Value Focus

Asset Management Industry

Segment Focus

Trust Banks

After several years of tepid returns on both an absolute and relative basis following the financial crisis of 2008, all three publicly traded trust banks domiciled in the U.S. outperformed the broader indices in 2012. Placing this recent comeback in its historical context reveals the headwinds these banks have been facing in a low interest rate environment that has significantly compressed their money market fees and fixed income yields. 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 their future prospects.

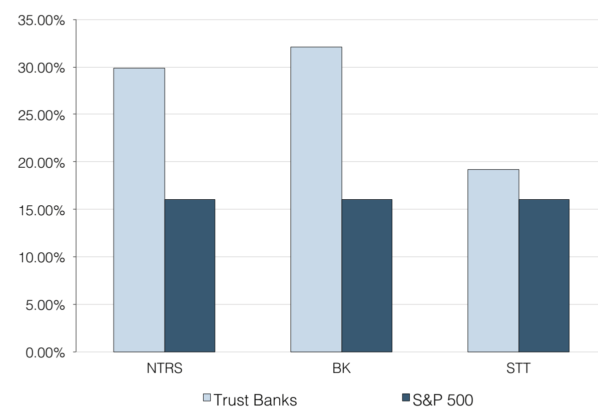
On the other hand, most interest rate sensitive businesses like trust banks have outperformed the S&P 500 in recent months, as a steepening of the yield curve could portend a rise in short term rates that would rehabilitate their money market revenue and reinvestment income. Conversely, a flattening of the yield curve or reduction in short term rates could check their recent momentum and send these stocks into correction territory.

In a recent conference call hosted by management, BK chairman and CEO, Gerald Hassell indicated that his firm has the financial capacity to "consider capital actions," including higher dividend payments and continued share repurchases, both of which would likely be well received by investors. Continued growth in client assets and a product mix shift towards higher-yielding investment management fees have also boosted shareholder value for BK while offsetting some of the adverse effects of interest rates hovering at unprecedented lows.

Michael O'Grady, CFO of Northern Trust, cited similar flexibility in capital decisions given the improvement in its financial position in recent months, but remains cautious to avoid any objections from its regulators. State Street has also returned capital to shareholders in the form of stock repurchases, though STT shares may be constrained by two separate lawsuits alleging that the Boston-based trust bank caused the plaintiffs to incur massive losses from unfair securities lending practices.

Total Returns

for 12 Months Ended 12/31/2012



Plans for returning capital to shareholders is certainly a recent theme for the industry, and market participants seem to be on board despite the low rate environment. Continued momentum in the space will likely depend on yield curve movements, capital market returns, and several other speculative factors, but the recent share repurchases appear to have stopped the bleeding, at least temporarily.

Market Review
Fourth Quarter 2012

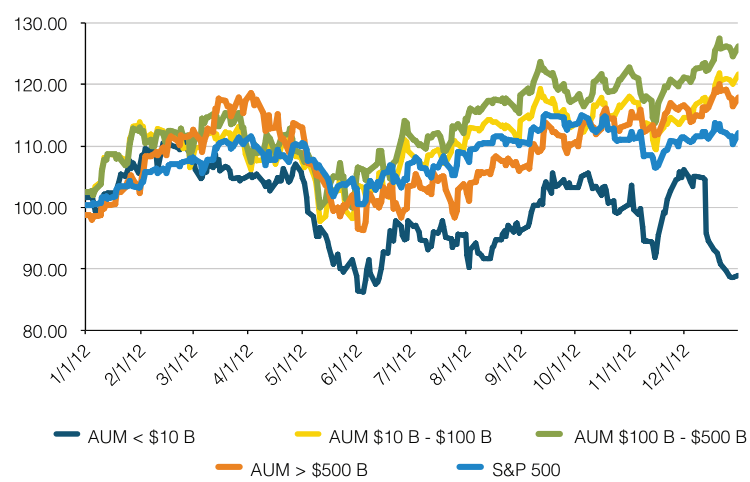
In a relatively flat quarter for most major indices, shares of publicly traded asset managers rose nearly 8% in the fourth quarter of 2012 (on average), outperforming the market by roughly 10% for the year after a gloomy 2011 for most RIAs. One of the primary contributors to such a dismal performance in 2011 was client outflows, but this trend reversed last year, particularly for open-end mutual funds, which embraced net inflows of $243 billion in 2012, according to *Morningstar*. Unfortunately for most asset managers, fixed-income funds with lower revenue yields attracted more capital than their pricier equity counterparts for the sixth straight year.

