MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

VALUE FOCUS

Investment Management

Third Quarter 2023 | Segment Focus: Alternative Asset Managers

In This Issue

This quarter we take an in-depth look at the trends affecting alternative asset managers and the broader RIA industry, including the performance of publicly traded investment management firms and deal activity across the sector.

In our segment focus, we discuss the operational differences that have shielded alternative asset managers from the headwinds faced by other sectors of RIAs. Alternative asset managers fared particularly well during 2023 and outperformed in the first and third quarters as price returns over the last twelve months exceeded 50% before trending down slightly along with a modest market pullback in the public equities market during Q3.

Also in this issue, we address industry M&A trends and factors contributing to the continued decrease in transaction activity since the end of 2021. As RIA valuations have grown, acquirers have been forced to pay more per dollar of earnings compared to 2022. The net effect is that deal volume, as measured in dollars, has remained stable over the last year.

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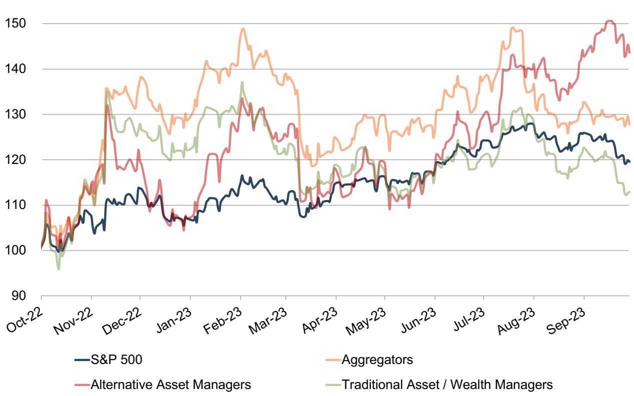
Segment Focus: Alternative Asset Managers

Alternative asset managers fared particularly well during favorable market conditions for the RIA sector. Over the past year, all categories of RIAs have experienced growth as the market has rebounded from its Q3 2022 trough. Alternative asset managers outperformed the *S&P 500* with gains of 44% over the past year.

Investment Manager Performance by Sector
Year Ended September 30, 2023

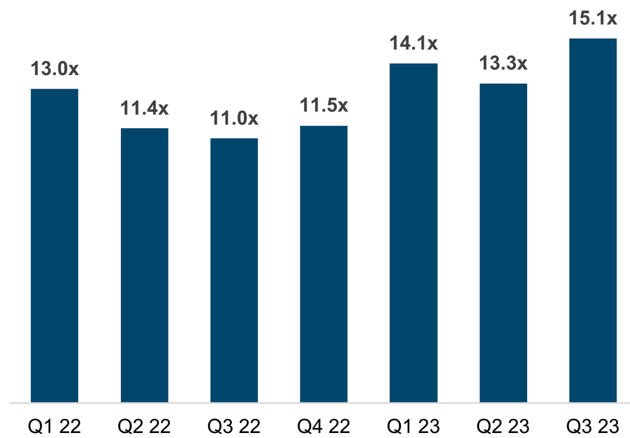


Source: S&P Market Intelligence

Many of the headwinds that have impacted the broader asset management industry have been felt less acutely by alternative managers. Lock up periods and opaque pricing of investments serve to insulate alternative managers from asset outflows and market volatility, and the nature of the asset class makes alt managers less exposed to competition from passive products.

As valuation analysts, we're often interested in how earnings multiples have evolved since these multiples can reflect market sentiment for the asset class. After a downward trend for most of 2022, EBITDA multiples for alternative asset managers trended upwards during 2023 as LTM earnings metrics began to fully reflect the impact of the tumultuous 2022 market conditions. There is, however, a notable caveat to this data: many publicly traded alternative asset managers have substantial investment assets (i.e., investments in their own funds) on their balance sheets, which are inherently reflected in the publicly traded price. When making comparisons between firms, significant adjustments to earnings and implied enterprise values may be required.

