VALUE FOCUS

Investment Management

First Quarter 2022 | Segment Focus: Wealth Managers

In This Issue

Segment Focus: Wealth Managers — 1

Market Update Alt Managers Best the Market and Other Types of RIAs During a Rocky Twelve Month Stretch for the Industry — 3

RIA M&A Update — 5

Investment Manager Multiples by Sector — 7

About Mercer Capital — 8

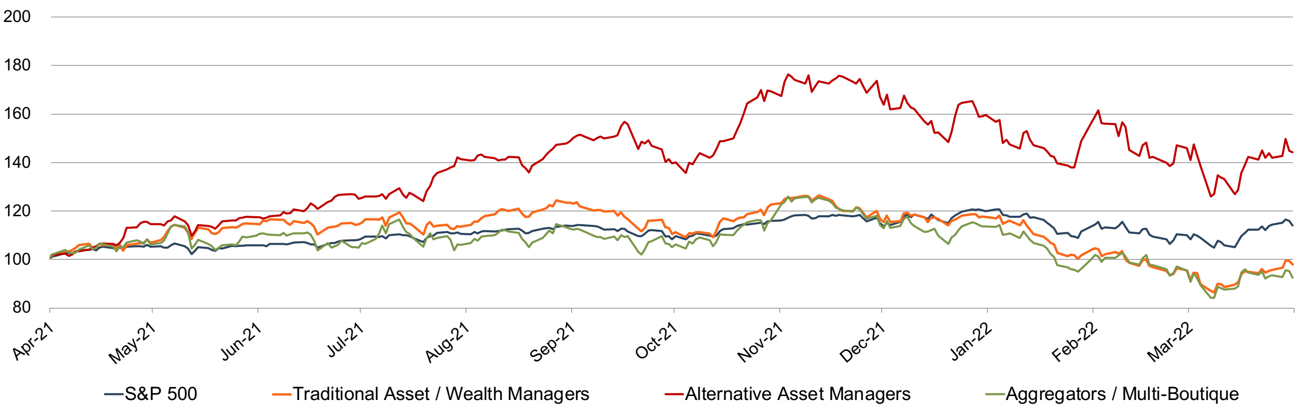
In our first quarter segment focus, we discuss the state of the wealth management industry and the emerging trends that are shaping the outlook and investor sentiment for wealth management firms.

Additionally, we cover recent M&A trends for asset and wealth management firms and the factors driving the continued momentum in deal activity during the first quarter.

Also in the issue, we review market performance for publicly traded asset and wealth management firms during what proved to be a volatile first quarter for both the investment management industry and the broader markets.

Segment Focus: Wealth Managers

Investment Manager Performance by Sector - Year ended March 31, 2022



Source: S&P Global Market Intelligence

Wealth Management Trendlines May Be Rolling Over

After A Great Year, Higher Rates And Weaker Markets Threaten Continued Growth

While wealth management continues to benefit from demographic trends in the U.S. and the general accumulation of investible assets during the pandemic, 2022 is proving to be somewhat more difficult for the sector, and sentiment among investors in wealth management firms has dimmed.

Public firms with substantial operations in the wealth management space have been underperforming alt asset managers and the broader market, and aggregator models like Focus Financial and CI Financial (whose share prices currently trade at 52 week lows) will need organic growth to overcome sluggish financial markets, fee pressure, and higher interest rates.

Recent market activity is a strong contrast to the up trend seen for much of 2021. Prices for aggregator models accelerated into December of last year, peaking as transaction activity in the space hit a fever pitch, fueled by higher multiples and the threat of changes in tax law that would make selling after year-end potentially disadvantageous.

The annual Schwab survey of wealth management firms confirmed this bullish sentiment, with advisors generally more optimistic about industry growth prospects than they were a year earlier.

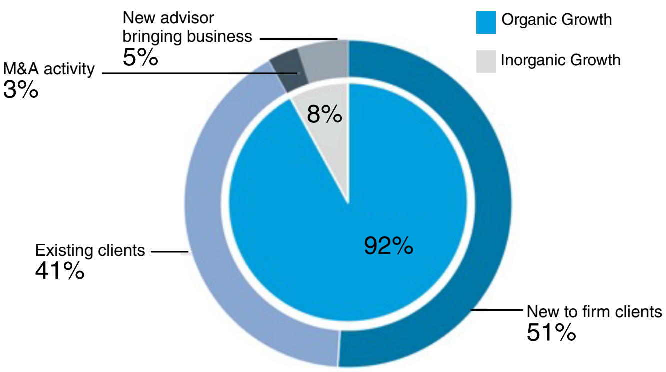
Current state of the RIA Industry		2020	2021
	RIA industry **will grow** at a slow and steady rate	58%	48%
	RIA Industry has not fully matured and will **continue to grow** at a higher rate than the market	33%	47%
	RIA industry has **hit its peak growth** and will now stabilize and remain flat other than market-based functions in assets	7%	4%
	RIA industry is on the **decline**	2%	1%

