

VALUE FOCUS

Asset Management Industry



SEGMENT FOCUS

Trust Banks

2015

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Q1: Mutual Funds
Q2: Traditional Asset Managers
Q3: Alternative Asset Managers
Q4: Trust Banks

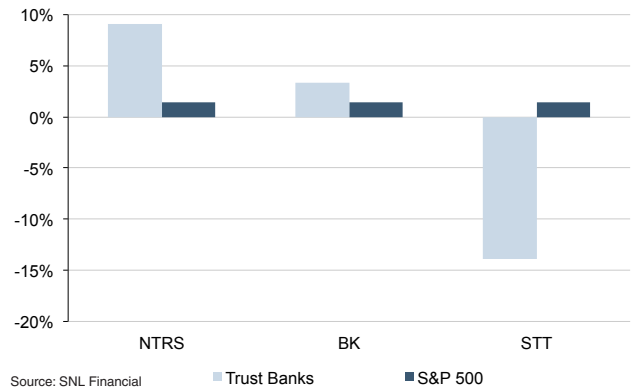
Segment Focus Trust Banks

Two of the sector's three components bested the market in 2015, continuing their upward trajectory from the prior two 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 banks 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 their future prospects.

Still, in recent quarters, most trust bank stocks have outperformed other classes of asset managers like mutual funds and alternative investors that endured a rocky 2015 as passive products and indexing strategies continued to gain ground on active management. Moving forward, rising interest rates coupled with any signs of yield curve steepening should lead to further gains in trust bank revenue, margins, and NIM spreads that would only be partially offset by declines in their fixed income holdings.

So far in 2016, BNY Mellon is off nearly 10% on poor market returns and lawsuits by investors alleging billions of dollars in trust losses. The largest case was filed by BlackRock and other investors alleging

Total Returns in 2015



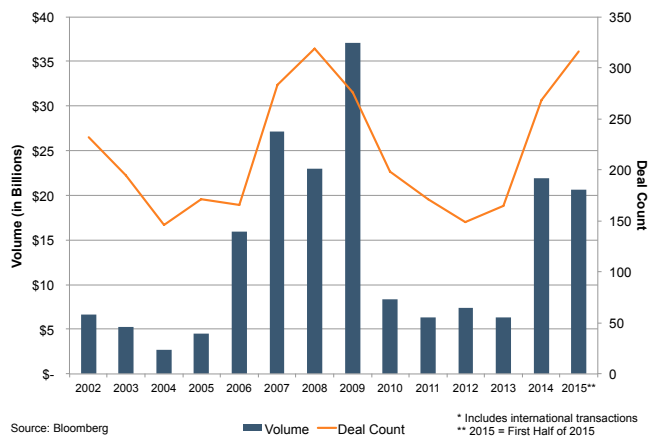
almost \$18 billion in damages, which is nearly half of BNY's current market cap. The lawsuits involve 260 trusts valued at more than \$175 billion when they were securitized with BNY Mellon serving as the trustee for the assets that were primarily invested in mortgage backed securities. Ongoing litigation and the persistent threat of ZIRP becoming the new normal remain the two biggest headwinds facing most of these businesses moving into the new year.

M&A Review Fourth Quarter 2015

Despite a rocky second half of the year for the equity markets, RIA transaction activity posted solid gains in 2015. According to Bloomberg, asset manager deals increased to 239 through November of this year from 211 in 2014 on lower volume from the lack of mega-deals like TIAA-CREF's 2014 purchase of Nuveen. Still, 2015 numbers were buoyed by a few notable transactions including **Edelman's \$800 million sale** to Hellman (<http://mer.cr/1NkNKSC>) and **Tri-State's recent purchase** of The Killen Group (<http://mer.cr/22v9JP6>).