Enterprise Value to EBITDA for Alternative Asset Managers



Source: CapIQ

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 headwinds such as fee pressure and asset outflows to passive products. Many sectors of closely held RIAs, particularly wealth managers and 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 arbitrary **changes in market multiples.**

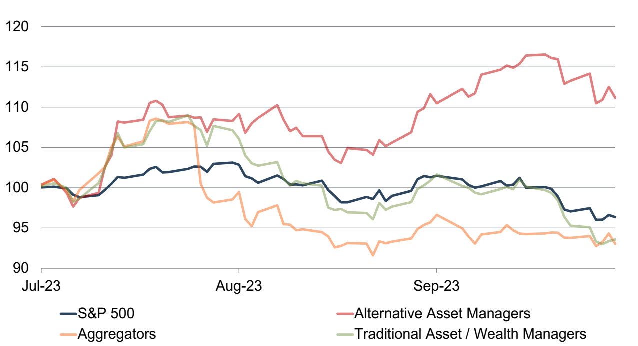
Q3 2023: Performance of Publicly Traded Asset / Wealth Management Firms

Share prices for most publicly traded asset and wealth management firms trended in line with the steady decrease in the broader market during Q3 2023. Alternative asset managers were a notable exception to this trend, ending the quarter up about 10%. On a year-over-year basis, all categories of RIAs experienced exceptional growth as the markets rebounded from their Q3 2022 trough, which marked the deepest dip since March 2020. RIAs directly benefit from improving market conditions as they result in a stronger asset base on which to collect fees.

Performance by Sector

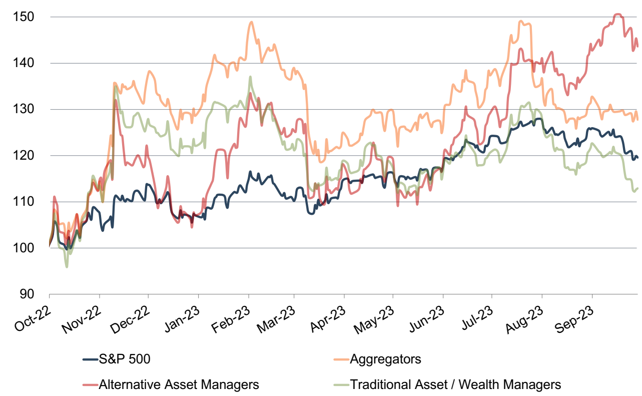
The market decline in Q3 translated to decreased prices for most public RIAs. Prices for aggregators and traditional asset managers faced a slightly more severe decline than the *S&P 500*. On the other hand, alternative asset managers experienced an increase in share price of just over 10%. In the last twelve months, most RIA sectors saw a decline in year-over-year earnings and revenue, reflecting lower average AUM. Market volatility since 2020, which drove volatility in AUM during this period, is one of the factors responsible for the increased demand for alternative asset manager stocks. Private equity funds and other alternative investment vehicles typically lock in assets for ten to twelve years, leading to a more predictable and stable revenue stream that is less correlated with the broader market.