Source: June 2021 Schwab Advisor Services Independent Advisor Outlook Study

It's noteworthy that the survey represents sentiment in mid-summer of 2021. In the nine months that have transpired since the survey was taken, the market has had to digest higher inflation, a new up trend in global interest rates, the Federal Reserve shrinking its balance sheet, and the war in Ukraine. A survey taken in 2022 could prove less sanguine.

Despite all of the media attention given to consolidation activity in the wealth management sector, it's noteworthy that the advisors surveyed by Schwab saw ample opportunity to grow their firms organically, with less than 10% of expected growth coming from recruiting or M&A.

Percent of Organic & Inorganic Firm Growth



Source: June 2021 Schwab Advisor Services Independent Advisor Outlook Study

Also noteworthy is a generally positive look back at the impact of the COVID pandemic on the wealth management industry, with most firms reporting better performance working remotely than expected. Many firms found opportunities for efficiency in video calls and expense saving opportunities by cuts in travel costs and office space.

Technology investment is a continued theme in the wealth management space, as firms look to new resources for investment management, client management, and firm management to improve service and efficiency. Most firms expect technology spending to increase in 2022, and some view it as a way to overcome staffing challenges presented by tremendous growth in clients and lack of available talent.

By the spring of 2022, many of the industry trends facing and favoring wealth managers started to shift, threatening margins and valuations.

Higher interest rates are undermining valuations in both debt and equity markets, taking an unusually strong toll on everything from U.S. treasuries to tech stocks. This shift creates a downward gravitational pull on assets under management, and therefore revenue, for wealth management firms. At the same time, inflationary forces are pushing up on both labor and non-labor expenses for RIAs. The consequence could be challenging for margins in 2022, and could deflate some of the positive influences on profitability that have provided a tailwind to RIA valuations for several years.

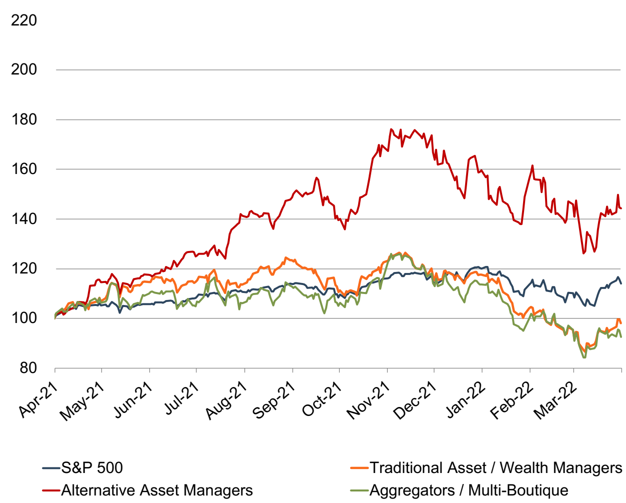
Valuations may ultimately suffer as well because of higher interest rates, as other income producing assets provide an alternative to investing in RIAs, and the cost of capital increases on both the equity and debt sides of the equation for leveraged consolidators of wealth management firms.

Alt Managers Best the Market and Other Types of RIAs During a Rocky Twelve Month Stretch for the Industry

Publicly Traded Hedge Fund Managers And PE Firms Almost Doubled In Value During 2021 Before Nearly Giving It All Back In The First Quarter

Access to cheap financing and favorable market conditions spurred significant gains for private equity firms and hedge fund managers during 2021. These tailwinds reversed course in the first three months of this year, and now many of these businesses are in bear market territory. Such volatility is typical for the alt space, which often relies on leverage to enhance returns on its underlying fund investments.

