VALUE FOCUS

Investment Management

First Quarter 2023 | Segment Focus: Asset Managers

In This Issue

Publicly traded asset and wealth management stocks saw a volatile first quarter; while broad equity markets generally increased, financial stock prices were disproportionately impacted by the failure of Silicon Valley Bank and Signature Bank in early March. While publicly traded alternative asset managers and aggregator models saw share prices rise during the quarter, traditional asset managers—the largest category by number of firms and the subject of this quarter's Segment Focus—experienced a quarter-over-quarter decline. In this newsletter, we take an in-depth look at the trends affecting the RIA industry and the state of the market, including the performance of publicly traded asset and wealth management firms, the state of the RIA M&A market, and the effect of macroeconomic factors on the asset and wealth management industries.

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Segment Focus: Asset Managers

Challenging Year Ahead for Asset Managers

2022 proved to be a challenging year for the RIA industry and the stock market as a whole. Persistent inflation, rising interest rates, a tight labor market, and heightened geopolitical tensions affected most sectors of the economy but had a particularly acute impact on the RIA industry.

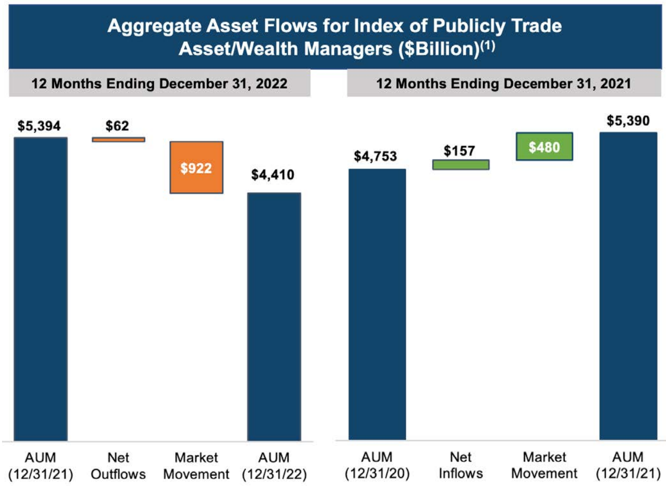
As asset management firms are generally leveraged to the market, variations in equity prices tend to have an amplified effect on their valuations. Our index of publicly traded asset/wealth management firms reflected this, with stock prices for these firms down 14.8% over the year ended March 31, 2023, underperforming the broader market (the S&P 500 was down 9.6%) and aggregator models, like Focus Financial and CI Financial (down 1.3%).

Fund Flows

While market movement is often the dominant contributor to AUM changes over a particular period, it's a variable that's largely outside a manager's control. On the other hand, organic growth can be influenced by the quality of a firm's marketing and distribution efforts and can be a real differentiator between asset management firms over longer periods.

Many asset managers have struggled with organic growth in recent years, partly due to rising fee sensitivity and the influence of passively managed investment products. This year proved no different, with our index of publicly traded asset/wealth management companies seeing $62 billion in net outflows, compared to aggregate net inflows of $157 billion in 2021.

As expected, considering the performance of the stock and bond markets over the past year, market movement was the primary driver of the $922 billion decline in AUM during 2022, compared to a $480 billion increase in 2021.



Source: Mercer Capital
(1) Index includes DHIL, GAMI, HNNA, SAMG, WHG, VRTS, FHI, BEN, IVZ, and TROW. Excludes impact of acquisitions.

Outflows from Active Funds Accelerate

While asset managers saw net outflows over the past twelve months, there were significant variances between active and passively managed funds. Fund flow data from Morningstar (table below) shows that total outflows across active funds for the year ended March 31, 2023, were approximately $878 billion. The aggregate outflows over the past year were most severe for U.S. equity, international equity, and fixed income, with these asset classes shedding a combined $819 billion in assets. For perspective, all categories of actively managed funds except alternative investments and nontraditional equities saw net outflows over the past year.

