

the Curtis Alert

Asset Managers—Is Now the “Right” Time to Sell, Buy or Gift?

By Michael T. Demers

The past several years have been an exciting but tumultuous period for the asset management industry. The industry has witnessed a doubling in the number of publicly traded U.S. asset management companies but has also endured wild stock market fluctuations. For example, the NASDAQ stock market index, which traded below 2000 for most of 1998, reached a peak value of over 5000 in early 2000 before collapsing and has traded below 2000 for most of 2002.

Despite this volatility, many asset managers have fared well, particularly those with a value investment style and minimum exposure to out of favor sectors such as technology and telecommunications. Near the end of May 2002, approximately one-third of the publicly traded stocks of U.S. asset managers were trading within 5% of their all-time highs. Further, while all of the major U.S. stock market averages have declined since the end of 1999, the stock prices of every asset manager listed at that time have risen.

A positive outlook for the asset management industry is not surprising because the industry fundamentals are favorable overall. Members of the Baby Boom generation will continue to put money away for retirement, and the industry has

benefited from government initiatives such as the tax deferred 529 education savings plan.

The current market environment has important strategic implications for owners of asset management firms. Firms that are experiencing growth may want to retain key personnel by rewarding them with equity ownership. Owners of closely held firms with a focus on currently out of favor sectors or styles can use this period as an opportunity to gift lower value ownership interests to

family members. In addition, now may be an opportune time to consider an acquisition of another asset management company.

Currently, approximately 85% of all U.S. asset management firms (out of a total of approximately 6,500 such firms) have \$1 billion or less in assets under management (AUM). This fragmentation can lead to further industry consolidation. The acquisition of another asset management firm can result in economies of scale, round out the acquiring firm's investment product line, and/or add strength to the acquiring firm's weaker departments. For example, a value style investment shop, which may have lost clients in the late 1990s to growth shops, may now find it an appropriate time to evaluate growth style acquisition candidates before this style is again in favor.

It also may be an opportune time for some asset management firms to sell. The market is flush with acquirers interested in select asset management firms. Recently, Affiliated Managers Group announced that it would acquire a 60% stake in the Third Avenue Funds, a value style firm, and the Bank of Ireland announced that it would acquire a 61% stake in Connecticut-based Iridium Asset Management Group, an institutional fund manager. While the full details of these



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Opportunity in Postsecondary Education

By David R. Bogus

The U.S. education industry is experiencing significant change, creating opportunities for investors and owners of for-profit education companies. The for-profit sector of the education industry is small, with revenues of these companies accounting for only about 10% of the approximately \$750 billion spent on education in the U.S., but rapidly growing.

Consumer demand for high quality education that provides the skills considered necessary in the modern economy has created opportunity for the private sector. So-called “edupreneurs”

Curtis in the News

Adam J. Wowak has joined Curtis Financial as an Associate, bringing the total number of professionals to nine. Previously, Adam was an Analyst at Berwind Financial, where he worked on a variety of transactions in the areas of mergers and acquisitions, management buyouts, and capital raising.

In our inaugural newsletter, Curtis reported on the recent activity and rationale on the marriage of banks and title agencies. On June 13, 2002, Tony Latini, Senior Vice President of Curtis, spoke at a joint New Jersey Bankers Association–NJ League of Community Bankers seminar in which he discussed lessons banks have learned in the first years since being permitted to operate title agency and insurance agency joint ventures.

On June 4, 2002, Eric Meltzer, Senior Vice President of Curtis, participated in the Smeal Business Club of Philadelphia (Penn State) telecommunications panel where he discussed the evolution of convergence in the telecommunications industry.

are using this opportunity to develop innovative products and services to fill the void left by public schools.

The education industry is divided into three major segments:

- Elementary and secondary education (grades K through 12);
- Distance education; and
- Postsecondary education (beyond high school).

The postsecondary education segment provides perhaps the greatest opportunities due to the size and fragmentation of the market and the demands for the services provided by these institutions.

Postsecondary Education

Postsecondary education consists of education beyond high school, not including traditional college education. Currently, there are numerous for-profit companies providing postsecondary educational programs for adults. Adults over age 25 represent nearly 50 percent of the postsecondary education population and the addressable market of adult postsecondary students is estimated to approach 29 million. These for-profits differ from traditional colleges and universities in three important ways:

- Flexible, worker-friendly schedules;
- Focus on providing job-related skills; and
- Success is ultimately measured through placement in the job market.