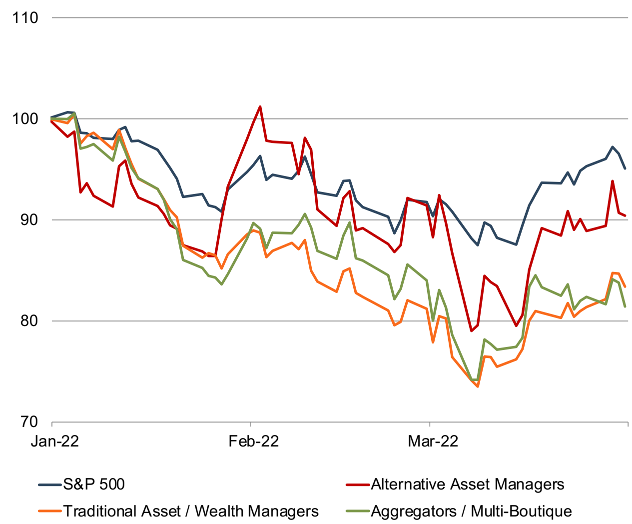
Investment Manager Performance by Sector
Year ended March 31, 2022



Source: S&P Global Market Intelligence

Other classes of RIAs didn't fare so well as the market downturn in January and February erased all their gains over the prior nine months. A closer inspection of the first quarter shows all classes of RIAs down 20% or more at the end of February when the S&P was only off 8%. Investors are likely anticipating lower margins for the RIA industry as AUM and revenue falls with the market while labor costs continue to rise. See our **recent blog post** for more on this topic.

Investment Manager Performance by Sector
Q1 2022

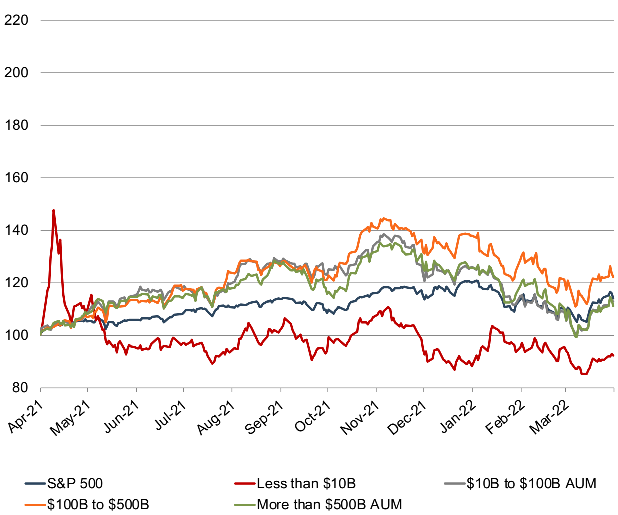


Source: S&P Global Market Intelligence

RIA aggregators also had a rough start to the year. Because the aggregator model is levered to the performance of the wealth management industry generally, the recent downturn for RIA stocks has impaired consolidator valuations too. While the opportunity for continued consolidation in the RIA space is significant, investors in aggregator models have expressed mounting concern about rising interest rates and leverage ratios which may limit the ability of these firms to continue to source attractive deals.

Performance for many of these public companies continues to be impacted by headwinds including fee pressure, asset outflows, and the rising popularity of passive investment products. These trends have especially impacted smaller publicly traded RIAs, while larger asset managers have generally fared better. For the largest players in the industry, increasing scale and cost efficiencies have allowed these companies to offset the negative impact of declining fees. Market performance over the last year has generally been better for larger firms, with firms managing more than $100B in assets outperforming their smaller counterparts.

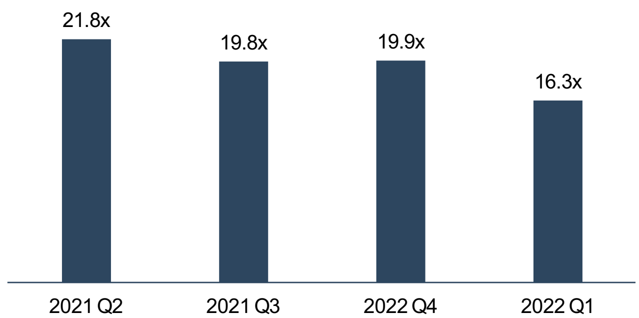
Investment Manager Performance by AUM Size
Year ended March 31, 2022



Source: S&P Global Market Intelligence

As valuation analysts, we're often interested in how earnings multiples have evolved over time, since these multiples can reflect market sentiment for the asset class. After steadily increasing over the second half of 2020 and first quarter of 2021, LTM earnings multiples for publicly traded asset and wealth managers declined modestly in the back of last year before dropping nearly 20% last quarter, reflecting investor anticipation of lower revenue and earnings as the market pulled back in the first two months of the year.

Price to LTM EPS for Traditional Asset / Wealth Managers



Source: S&P Market Intelligence

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 closely 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.