U.S. Category Group	Active 1-Mo ($Mil)	Active TTM ($Mil)	Active Assets ($Bil)	Passive 1-Mo ($Mil)	Passive TTM ($Mil)	Passive Assets ($Bil)
U.S. Equity	(20,464)	(235,436)	4,814	4,010	167,925	6,685
Sector Equity	(2,705)	(33,342)	420	(3,242)	(37,046)	768
International Equity	(3,987)	(121,863)	1,934	(207)	64,299	1,667
Allocation	(7,926)	(90,184)	1,328	(1,008)	(1,143)	7
Taxable Bond	(19,365)	(315,622)	2,852	30,953	222,275	2,052
Municipal Bond	(2,768)	(112,986)	770	579	25,320	97
Alternative	(1,210)	11,522	165	(73)	135	27
Commodities	(1,567)	(6,208)	40	649	(22,525)	129
Nontraditional Equity	2,268	25,023	64	105	3,134	11
Miscellaneous	(191)	1,455	3	1,012	18,493	82
All Long Term	(57,914)	(877,641)	12,391	32,778	440,867	11,525

Source: Morningstar Direct Asset Flows. Data as of March 31, 2023. TTM is trailing 12 months.

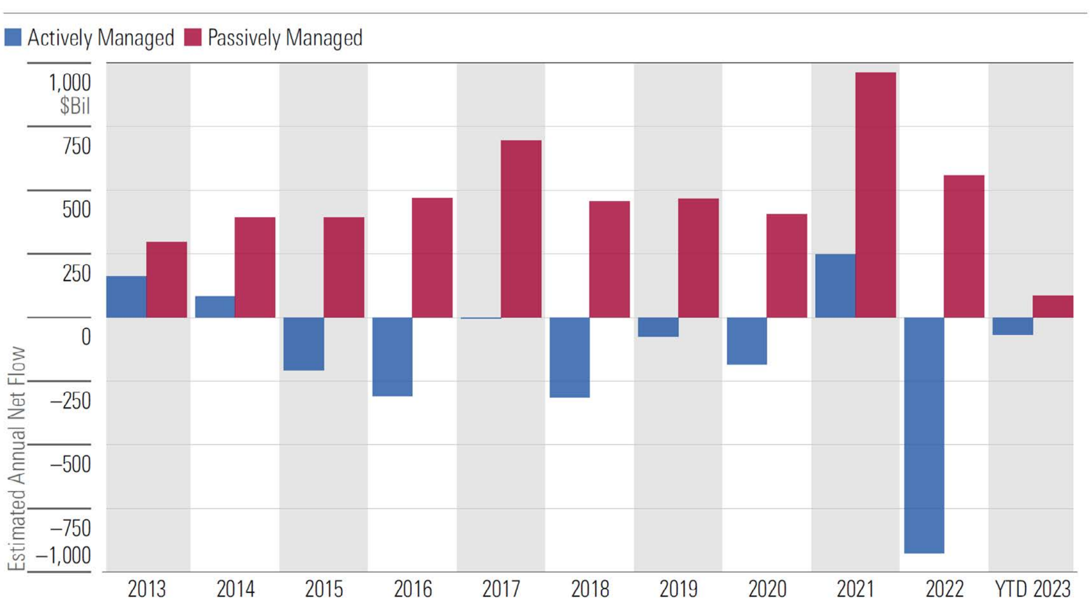
On the other hand, passively managed funds continued to outpace active funds in terms of net new assets over the past twelve months. Fund flow data from Morningstar (table below) shows that total inflows across passively managed funds for the year ended March 31, 2023, were approximately $441 billion.

As you can see from the chart below, there has been a trend over the past ten years of investors moving from active to passive funds, and this trend accelerated with the market downturn in 2022. The relative underperformance of active managers, when compared to their benchmarks over the past ten years, has driven investors to low-fee passive funds. This trend will likely continue to pose a challenge for many types of active asset managers in attracting new assets.

Outlook

The outlook for asset managers depends on several factors. Investor demand for a particular manager's asset class, recent relative performance, fee pressure, rising costs, and regulatory overhang can all impact RIA valuations to varying extents. Alternative asset managers tend to be more idiosyncratic but are still influenced by investor sentiment regarding their hard-to-value assets. Aggregators and multi-boutiques are in the business of buying RIAs, and their success depends on their ability to complete deals at attractive valuations, to successfully integrate firms and accelerate growth, and their access to (and cost of) financing.

Rising interest rates and inflation caused painful losses in the stock and bond markets in 2022, and market conditions have remained choppy so far in 2023. Moody's lowered their December outlook for the global asset management industry from stable to negative in response to the current business and economic environment. Following the decline in AUM in 2022, lower starting AUM levels will likely weigh down industry-wide revenues and earnings in 2023.



