.S. dollars, indices are unmanaged and therefore not subject to fees. 2025 shows year to **31 January 2025**. Annualised column shows the annualised total return over the last 10-years from the same date. Indexes or prices used are: U.S. equities - MSCI USA Index, EM equities - MSCI Emerging Markets Index, Europe equities - MSCI Europe Index, Japan equities - MSCI Japan Index, China equities - MSCI China Index, DM gov. debt - Bloomberg Barclays Global Treasury Index, Emerging debt - JP Morgan Emerging Market Bond Index (EMBI) Global Composite, High yield - Bloomberg Barclays Global High Yield Index, IG credit - Barclays Global Corporate Credit Index, Commodities - Commodity Research Bureau (CRB) Index, Cash - Bloomberg Barclays U.S. Treasury Bill Index, REITs - S&P Global Real Estate Investment Trust (REIT) Index, Infrastructure - S&P Global Infrastructure Index.

Trends in Active vs Passive Management

Active management refers to investment strategies where the asset management firm actively buys and sells securities in an attempt to outperform a benchmark index. Passive management refers to investment strategies where the asset management firm replicates the holdings of a benchmark index in order to deliver performance that closely tracks that of the index. As the names suggests, active management typically involves more research, analysis, and monitoring of individual securities than passive management. Due to the higher cost of delivering actively managed strategies, the fees charged by active managers are typically higher than those charged by passive managers.

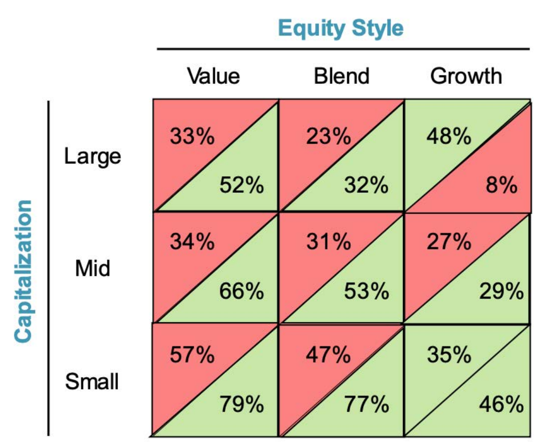


Since the 1990s, there has been a significant shift from active to passive investment management. As the chart above demonstrates, passively managed U.S. equity funds have gained significant market share from actively managed assets, growing from a small percentage of the total market in the late 1990s to reach parity with actively managed funds in 2019. This shift has been driven by a combination of factors, including the difficulty of consistently outperforming the market, the availability of low-cost index funds and ETFs, and increasing transparency and awareness of the fees charged by investment managers.

As indicated in the chart on the right, most active U.S. equity fund managers failed to outperform their benchmark during the three-year period ended December 31, 2023.

Similar data from Morningstar indicates that actively managed large-cap equity funds have underperformed their passive peers over a trailing 10-year period as well, and that actively managed small and mid-cap funds have also generally underperformed relative to passive peers over a trailing 10-year period.