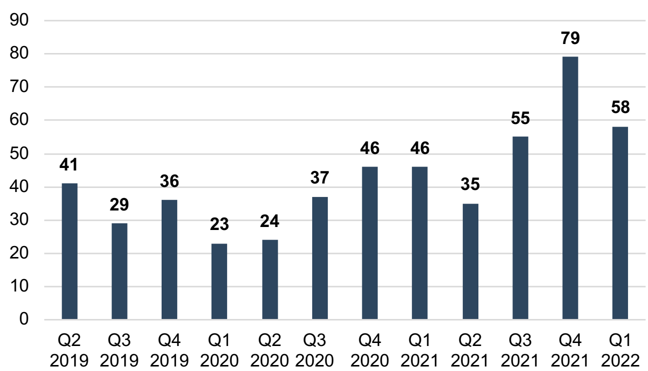
In contrast to public asset/wealth managers, many smaller, private RIAs, particularly those focused on wealth management for HNW and UHNW individuals, have been more insulated from industry headwinds, and the fee structures, asset flows, and deal activity for these companies have reflected this.

Notably, the market for privately held RIAs remained strong in 2021 as investors flocked to the recurring revenue, sticky client base, low capex needs, and high margins that these businesses offer. Deal activity for these businesses continued to be significant in 2021, and multiples for privately held RIAs tested new highs due to buyer competition and shortage of firms on the market. As these dynamics continue into 2022, the outlook for continued multiple expansion and robust deal activity remains favorable assuming interest rates and market conditions stabilize in the near future.

RIA M&A

First Quarter 2022

Deal Volume



Source: Fidelity

RIA M&A activity continued to trend upward through the first quarter of 2022 even as potential macro headwinds for the industry emerged. **Fidelity's March 2022 *Wealth Management M&A Transaction Report*** listed 58 deals in the first quarter, up 26% from the first quarter of 2021. These transactions represented $89.2 billion in AUM, down 2% from the prior year quarter.

Deal volume continues to be led by serial acquirers and aggregators. Mariner, CAPTRUST, Beacon Pointe, Mercer Advisors, Creative Planning, Wealth Enhancement Group, Focus Financial, and CI Financial all completed multiple deals during the quarter. This group of companies, along with other strategic acquirers and consolidators, have continued to increase their share of industry deal volume and now account for about half of all deals. In addition to driving overall industry deal volume, the proliferation of strategic acquiror and aggregator models has led to increased competition for deals throughout the industry, which has contributed to multiple expansion and shifts to more favorable deal terms for sellers in recent years.

While deal activity remained robust, the first quarter this year was dominated by macro headlines like inflation, rising interest rates, tight labor markets, and multiple contraction in equity markets—all of which are factors that have potential to impact RIA performance and M&A activity. Rising costs and interest rates coupled with a declining fee base could lead to strain on highly-leveraged consolidator models, and a potential downturn in performance could put some sellers on the sidelines until fundamentals improve. While the duration and extent to which these trends will ultimately impact RIA M&A are still uncertain, recent pricing trends for publicly traded consolidators suggest that investors aren't particularly optimistic about these models in the current environment.

On the other side of the equation, historically tight labor markets and rising costs could amplify certain acquisition rationales like talent acquisition and back-office synergies. Structural trends continue to support M&A activity as well: the RIA industry remains highly fragmented and growing with over 13,000 registered firms and more money managers and advisors who are capable of setting up independent shops. As advisors age, succession needs will likely continue to bring sellers to market.

Whatever net impact the current market conditions have on RIA M&A, it may take several months before the impact becomes apparent in reported deal volume given the often multi-month lag between deal negotiation, signing, and closing. But at least through March, transaction activity has remained steady. The Fidelity report lists 19 deals in March, a record level for the month and in line with the levels reported in January and February.

What Does This Mean for Your RIA?

For RIAs planning to grow through strategic acquisitions: Pricing for RIAs has continued to trend upwards in recent years, leaving you more exposed to underperformance. While the impact of current macro conditions on RIA deal volume and multiples remains to be fully seen, structural developments in the industry and the proliferation of capital availability and acquiror models will likely continue to support higher multiples than the industry has been accustomed to in the past. That said, a long-term investment horizon is the greatest hedge against valuation risks.

Short-term volatility aside, RIAs continue to be the ultimate growth and yield strategy for strategic buyers looking to grow their practice or investors capable of long-term holding periods. RIAs will likely continue to benefit from higher profitability and growth compared to broker-dealers and other diversified financial institutions.

For RIAs considering internal transactions: We're often engaged to address valuation issues in internal transaction scenarios. Naturally, valuation considerations are front of mind in internal transactions as they are in most transactions. But how the deal is financed is often an important secondary consideration in internal transactions where buyers (usually next-gen management) lack the ability or willingness to purchase a substantial portion of the business outright. As the RIA industry has grown, so too has the number of external capital providers who will finance internal transactions. 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 there are also an increasing number of bank financing and other external capital options that can provide the selling partners with more immediate liquidity and potentially offer the next-gen cheaper financing costs.