A snapshot of some of the key public companies in the industry shows the vibrancy of this market segment:

Corinthian Colleges, Inc. (Nasdaq: COCO)

Operates 56 colleges in 20 states with approximately 25,000 students. Offers a variety of degrees and diploma programs in the healthcare, electronics, and business fields.

Career Education Corp. (Nasdaq: CECO)

Operates 42 campuses with approximately 42,000 students. Offers a variety of bachelor’s degree, associate degree and non-degree programs in career-oriented disciplines.

DeVry, Inc. (NYSE: DV)

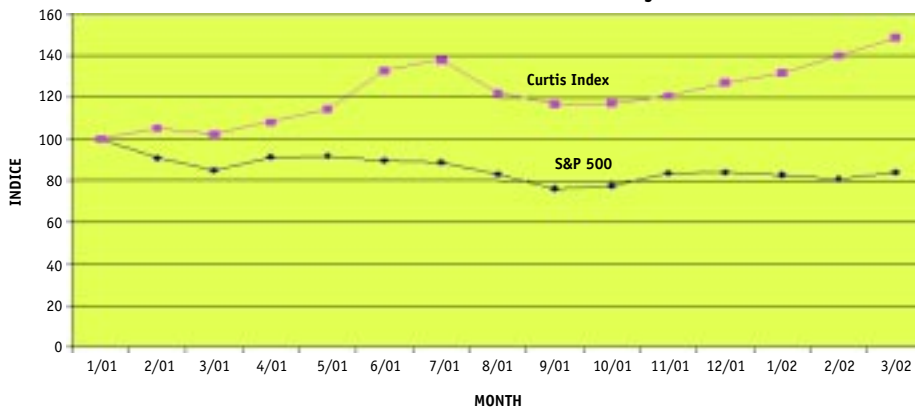
Provides career-oriented technology-based education to college and graduate students in the United States and Canada. Also operates the Keller Graduate School of Management and Becker Conviser Professional Review. Table 1 presents select financial information on these companies.

A significant portion of this industry is comprised of small, regional players with between one and ten schools. Due to the large size and high fragmentation of this industry sector, there was a great deal of consolidation activity in the 1990s. Companies such as Career Education Corporation took advantage of this market and completed approximately 22 acquisitions. After a period of relative slowdown in consolidation, recent Nasdaq weakness, coupled with limited accessibility to equity capital, valuation

Table 1: Postsecondary Education Industry – Key Data

Company	Ticker	Market Cap (Mil)	P/E	Recent Price	EPS (TTM)
Corinthian Colleges, Inc.	COCO	\$1,190	35.89	\$55.78	\$1.55
Career Education Corp.	CECO	\$1,957	45.55	\$43.50	\$0.96
DeVry, Inc.	DV	\$1,844	28.78	\$26.39	\$0.92

Chart 1: For-Profit Educational Institutions: Stock Analysis—Trended vs. S&P 500



levels of acquisition targets have been pushed down. As a result, we expect active industry consolidators, such as Career Education Corp., to take advantage of this contraction in valuation in the coming months. In addition to increased activity from traditional industry consolidators, we believe private equity groups will provide the capital to allow small, regional postsecondary education companies to consolidate and grow.

Recent Stock Market Performance

For-profit education providers have produced double-digit enrollment growth and strong earnings performance in recent quarters. The market has responded favorably to these results, with the Curtis Securities Educational Provider Index outperforming the S&P 500 by significant levels since January 2001, as shown in Chart 1.

Based upon research and monitoring of the education industry, Curtis Securities has developed an index of leading players in this market. The companies included in the index are listed in Table 2.

Factors contributing to this strong performance relative to the S&P 500 include:

- The demands of business for a more educated workforce; and
- Consumers' need for retraining to keep pace with the ever-changing workplace.

Given the current market dynamics in the education industry, now is the time for owners of postsecondary education provider companies to be positioning themselves to maximize long-term shareholder value.

