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WHAT DOES IT TAKE FOR A MANAGED ACCT TO BREAK EVEN

Managed Acct Break-Even Varies Widely

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It can take \$6 million or \$80 million. That's the disparity in the cost of reaching break-even in the managed account business. Managers need a clear understanding of how their own approach to the business dictates how much it will need in spending and revenues to reach profitability, according to *Driving Profits: An Executive's Roadmap to Financial Success in Retail Separate Account Management*, a new report published by 3C Financial Partners, a Los Angeles-based investment bank and strategic consultancy.

"It can take substantial capital to get up and running," says Dan Seivert, 3C's founder and managing principal. "If you're growing out of existing asset management business, you have to report your progress to the powers that be; if you're a start-up, you're dipping into your own pockets and turning to the private capital markets. In either case you're accountable to others."

The gulf between the costs of reaching break-even is easily explained. Managers don't enter the fray with identical forces at their backs. For that reason, 3C outlines three approaches to the managed account business: conservative, moderate and aggressive. These categories refer to the resources allotted to the managed account business, not the intensity or flair with which it's tackled. "Conservative doesn't mean laid-back," says Seivert. "This is not a business where you can take it easy."

A conservative entry approach to the business might resemble that of NorthRoad Capital Management, says Seivert. Northroad is a New York-based specialist in large-cap global and international equities started by former employees of Lazard Asset Management.

"[Northroad] started with a staff of about 10 — a CEO, three portfolio managers, three wholesalers, three [operations] staff," says Seivert, who adds that a 10-member team is the minimum needed for consideration by significant sponsors. "They started as a small team in humble office space and they brought assets over with them when they started up." Founded less than two years ago, Northroad has \$1.1 billion in assets, CEO Robert Morgenthau told *FundFire* in June.

That means Northroad might already have reached break-even — and it got there earlier than most. By 3C's reckoning a manager using a conservative entry strategy would have reached break-even at \$900 million in assets under management. Typically, that's to be expected after three to seven years of doing business. 3C figures a conservative approach would require between \$5.7 million and \$13.2 million in start-up capital costs before reaching profitability. Viewed from the perspective of annual revenue, a conservative entry approach would require, on average, \$3.8 million to break even.

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Eaton Vance is another manager to have come out of the gate quickly. The Boston-based company's managed account unit reached break-even well over a year ago, less than three years after it entered the business, says Lawrence Sinsimer, who heads up the effort. But then Eaton's ability to reach profitability in such short order owes a lot to its acquisition of established managers Parametric Portfolio Associates, Fox Asset Management and Atlanta Capital Management. All told, Eaton employs about 30 people in its managed account division. It declines to say what its managed account assets under management are, citing a quiet period before its quarterly earnings announcement later this week. According to their last earnings release, retail managed account assets comprise 5% of the firm's \$85.1 billion in assets, or \$4.3 billion.

Sinsimer describes Eaton's approach to the managed account business as "moderately aggressive." By 3C's reckoning, a moderate approach to the managed account business requires between \$17 million and nearly \$40 million in start-up funding. Break-even usually comes after three to seven years in the business. With respect to assets under management, a manager using a moderate approach would require an average \$2.7 billion before becoming profitable. In terms of sales, annual revenue of, on average, \$11.3 million suggests a break-even scenario for a moderate approach.

As an example of an aggressive approach to managed account manufacturing, Seivert points to MFS Investment Management of Boston, a fund company that debuted as a managed account manager in 2000. "They hired a head of sales," — William Taylor, senior v.p. for MFS managed account unit, formerly of Alliance Capital Management— "they've got five [managed account wholesale] specialists with production on the back of one of the industry's largest team of wholesalers," says Seivert. MFS wasn't available for comment.

Aggressive spending like that calls for start-up capital of between \$34 million and \$79.4 million, says 3C. That points to break-even assets under management of around \$5.4 billion resulting in annual sales of \$22.7 million.

As with the conservative and moderate approaches, the period to break-even varies between three and seven years for aggressive managers. There's a simple enough reason for these uniform ranges, says 3C's Seivert. "Spending levels may be lower in a conservative approach, but the corresponding break-even is lower as well," he says. "It's the cost of reaching break-even that varies in the three approaches, not so much the time it takes to get there."

Janus Capital, another fund company, got into the managed account business less than a year ago. So far its managed accounts are offered only on Wachovia's multi-style account platform, says Erich Gerth, who joined Janus in July 2003 from Goldman Sachs Asset Management to head up its managed account team. The company has a team of 20 or so senior wholesalers that supports both managed accounts and mutual funds.

Although Gerth says Janus is keeping track of its progress toward profitability, it doesn't publicize those numbers. "We're still in the early stages," he says.

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