MERCER CAPITAL

VALUE FOCUS

Asset Management Industry

SEGMENT FOCUS

Trust Banks

2016

Segment Focus
Trust Banks

All three publicly traded trust banks (BNY Mellon (BK), State Street (STT), and Northern Trust (NTRS)) outperformed the market in 2016, continuing their upward trajectory over the last few years but still lagging the broader indices since the financial crisis of 2008 and 2009. Placing this recent comeback in its historical context reveals the headwinds these businesses have been facing in a low interest rate environment that has significantly compressed their money market fees and yields on fixed income investments. Their recent success may therefore be more indicative of a reversion to mean valuation levels following years of depressed performance rather than a sudden surge of investor optimism regarding future prospects. Further, pricing improvements for this group appear to be more relative to an improved banking environment than a change in circumstances for trust services.

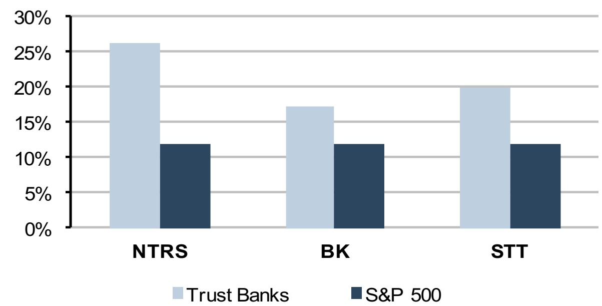
Still, in recent quarters, most trust bank stocks outperformed other classes of asset managers like mutual funds and alternative investors that endured a rocky 2016 as passive products and indexing strategies continued to gain ground on active management. The steepening yield curve portends higher NIM spreads and reinvestment income, and the market has responded accordingly – our trust bank index gained 20% for the year, besting the broader indices and all other classes of asset managers.

So have these securities gone from oversold to overbought? A quick glance at year-end pricing (page 4) shows the group valued at 15x (forward and trailing) earnings with the rest of the market closer to 25x, so that alone would certainly suggest they aren't yet too aggressively priced. Still, the three companies are all trading within 5% of their 52 week high (and all-time high for that matter), so it's hard to say they're really all that cheap either.

If you're looking for mean reversion within the sector then alternative asset managers might be your best bet, though we'd be remiss not to point out the **inherent risks associated** with some of these businesses.

Trust Banks Returns

2016



Source: S&P Global Market Intelligence

Market Overview

2016 in Review

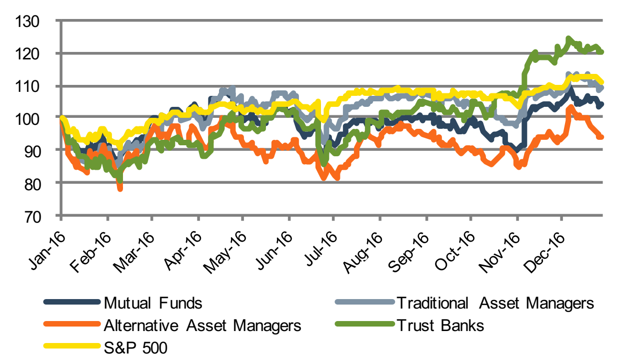
A quick glance at year-end pricing of publicly traded asset managers reveals a continued skid in cap factors for mutual fund providers offset by some multiple expansion for traditional and alternative asset managers.

This downward trend in mutual fund valuation metrics is likely attributable to their diminished growth prospects in the face of heightened competition from ETF products and passive investment strategies. Alternative and traditional asset manager valuations, on the other hand, have been buoyed by the recent stock market rally and the anticipation of higher management fees. While this should benefit all sectors of the RIA space, mutual funds seem to be facing stronger headwinds.

Actual share price performance by sector highlights the recent momentum enjoyed by publicly traded trust banks. RIAs have also performed well over the last few months, which is likely attributable to higher AUM balances in a rising stock market. On balance these gains have more than offset the January sell-off for most classes of asset managers. Publicly traded PE firms and hedge funds are a notable exception, and have been adversely affected by fee compression and relatively poor performance in an otherwise upward trending market.

