

VALUE FOCUS

Investment Management

First Quarter 2021 | Segment Focus: Wealth Managers

In This Issue

| | |
|---|----------|
| RIA Industry Extends Its Bull Run Another Quarter | 1 |
| Segment Focus: Wealth Managers | 3 |
| RIA M&A: Deal Activity Continues at Record Highs | 4 |
| Investment Manager Multiples by Sector | 6 |
| About Mercer Capital | 7 |

In this issue, we review public market performance across the investment management industry in light of the market's swift recovery from the COVID-19 global pandemic. AUM has risen with the market over this time, and so have industry-wide revenue and earnings. On balance, the outlook for RIAs remains strong.

In our segment focus for this quarter, we look at the performance of wealth managers, who have performed surprisingly well despite industry headwinds such as fee pressure and a lack of succession planning. We discuss near term opportunities presented by the potential reversal of the Tax Cuts and Jobs Act of 2017 and the challenges of virtual communication.

Also in this issue, we address industry M&A trends and factors driving deal activity. Record deal activity was supported by increased availability of funding in the space, in tandem with more lenient financing terms.

RIA Industry Extends Its Bull Run Another Quarter

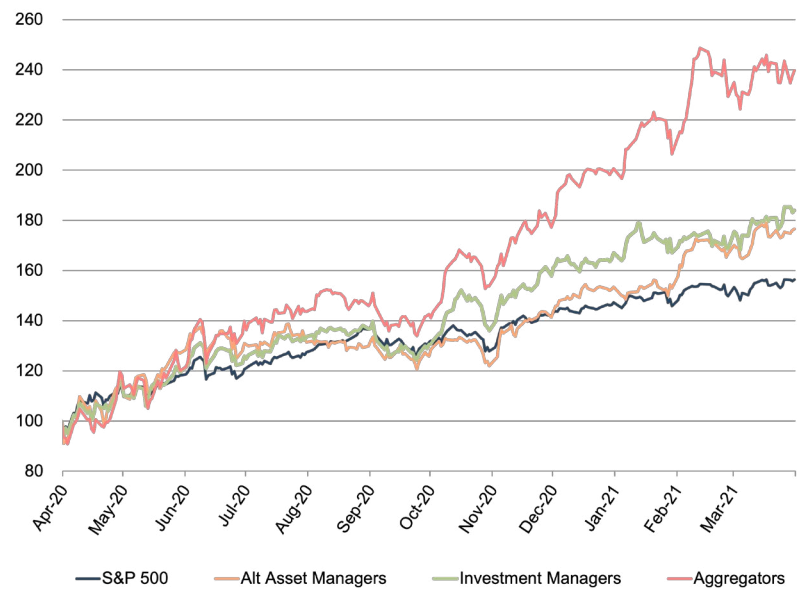
Publicly Traded Asset / Wealth Managers See Continued Momentum Through First Quarter As Market Backdrop Improves

About a year ago, share prices for publicly traded investment managers hit rock bottom, as investors reacted negatively to having a revenue stream tied to the overall market. Since then, investment managers have had a straight-line recovery driven by the larger bull market. Today, most individual stocks in our indices are hovering near 52-week highs. Aggregators have fared particularly well over the last twelve months on low borrowing costs and steady gains on their RIA acquisitions. Traditional investment managers have also performed well over this time on rising AUM balances with favorable market conditions.

The upward trend in publicly traded asset manager share prices since March 2020 is promising for the industry, but it should be evaluated in the proper context. Pre-COVID, many of these public companies were already facing numerous headwinds including fee pressure, asset outflows, and the rising popularity of passive investment products. While the 11-year bull market run largely masked these issues, asset outflows and revenue pressure can be exacerbated in times of market pullbacks and volatility. The first quarter was also favorable for publicly traded RIAs of all sizes as shown in the chart on the right.

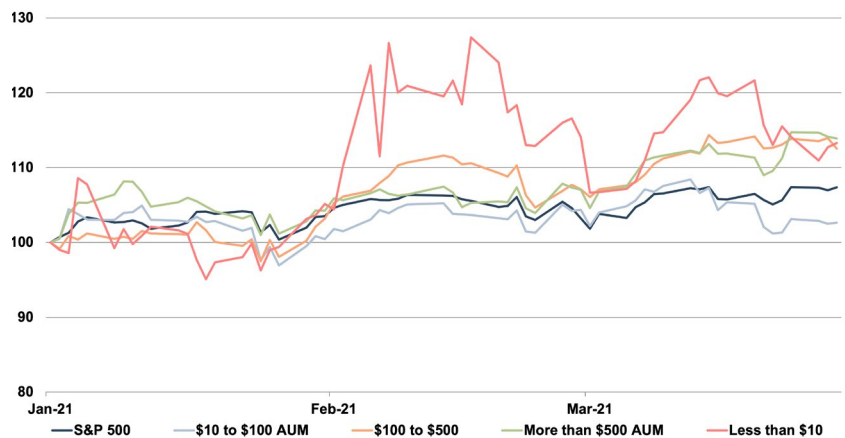
As valuation analysts, we are often interested in how earnings multiples have evolved over time, since these multiples can reflect market sentiment for the asset class. LTM earnings multiples for publicly traded asset and wealth management firms declined significantly during the first quarter of 2020—reflecting the market's anticipation of lower earnings due to large