% OF ACTIVE U.S. EQUITY FUNDS BEATING BENCHMARK ON 1- / 3- YEAR ANNUALIZED BASIS

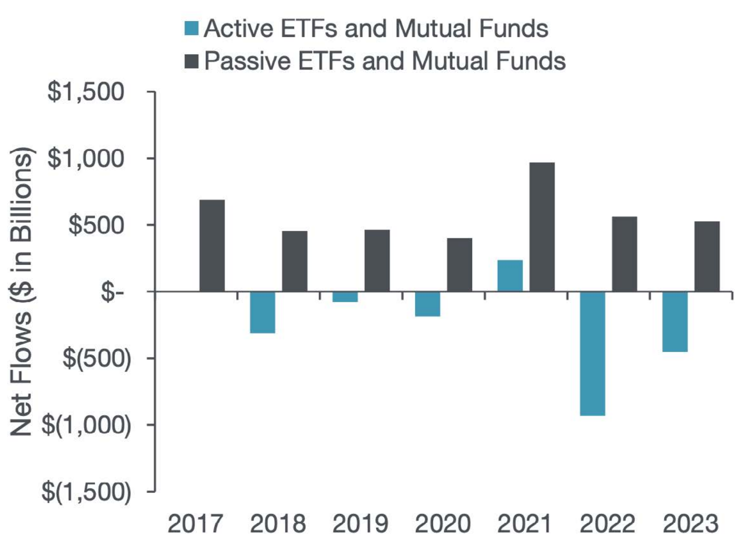


Source: Piper Sandler 2023 Asset Wealth Manager Transaction Review

Comparison of Asset and Equal-Weighted 10-Year Returns %

Category	Active Funds Asset-Weighted	Active Funds Equal-Weighted	Active Funds Difference	Passive Funds Asset-Weighted	Passive Funds Equal-Weighted	Passive Funds Difference	Difference Between Passive and Active Returns Asset-Weighted	Difference Between Passive and Active Returns Equal-Weighted
US Large Blend	10.4	9.6	0.8	11.7	11.2	0.6	1.3	1.5
US Large Value	8.9	8.1	0.9	9.3	9.1	0.2	0.3	1.0
US Large Growth	12.3	11.4	0.9	15.1	13.2	1.9	2.8	1.8
US Mid Blend	8.5	7.4	1.1	8.9	8.7	0.3	0.4	1.3
US Mid Value	8.0	7.3	0.8	8.6	8.8	–0.2	0.6	1.6
US Mid Growth	9.4	9.1	0.2	9.6	9.0	0.6	0.3	–0.1
US Small Blend	7.1	6.7	0.4	7.9	7.4	0.5	0.8	0.7
US Small Value	7.4	6.7	0.7	7.8	7.3	0.5	0.4	0.7
US Small Growth	8.2	7.8	0.4	7.8	7.5	0.3	–0.5	–0.3
Foreign Large Blend	4.2	3.7	0.4	4.2	4.1	0.1	0.1	0.4
Foreign Large Value	4.2	3.3	0.9	3.0	3.5	–0.4	–1.2	0.2
Foreign Small-Mid Blend	4.2	3.9	0.3	4.3	4.3	0.0	0.1	0.4
Global Large Blend	7.2	7.1	0.2	8.0	8.6	–0.5	0.8	1.5
Diversified Emerging Markets	2.8	2.3	0.5	2.7	2.5	0.2	–0.1	0.2
Europe Stock	3.2	3.9	–0.7	4.5	4.1	0.4	1.3	0.2
US Real Estate	7.5	6.9	0.6	7.1	6.2	0.9	–0.4	–0.7
Global Real Estate	3.9	3.6	0.3	1.8	2.4	–0.6	–2.1	–1.2
Intermediate Core Bond	2.0	1.7	0.3	1.8	1.5	0.2	–0.2	–0.1
Corporate Bond	3.2	2.8	0.4	2.9	2.4	0.5	–0.3	–0.4
High-Yield Bond	4.0	3.5	0.6	3.5	3.8	–0.3	–0.5	0.4

Source: Morningstar. Data and calculations as of Dec. 31, 2023



Source: Piper Sandler, Morningstar Direct

On an industry wide basis, the lack of consistent outperformance relative to passive alternatives continues to be a significant headwind for active managers, and has contributed to the shift from actively managed funds to passively managed funds.

Competitive Environment

The asset management industry is a highly competitive global industry. In order to be successful and grow, an asset management firm must be able to compete effectively for assets under management. Competition in the industry is primarily based on the following:

- Performance of investment products
- Fees charged in relation to investment services delivered
- Range of investment services offered
- Quality of client service
- Distribution relationships
- Independence, ownership structure, and stability
- Ability to attract and retain key talent
- Brand recognition and reputation within the investing community

Regulation of Asset Management Firms

Asset management firms with more than $110 million in assets under management are generally required to register with the SEC under the *Investment Advisers Act of 1940.* The Advisers Act, together with other applicable laws, imposes substantial restrictions and requirements on the operations of investment advisers. The SEC is authorized to institute proceedings and impose sanctions for violations, ranging from fines to censures and, in the case of investment advisers, the termination of an adviser's registration.

When Do Asset Managers Need a Valuation?

All businesses sell. Like all private companies, ownership interests in asset management firms eventually transact. Whether voluntary or involuntary, these transactions tend to be among the most important of the owner's business life.

The table below depicts events ranging from voluntary transfers such as gifts to family members or an outright sale to a third party to involuntary transfers such as those precipitated by death or divorce. An understanding of the context of valuing your business is an important component in preparing for any of these eventualities.