Investment Manager Performance by Sector
Q3 2023



Source: S&P Global Market Intelligence

Investment Manager Performance by Sector
Year ended September 30, 2023

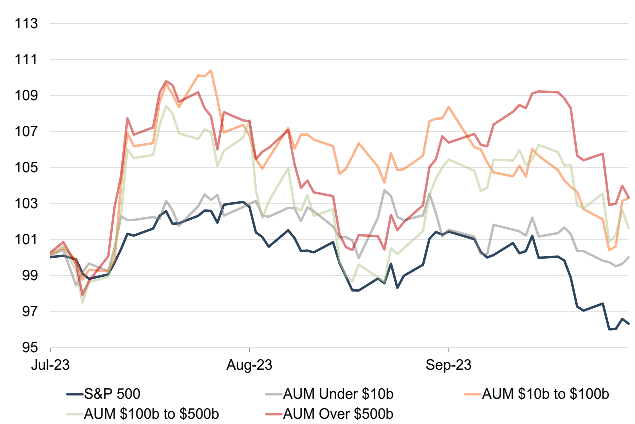


Source: S&P Global Market Intelligence

Performance by Size Category

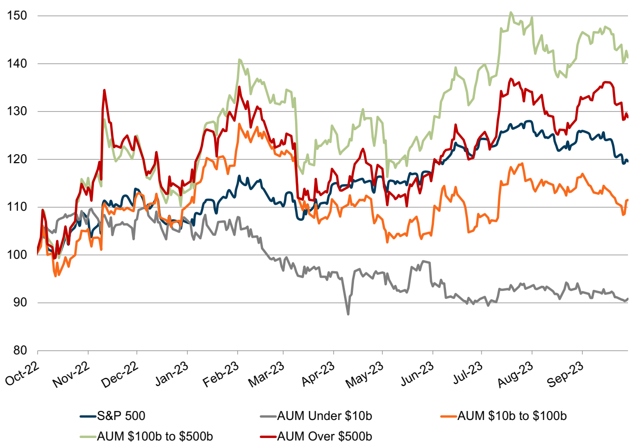
As measured by AUM size, all groups of RIAs outperformed the *S&P 500* during Q3. Over the past year, larger RIAs (those over $100B in AUM) outperformed the *S&P 500*, with smaller RIAs underperforming the S&P. While all AUM size groups outperformed the *S&P* during Q3, larger asset managers experienced a stronger increase in share price.

Investment Manager Performance by AUM Size
Q3 2023



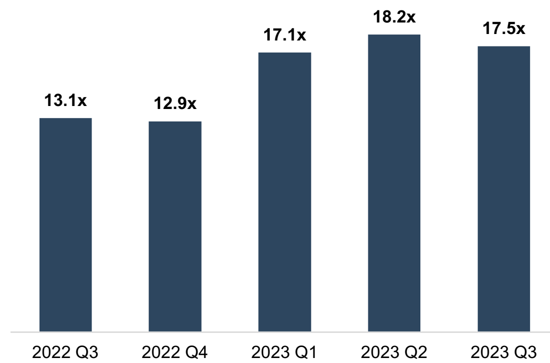
Source: S&P Global Market Intelligence

Investment Manager Performance by AUM Size
Year Ended September 30, 2023



Source: S&P Market Intelligence

Price to LTM EPS for Traditional Asset / Wealth Managers



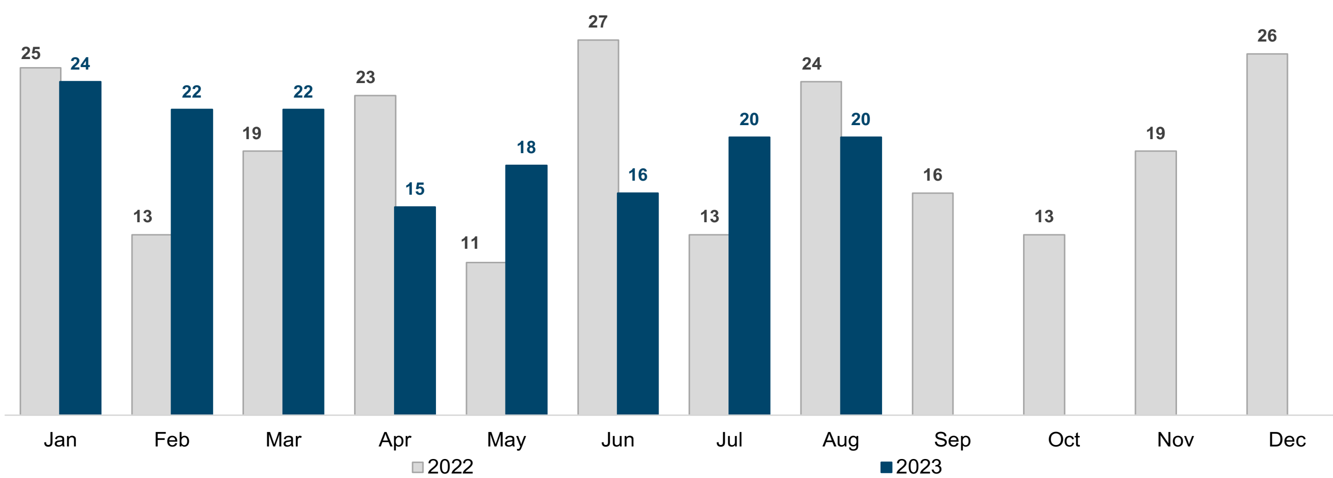
Pricing Trends

The median LTM earnings multiple for publicly traded asset and wealth management firms decreased 3.8% during the third quarter of 2023, representing the first decrease since Q4 2022. After trending downwards for most of 2022, multiples began to increase during the first half of 2023 as LTM earnings metrics began to fully reflect the impact of 2022 market conditions. The modest multiple decrease in Q3 2023 also reflects the moderating interest rate environment and market decrease during the quarter, translating into slightly lower AUM balances and future earnings power for RIAs.