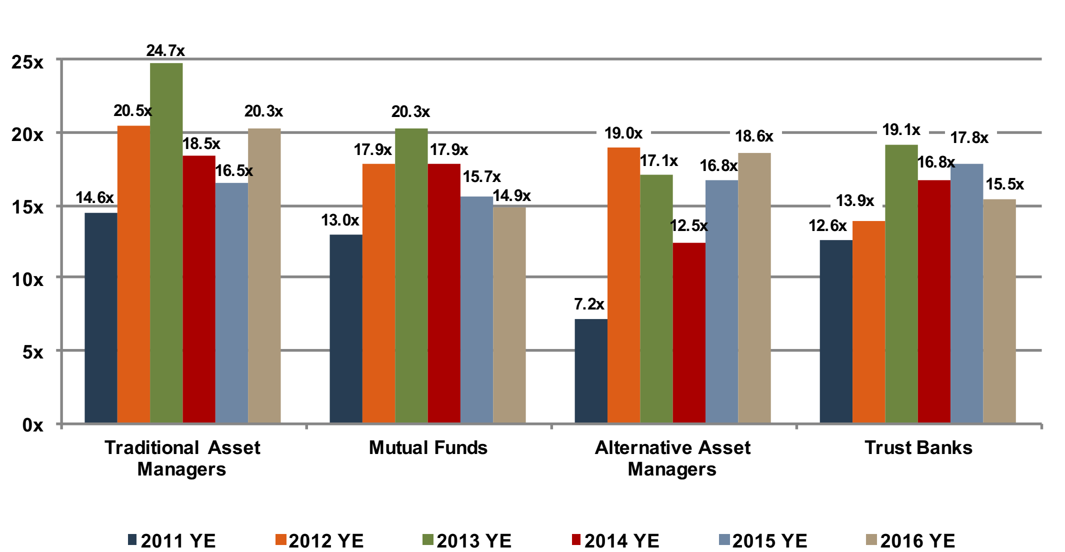
The outlook for these businesses is similarly market driven – though it does vary a bit by sector. Trust banks are more susceptible to changes in interest rates and yield curve positioning. Alternative asset managers tend to be more idiosyncratic but still influenced by investor sentiment regarding their hard-to-value assets. Mutual funds and traditional asset managers are more vulnerable to trends in active and passive investing. All are off to a good start in 2017 after entering bear market territory just one year ago, showing how much can change for these market-leveraged businesses in a relatively short timeframe.

Asset Manager Performance by Sector in 2016



Source: S&P Global Market Intelligence

Historical Median Price / LTM EPS by Sector



M&A Review

2016 in Review

Despite a rocky year for asset manager valuations, sector M&A was still strong. Total transactions were down about 10% from 2015 while aggregate deal value increased close to 20%. Several themes from the prior year also persisted as wealth management acquisitions remained robust and banks continued to play a pivotal role on both the buy-side and the sell-side.

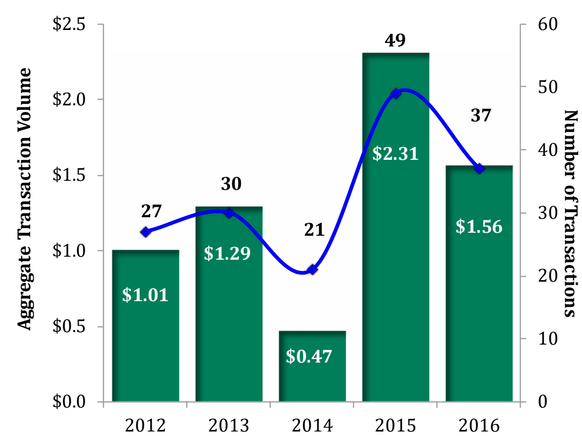
Banks have been on the hunt for RIA acquisitions for quite some time in their **quest for returns not tied to interest rate movements**. A steepening yield curve could curtail some of this momentum as lending profits improve, but we haven't seen it yet. Given the favorable economics underlying many RIAs (high margins, low capital requirements, recurring revenue stream, etc.), we suspect they'll continue to be in demand by financial institutions.

Perhaps a more surprising trend is the continued interest in alternative asset managers, despite the **sector's recent woes**. Acquisitions involving alt managers accounted for approximately one-quarter of investment management transactions globally last year, according to data from Cambridge International Partners. This trend seems counterintuitive in the era of passive investing and fee compression, but strategic and financial acquirers appear to be drawn to the segment's exposure to non-correlated asset classes and high revenue yield on assets under management.

Less surprising is the recent consolidation of discount brokers for self-directed investors. Falling commission rates and transaction fees have spurred capitulation in the sector to create scale and cost efficiencies. 2016 was no exception to this trend as Ally Financial bought Tradeking, E-Trade purchased OptionsHouse, and TD Ameritrade agreed to buy Scottrade. The culmination of all these deals is the creation of two large independent retail brokers, TD Ameritrade and E-Trade as rivals to much larger Schwab and Fidelity. With so few sizeable independent brokerage firms left, industry consolidation may have run its course. Keep an eye on E-Trade though – new senior leadership hasn't ruled out a potential sale over the next year or two.

U.S. Wealth Management Transactions

($ Billions)



Source: Cambridge International Partners

On balance, the outlook for asset manager M&A in 2017 is more promising. With over 11,000 RIAs currently operating in the U.S., the industry is still very fragmented and ripe for further consolidation. An aging ownership base is another impetus, and the recent market gains might induce prospective sellers to finally pull the trigger. Fee compression could also lead to more transactions if RIAs look to create synergies and cost efficiencies to maintain their profit margin. Absent another correction or heightened volatility, 2017 could prove to be a record year for asset manager M&A.