As always, we caution against reading too much into the volume figures since transaction value is often not reported, though it is promising that the number of deals has increased fairly consistently over the last few years. Whether this reflects more interest from buyers (who seek the safety of recurring revenue in a ZIRP environment) or sellers (in an industry with aging players and a poor track record for internal succession) remains to be seen. Regardless, prospective buyers should be intrigued by many of these businesses now trading at a 30% discount to their 52 week high.

Asset Manager M&A Since 2002*



Sector Analysis 2015 in Review

Year-end pricing of publicly traded asset managers reveals a continued skid in multiples for traditional RIAs and mutual funds with modest advancement for the alternative managers and trust banks.

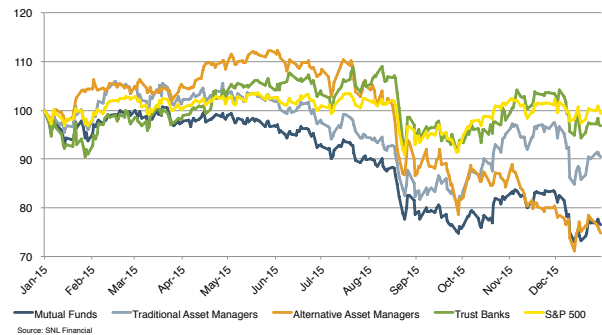
Earnings multiples are essentially a function of risk and growth, so a decline in cap factors for the traditional managers and mutual funds means one of two things must be happening: either the cost of capital is increasing or the growth outlook for asset managers is stalling. Despite the Fed's recent actions, WACC's are generally declining in most industries. There is no reason to assume the cost of capital is now higher in asset management than a year or two ago, so the trend in multiples suggests that the growth outlook for RIA earnings continues to be revised downward.

Given that traditional asset managers and mutual funds are so highly levered to market conditions, some consider RIA valuations as a de facto futures contract on the broader indices. If that's the case, a continued contraction in multiples could portend a pullback or lack of upside for the stock market in general. The market activity so far this year tends to confirm this suspicion.

Since most of the group is currently trading at a 30% discount to their 52 week high, the market is clearly bearish on the prospects for many of these businesses moving into the new year. Meanwhile, more optimistic investors will view this as a buying opportunity for companies that have gotten a lot cheaper in recent months.

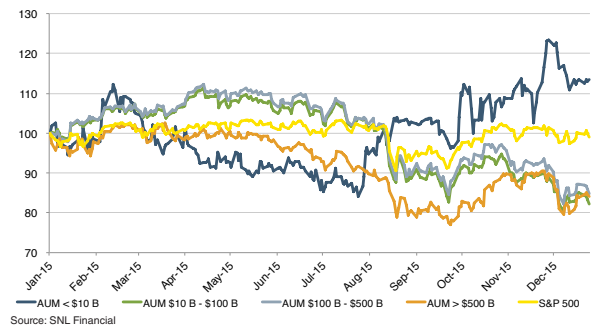
Asset Managers Index

Breakdown by Type



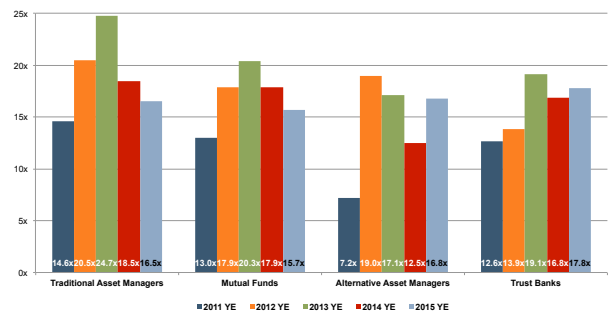
Asset Managers Index

Breakdown by Size



Historical Median Price

LTM EPS by Sector



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TriState Capital Holdings Acquisition of The Killen Group

