

MERCER CAPITAL

What Is Your Trust Company Worth?

Assessing the Value of an Independent Trust Company

Matt Crow | crowm@mercercapital.com

Taryn Burgess | burgess@mercercapital.com

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Common Truths: What We Can Generally Say About TrustCos

**TrustCos are
often very
valuable**

Worth so much no one
can afford to buy them

**TrustCos are
typically owned
by unrelated
parties**

Most private
companies are family
businesses

**TrustCos typically
tie equity
participation to
employment**

Passive ownership is
difficult absent
substantial scale

Common Myths: Firm's Aren't Always Worth 2% of AUA/AUM

Rules of Thumb

- TrustCos are worth **2% of AUA/AUM**
- TrustCos are worth **2x Revenue**



*Rules of Thumb
are only accurate
by coincidence*

“Rules of Thumb” Don’t Work

“2% of AUA / AUM” rule of thumb implies different and reasonable / unreasonable EBITDA multiples

	Firm A	Firm B
Assets Under Administration	\$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 AUA/AUM	\$20,000,000	\$20,000,000
Effective Multiple of EBITDA	8.0x	50.0x

Standard of Value Sets the Perspective of the Analysis

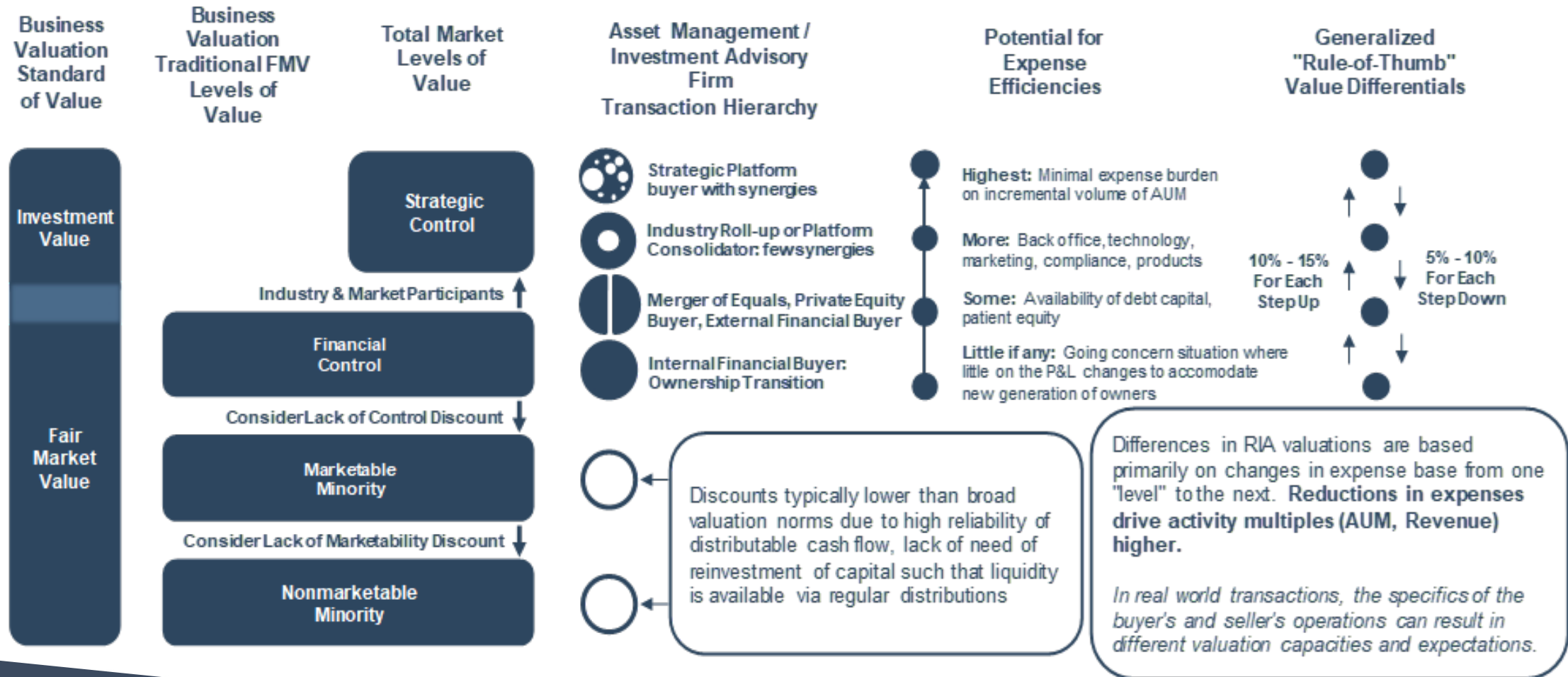
Fair Market Value according to Revenue Ruling 59-60

The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

In contrast to **Investment Value**

The value to a particular investor based on individual requirements and expectations

There Is More Than One Value



When Do You Need a Valuation?