Investment Manager Performance by Sector - LTM ended 3/31/2021



Source: S&P Global Market Intelligence

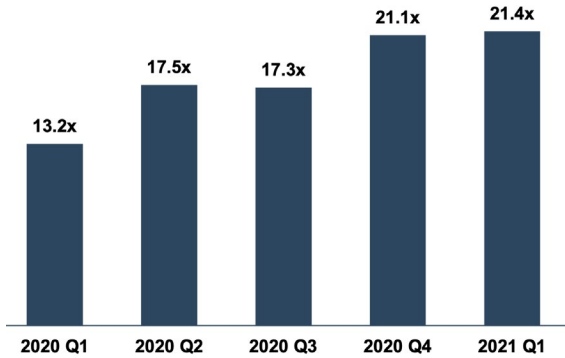
Investment Manager Performance by AUM Size - Q1 2021



Source: S&P Global Market Intelligence

Price to LTM EPS

Traditional Asset / Wealth Managers



Source: S&P Global Market Intelligence

decreases in client assets attributable to the overall market decline. Multiples have since recovered as prospects for earnings growth have improved with AUM balances.

Implications for Your RIA

The value of public asset and wealth managers provides some perspective on investor sentiment towards the asset class, but strict comparisons with privately-held RIAs should be made with caution. Many of the smaller publics are focused on active asset management, which has been particularly vulnerable to the headwinds such as fee pressure and asset outflows to passive products. Many smaller, privately held RIAs, particularly those focused on wealth management for HNW and UHNW individuals, have been more insulated from industry headwinds, and the fee structures, asset flows, and deal activity for these companies have confirmed this.

The market for privately held RIAs has remained strong as investors have flocked to the recurring revenue, sticky client base, low capex needs, and high margins that these businesses offer. Like the public companies, value likely declined during the first quarter of last year, but these were largely paper losses (not many transactions were completed based on value at the bottom of the downturn). Likely, not more than a quarter or two of billing was impacted last year by the market downturn. Since then, revenue and profitability have recovered rapidly, and value has likely improved as well.

Improving Outlook

The outlook for RIAs depends on a number of factors. Investor demand for a particular manager's asset class, fee pressure, rising costs, and regulatory overhang can all impact RIA valuations to varying extents. The one commonality is that RIAs are all impacted by the market.

The impact of market movements varies by sector, however. Alternative asset managers tend to be more idiosyncratic but are still influenced by investor sentiment regarding their hard-to-value assets. Wealth manager valuations are tied to the demand from consolidators while traditional asset managers are more vulnerable to trends in asset flows and fee pressure. Aggregators and multi-boutiques are in the business of buying RIAs, and their success depends on their ability to string together deals at attractive valuations with cheap financing.

On balance, the outlook for RIAs has generally improved with market conditions over the last several months. AUM has risen with the market over this time, and it's likely that industry-wide revenue and earnings have as well. The first quarter was generally a good one for RIAs, but who knows where the rest of 2021 will take us.

Segment Focus: Wealth Managers

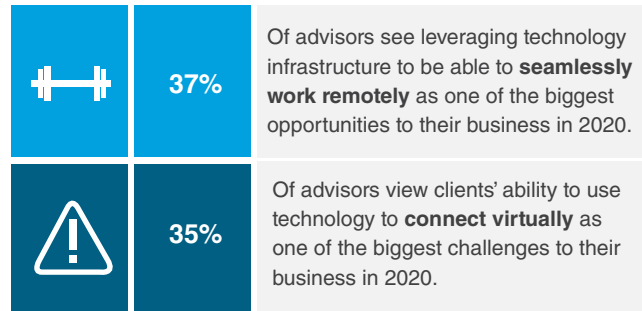
Strong Gains in the Wealth Management Industry Propel RIA Aggregators to New Highs

Nearly all sectors of the stock market are up over the last year, but that's especially true for the RIA industry. Even if most wealth management firms don't employ any debt in their capital structure, their performance is very much levered to the stock market due to its direct effect on AUM balances, and the operating leverage inherent in the wealth management model. RIA aggregators are even more levered to market conditions, since they typically borrow money to purchase wealth management firms. It shouldn't be too surprising that our aggregator index is up 140% over the last year.