On December 16th, 2015, Pittsburgh-based TriState Capital Holdings, Inc. (NASDAQ: TSC) and its Chartwell Investment Partners, LLC subsidiary announced they had entered into a definitive agreement and plan of merger with The Killen Group, Inc. (TKG), an investment management firm headquartered in Berwyn, Pennsylvania. TKG is the advisor to The Berwyn Funds and manages \$2.5 billion in client assets for 300 clients. TriState Capital has agreed to a purchase price of \$15 million at closing with an additional performance-based contingent consideration of \$15-\$20 million payable in cash in the second quarter of 2017. The deal is expected to close in the second quarter of 2016. Similar to the Simmons First/Trust Company of the Ozarks deal in 2015 (see our [First Quarter 2015](#) issue at <http://mer.cr/1HELI3m>) and the Boston Private/Banyan Partners deal in 2014 (see our [Second Quarter 2014](#) issue at <http://mer.cr/1yqzi5s>) the terms of the transaction were disclosed via an investor presentation and outlined in Figure 1.

All of these deals involve bank acquisitions of closely held RIAs. In a low interest rate environment coupled with rising capital requirements, many banks are turning their attention to asset managers and trust companies for a multitude of reasons:

- Exposure to fee income that is uncorrelated to interest rates
- Minimal capital requirements to grow AUM and AUA
- Higher margins and ROEs relative to traditional banking activities
- Greater degree of operating leverage – gains in profitability with management fees
- Largely recurring revenue with monthly or quarterly billing cycles

These recent deals are particularly instructive to other industry participants since, of the near 11,000 RIAs nationwide, less than 1% transact in any given year, and the terms of those deals are rarely disclosed to the public. Contemporary transactions at these valuations suggest growing interest in businesses with recurring revenue streams and sustainably high EBITDA margins.

Figure 1

Deal Analysis (in \$ Mil.)	Tri-State / Killen	SFNC / TCO	Tri-State / Chartwell	BPFH / Banyan
Announcement Date	12/16/15	4/19/15	1/7/14	7/16/14
AUM	\$2,463	\$1,100	\$7,500	\$4,317
Realized Average Fee	0.58%	0.60%	0.34%	0.58%
Revenue	\$14.3	\$5.9	\$25.9	\$25.0
Operating Expense (Excl. Depr.)	11.3	3.9	19.9	18.0
EBITDA	\$3.0	\$2.0	\$6.0	\$7.0
<i>EBITDA Margin</i>	21.0%	34.5%	23.2%	28.0%
Initial Consideration	\$15.0	\$20.7	\$45.0	\$65.0
Earn-out*	20.0	-	15.0	20.0
Total Purchase Price	\$35.0	\$20.7	\$60.0	\$85.0
Implied % of AUM (Excl. Earn-out)	1.4%	1.9%	0.6%	1.5%
Multiple of Revenue (Excl. Earn-out)	1.0x	3.5x	1.7x	2.6x
Multiple of EBITDA (Excl. Earn-out)	5.0x	10.2x	7.5x	9.3x

*Earn-out for TSC/Killen represents the maximum additional performance-based contingent consideration

What We're Reading

A Simple Warning

Zero Hedge: Tyler Durden
<http://mer.cr/1K6H10N>

How Live Oak Is Solving RIAs' Succession Problem

Think Advisor:
Savita Iyer-Ahrestani
<http://mer.cr/1UmfQzv>

The Bond-Market Exodus is Accelerating

Business Insider:
Ben Moshinsky
<http://mer.cr/1PNyn3Y>

A Bullish Forecast for BlackRock, T. Rowe Price, and Others in 2016

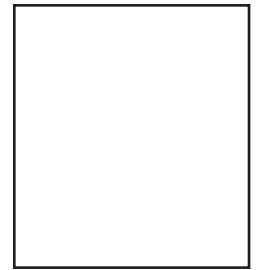
Barron's: Andrew Bary
<http://mer.cr/1QnWHMy>