- 1. Transactions
- 2. Shareholder Agreements
- 3. Litigation



OWNERSHIP TRANSFER MATRIX	Partial Sale/Transfer	Total Sale/ Transfer
Voluntary Transfers	ESOP Outside Investor(s) Sales to Insiders/ Relatives Combination Merger/Cash Out Going Public Gifting Programs Buy-Sell Agreements	Sale of Business Stock-For-Stock Exchange w/ Public Company Stock Cash Sale to Public Company Installment Sale to Relatives/ insiders ESOP Management/ Buyout Buy-Sell Agreements
Involuntary Transfers	Divorce Forced Restructuring Shareholder Disputes Buy-Sell Agreements	Death Divorce Forced Restructuring Bankruptcy Shareholder Disputes Buy-Sell Agreements

How Are TrustCos Valued?

Asset Approach

Generally not applicable because trust companies are not (internally) capital intensive businesses

Income Approach

Discounted cash flow analysis to evaluate business plan and industry trends

Market Approach

Pricing metrics from public companies and transactions relative to company performance characteristics

Value Is a Function of Cash Flow, Risk, and Growth

$$V_0 = \frac{CF_1}{r - g}$$

Income Approach: Discounted Cash Flow Method

Projected Cash Flow

Project likely revenue mix

- AUA/AUM trends
- Fee schedule and trends
- Fees for ancillary services

Project expense base

- Non-labor cost trends
- Staffing for business plan
- Evaluated in light of industry norms and trends
- Potential for operating leverage as firm grows to maturity

WACC

Cost of equity

- CAPM (considered in light of WACC of comparable public companies)
- Non-systemic (company specific) risk considered (client demographics, sector focus, management dependence, etc.)

Cost of debt

- Usually irrelevant:

Capital structure

- Typically assume 100% equity

Indicated Value

Indicated value

- Expressed on a total capital basis
- Before consideration of capital structure implications
- Evaluated against available market pricing metrics for reasonableness

Your TrustCo's Ongoing Profitability

You can calculate your ongoing profitability to assess the financial well-being of your firm

Ongoing Revenues

Current AUA/AUM
X Current Fee Schedule
Asset Based Revenues
+ Other Revenue
Ongoing Revenue



Ongoing Expenses

Personnel Expenses
(Annualize Last Month's P&L)
+
Other Fixed Operating Expenses
(Rent, Research, & Compliance)

How Does Your TrustCo Measure Up?

Average Trust Company Metrics

Average AUA	\$1,508,788,743
x Implied Fees	0.466%
Average Revenue	7,033,634
x Average Operating Margin	36.90%
Average Operating Profit	\$2,595,411

Source: Pohl Consulting, Trust Compare 2018 Data

Trends in Profitability



Growing AUA Base



More Volatile AUA Base



Declining Fees



Declining Operating Expenses
as % of Revenue

The Key to Value Is Ultimately Distributable Cash Flow

Projected Distributable Cash Flow	
Average AUA/AUM	Revenue Mix, Capture & Loss Rate, Marketing Effectiveness
x Realized Fees	Fees schedule trends in light of competitive pressure
= Revenue	Include any non fee-based sources of revenue
- Owner Compensation	Salary, bonus, & benefits
- Staff Compensation	Appropriate staffing for business plan; wage pressure for key relationship managers
- Non-Personnel Costs	Non-labor cost trends; can be source of operating leverage
= Pre-Tax Profitability	Evaluate in light of industry norms and trends
+/- Noise (CapEx, Depreciation, Investment in Working Capital)	Rarely significant
- Taxes	State or federal taxes or tax pass-through
= Distributable Cash Flow	Source of incentive compensation or real profitability?

Balance Between Returns to Labor and Returns to Equity

Returns to Labor (Compensation)

Too little:

Can't replace in the event of turnover
Margins are artificial
Valuation inflated

Too much:

No incentive for ownership
Margins won't withstand bear markets
Valuation biased to the downside

Returns to Equity (Distributions)

Too little:

No incentive for ownership
Hard to finance transitions
Valuation deflated

Too much:

No money to reinvest in talent pool
Second generation can't afford to become partners
Valuation inflated

Pricing Cash Flow Is All About Risk

Trust Companies benefit from recurring revenue but suffer from concentration risks