After a rough Q1 in 2020, wealth management firms have fared particularly well over the last year, with favorable market conditions and rising demand for financial advisory services. During times of excessive volatility and market turmoil, individual investors rely on their advisors to stay the course and rebalance portfolios in accordance with their investment objectives. Wealth management firms have capitalized on this reliance as the number of advisors charging financial planning fees on top of asset-based fees or commissions **increased 72% in 2020**.

Despite steady gains over the last year, wealth management firms still face challenges pertaining to fee pressure, succession planning, and connecting with millennials who are more interested in robo-advisors and fintech products than being counseled by their parents' advisor. Additionally, the switch from in-person meetings to digital communication is viewed by many as another obstacle. According to a recent Schwab study, 35% of advisors viewed clients' ability

to connect virtually as one of the biggest challenges to their business in 2020. Conversely, 37% of advisors view leveraging technology infrastructure to be able to seamlessly work remotely as one of the biggest opportunities to their business.



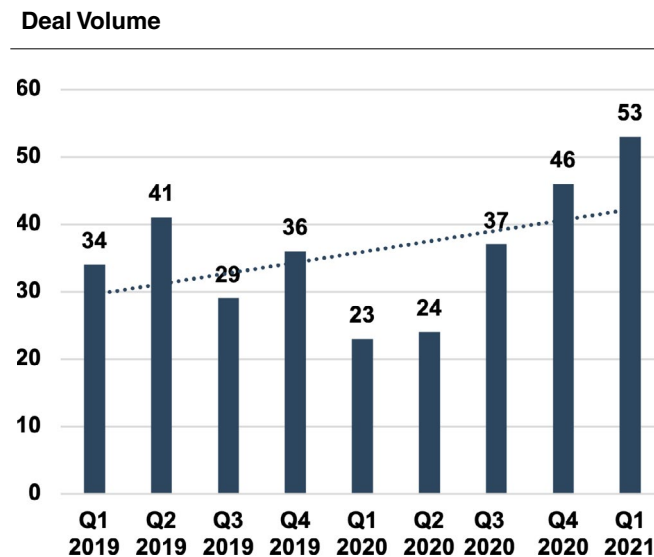
Source: Schwab Advisor Services' 2020 Independent Advisor Outlook Study

Another near-term opportunity is the pending reversal of some or all of the Tax Cuts and Jobs Act of 2017, and the implications it has for **estate planning in 2021**. Biden's current proposal cuts the Unified Tax Credit (the exemption on gift and estate taxes) in half from \$23.2 million to \$11.6 million for married couples and from \$11.6 million to \$5.8 million per individual. As a consequence, many high net worth families will have significant gift and estate planning needs from their advisors to avoid a substantial increase in their embedded estate tax liability next year.

On balance, 2021 should prove to be another challenging but favorable year for wealth management firms that focus on their clients' needs and take advantage of rising demand for financial planning services. Industry headwinds remain, but we're confident that the industry will prosper, diversify, and expand.

RIA M&A

Deal Activity Continues at Record Highs



Source: Fidelity; Q1 estimate based on first 2 months of data

Despite the hiatus in M&A beginning with the onset of COVID-19, 2020 was a strong year for RIA mergers and acquisitions, and 2021 is expected to be even stronger.

Many of the same forces that have spurred M&A over the last five years drove deal activity in late 2020 and early 2021. Fee pressure in the asset management space and a lack of succession planning by wealth managers are still driving consolidation. But the increased availability of funding in the space, in tandem with more lenient financing terms, has also caused some of this uptick.

There has been growing interest over the last few years from private equity and permanent capital providers who find investment managers' recurring revenue streams and availability for operating leverage attractive. Investors, hungry for alpha in a low-yield environment, are driving up deal prices leading more firms to hang up a for-sale sign.

Additionally, deal activity was bolstered by the low cost of credit and lenient financing terms by historical standards. Loans in the commercial banking system declined for the first time in a decade in 2020 and for only the second time in 28

years while deposits remain historically high. In the current low-rate environment, revenue pressures are high for banks as cash and bonds yield little to nothing. Without a competitive alternative, **banks and investors flush with capital are under pressure to compete for lending opportunities** to produce a return while loan demand is weak as the U.S. market rounds what many believe to be the very beginnings of a new economic cycle.