Asset Manager Multiples by Sector

	Ticker	12/31/15 Stock Price	% of 52 Week High	Pricing as of December 31, 2015			
				Price / Trailing EPS	Price / Forward EPS	Total Capital / AUM	Total Capital / EBITDA
TRADITIONAL ASSET MANAGERS							
Affiliated Managers Group, Inc.	AMG	\$159.76	69.27%	16.66	11.39	1.77%	7.78
BlackRock, Inc.	BLK	340.42	88.92%	17.51	16.35	1.36%	12.19
Legg Mason, Inc.	LM	39.23	66.28%	13.91	11.71	0.79%	9.45
Pzena Investment Management, Inc.	PZN	8.60	70.20%	16.54	16.23	2.22%	10.82
Westwood Holdings Group, Inc.	WHG	52.09	81.28%	14.55	nm	2.20%	9.99
Group Median			70.20%	16.54	13.97	1.77%	9.99
MUTUAL FUNDS							
AllianceBernstein Investments, Inc.	AB	\$23.85	72.85%	12.23	12.28	nm	10.66
Calamos Asset Management, Inc.	CLMS	9.68	70.66%	24.82	20.60	0.95%	nm
Cohen & Steers, Inc.	CNS	30.48	64.63%	18.93	16.04	2.78%	10.94
GAMCO Investors, Inc.	GBL	31.04	64.48%	8.53	10.74	2.29%	5.82
INVESCO Ltd.	IVZ	33.48	79.62%	13.95	12.40	2.85%	12.32
Franklin Resources, Inc.	BEN	36.82	65.86%	11.19	11.40	3.16%	7.70
Diamond Hill Investment Group, Inc.	DHIL	189.00	81.52%	16.55	nm	4.05%	10.63
Eaton Vance Corp.	EV	32.43	73.40%	16.89	12.01	1.52%	10.81
Hennessy Advisors, Inc.	HNNA	29.96	90.79%	15.69	nm	3.11%	9.27
Manning & Napier, Inc.	MN	8.49	88.00%	nm	10.35	0.34%	nm
T. Rowe Price Group, Inc.	TROW	71.49	81.97%	15.51	15.18	2.48%	8.39
U.S. Global Investors, Inc.	GROW	1.17	33.33%	nm	nm	2.64%	nm
Waddell & Reed Financial, Inc.	WDR	28.66	55.33%	9.10	9.88	2.42%	5.65
Federated Investors, Inc.	FII	28.65	80.14%	18.48	14.46	0.91%	11.68
Virtus Investment Partners, Inc.	VRTS	14.09	74.26%	nm	nm	2.64%	9.74
Janus Capital Group Inc.	JNS	15.18	58.84%	17.61	13.74	1.63%	nm
Group Median			73.13%	15.69	12.34	2.48%	10.19
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management, LLC	APO	\$15.18	58.84%	24.10	7.78	2.83%	6.78
Brookfield Asset Management, Inc.	BAM.A	nm	nm	16.35	26.12	nm	10.50
Blackstone Group L.P.	BX	29.24	65.81%	17.20	8.48	5.45%	nm
Carlye Group, L.P.	CG	15.62	49.00%	nm	6.65	0.67%	10.16
Fortress Investment Group LLC	FIG	5.09	58.84%	16.42	5.59	2.25%	6.80
Kohlberg Kravis Roberts & Co.	KKR	15.59	62.26%	16.76	6.09	23.96%	nm
Oaktree Capital Group, LLC	OAK	47.72	83.62%	25.66	13.80	16.74%	nm
Och-Ziff Capital Mgmt Group LLC	OZM	6.23	46.18%	8.90	5.11	nm	13.46
Group Median			58.84%	16.76	7.21	4.14%	10.16
TRUST BANKS							
Northern Trust Corporation	NTRS	\$72.09	90.97%	18.11	17.16	nm	nm
Bank of New York Mellon Corporation	BK	41.22	90.69%	17.77	13.30	nm	nm
State Street Corporation	STT	66.36	81.66%	15.50	12.62	nm	nm
Group Median			90.69%	17.77	13.30	nm	nm
OVERALL MEDIAN			70.66%	16.54	12.28	2.35%	10.08



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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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