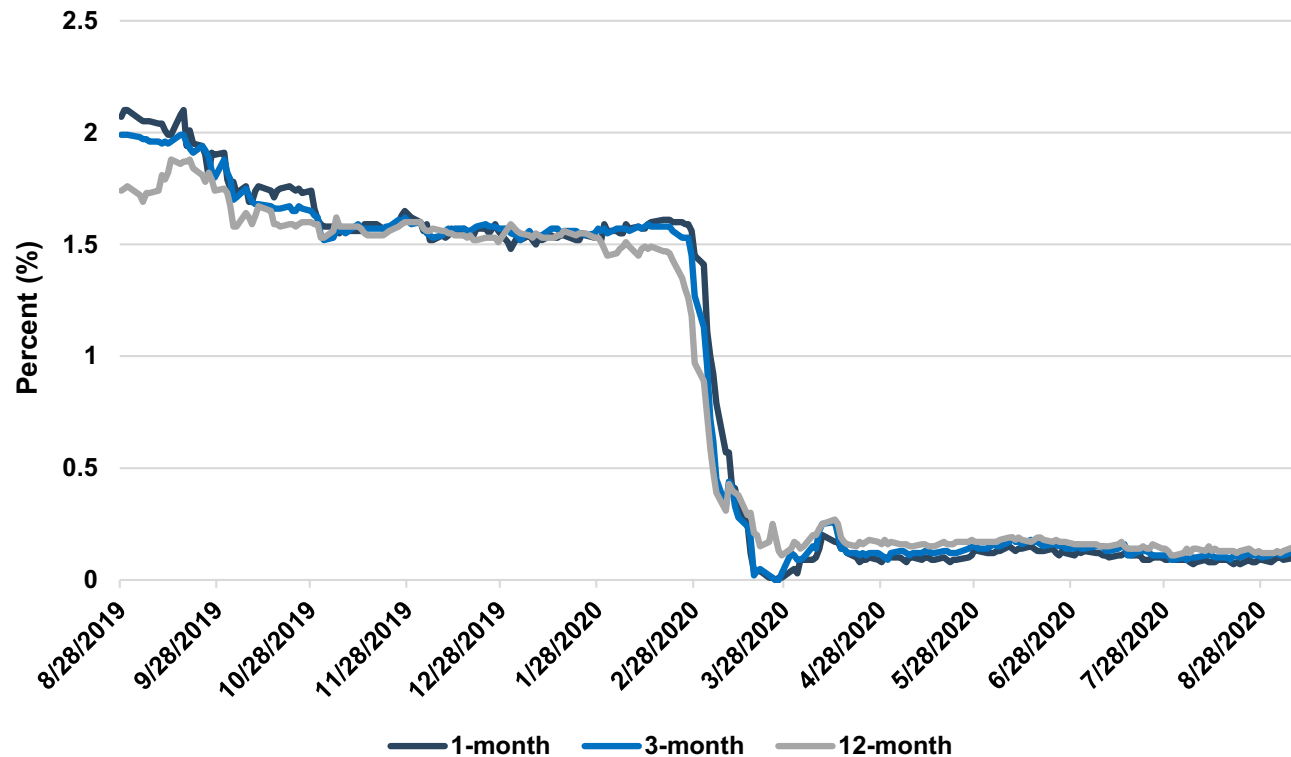
Risk-Free Rate		1.18%
Equity Risk Premium	5.50%	
Guideline Beta	1.00	
Beta Adjusted Common Stock Premium		5.50%
COVID-19 Risk Premium		1.00%
Size Premium		4.99%
Specific Company Risk Premium		
Dependence on key management	2.00%	
Dependence on key clients	1.00%	
Ownership transition plan	1.00%	
Established nature of enterprise	-1.00%	
Net Specific Company Risk Premium		3.00%
Equity Discount Rate (Required Rate of Return)		15.67%

Expected equity returns for independent trust companies fall in the low to high teens for established firms with industry-normal levels of risk.

The weighted average cost of capital (WACC) usually at or close to the cost of equity because leverage is rarely employed.

ZIRP & Valuations

Short Term Treasury Yields – Last 12 Months



Valuations in the Trustco space might otherwise be biased upward by ZIRP; however, dampened expectations of AUA/AUM growth and concerns regarding margin sustainability are mitigating any impact from the yield curve.

Although transactions in the investment management space, in general, are closing at the high end of the historical range of multiples, the range has not, in and of itself, changed.