If you are an RIA considering selling: After years of steadily increasing multiples and fundamental performance, RIA valuations are now at or near all-time highs. But whatever the market conditions when you go to sell, 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. As the RIA industry has grown, a wide spectrum of buyer profiles has emerged to accommodate different seller motivations. A strategic buyer will likely be interested in acquiring a controlling position in your firm and integrating a significant portion of the business to create scale. At the other end of the spectrum, a sale to a patient capital provider can allow your firm to retain its independence and continue operating with minimal outside interference. Given the wide range of buyer models out there, picking the right buyer type to align with your goals and motivations is a critical decision, and one which can have a significant impact on personal and career satisfaction after the transaction closes.

Investment Manager Multiples by Sector

				Pricing as of March 31, 2022			
	Ticker	3/31/2022 Stock Price	% of 52 Week High	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	187.30	79.8%	9.9x	nm	1.72	5.1x
GAMCO Investors, Inc.	GBL	22.11	73.8%	8.2x	nm	1.45	4.2x
Hennessy Advisors, Inc,	HNNA	10.13	86.6%	9.4x	nm	1.49	5.3x
Pzena Investment Management, Inc.	PZN	8.02	66.1%	9.4x	nm	1.23	5.6x
Silvercrest Asset Management Group	SAMG	20.45	91.3%	10.5x	11.5x	0.90	6.9x
Westwood Holdings Group, Inc.	WHG	15.32	56.7%	12.4x	nm	0.81	14.1x
Group Median			**76.8%**	**9.7x**	**11.5x**	**1.34**	**5.4x**
TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $100B)							
AllianceBerstein Investments, Inc.	AB	47.02	81.7%	12.1x	13.9x	1.70	4.0x
BlackRock, Inc.	BLK	764.17	78.5%	20.2x	19.4x	1.17	13.5x
Federated Investors, Inc.	FHI	34.06	85.5%	13.0x	11.4x	0.50	8.3x
Franklin Resources, Inc.	BEN	27.92	73.0%	6.4x	7.5x	1.24	8.1x
Invesco Ltd.	IVZ	23.06	77.6%	8.3x	8.9x	1.22	7.8x
T. Rowe Price Group, Inc.	TROW	151.19	67.3%	11.4x	14.3x	2.11	8.8x
Virtus Investment Partners, Inc.	VRTS	239.99	70.8%	8.7x	7.3x	0.95	3.5x
Group Median			**77.6%**	**11.4x**	**11.4x**	**1.22**	**8.1x**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management LLC	APO	61.99	76.5%	nm	11.0x	5.40	nm
Ares Management Corp	ARES	81.23	90.2%	45.2x	25.3x	9.39	nm
Associated Capital Group Inc	AC	41.91	88.2%	nm	nm	nm	9.5x
Blackstone Group Inc/The	BX	126.94	84.8%	15.3x	22.1x	19.45	10.0x
Carlyle Group LP/The	CG	48.91	80.7%	5.7x	12.3x	5.91	4.0x
Cohen & Steers Inc	CNS	85.89	84.9%	18.8x	20.9x	3.82	14.2x
Hamilton Lane Inc	HLNE	77.29	66.6%	18.3x	18.0x	0.55	25.0x
KKR & Co Inc	KKR	58.47	69.7%	7.9x	13.7x	22.31	nm
Sculptor Capital Management Inc	SCU	13.93	48.2%	nm	4.2x	8.02	15.3x
Group Median			**80.7%**	**16.8x**	**15.9x**	**6.97**	**12.1x**
AGGREGATORS							
Affiliated Managers Group, Inc.	AMG	140.95	73.6%	10.7x	7.5x	1.08	9.3x
Artisan Partners Asset Management Inc.	APAM	39.35	68.3%	7.8x	10.2x	na	5.7x
Focus Financial Partners Inc	FOCS	45.74	66.2%	19.0x	10.1x	na	20.0x
Victory Capital Holdings Inc	VCTR	28.87	67.0%	6.6x	5.9x	1.66	7.7x
Brightsphere Investment Group Inc	BSIG	24.25	77.8%	26.8x	11.7x	1.13	6.4x
Group Median			**68.3%**	**10.7x**	**10.1x**	**1.13**	**7.7x**
OVERALL MEDIAN			**76.5%**	**10.6x**	**11.5x**	**1.47**	**8.0x**

Source: Bloomberg

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

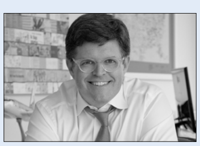
Sectors Served

- 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

Mercer Capital

www.mercercapital.com