Despite this incredible streak, Syl Flood of *Morningstar* acknowledges the transient nature of the recent bond run. "Persistent bond-fund inflows feel like a tired story, except that with each passing month the drama builds rather than dissipates," Flood said. "With yields across many fixed-income sectors either at or near all-time lows, investors appear content playing musical chairs until the day that interest rates tick up and the music stops."

Another recent trend reversal is larger publicly traded asset managers outperforming more diminutive RIAs in 2012. It's worth noting that the AUM under $10 billion category is by far the least diversified index tracked with only three component businesses, so its bleak performance in recent months is likely more attributable to company-specific events at Diamond Hill and U.S. Global Investors (which together account for almost 90% of the index) than necessarily indicative of any underlying industry trends. Still, the volatility for the group does indicate the risky nature of smaller asset managers that typically have lower margins, greater client concentrations, more executive dependency issues, and more modest owner/officer succession plans than their more established counterparts.

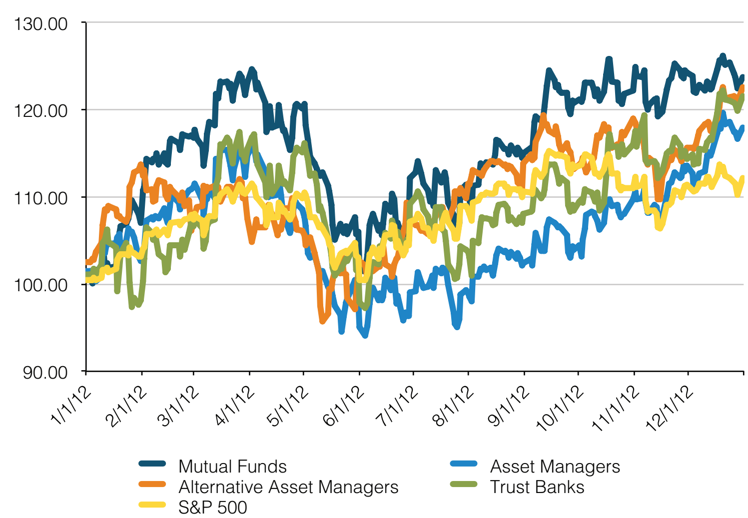
Asset Managers Index

Breakdown by Size



Asset Managers Index

Breakdown by Type



M&A Review
Fourth Quarter 2012

Consistent with prior years, transaction activity among asset managers fell short of expectations again in 2012. According to Schwab Advisor Services, the year closed with 45 completed deals, compared to 57 in 2011. On the positive side, AUM transacted did increase over 30% from $44 billion to $59 billion in 2012. Jon Beaty, senior vice president of sales and relationship management at Schwab, notes that "the independent [RIA] model has become a destination of for both advisors and high-net worth investors alike, and the growth in the overall size of the deals we saw in 2012 is proof that this is a model that is growing and flourishing."

Still, many industry participants expected a boon in transactions with the rise in the equity markets and pending capital gains tax hikes following the fiscal cliff at year-end 2012. David DeVoe, CEO of RIA M&A advisory firm DeVoe & Company, acknowledges, "It was a loft softer than I anticipated. We should be seeing a couple of hundred transactions a year. I can't help but think we're headed for a situation where a lot of RIAs will be looking for buyers at the same time. That could affect valuations."

National acquiring firms like Affiliated Managers Group remain the dominant buyer category, finishing the year with 25 of the 45 total M&A deals, according to Schwab. "National acquiring firms are proving to be a good overall alternative for the growth of the industry, attractive to both advisors that are looking to join the move to independence or RIAs that are seeking to expand their footprint or execute a succession strategy," explains Beatty.