Public Company Cost of Capital

Publicly traded RIAs employing little to no debt typically have imputed WACCs of approximately 10%-11% (in the current interest rate environment)

		(1) Treasury Yield	(2) ERP	(3) 2 Yr Beta	(4) (2x3) Beta Adj. ERP	(5) COVID-19 Risk Premium	(6) Size Premium	(7) (1+4+5+6) Eq. Disc. Rate	(8) % Equity	(9) % Debt	(10) After Tax Cost of Debt	(7x8) + (9x10) Implied WACC
<i>AUM Under \$100 Billion</i>												
Diamond Hill Investment Group Inc	DHIL	1.18%	5.50%	0.90x	4.95%	1.00%	2.22%	9.35%	99.2%	0.8%	2.66%	9.29%
GAMCO Investors Inc	GBL	1.18%	5.50%	1.16x	6.40%	1.00%	2.22%	10.80%	92.6%	7.4%	2.66%	10.20%
Hennessy Advisors Inc	HNNA	1.18%	5.50%	0.65x	3.58%	1.00%	4.99%	10.75%	99.0%	1.0%	2.66%	10.67%
Pzena Investment Management Inc	PZN	1.18%	5.50%	1.16x	6.36%	1.00%	2.22%	10.76%	96.6%	3.4%	2.66%	10.49%
Silvercrest Asset Management Group Inc	SAMG	1.18%	5.50%	1.24x	6.79%	1.00%	4.99%	13.96%	76.9%	23.1%	2.66%	11.35%
Westwood Holdings Group Inc	WHG	1.18%	5.50%	1.24x	6.80%	1.00%	4.99%	13.97%	93.9%	6.1%	2.66%	13.28%
Waddell & Reed Financial Inc	WDR	1.18%	5.50%	0.99x	5.42%	1.00%	1.47%	9.07%	84.4%	15.6%	2.66%	8.07%
Virtus Investment Partners Inc	VRTS	1.18%	5.50%	1.28x	7.06%	1.00%	1.59%	10.83%	78.1%	21.9%	2.66%	9.04%
Average (AUM under \$100B)				1.05x				11.24%	91.80%	8.20%		10.48%
Median (AUM under \$100B)				1.16x				10.76%	93.94%	6.06%		10.49%

