cogent valuation

Valuation Case

The Value of an Asset Management Firm

When an equity partner in an asset management firm separated from the company, Cogent Valuation was hired to determine the going concern value of the departing partner's equity interest in the firm, with full consideration of the diminution in the firm's market value caused through his departure. Since certain clients accompanied the departing partner out the door, the price he should be paid for his equity interest would necessarily reflect the exodus of the assets under his management.

Overview of the Legal Actions and Scope of the Assignment

Cogent Valuation was retained to value an equity interest in an investment management firm (the "Company") in connection with certain actions initiated by a departing manager ("Plaintiff") against the majority owner ("Defendant"). The Plaintiff contended that he held an equity interest in the Company based on his employment agreement. When the Defendant and the Company refused to redeem the Plaintiff's interest in the Company, the Plaintiff argued that the Defendant was required to purchase his interest based on the "going concern" value of the Company following his departure.

Cogent Valuation was engaged to value the Plaintiff's equity interest following his departure. Key to the analysis, the Plaintiff took many of his clients with him along with their managed assets. The conclusion of the analysis would be used to support the Plaintiff's claim for the redemption value of his equity interest in a mediation and potentially at trial.

Valuation Analysis

Cogent Valuation first examined the key elements of the investment management industry as well as the pricing of investment management firms to determine how comparable companies were priced in the market. Second, a discounted cash flow model was used to present value the forecasted free cash flows.

Assets under Management ("AUM") and the Company's fee structure were significant drivers of market value. While the important issue of professional versus insti- tutional goodwill was not raised explicitly, the Company's higher than industry gross profit margin is one marker of institutional goodwill. The fact that not all of the Plaintiff's clients and assets departed with him is another. Because the value was determined as of a post departure date, none of the remaining assets or revenues was deemed to be attributable to the plaintiff's personal goodwill.

Income Approach

Cogent Valuation examined the Company's historical financial statements to determine relationships between AUM, revenues, and expenses. Revenues were derived solely from fees charged as a percentage of AUM.

To value the Company following the Plaintiff's departure, Cogent Valuation isolated the AUM, revenues, and expenses attributed to the Plaintiff's clients which went with him. The Plaintiff's contributions and costs were factored out of the historical financial statements to reconstruct financial statements that simulated the business and AUM absent the Plaintiff.

Forecasting Revenues and Earnings

Cogent Valuation determined that the AUM of the investment management industry was expected to grow approximately 10% annually in the near term then taper over time to 4.0%, the long-term expected growth rate of the economy. Historically, the Company derived revenues by charging a percentage of AUM, with different rates for equity and fixed income securities. Cogent Valuation assumed the fee structure of the Company would remain constant, and calculated the Company's future revenues based upon the expected AUM and fee structure. Earnings forecasts were based on the historical relationships between the Company's expenses and revenues and benchmarked against the profit margins of comparable companies operating in the investment management industry.

The Simulation of the Defendant's Market Based Salary Expense

Finally, the adjusted financial statements did not include the costs required to generate the Defendant's revenues because he received no salary but was compensated with distributions of surplus cash from operations. To account for the legitimate salary costs of the Defendant, Cogent Valuation researched the compensation of a manager with similar experience and

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and duties. The estimated market compensation for someone with a similar skill set and revenue production ability was added to the Company's expenses to determine the earnings and cash flows of the Company. Based on the resulting forecasted cash flows of the Company, Cogent Valuation employed a discounted cash flow analysis to calculate the going concern value of the Company following the Plaintiff's departure.

Market Approach

Cogent Valuation also utilized pricing metrics of publicly traded investment management firms and recent M&A transactions to determine other value indications for the Company. An examination of the industry and previous M&A transactions revealed that money management firms are valued as a percentage of AUM, and as a function of revenues, earnings, and cash flow multiples.

The research included fundamental analysis of the comparable companies' AUM, portfolio composition, profitability, historical and projected growth, and leverage. The analysis demonstrated that investment management firms with strong historical performance and broad market recognition were able to leverage their brand in order to charge higher fees and realize stronger profit margins, and premium valuations.

A difficulty with using the pricing metrics of publicly traded investment management firms is that several of the companies were much larger and more diversified than the subject.

While the publicly traded investment management firms operated in several countries and pursued several lines of business, the subject conducted all of its business in the United States and focused its activities on managing funds for institutions and high net worth individuals. To ensure the comparability of the publicly traded companies, Cogent Valuation examined the Securities and Exchange Commission ("SEC") filings of each company to determine the sources of revenues from each line of business. Investment management firms that did not generate the majority of their revenues from investment management fees were excluded from the analysis.

Based on an analysis of the Company's historical and projected performance, Cogent Valuation selected pricing multiples derived from recent M&A transactions and publicly traded investment management firms to determine market based indications of value for the Company. These indications along with the indications from the discounted cash flow model were reconciled to conclude the market value of the equity interest in the Company.

The Defendant's Valuation Expert

The Defendant also retained an expert to value his interest in the Company. Cogent Valuation audited the analysis of the opposing side's expert and found several vulnerabilities. The expert's forecasted profit margins of the Company were understated since they utilized industry averages that were consistently lower than the Company's historical profit margins, thus disregarding the stronger performance which would derive a higher value for the Company. By ignoring the Company's actual profit margins, the resulting analysis gave no credit to the Company's operational efficiencies and institutional goodwill.

In addition, the opposing side's analysis failed to provide an indication of value based on the pricing multiples derived from publicly traded companies. Further, the expert witness utilized price to revenue multiples of merely two M&A transactions to conclude a stilted indication of value for the Company. Since one target company from the transaction approach was not profitable, Cogent Valuation asserted that the target company was not comparable and the opposing expert's value indication from the M&A approach was not meaningful.

Case Summary

For purposes of an equity interest claim, Cogent Valuation assembled a highly qualified and experienced team to value an investment management firm. Cogent Valuation provided an in-depth valuation analysis, which employed a combination of research, financial, statistical, and business valuation expertise, and was based on documented research and well-supported assumptions of future performance and fundamental financial analysis.

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