Post-fiscal cliff, many ownership succession plans for RIAs with aging executives remain unresolved, and transacting the business is still a viable solution even if the prospective sellers missed out on the lower capital gains rate. These realities, combined with the market ascension in the back half of the year could trigger a wave of deal flow in 2013, but recent history suggests a more tempered outlook is likely prudent.

	Ticker	Price / Trailing EPS	Price / Forward EPS	Total Capital / AUM	Total Capital / EBITDA
TRADITIONAL ASSET MANAGERS					
Affiliated Managers Group, Inc.	AMG	51.08	15.00	2.05%	14.65
Artio Global Investors, Inc.	ART	nm	nm	0.68%	0.80
BlackRock, Inc.	BLK	16.47	14.18	1.22%	11.62
Legg Mason, Inc.	LM	20.80	11.70	0.75%	12.39
Pzena Investment Management, Inc.	PZN	20.19	16.03	2.09%	10.81
Virtus Investment Partners, Inc.	VRTS	6.45	18.66	2.39%	17.53
Westwood Holdings Group, Inc.	WHG	24.17	nm	2.39%	15.78
Group Median		**20.49**	**15.00**	**2.05%**	**12.39**
MUTUAL FUNDS					
AllianceBerstein Investments, Inc.	AB	nm	12.76	nm	nm
Calamos Asset Management, Inc.	CLMS	16.47	13.42	0.91%	2.05
Cohen & Steers, Inc.	CNS	22.43	17.68	2.97%	13.24
GAMCO Investors, Inc.	GBL	18.55	16.09	4.71%	12.12
Epoch Holding Corporation	EPHC	23.46	20.68	2.74%	13.09
INVESCO Ltd.	IVZ	16.96	13.06	2.51%	12.31
Franklin Resources, Inc.	BEN	14.52	11.69	4.05%	10.37
Diamond Hill Investment Group, Inc.	DHIL	12.90	9.36	2.27%	8.24
Eaton Vance Corp.	EV	19.05	13.83	2.38%	9.78
Hennessy Advisors, Inc,	HNNA	26.18	nm	3.00%	14.67
Manning & Napier, Inc.	MN	nm	11.49	0.41%	nm
T. Rowe Price Group, Inc.	TROW	20.87	17.63	2.97%	12.87
U.S. Global Investors, Inc.	GROW	85.60	10.97	3.75%	38.80
Waddell & Reed Financial, Inc.	WDR	17.21	14.46	3.46%	10.67
Federated Investors, Inc.	FII	12.43	11.74	0.69%	8.04
Janus Capital Group Inc.	JNS	15.43	15.17	1.41%	8.36
Group Median		**17.88**	**13.42**	**2.74%**	**11.40**
ALTERNATIVE ASSET MANAGERS					
Apollo Global Management, LLC	APO	20.38	6.05	13.09%	4.94
Brookfield Asset Management, Inc.	BAM	17.59	29.36	nm	9.59
Blackstone Group L.P.	BX	101.19	7.92	4.16%	nm
Carlye Group, L.P,	CG	nm	8.17	0.71%	21.81
Fortress Investment Group LLC	FIG	nm	7.65	4.63%	nm
Kohlberg Kravis Roberts & Co.	KKR	7.58	6.95	7.70%	nm
Oaktree Capital Group, LLC	OAK	nm	9.89	9.29%	1.06
Och-Ziff Capital Mgmt Group LLC	OZM	nm	8.28	14.95%	nm
Group Median		**18.98**	**8.04**	**7.70%**	**7.26**
TRUST BANKS					
Northern Trust Corporation	NTRS	19.55	15.47	nm	nm
Bank of New York Mellon Corporation	BK	13.86	11.34	nm	nm
State Street Corporation	STT	12.23	11.24	nm	nm
Group Median		**13.86**	**11.34**	**nm**	**nm**
OVERALL MEDIAN		**18.80**	**13.24**	**2.39%**	**11.87**

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Value Focus Asset Management Industry

Segment Focus: Trust Banks

Fourth Quarter 2012 Market Overview

Fourth Quarter 2012 M&A Review

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.

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