Risk Is Relative to the Industry

Client Demographics

Concentrations

Age

Longevity

Generational
connectedness

Turnover

Staff Dependence

Succession

Client teams

Turnover

Competitive Position

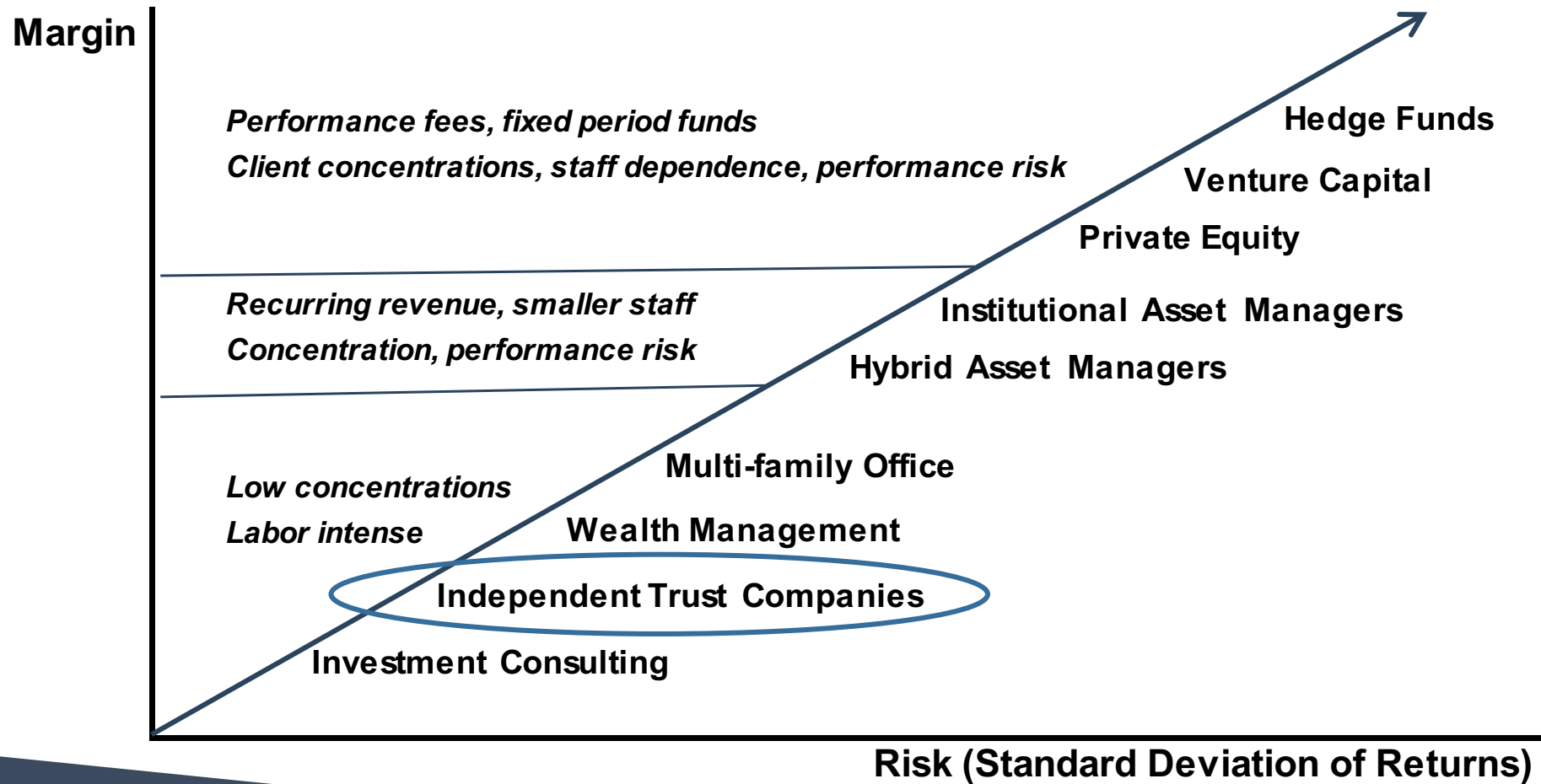
Location

Industry trends

Differentiation

Fees relative to market

Value Tradeoff Between Margin and Risk? Yes!



Value Tradeoff Between Margin and Risk? No!

Margin is safety in bear markets

High Margin Firm					
(\$000s)	Year 1	Year 2	Year 3	Year 4	Year 5
AUA/AUM	\$100,000	\$110,000	\$70,000	\$80,000	\$90,000
x Realized Fee	0.85%	0.85%	0.85%	0.85%	0.85%
Asset Based Revenue	\$850	\$935	\$595	\$680	\$765
Other Income	100	100	100	100	100
Total Revenue	\$950	\$1,035	\$695	\$780	\$865
- Expenses	-\$500	-\$500	-\$500	-\$500	-\$500
Profit	\$450	\$535	\$195	\$280	\$365
Margin	47%	52%	28%	36%	42%

Low Margin Firm					
(\$000s)	Year 1	Year 2	Year 3	Year 4	Year 5
AUA/AUM	\$100,000	\$110,000	\$70,000	\$80,000	\$90,000
x Realized Fee	0.85%	0.85%	0.85%	0.85%	0.85%
Asset Based Revenue	\$850	\$935	\$595	\$680	\$765
Other Income	100	100	100	100	100
Total Revenue	\$950	\$1,035	\$695	\$780	\$865
- Expenses	-\$750	-\$750	-\$750	-\$750	-\$750
Profit	\$200	\$285	-\$55	\$30	\$115
Margin	21%	28%	-8%	4%	13%

Marketing Failures Can Be Masked by the Market

AUM Growth of 8% entirely as a Consequence of the Market						
	Year 1	Year 2	Year 3	Year 4	Year 5	Cumulative
Beginning AUM	\$500,000,000	550,000,000	605,000,000	672,500,000	720,000,000	
New Business	5,000,000	7,500,000	10,000,000	12,500,000	15,000,000	50,000,000
Client Contributions (Withdrawals)	10,000,000	12,500,000	15,000,000	(5,000,000)	(20,000,000)	12,500,000
Terminations	(30,000,000)	(45,000,000)	(37,500,000)	(60,000,000)	(75,000,000)	(247,500,000)
Net New Business Gained / Lost	(15,000,000)	(25,000,000)	(12,500,000)	(52,500,000)	(80,000,000)	(185,000,000)
Change in Market Value	65,000,000	80,000,000	80,000,000	100,000,000	85,000,000	410,000,000
Ending AUM	550,000,000	605,000,000	672,500,000	720,000,000	725,000,000	
Average AUM	\$560,000,000	\$577,500,000	\$638,750,000	\$696,250,000	\$722,500,000	
x Effective Fees	0.75%	0.75%	0.75%	0.75%	0.75%	
Asset Based Revenues	\$4,200,000	\$4,331,250	\$4,790,625	\$5,221,875	\$5,418,750	

Market Approach Considerations

Ongoing Performance

Baseline revenue

- Current AUA/AUM
- Realized fee schedule

Baseline expenses

- Run-rate labor costs evaluated in light of market data as available
- Differentiation between base and bonus consideration as appropriate
- Most non-labor costs slated at run-rate as of valuation date

Nonrecurring items of income and expense adjusted out as appropriate

Market Pricing

Publicly traded asset managers

- Evaluated for comparability
- EBITDA most meaningful, but look at EV to AUM, revenue, and earnings multiples for context
- Multiples potentially adjusted for size and non-systemic risk factors

Transactions data

- Data is thin and idiosyncratic
- Deals occur for specific reasons which may be irrelevant
- Trends in deal pricing offer bands of reasonableness

Indicated Value

Indicated value

- Expressed on a total capital basis
- Before consideration of capital structure implications
- Evaluated against discounted cash flow analysis for reasonableness