RIA M&A

Third Quarter 2023

Number of RIA M&A Transactions, 2022 vs 2023



Source: Fidelity

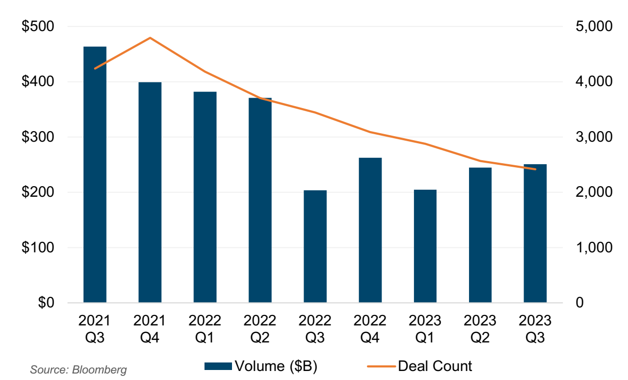
Although inflation has begun to subside and the stock market has rallied after a turbulent start to 2023, elevated interest rates and macroeconomic uncertainty have contributed to a leveling off of deal volume so far in 2023. Fidelity's August *2023 Wealth Management M&A Transaction Report* listed 157 deals through August 2023, up 1% from the 155 deals executed during the same period in 2022. While the increase in deal volume was modest, total transacted AUM was $234.2 billion—a 10.5% increase from the same period in 2022.

There was a notable slowdown during the second quarter of 2023 with total transactions falling approximately 20%. Deal volume recovered in the third quarter with a total of 40 deals in July and August, representing a 8% year-over-year increase in deal count.

Relative to the broader M&A market, RIA deal activity has been remarkably resilient. The overall M&A transaction value for all industries (excluding the RIA industry) decreased 27% year-over-year through the third quarter of 2023.

The average AUM per transaction during 2023 was $1.5 billion, a 9% increase over the prior year. The increase in deal size has been an encouraging sign, given the rise in the cost of capital over the past year. Echelon's *Q3 2023 RIA M&A Deal Report* stated that the growth in deal size can primarily be attributable to "an increase in equity markets and the consistent deployment of newly raised capital by firms like Mercer Advisors, Corient, HUB International, and CAP-TRUST. Echelon estimates that large wealth platforms raised an incremental ~$7.2 billion to pay down debt, increase war chests for acquisitions, and invest in growth."

Global M&A Activity (Excluding RIA Industry)



Source: Bloomberg

Another contributor to the increase in deal size has been RIAs partnering with private equity firms. According to Fidelity's August *2023 Wealth Management M&A Transaction Report*, private equity backing was involved in 75% of the transactions in August. Private equity acquirers directly invested in wealth managers with assets totaling $877 billion in the third quarter of 2023, more than tripling the amount in the second quarter of 2023 (per Echelon's *Q3 2023 RIA M&A Deal Report*). This increase was due to some of the largest wealth management consolidators taking on new private equity partners. Notable transactions of this nature include **CAPTRUST**, which sold an undisclosed stake in its wealth management business to Carlyle Group; Prime Capital Investment Advisors, who received a minority investment from Abry Partners; and Titan Wealth Holdings, who sold an interest in its business to Parthenon Capital.

The prevalence of serial acquirers and aggregators has continued in the RIA M&A market. 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 67% of transactions during 2023. Cerity Partners, CAPTRUST, Mercer Advisors, and Wealth Enhancement Group all completed multiple deals during the third quarter.

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 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 during market downturns.

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 seen 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 their 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, where valuation considerations are top of mind. 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.