There is a growing number of banks interested in lending to the space. **Live Oak Bank** pioneered an SBA vertical in lending to RIAs and investment advisors. **Oak Street Funding** has played a role in a substantial portion of leveraged transactions in this space, and most recently **SkyView** began offering financing solutions for RIAs.

Further, the Biden administration's efforts to increase the capital gains tax rate may also accelerate some M&A activity in the immediate short-term as sellers seek to position transactions to be taxed at current tax rates.

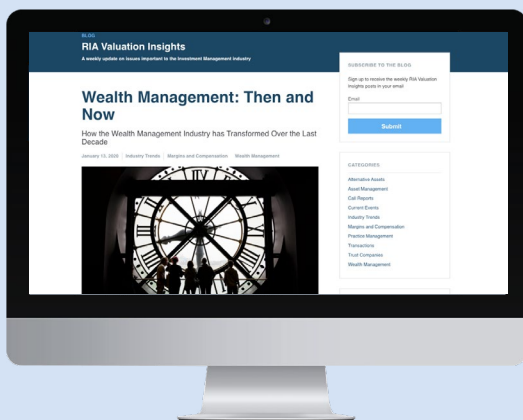
What Does This Mean For Your RIA?

If you are planning to grow through strategic acquisitions, the price may be higher, and the deal terms will likely favor the seller, leaving you more exposed to underperformance. In a market this competitive, acquirers need to distinguish themselves on more than price. Sellers are often looking for buyers who can help them achieve scale, reduce the load of managing a business, and/or expand their reach or distribution capability.

If you are considering an internal transition, know there are more ways to finance the buy-out than there used to be. A seller-financed note has traditionally been one of the primary ways to transition ownership to the next generation of owners (and in some instances may still be the best option), but bank financing can provide the founding generation with more immediate liquidity and potentially offer the next-gen cheaper financing costs.

If you are an RIA considering selling, there are many options, and it is important to have a clear vision of your firm, its value, and what kind of partner you want before you go to market. A strategic buyer will likely be interested in acquiring a controlling position in your firm with some form of contingent consideration to incentivize the selling owners to transition

the business smoothly after closing. Alternatively, a sale to a patient capital provider can allow your firm to retain its independence and continue operating with minimal outside interference.



SUBSCRIBE

DON'T MISS OUT
Subscribe to our
RIA Valuation Insights Blog

A weekly update on issues important to the Investment Management industry.