Market Multiples

Subject Company Metric x Market Multiple = Indication of Value

Activity Metrics

EV / AUA & EV / Revenue

- **Pro:** Can be used with out normalizing to firm's expense base
- **Con:** Does not account for differences in margin

Fundamental Adjustment applied to account for difference's in subject company's profitability, prospects for growth, and risk profile

Profitability Metrics

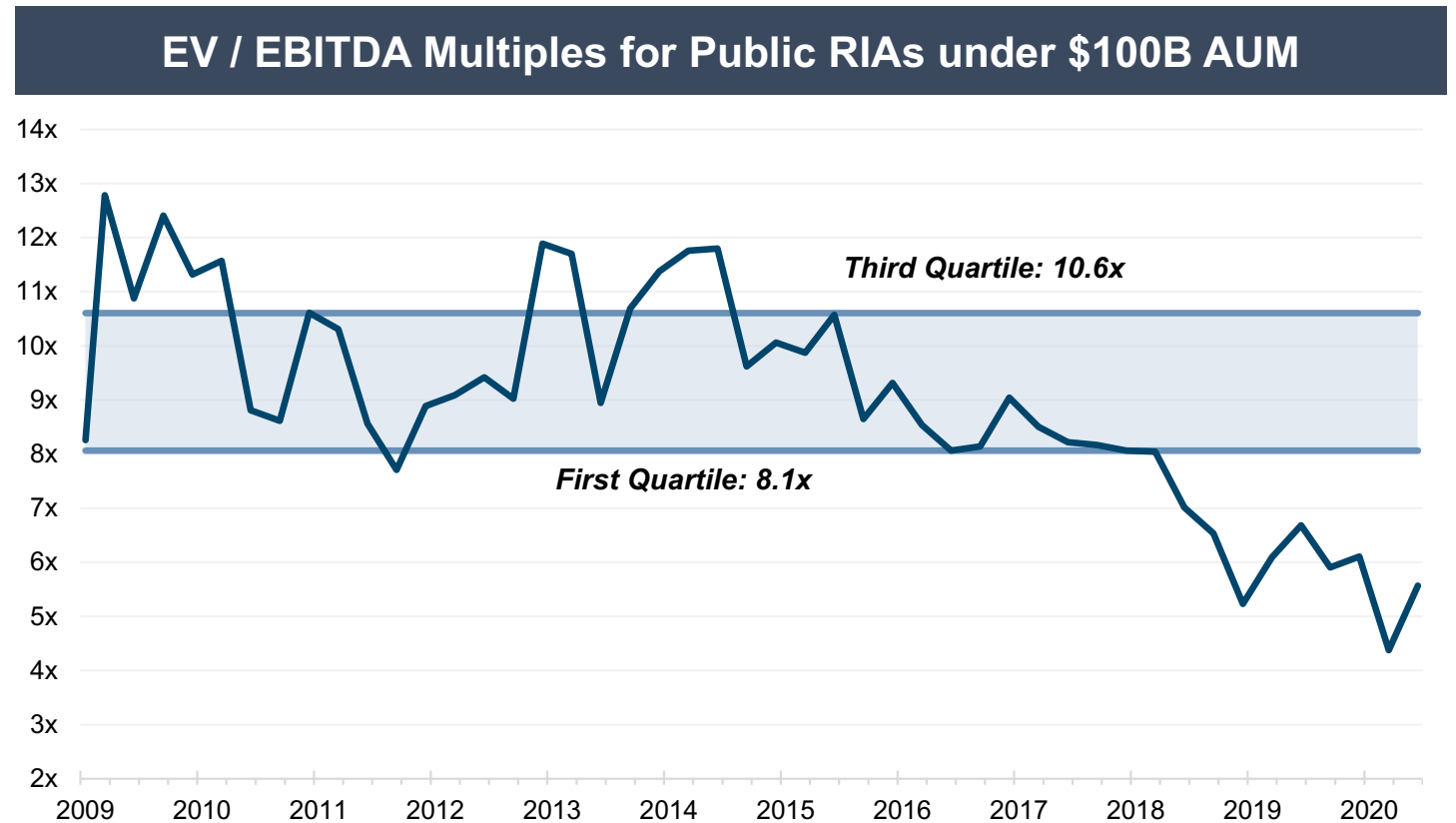
EV / EBITDA

- **Pro:** Based on actual cash flow of firm
- **Con:** Does not account for differences in risk and growth characteristics of firm

Fundamental Adjustment applied to account for difference's in subject company's prospects for growth and risk profile

Guideline Public Company Multiples Have Trended Down

Publicly traded investment managers have historically priced on average in the 8-11x trailing EBITDA range. Closely held trust companies typically transact at a discount to this range due to differences in size and risk exposures.