Asset Manager Multiples by Sector

	Ticker	12/31/2016 Stock Price	% of 52 Week High	Price / Trailing EPS	Price / Forward EPS	Enterprise Value / AUM (%)	Enterprise Value / EBITDA
				Pricing as of December 31, 2016			
TRADITIONAL ASSET MANAGERS							
Affiliated Managers Group, Inc.	AMG	145.30	80.79%	11.61	13.67	1.67	12.51
BlackRock, Inc.	BLK	380.54	95.26%	20.34	19.75	1.26	12.94
Legg Mason, Inc.	LM	29.91	76.78%	10.99	8.91	0.67	69.15
Pzena Investment Management, Inc.	PZN	11.11	96.78%	26.74	26.45	2.69	14.67
Westwood Holdings Group, Inc.	WHG	59.99	93.75%	23.17	nm	2.37	14.24
Group Median			**93.75%**	**20.34**	**16.71**	**1.67**	**14.24**
MUTUAL FUNDS							
AllianceBerstein Investments, Inc.	AB	23.45	97.30%	11.61	13.67	0.46	nm
Calamos Asset Management, Inc.	CLMS	8.55	93.17%	44.51	nm	0.32	3.32
Cohen & Steers, Inc.	CNS	33.60	78.83%	19.57	17.82	2.44	10.77
INVESCO Ltd.	IVZ	30.34	91.00%	14.43	13.53	2.10	12.57
Franklin Resources, Inc.	BEN	39.58	94.30%	13.75	14.12	2.16	6.40
Diamond Hill Investment Group, Inc.	DHIL	210.38	98.03%	18.64	nm	3.77	9.39
Eaton Vance Corp.	EV	41.88	95.46%	21.40	19.62	nm	10.93
Hennessy Advisors, Inc,	HNNA	31.75	80.84%	11.36	nm	2.91	7.84
Manning & Napier, Inc.	MN	7.55	75.66%	11.27	11.14	0.07	0.27
T. Rowe Price Group, Inc.	TROW	75.26	96.01%	16.55	17.16	2.21	9.93
U.S. Global Investors, Inc.	GROW	1.36	58.88%	nm	nm	2.27	nm
Waddell & Reed Financial, Inc.	WDR	19.51	73.35%	8.04	9.07	1.35	3.77
Federated Investors, Inc.	FII	28.28	89.67%	14.74	14.16	0.80	8.25
Virtus Investment Partners, Inc.	VRTS	118.05	92.15%	23.72	20.57	2.22	13.41
Janus Capital Group Inc.	JNS	13.27	80.56%	14.97	15.39	1.27	6.57
Group Median			**91.00%**	**14.86**	**14.78**	**2.13**	**8.25**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management, LLC	APO	19.36	91.45%	14.25	10.70	2.67	7.15
Brookfield Asset Management, Inc.	BAM.A	33.01	91.42%	14.32	40.75	42.86	15.94
Blackstone Group L.P.	BX	27.03	89.36%	25.77	13.88	10.77	17.51
Carlye Group, L.P,	CG	15.25	92.71%	94.90	13.46	2.78	8.92
Fortress Investment Group LLC	FIG	4.86	88.52%	21.45	5.35	2.43	7.29
Kohlberg Kravis Roberts & Co.	KKR	15.39	87.59%	59.19	21.40	18.16	nm
Oaktree Capital Group, LLC	OAK	37.50	77.91%	15.72	13.37	9.04	nm
Och-Ziff Capital Mgmt Group LLC	OZM	3.31	50.50%	5.30	nm	4.05	nm
Group Median			**88.94%**	**18.58**	**13.46**	**6.55**	**8.92**
TRUST BANKS							
Northern Trust Corporation	NTRS	89.05	97.90%	21.49	20.73	nm	nm
Bank of New York Mellon Corporation	BK	47.38	95.64%	15.45	15.00	nm	nm
State Street Corporation	STT	77.72	95.35%	15.03	15.40	nm	nm
Group Median			**95.64%**	**15.45**	**15.40**	**nm**	**nm**
OVERALL MEDIAN			**91.42%**	**15.58**	**14.58**	**2.27**	**9.93**

Data Source: S&P Global Market Intelligence

MERCER CAPITAL
5100 Poplar Avenue, Suite 2600
Memphis, Tennessee 38137

In This Issue

About Value Focus Asset Management Industry

Mercer Capital's Value Focus is a quarterly publication providing perspective on valuation issues pertinent to asset managers, trust companies, and investment consultants. Each issue highlights a market segment: 1st quarter: Mutual Fund Companies, 2nd quarter: Traditional Asset Managers, 3rd quarter: Alternative Asset Managers, and 4th quarter: Trust Banks. View past issues at www.mercercapital.com.

About Mercer Capital

As one of the largest valuation firms in the United States, Mercer Capital provides asset managers, trust companies, and investment consultants with corporate valuation, financial reporting valuation, transaction advisory, portfolio valuation, and related services.

Matt Crow, ASA, CFA
President
901.322.9728
crowm@mercercapital.com

Brooks Hamner, CFA
Vice President
901.322.9714
hamnerb@mercercapital.com

www.mercercapital.com

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