Investment Manager Multiples by Sector

| | Ticker | 3/31/2021 Stock Price | % of 52 Week High | Pricing as of March 31, 2021 | | | |
|---|--------|--------------------------|-------------------------|------------------------------|---------------------------|----------------------------------|---------------------------------|
| | | | | Price / Trailing EPS | Price / Forward EPS | Enterprise Value / AUM (%) | Enterprise Value / EBITDA |
| TRADITIONAL ASSET / WEALTH MANAGERS (AUM UNDER \$100B) | | | | | | | |
| Diamond Hill Investment Group, Inc. | DHIL | 156.01 | 88.1% | 15.1x | nm | 1.54 | 7.5x |
| GAMCO Investors, Inc. | GBL | 18.55 | 87.0% | 6.9x | nm | 1.56 | 5.5x |
| Hennessy Advisors, Inc. | HNNA | 8.61 | 68.9% | 9.1x | nm | 1.40 | 5.0x |
| Pzena Investment Management, Inc. | PZN | 10.53 | 87.7% | 33.9x | nm | 1.80 | 15.0x |
| Silvercrest Asset Management Group | SAMG | 14.38 | 90.0% | 11.9x | 8.9x | 1.00 | 7.0x |
| Westwood Holdings Group, Inc. | WHG | 14.46 | 53.8% | nm | nm | 0.88 | 42.0x |
| Waddell & Reed Financial, Inc. | WDR | 25.05 | 96.7% | 15.8x | 13.5x | 1.94 | 11.7x |
| Group Median | | | 87.7% | 13.5x | 11.2x | 1.54 | 7.5x |
| TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER \$100B) | | | | | | | |
| AllianceBernstein Investments, Inc. | AB | 39.99 | 93.2% | 13.8x | 12.0x | 1.70 | 11.0x |
| BlackRock, Inc. | BLK | 753.96 | 95.7% | 24.0x | 20.4x | 1.35 | 16.6x |
| Federated Investors, Inc. | FHI | 31.30 | 98.3% | 9.8x | 9.7x | 0.53 | 7.0x |
| Franklin Resources, Inc. | BEN | 29.60 | 96.9% | 12.7x | 9.7x | 1.20 | 12.5x |
| Invesco Ltd. | IVZ | 25.22 | 96.8% | 12.6x | 9.5x | 1.48 | 15.2x |
| T. Rowe Price Group, Inc. | TROW | 171.60 | 95.5% | 17.1x | 14.0x | 2.63 | 13.2x |
| Virtus Investment Partners, Inc. | VRTS | 235.50 | 87.2% | 18.0x | 8.2x | 1.36 | 6.0x |
| Group Median | | | 95.7% | 13.8x | 9.7x | 1.36 | 12.5x |
| ALTERNATIVE ASSET MANAGERS | | | | | | | |
| Apollo Global Management LLC | APO | 47.01 | 84.9% | nm | 17.1x | 6.23 | 38.1x |
| Ares Management Corp | ARES | 56.03 | 97.7% | 25.3x | 24.7x | 10.24 | nm |
| Associated Capital Group Inc | AC | 35.86 | 78.8% | nm | nm | nm | 33.5x |
| Blackstone Group Inc/The | BX | 74.53 | 97.7% | 43.5x | 22.8x | 16.45 | 60.2x |
| Carlyle Group LP/The | CG | 36.76 | 97.2% | 34.3x | 16.1x | 5.99 | 15.3x |
| Cohen & Steers Inc | CNS | 65.33 | 82.9% | 25.6x | 19.8x | 3.96 | 31.5x |
| Hamilton Lane Inc | HLNE | 88.56 | 90.8% | 36.4x | 34.9x | 11.97 | 31.2x |
| KKR & Co Inc | KKR | 48.85 | 98.1% | 15.3x | 18.1x | 33.73 | nm |
| Sculptor Capital Management Inc | SCU | 21.88 | 83.0% | 7.3x | 6.4x | 5.58 | 8.5x |
| Group Median | | | 90.8% | 25.6x | 19.0x | 8.23 | 31.5x |
| AGGREGATORS | | | | | | | |
| Affiliated Managers Group, Inc. | AMG | 149.03 | 97.1% | 33.9x | 9.1x | 1.56 | 14.5x |
| Artisan Partners Asset Management Inc. | APAM | 52.17 | 94.4% | 16.8x | 10.9x | 2.66 | 11.0x |
| Focus Financial Partners Inc | FOCS | 41.62 | 73.6% | 20.6x | 11.5x | na | 14.9x |
| Victory Capital Holdings Inc | VCTR | 25.56 | 93.9% | 7.7x | 5.7x | 1.68 | 7.4x |
| BrightSphere Investment Group Inc | BSIG | 20.38 | 94.0% | 4.0x | 10.4x | 1.15 | 7.8x |
| Group Median | | | 94.0% | 16.8x | 10.4x | 1.62 | 11.0x |
| OVERALL MEDIAN | | | 93.5% | 15.8x | 11.8x | 1.69 | 12.8x |

Mercer Capital's Investment Management Industry Expertise

Mercer Capital provides RIAs, independent trust companies, and alternative asset managers with business valuation and financial advisory services related to corporate disputes, litigated matters, tax compliance, 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:

- Corporate valuation services for clients ranging from start up managers with as little as \$50 million in assets under management to established industry leaders managing over \$400 billion
- Litigation support services and expert witness testimony in matters involving economic damages, shareholder disputes, and marital dissolution
- Transaction advisory services involving investment managers from sell-side, buy-side, and mutually retained perspectives
- Providing financial statement reporting services related to purchase price allocation and goodwill impairment testing
- Assisting RIAs and other investment managers with annual ESOP valuations, fairness opinions, and appraisals for gift and estate tax compliance

Sectors Served

- Registered Investment Advisors
- Money Managers
- Wealth Management Firms
- Mutual Fund Companies
- Independent Trust Companies
- Investment Consultants
- Hedge Fund Managers
- Real Estate Investment Companies
- Private Equity & Venture Capital Firms
- Bank Trust Departments
- Broker-Dealers / Hybrid RIAs

Services

- Corporate Valuation
- Fairness Opinions
- M&A Representation & Consulting
- Buy-Sell Agreement Valuation & Consulting
- Financial Reporting Valuation
- Tax Compliance Valuation
- Litigation & Dispute Resolution Consulting/ Testimony
- ERISA Valuation

Mercer Capital's Investment Management Industry Team



Matthew R. Crow, ASA, CFA
901.322.9728
crowm@mercercapital.com



Brooks K. Hamner, CFA, ASA
901.322.9714
hamnerb@mercercapital.com



Zachary W. Milam, CFA
901.322.9705
milamz@mercercapital.com



Taryn E. Burgess, CFA, ABV
901.322.9757
burgess@mercercapital.com



Mercer Capital

www.mercercapital.com