Source: Morningstar Direct Asset Flows. Data as of March. 31, 2023.

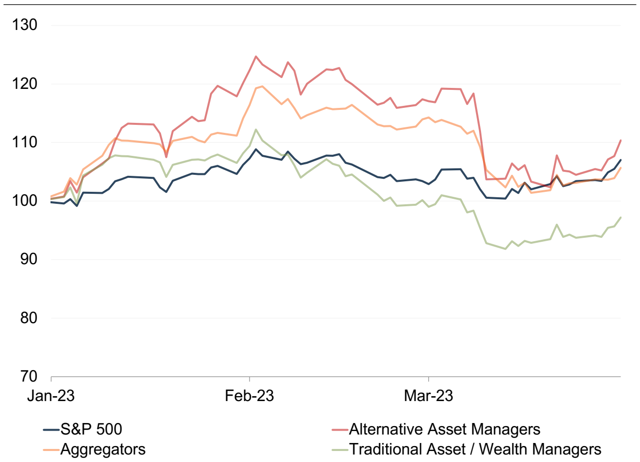
The Market Rallies, RIAs Stay Behind

The RIA industry saw a tumultuous first quarter, with most categories of publicly traded investment managers underperforming the S&P 500. Alternative asset managers, however, saw a last-minute rally during the final few days of the quarter, leading to this category outperforming the S&P during the period.

Performance by Sector

The uptick in the broader market during Q1 translated to an improved profitability outlook for investment managers since their revenue is typically tied to the market value of assets under management. In 2022, most RIA sectors saw a decline in year-over-year earnings, although earnings were still higher than pre-pandemic levels. This decline in 2022 RIA earnings is consistent with the **broader market decline in 2022.**

Investment Manager Performance by Sector
Q1 2023

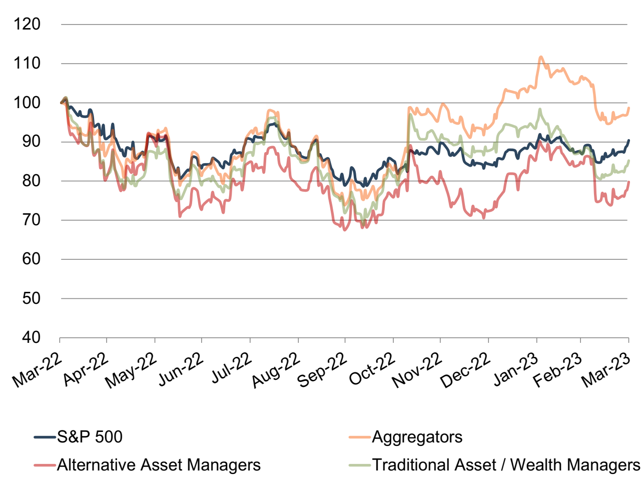


Source: S&P Global Market Intelligence

Performance by Size Category

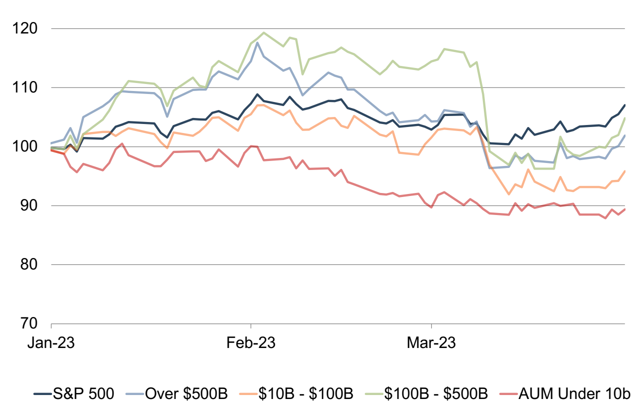
RIAs of all asset sizes underperformed the S&P 500 during Q1 2023. Smaller managers (below $100B AUM) saw a moderate decline, while larger asset managers (above $100B AUM) experienced a modest increase in price during the period. Up until the first week of March, asset managers between $100B and $500B AUM had been outperforming the S&P 500. With the events surrounding the failure of Silicon Valley Bank and Signature Bank in early March, this class of asset managers saw the sharpest decline in price, causing the group to ultimately underperform the S&P 500 by the end of the quarter. This group still outperformed other AUM groups, though. The full-year graph below shows that the smallest asset managers (below $10B AUM) outperformed the S&P 500 for most of 2022. This trend did not continue into Q1 2023.