Guideline Transactions Method

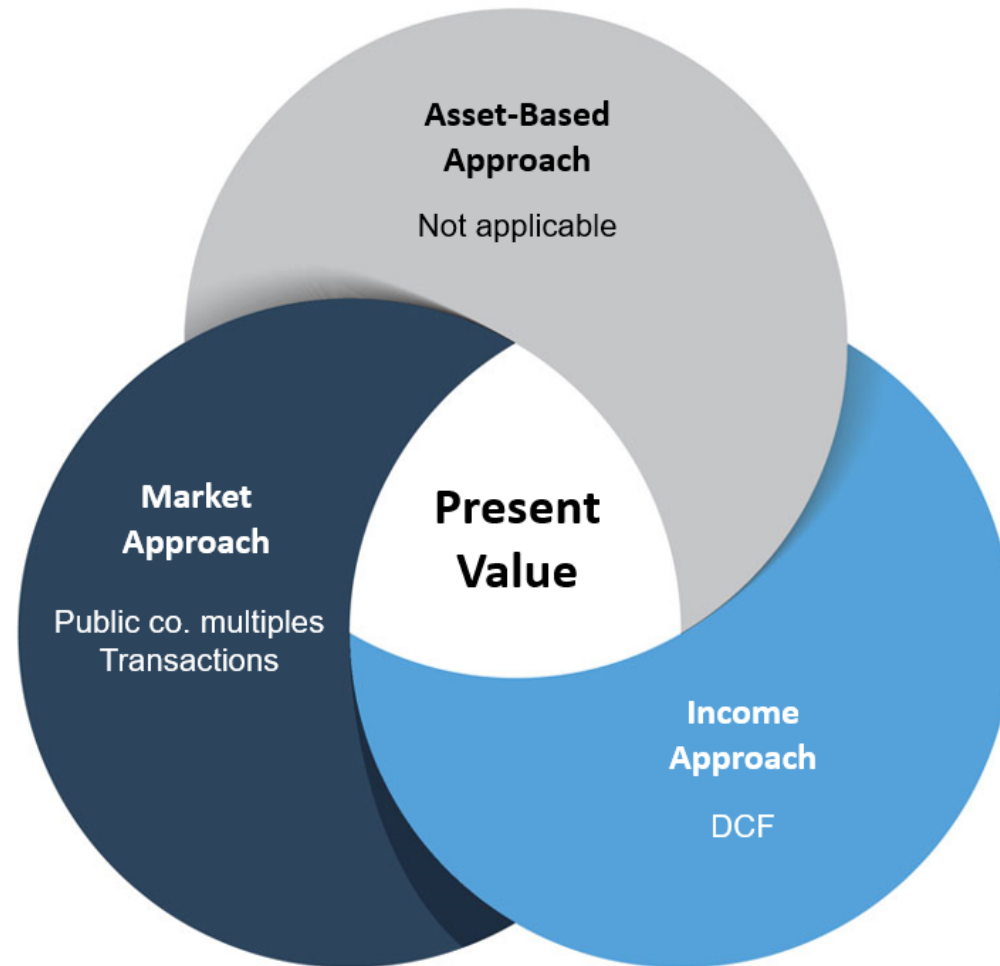
All deals are situation specific, but data forms a range.

Issues of comparability are less pronounced than with guideline public companies.