The Business Transfer Matrix	PARTIAL SALE/TRANSFER	TOTAL SALE/TRANSFER
THINGS YOU MAKE HAPPEN	ESOP Outside Investor(s) Sale to Insiders/Family Combination Merger/Cash Out Going Public	Sale of Business Stock-for-Stock Exchange w/ Public Co. Stock Cash Sale to Public Co. Installment Sale to Insiders/Family ESOP/Management Buyout
THINGS THAT HAPPEN TO YOU	Death Divorce Forced Restructuring Shareholder Disputes	Death Divorce Forced Restructuring Bankruptcy

A business valuation is necessary in the event of a business transaction, as described above. Note that valuations when acquiring a business are just as important as valuations when selling a business. Other cases which necessitate a valuation include:

- Charitable donations of business interest (specifically, donations of illiquid assets in excess of $5,000)
- Issuance of employee stock options, preferred shares, warrants, etc. (note that these may represent a liability on the balance sheet, and therefore may require recurring valuations)
- After the acquisition, intangible assets of the acquired business may need to be valued in order to allocate the purchase price for accounting purposes
- Legal cases (included bankruptcy and divorce, as mentioned above)

Rules of Thumb

There are both formal and informal approaches to value, and while we at Mercer Capital are obviously more attuned to the former, we don't ignore the latter. Industry participants often consider the value of asset managers using broad-brush metrics referred to as "rules of thumb." Such measures admittedly exist for a reason but cannot begin to address the issues specific to a given enterprise.

Understanding why such rules of thumb exist is a good way to avoid being blindly dependent on them. During periods of consolidation, buyers often believe that the customer base (or AUM in the case of an asset manager) of an acquisition candidate can be integrated with the acquiring firm's existing client assets to generate additional profits. So, if most asset managers are priced at, say, 10x earnings and profit margins are 40%, the resulting valuation multiple of revenue is 4.0x. If revenue is generated by average fees of 50 basis points of assets under management, then the implied valuation is about 2% of AUM. Note, however, all the "ifs" required to make the 2% of AUM rule of thumb work.

As with other businesses, the revenue of investment management firms is a function of price and volume. In this case, price represents the rate charged for assets under management, and volume reflects the asset base or AUM for RIAs. Value, however, is related to profits, which can only be derived after realizing the costs associated with delivering investment management services. High-priced services are typically more costly to deliver, so margins may fall within an expected range regardless of the nature of the particular firm. Still, larger asset managers generally realize better margins, so size tends to have a compounding effect on value.

Activity ratios (valuation multiples of AUM, AUA, revenue, etc.) are ultimately the result of some conversion of that activity into profitability at some level of risk. If a particular asset manager doesn't enjoy industry margins (whether because of pricing issues or costs of operations), value may be lower than the typical multiple of revenue or AUM. On a change of control basis, a buyer might expect to improve the acquired company's margins to industry norms, and may or may not be willing to pay the seller for that opportunity.

In the alternative case, some companies achieve sustainably higher than normal margins, which justify correspondingly higher valuations. However, the higher levels of profitability must be evaluated relative to the risk that these margins may not be sustainable. Whatever the particulars, our experience indicates that valuation is primarily a function of expected profitability and is only indirectly related to level of business activity. Rules of thumb, if used at all, should be employed with an appropriate level of discretion.

As an example of this, industry participants might consider asset management firms as being worth some percentage of AUM. At one time, asset manager valuations were thought to gravitate toward about 2% of AUM. The example below demonstrates the problematic nature of this particular rule of thumb for two RIAs of similar size, but with widely divergent fee structures and profit margins.

Firm A charges a higher average fee and is significantly more profitable than Firm B despite having identical AUM balances. Because of these discrepancies, Firm A is able to generate over six times the profitability of its counterpart. Application of the 2% rule yields a $20 million valuation for both businesses, an effective EBITDA multiple of 8x for Firm A and 50x for Firm B. While 2% of AUM, or 8x EBITDA, may be a reasonable valuation for Firm A, it is in no way representative of a rational (or non-synergistic) market participant's realistic appraisal of its counterpart; it would imply an effective EBITDA multiple of 50x. It is our experience that money managers with higher asset balances, fee structures, and profit margins

	Firm A	Firm B
Assets Under Management (AUM)	$1,000,000,000	$1,000,000,000
x Realized Average Fee	**1.00%**	**0.40%**
= Revenue	$10,000,000	$4,000,000
x EBITDA Margin	**25.00%**	**10.00%**
= EBITDA	$2,500,000	$400,000
Implied Value at 2% of AUM	$20,000,000	$20,000,000
Effective Multiple of EBITDA	**8.0x**	**50.0x**

typically attract higher AUM multiples in the marketplace. In the case of RIAs with performance fee components to their revenue stream, the math gets a bit more interesting.