Investment Manager Performance by Sector
Year ended March 31, 2023



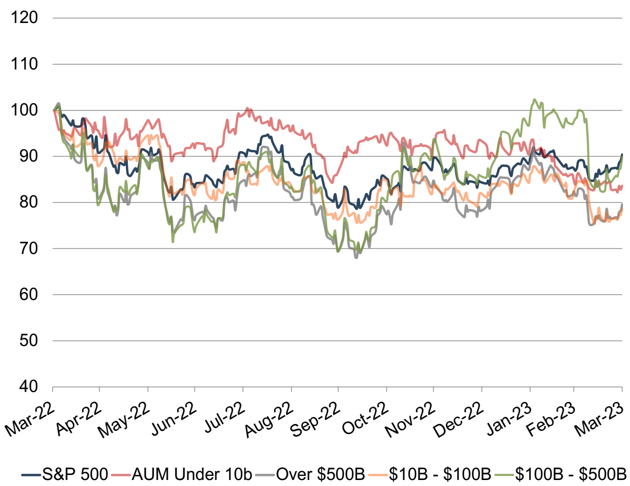
Source: S&P Global Market Intelligence

Investment Manager Performance by AUM Size
Q1 2023



Source: S&P Global Market Intelligence

Investment Manager Performance by AUM Size
Year Ended March 31, 2023

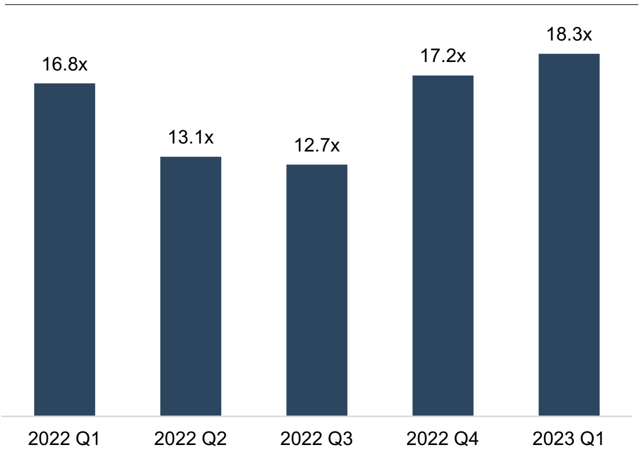


Source: S&P Market Intelligence

Pricing Trends

The median LTM earnings multiple for publicly traded asset and wealth management firms increased 6.4% during the first quarter of 2023. After trending downwards for most of 2022, multiples began to increase in Q4, and continued to increase in Q1 2023, as LTM earnings metrics began to fully reflect the impact of market conditions in 2022.

Price to LTM EPS for Traditional Asset / Wealth Managers



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 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 sectors of closely held RIAs, particularly wealth managers, as well as larger public asset managers, have been less impacted by these trends and have seen more resilient multiples as a result. In the case of wealth management firms, strong demand from aggregators has also helped to bolster pricing in recent years. Focusing on the fundamentals of your RIA—**compensation structures**, cost controls, hiring practices, etc.—may offer protection from **changes in market multiples.**