Table 2: Index of Leading Players in the Education Industry

Company	Ticker	Market Cap (\$ Mil)	P/E
Apollo Group, Inc.	APOL	6,125	50.5
Career Education Corporation	CECO	1,957	45.6
Corinthian Colleges, Inc.	COCO	1,190	35.9
DeVry, Inc.	DV	1,844	28.8
Education Mgmt. Corporation	EDMC	1,461	35.9
ITT Educational Services	ESI	1,122	33.3
Strayer Education, Inc.	STRA	489	42.0
Sylvan Learning Systems, Inc.	SLVN	1,115	NM
University of Phoenix Online	UOPX	2,598	86.7
Whitman Education Group	WIX	90	74.2

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transactions are not yet public, the purchase price multiples are estimated to range from 3.0% to 3.6% of AUM for Third Avenue and 2.6% to 3.0% for Iridium.

The value of an asset management firm is dependent on many factors, including management and employees, historical investment performance compared to relevant benchmarks, the firm's size as measured by AUM, cash flow, profitability, client base diversity and type(s) (retail, high net worth, or institutional), and investment philosophy and style(s).

Management and employees are the key value drivers of all asset management firms. Employees of asset management firms with an in house portfolio selection process have a strong impact on investment performance, which has a significant impact on AUM and profitability. However, an asset management firm can be successful without a dedicated in house investment philosophy. Asset management firms with a strong marketing focus and talented sales force that sell best of breed offerings from other firms have also had success in the asset management industry.

The current market environment and existing asset management industry structure present many interesting opportunities for asset management firm owners. Curtis Financial Group can help owners better understand the opportunities that are present in today's ever changing market.

Delaware Holding Companies

By Charles M. DeVinney

A Delaware (or other state with favorable regulations regarding passive investment companies or intellectual property holding companies) holding company (DHC) is a passive investment company established as a vehicle to hold and manage intellectual assets. A DHC qualifies for complete exemption from the Delaware income tax and gross receipts tax by limiting its activities within Delaware to the maintenance and management of intangible investments. Section 1908(b)(8) of the Delaware Corporate Income Tax Law provides an exemption from taxation for:

“corporations whose activities within this State are confined to the maintenance and management of their intangible investments or the intangible investments of corporations or business trusts registered as investment companies under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1) and the collection and distribution of the income from such investments or from tangible property physically located outside of this State. For purposes of this paragraph ‘intangible investments’ shall include without limitation: investments in stocks, bonds, notes and other debt obligations (including debt obligations of affiliated corporations), patents, patent applications, trademarks, trade names and similar types of intangible assets.”

Tax savings is achieved by shifting income, which would otherwise be taxed in another state, to a DHC. To gain these tax savings, a corporation typically forms a subsidiary in Delaware and then transfers its intellectual property to the new subsidiary or DHC. The new subsidiary then licenses the assets back to the operating company in exchange for a royalty payment. The operating company deducts the royalty fee it pays to its subsidiary DHC. The payments (income) to the subsidiary DHC are exempt from corporate level state taxes.

The mechanics of the tax benefits of a DHC are best shown by using a simple example, as shown in Table 1.

Table 1

	Before Forming DHC	After Forming DHC
Sales	\$ 10,000,000	\$ 10,000,000
Income Before Royalty	\$ 1,000,000	\$ 1,000,000
Royalty Paid to DHC (5% of Sales)		\$ 500,000
Taxable Income	\$ 1,000,000	\$ 500,000
State Tax at 10%	\$ 100,000	\$ 50,000
State Tax Savings		\$ 50,000

To help preserve this tax savings, and successfully rebut any claim of taxability from another state on the DHC’s income, it is essential that a bona fide and substantial presence be established in Delaware, and that the company have business activities apart from licensing intellectual property back to the operating subsidiary. Over the past several years, certain States have launched challenges to the deductions for royalties paid. Most of these challenges are based on nexus arguments, attacking the holding company’s “business purpose” or “economic substance.” The following non-exclusive factors can help to establish nexus in Delaware:

- Establishment of an office in the state;
- Hire employees within Delaware to effect the day-to-day operations;
- Officers and employees perform their duties within the state;
- Establish appropriate bank accounts and receive any fees and make any payment from within the state; and
- Execute all contracts and keep all records in the Delaware office.

Because of the complexity of the structure, we recommend that a company considering the formation of a DHC retain the assistance of competent outside tax advisors and/or legal counsel.

Curtis Financial can provide assistance in identifying intellectual property which can be transferred to a DHC, determining the appropriate “reasonable royalty” and, thereby, if needed, estimate the fair market value of the intangible asset(s) being transferred to the DHC.

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