Background Concepts of "Value"

The industry issues discussed above can and should impact the valuation of asset managers, but a professional valuation practitioner considers other issues as well.

Many business owners are surprised to learn that there is not a single value for their business or a portion of their business. Numerous legal factors play important roles in defining value based upon the circumstances related to the transfer of equity ownership. While there are significant nuances to each of the following topics, our main goal is to help you combine the economics of valuation with the legal framework of a transfer (whether voluntary or involuntary).

Valuation Date

Every valuation has an "as of date" which, simply put, is the date at which the analysis is focused. The date may be set by legal requirements related to a certain event, such as death or divorce, or may be implicit, such as the closing date of a transaction.

Purpose

The purpose of the valuation is significant to how the valuation is performed. A valuation prepared for one purpose is not necessarily transferable to another. The purpose of the valuation is likely to determine the "standard of value."

Stay Updated on How Current Events Are Affecting the Value of Your Firm

Value Focus: Investment Management Newsletter

The team produces a complimentary quarterly newsletter which contains an industry market overview, a review of recent transactions, and tracks multiples by industry sector.

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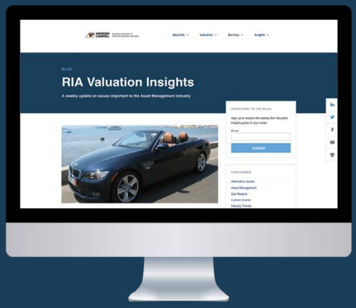

RIA Valuation Insights Blog

Mercer Capital's blog, *RIA Valuation Insights*, presents weekly updates on issues important to the investment management industry.

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Standard of Value

The standard of value is a legal concept that influences the selection of valuation methods and the level of value. There are many standards of value, the most common being fair market value, which is typically used in tax matters. Other typical standards include investment value (purchase and sale transactions), statutory fair value (corporate reorganizations), and intrinsic value (public securities analysis). Using the proper standard of value is part of obtaining an accurate determination of value.

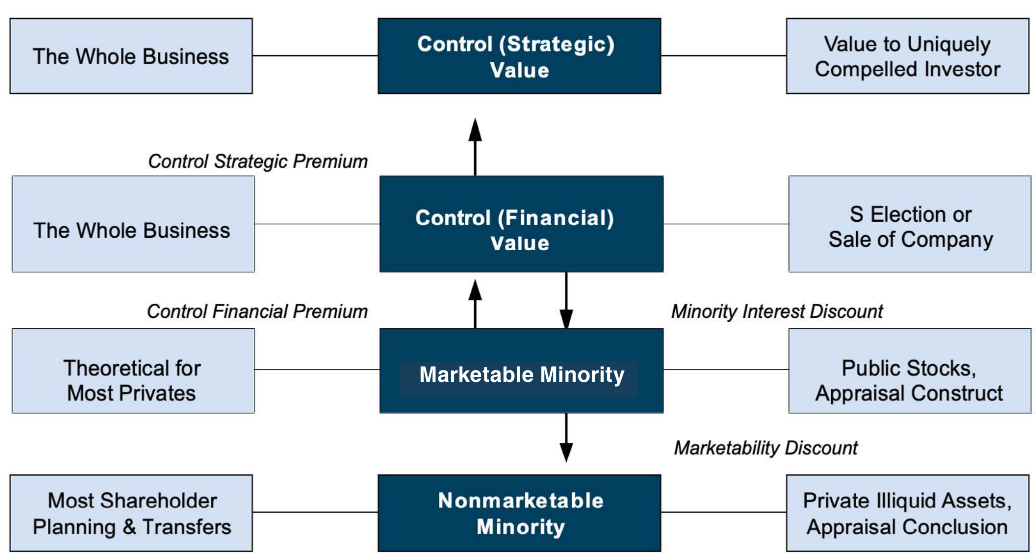
Level of Value

When business owners think about the value of their business, the value considered commonly relates to the business in its entirety. From this perspective, the value of a single share is the value of the whole divided by the number of outstanding shares. In the world of valuation, however, this approach may not be appropriate if the aggregate block of stock being examined does not have control of the enterprise; in some cases, the value of a single share will be less than the whole divided by the number of shares.

The determination of whether the valuation should be on a controlling interest or minority interest basis can be a complex process, and it is also essential. A minority interest value often includes discounts for a lack of control and marketability; therefore, it is quite possible for a share of stock valued as a minority interest to be worth less than a share valued as part of a control block. Grasping the basic knowledge related to these issues can help you understand the context from which the value of a business interest is developed.