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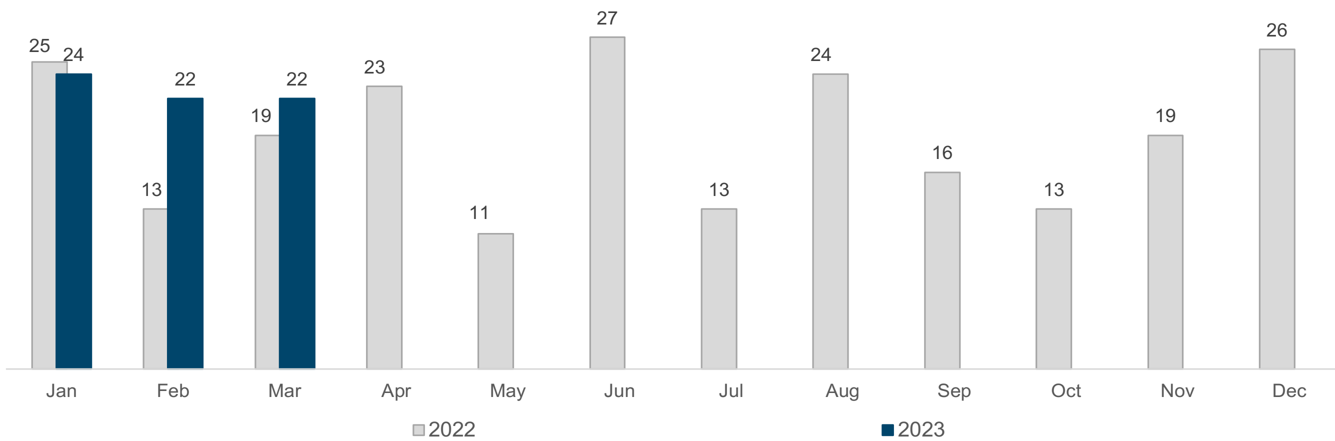
RIA M&A

First Quarter 2022

Number of RIA M&A Transactions, 2022 vs 2023



Source: Fidelity

RIA M&A activity has remained resilient through the first quarter of 2023, even as macro headwinds have emerged for the industry over the past year. Fidelity's March 2023 Wealth Management M&A Transaction Report listed 68 deals in the first quarter of 2023, up 19% from the 57 deals executed during the same period in 2022. These transactions represented $108.3 billion in AUM—a 21% increase from the first quarter of 2022, although much of this increase was attributable to First Citizens Bank's purchase of Silicon Valley Bank's $15.9 billion RIA division in March. Excluding the SVB transaction, transacted AUM was up about 4% year-over-year.

2022 was a year plagued with high inflation, rising interest rates, and tight labor markets. Rising costs and interest rates coupled with a declining fee base have put pressure on highly leveraged consolidator models. At the same time, a potential downturn in performance has left some sellers on the sidelines until fundamentals improve. Despite these pressures, M&A activity set new records in 2022 with 229 deals completed, although the pace of M&A did show signs of cooling in the second half of the year.

While macro conditions have been challenging, structural changes in the RIA landscape have continued to support deal activity. In recent years, the professionalization of the buyer market and the entrance of outside capital have driven demand and increased competition for deals. Serial acquirers and aggregators have increasingly contributed to deal volume, supported by dedicated deal teams and access to capital. Such firms accounted for approximately 65% of transactions through the first quarter of 2023. Mariner, CAPTRUST, Beacon Pointe, Wealth Enhancement Group, and Focus Financial all completed multiple deals in the first quarter of 2023.

On the supply side, the current market environment will likely have a mixed impact on bringing sellers to market. On one hand, some sellers may be reluctant to sell when the markets (and their firm's financial performance) are down significantly from their peak. On the other hand, a concern that multiples may decline if the current market environment persists may prompt some sellers to seek an exit while multiples remain relatively robust. This dynamic has prompted many sellers to hedge their exit by pursuing a partial sale now with an eye for a more complete exit once market conditions improve.

While market conditions play a role in exit timing, the motives for sellers often encompass more than purely financial considerations. Sellers are often looking to solve succession issues, improve quality of life, and access organic growth strategies. Such deal rationales are not sensitive to the market environment and will likely continue to fuel the M&A pipeline even in a downturn. Whatever net impact the current market conditions have on RIA M&A, it may take additional time before the impact becomes apparent in reported deal volume, given the often multi-month lag between deal negotiation, signing, and closing.

What Does This Mean for Your RIA?

For RIAs planning to grow through strategic acquisitions: Pricing for RIAs has trended 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 acquirer models will likely continue to support higher multiples than the industry has 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 than broker-dealer counterparts and other diversified financial institutions.

For RIAs considering internal transactions: We're often engaged to address valuation issues in internal transaction scenarios. As in most transactions, valuation considerations are front of mind in internal transactions. But how the deal is financed is often a crucial 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). Still, an increasing amount of bank financing and other external capital options can provide selling partners with more immediate liquidity and potentially offer the next-gen cheaper financing costs.