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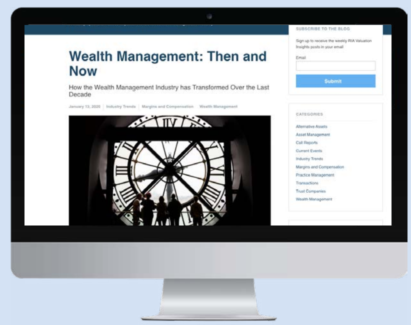
A weekly update on issues important to the Investment Management industry.



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Investment Manager Multiples by Sector

	Ticker	9/30/2023 Stock Price	% of 52 Week High	Price / Trailing EPS	Price / Forward EPS	Enterprise Value / AUM (%)	Enterprise Value / EBITDA
				Pricing as of September 30, 2023			
TRADITIONAL ASSET / WEALTH MANAGERS (AUM UNDER $250B)							
Diamond Hill Investment Group, Inc.	DHIL	168.57	86.0%	13.4x	nm	1.84%	10.7x
GAMCO Investors, Inc.	GAMI	20.03	91.9%	12.1x	nm	1.14%	nm
Hennessy Advisors, Inc.	HNNA	6.66	65.6%	12.8x	nm	1.02%	4.4x
Silvercrest Asset Management Group Inc.	SAMG	15.87	68.4%	22.8x	11.0x	0.63%	7.5x
Virtus Investment Partners, Inc.	VRTS	201.99	81.4%	12.4x	9.1x	0.90%	7.3x
Artisan Partners Asset Management Inc.	APAM	37.42	87.1%	18.9x	12.8x	2.35%	11.1x
Victory Capital Holdings, Inc.	VCTR	33.34	95.4%	12.5x	7.4x	1.91%	7.9x
BrightSphere Investment Group Inc.	BSIG	19.39	72.1%	12.6x	12.4x	0.98%	7.2x
WisdomTree, Inc.	WT	7.00	92.8%	11.4x	19.4x	1.36%	20.7x
Westwood Holdings Group, Inc.	WHG	10.15	71.5%	46.6x	nm	0.30%	9.3x
Group Median			**83.7%**	**12.7x**	**11.7x**	**1.08%**	**7.9x**
TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $250B)							
BlackRock, Inc.	BLK	646.49	82.3%	25.9x	18.2x	1.06%	15.2x
Federated Hermes, Inc.	FHI	33.87	74.4%	13.6x	10.2x	0.39%	7.0x
Franklin Resources, Inc.	BEN	24.58	71.5%	12.6x	10.3x	0.95%	6.4x
Janus Henderson Group plc	JHG	25.82	82.5%	15.8x	11.3x	0.99%	6.8x
Affiliated Managers Group, Inc.	AMG	130.34	72.2%	13.3x	7.3x	1.09%	6.8x
Invesco Ltd.	IVZ	14.52	70.6%	7.4x	9.4x	0.80%	9.4x
T. Rowe Price Group, Inc.	TROW	104.87	77.9%	17.1x	14.4x	1.61%	8.5x
Group Median			**74.4%**	**13.6x**	**10.3x**	**0.99%**	**7.0x**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management, Inc.	APO	89.76	96.3%	nm	13.3x	9.75%	nm
Ares Management Corporation	ARES	102.87	95.8%	114.1x	27.6x	9.27%	28.5x
Associated Capital Group, Inc.	AC	36.50	84.9%	nm	nm	26.88%	nm
Blackstone Inc.	BX	107.14	91.7%	131.5x	25.1x	9.67%	nm
The Carlyle Group Inc.	CG	30.16	78.7%	36.8x	10.0x	4.88%	15.1x
Cohen & Steers, Inc.	CNS	62.69	79.5%	25.7x	21.3x	3.69%	15.2x
Hamilton Lane Incorporated	HLNE	90.44	95.9%	75.6x	23.2x	3.26%	14.7x
KKR & Co. Inc.	KKR	61.60	95.1%	52.6x	18.1x	22.76%	nm
Group Median			**93.4%**	**64.1x**	**21.3x**	**9.47%**	**15.1x**
OVERALL MEDIAN			**82.3%**	**17.1x**	**13.3x**	**1.61%**	**8.9x**

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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

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

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