Typical Approaches to Valuation

Within the common valuation lexicon, there are three approaches to valuing a business: the asset approach, the income approach, and the market approach.



The Asset Approach

The various methodologies that fall under the umbrella of the asset approach involve some market valuation of a subject company's (i.e., the company being valued) assets net of its liabilities. In the case of an RIA, the primary "assets" of the business get on the elevator and go home every night. In some contexts, it may be useful to evaluate the worth of a company's trade name, assembled workforce, customer list, or other intangible assets. The balance sheet can be significant regarding the presence of non-operating assets and liabilities or excessive levels of working capital, but the value of any professional services firm, including asset managers, is usually better expressed via the income and market approaches.

The Income Approach

The income approach usually follows one of two methodologies: the discounted cash flow method or the single period capitalization method. The discounted cash flow method (or DCF) requires projecting the expected profitability of a company over some term and then "pricing" that profitability using an expected rate of return, or discount rate. Single period capitalization models generally involve estimating an ongoing level of profitability which is then capitalized using an appropriate multiple based on the subject company's risk profile and growth prospects. In either case, the income approach requires a thorough analysis of the pertinent risks and opportunities. In the case of valuing asset managers, the income approach can be a useful arena to capture the unique characteristics of the subject company.

Within the spectrum of asset managers, family offices, for example, may exhibit lower expected growth (which, all else equal, would suggest lower valuations), but also more stable client bases (with higher probability of recurring revenue, which tends to raise valuations). On the other end of the spectrum, valuing a hedge fund manager might require balancing the potential for supernormal earnings growth with supernormal earnings volatility.

The Market Approach

The market approach can be applied in a number of ways: by looking at the valuation multiples implied by outright sales of similar businesses, by observing the trading activity in shares of comparable publicly traded companies, or by looking at prior transactions in the subject company.

Because it considers real world transactions, the market approach can be a compelling way to value asset managers—but it can also be misused. It is possible to find transactions involving investment management companies or publicly traded asset managers that are similar to a subject company, but it is also important to understand and isolate what is different about the subject company that can affect value.

Market data also has its drawbacks. Transactions data may offer limited information about multiples paid for various measures of profitability, and there may be no real way to isolate potential synergies reflected in the transaction pricing that might have been unique to the buyer and seller. Details on contingent consideration—a common feature of asset management transactions—are often not publicly available, further complicating the interpretation of transaction multiples. Publicly traded investment management firms offer more thorough and consistent data, but they tend to be much larger and more diversified than closely held RIAs.

The potential differences in margin and product line have already been discussed in this article, but smaller investment management firms may have other limitations that are a product of scale. These issues include greater dependence on certain managers or clients, the loss of which could be difficult to replace without a detrimental impact on the financial returns of the business. Narrow product offerings or problems in the economic area served by the RIA could also constrain growth opportunities. Of course, it's also possible that a subject enterprise might have a better-than-market opportunity because of a particular customer base served or a particular product offering.

In any event, the valuation multiples implied by transaction activity or public asset managers may, and often do, require some adjustment for various factors before application to the subject RIA.

Putting It All Together

Valuation analysis is not complete if it is left untested. In the valuation of RIAs, whatever methodologies are employed should ultimately reconcile to a conclusion of value that is reasonable given expectations for the company relative to industry pricing. This might ultimately fit within some kind of rule of thumb, but only by coincidence. Experience has taught us that in the investment management industry, as elsewhere, maximizing opportunity and minimizing risk usually enhances value.

ABOUT MERCER CAPITAL

Mercer Capital's investment management group provides valuation, transaction, litigation, and related services to a client base consisting of asset managers, wealth managers, independent trust companies, broker-dealers, PE firms and alternative managers, and related investment consultancies.

Mercer Capital provides a comprehensive suite of valuation and financial advisory services to meet your needs. Experience includes:

- Assisting RIAs and other asset managers with annual valuations, fairness opinions, and appraisals for gift and estate tax compliance
- Valuing start up managers with as little as $50 million in assets under management to established industry leaders managing over $400 billion
- Negotiating transactions involving asset managers from sell-side, buy-side, and mutually retained perspectives
- Providing expert witness testimony for purposes of shareholder disputes, commercial litigation, and marital dissolution
- Providing financial statement reporting services related to purchase price allocation and goodwill impairment testing

Mercer Capital's Investment Management industry group publishes research on the industry via its quarterly newsletter, ***Value Focus: The Investment Management Industry.*** The Group also writes about issues important to the industry on the ***RIA Valuation Insights*** blog.

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