Buyer	Target	AUM	Announced	Total Deal	Deal Value (Excl. Earn-out) ÷		
		(\$M)		Val (\$M)	EBITDA	AUM (%)	Rev
City of London Investment Group Plc*	Karpus Management, Inc.	3,200	6/9/2020	99.9	NA	3.12%	NA
Boys, Arnold & Company, Inc.*	AMG National Trust Bank	1,308	2/3/2020	11.6	NA	0.89%	NA
Perpetual Ltd. (ASX:PPT)	Trillium Asset Management, LLC	3,800	1/30/2020	41.4	NA	0.96%	NA
Blucora, Inc. (NASDAQ:BCOR)	Honkamp Krueger Financial Services, Inc.	4,052	1/7/2020	160.0	NA	2.47%	NA
Estancia Capital Management, LLC	Geneva Capital Management LLC	5,274	12/6/2019	73.6	NA	0.73%	NA
Assured Guaranty Ltd.	BlueMountain Capital Management, LLC	19,300	8/7/2019	160.0	NA	0.83%	NA
LPL Financial Holdings Inc	Allen & Co	NA	5/21/2019	30.0	10.60x	3.05%	NA
Silvercrest Asset Management Group LLC	Cortina Asset Management, LLC	1,693	4/15/2019	71.1	NA	4.20%	NA
Carlyle Group L.P.	Apollo Aviation Group, LLC	5,600	10/15/2018	225.0	NA	1.34%	NA
Kudu Investment Management	Bingham, Osborn & Scarborough LLC	4,700	10/17/2018	21.0	NA	0.72%	NA
Morningstar Japan K.K.	Carret Asset Management, LLC	2,602	8/29/2018	120.6	NA	6.92%	NA
Edelman Financial Services, LLC	Financial Engines, Inc.	NA	4/30/2018	3,024.6	17.98x	NA	6.13x
TriState Capital Holdings, Inc.	Fixed Income Business and Equity Business	1,000	1/24/2018	5.0	NA	0.12%	NA
Virtus Investment Partners, Inc.	Sustainable Growth Advisers, LP	9,971	2/2/2018	129.5	NA	1.86%	NA
Khandwala Capital Management, Inc.	Winthrop Corporation	NA	4/11/2018	6.0	NA	NA	1.10x
Investor group	Anchor Capital Advisors LLC	9,181	12/20/2017	47.0	NA	0.35%	0.97x
Calamos Partners LLC	Calamos Asset Management, Inc.	20,068	12/19/2016	201.6	5.19x	1.00%	0.92x
Island Capital Group LLC	Resource America, Inc.	22,393	5/23/2016	206.9	4.99x	0.92%	1.33x
Fiera Capital Corporation	Apex Capital Management, Inc.	7,100	2/29/2016	145.0	NA	2.04%	NA
TriState Capital Holdings Inc.	The Killen Group, Inc.*	2,500	12/16/2015	20.0	5.00x	0.60%	1.05x
Hellman & Friedman	Edelman Financial*	15,000	10/12/2015	800.0	10.15x	5.33%	3.56x
Average		7,708		266.7	8.98x	1.97%	2.15x
Median		4,987		99.9	7.67x	1.00%	1.10x

Reconciling Indicated Values

Using multiple valuation approaches serves to generate tests of reasonableness against which the different indications can be evaluated.



Questions?

Matthew R. Crow, CFA, ASA
901.685.2120
crowm@mercercapital.com

Taryn E. Burgess, CFA, ABV
901.685.2120
burgess@mercercapital.com

www.mercercapital.com

NEW WHITEPAPER

Valuing Independent Trust Companies



In this whitepaper, we describe the situations that may lead to a valuation of your firm, provide an overview of what to expect during the valuation engagement, introduce some of the key valuation parameters that define the context in which a firm is valued, and describe the valuation methods and approaches typically used to value independent trust companies.

Contact



Matthew R. Crow, CFA, ASA
President
901.685.2120
crowm@mercercapital.com

Matthew is the president of Mercer Capital and leads the Investment Management Industry team. The team provides RIAs, independent trust companies, broker-dealers, and investment consulting firms with valuation services related to corporate planning and reorganization, transactions, employee stock ownership plans, and tax issues as well as valuations of intangible assets, options, and assets subject to specific contractual restrictions. Matt and his team also consult with investment management clients in the process of selling or buying. Matt publishes research related to the investment management industry and is a regular contributor to Mercer Capital's weekly blog, *RIA Valuation Insights*.

He also has broad industry experience in insurance, real estate investment ventures, and technology companies accumulated by working with hundreds of client companies during his tenure at Mercer Capital.



Taryn E. Burgess, CFA, ABV
Senior Financial Analyst
901.685.2120
burgessst@mercercapital.com

Taryn is a senior financial analyst with Mercer Capital. Taryn has valuation experience in engagements related to corporate planning and reorganizations, financial reporting, fairness opinions, litigation support, employee stock ownership plans, and estate and gift tax planning and compliance matters.

As a member of the firm's Investment Management Industry team, Taryn publishes research related to the investment management industry and is a regular contributor to Mercer Capital's weekly blog, *RIA Valuation Insights*.

About Mercer Capital

Mercer Capital provides investment managers, wealth managers, independent trust companies, and financial institutions with business valuation and financial advisory services related to corporate disputes, litigated matters, and financial reporting requirements. Mercer Capital also provides transaction advisory and consulting-related services.

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

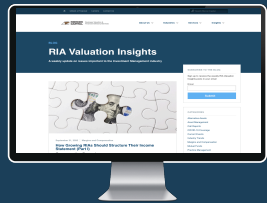
- Valuing start up managers with as little as \$50 million in AUM to established industry leaders managing over \$400 billion
- Negotiating transactions involving investment managers from sell-side, buy-side, and mutually retained perspectives
- Providing expert witness testimony for purposes of marital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



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WHITEPAPER

Valuing Independent Trust Companies



In the whitepaper, we describe the situations that may lead to a valuation of your firm, provide an overview of what to expect during the valuation engagement, introduce some of the key valuation parameters that define the context in which a firm is valued, and describe the valuation methods and approaches typically used to value independent trust companies.

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