If you are an RIA considering selling: Whatever the market conditions are when you go to sell, it is essential 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 broad spectrum of buyer profiles has emerged to accommodate different seller motivations and allow for varying levels of autonomy post-transaction. 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 that can significantly impact personal and career satisfaction after the transaction closes.

Investment Manager Multiples by Sector

				Pricing as of March 31, 2023			
	Ticker	3/31/2023 Stock Price	% of 52 Week High	Price / Trailing EPS	Price / Forward EPS	Enterprise Value / AUM (%)	Enterprise Value / EBITDA
TRADITIONAL ASSET / WEALTH MANAGERS (AUM UNDER $250B)							
Diamond Hill Investment Group, Inc.	DHIL	164.58	83.5%	10.6x	nm	1.83%	6.9x
GAMCO Investors, Inc.	GAMI	18.95	83.3%	9.1x	nm	1.41%	4.6x
Hennessy Advisors, Inc.	HNNA	7.75	70.5%	13.1x	nm	1.35%	4.6x
Silvercrest Asset Management Group Inc.	SAMG	18.18	80.2%	39.7x	12.0x	0.83%	8.8x
Virtus Investment Partners, Inc.	VRTS	190.39	76.7%	9.4x	8.2x	nm	4.8x
Artisan Partners Asset Management Inc.	APAM	31.98	78.6%	11.8x	12.0x	1.59%	7.0x
Victory Capital Holdings, Inc.	VCTR	29.27	86.1%	10.4x	6.5x	1.83%	7.3x
BrightSphere Investment Group Inc.	BSIG	23.58	87.7%	10.9x	15.0x	nm	7.3x
WisdomTree, Inc.	WT	5.86	91.4%	28.2x	21.8x	1.18%	18.1x
Westwood Holdings Group, Inc.	WHG	11.21	66.7%	41.5x	nm	nm	9.7x
Group Median			**81.7%**	**11.4x**	**12.0x**	**1.41%**	**7.1x**
TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $250B)							
BlackRock, Inc.	BLK	669.12	84.8%	24.3x	19.3x	1.13%	15.7x
Federated Hermes, Inc.	FHI	40.14	96.9%	16.1x	12.6x	0.50%	9.1x
Franklin Resources, Inc.	BEN	26.94	78.4%	11.1x	11.5x	1.05%	6.7x
Janus Henderson Group plc	JHG	26.64	74.0%	10.0x	12.7x	1.09%	6.8x
Affiliated Managers Group, Inc.	AMG	142.42	78.8%	15.6x	7.4x	1.17%	7.0x
Invesco Ltd.	IVZ	16.40	69.4%	8.6x	10.0x	0.91%	9.2x
T. Rowe Price Group, Inc.	TROW	112.90	71.6%	15.5x	16.7x	1.82%	8.9x
Group Median			**78.4%**	**15.5x**	**12.6x**	**1.09%**	**8.9x**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management, Inc.	APO	63.16	84.6%	nm	9.6x	7.98%	nm
Ares Management Corporation	ARES	83.44	95.4%	60.6x	20.5x	nm	23.4x
Associated Capital Group, Inc.	AC	36.95	83.0%	nm	nm	22.64%	nm
Blackstone Inc.	BX	87.84	66.1%	65.9x	18.2x	8.38%	nm
The Carlyle Group Inc.	CG	31.06	62.0%	12.0x	8.3x	4.97%	12.0x
Cohen & Steers, Inc.	CNS	63.96	72.5%	19.7x	20.1x	3.80%	14.1x
Hamilton Lane Incorporated	HLNE	73.98	91.1%	79.3x	23.2x	2.83%	11.9x
KKR & Co. Inc.	KKR	52.52	85.4%	nm	13.2x	20.02%	nm
Group Median			**83.8%**	**60.6x**	**18.2x**	**7.98%**	**13.1x**
AGGREGATORS							
Focus Financial Partners Inc.	FOCS	51.87	98.6%	88.3x	12.6x	nm	12.5x
Group Median			**98.6%**	**88.3x**	**12.6x**	**nm**	**12.5x**
OVERALL MEDIAN			**81.6%**	**15.6x**	**12.6x**	**1.61%**	**9.0x**

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

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- Financial Reporting Valuation
- Tax Compliance Valuation
- Litigation & Dispute Resolution Consulting/ Testimony
- ERISA Valuation

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