MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

VALUE FOCUS

Investment Management

Second Quarter 2024 | Segment Focus: Trust Companies

In This Issue

This quarter we take an in-depth look at the trends affecting trust companies and the broader RIA industry, including the performance of publicly traded asset management firms and deal activity across the sector. In the public markets, all sectors of RIAs we reviewed underperformed the S&P 500, with the larger RIAs seeing a decline in share price over the quarter. In the private market, deal count has declined since the end of 2021, although total value has remained stable over the last year as average deal size has increased and valuations have remained stable.

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Segment Focus: Trust Companies

One of the most frequently ignored sectors in the wealth management industry may be its first cousin, the independent trust industry. While many still associate trust administration with banks, which account for more than 75% of the space, the growing prominence of independent trust companies is capturing the attention of many participants in the investment management community. This quarter, we will examine current trends impacting independent trust companies.

Fees

Since the credit crisis, there has been a broad-based decline in pricing power across the investment management industry. Competition from low-fee passively indexed products and increasing fee consciousness among institutional clients have driven down effective realized fees for asset managers. Wealth management fees have been more resilient, but the threat of low-fee alternatives remains.

So, how have trust companies fared in this environment? Trust companies have fared remarkably well despite pricing pressure in the broader industry. Fee levels have been supported by increasing demand for trust administration services driven by generational wealth transfer trends and the increasing complexity of trust arrangements that require specialized knowledge with respect to legal, tax, regulatory, and investment matters. The story has been similar for many of our independent trust company clients. Realized fees have remained steady or increased over the last five years, while assets under administration have grown through market appreciation and net inflows.

Market Correlation

In 2024, the stock market has continued to rally, building on the momentum gained in 2023, positively impacting the top line for trust companies, as it will for all investment managers that charge a percentage of assets under management. As of the date of this post, the S&P 500 is up around 15% year-to-date.

Normally, trusts are shielded from some of the market volatility because of relatively higher exposure to fixed income. However, the change in the term structure of interest rates over the past two and a half years means bonds are well off their prices from a few years ago, resulting in a lower fee base for trust companies with fixed income exposure.

Unlike many asset and wealth management firms, trust companies often have revenue sources that aren't directly tied to assets under management or administration (e.g., tax planning or estate administration fees). Such fee structures can serve as a buffer during market downturns, providing trust companies with greater resilience in adverse market environments relative to their asset and wealth management peers.

Favorable Demographics

As America becomes older and wealthier, the number of potential clients for the trust industry is poised to grow markedly.

Trust companies primarily service high-net-worth and ultra-high-net-worth clients, and both demographics are growing. Credit Suisse's 2024 Global Wealth Report estimates that there are nearly 22 million people in the U.S. with a net worth over $1 million. At the same time, the median age in the U.S. has increased by 1.7 years in the past decade, and the oldest members of the baby boomer generation are now in their mid-70s.

The median age of high-net-worth individuals (those with a net worth over $1 million) is 62, and over a quarter are over the age of 70. Consequently, there is a growing pool of clients in need of the kinds of services the trust industry provides, which points to a sustained period of organic growth. While these trends will also provide a tailwind for wealth management firms—who often start working for clients around the time they retire—it is a more certain opportunity for trust providers, especially to the extent that wealth transfer services are part of a client's financial plan.

Additionally, the impending wealth transfer as baby boomers age should spur growth in trust assets. According to a report published by **Cerulli Associates**, the heirs of baby boomers are expected to inherit roughly $72.6 trillion over the next 20 years.

Regulatory Trends

As trust law has developed, a handful of states have emerged as particularly favorable for establishing trusts. While the trust law environment varies from state to state, leading states typically have favorable laws for asset protection, taxes, trust decanting, and general flexibility in establishing and managing trusts. Opinions vary, but the following states (listed alphabetically) are often identified with a favorable mix of these features.

- Alaska
- Delaware
- Florida
- Nevada
- New Hampshire
- South Dakota
- Tennessee
- Texas
- Wyoming

Over the last several decades, many states like Delaware, Nevada, New Hampshire, and South Dakota have modernized their trust laws to allow for perpetual trusts, directed trustee models, and self-settled spendthrift trusts (or asset protection trusts). In particular, the directed trust model is a major change in how trust companies manage assets, and it has been gaining popularity among trust companies and their clients. Under the directed trust model, the trust's creator can delegate different functions to different parties. Most frequently, this involves directing investment management to an investment advisor other than the trust company (this could be a legacy advisor or any party the client chooses). Administrative functions and decisions on how the trust's assets are made available to beneficiaries are typically delegated to the trust company.

The directed trustee model leads to a mutually beneficial relationship between the trust company, the investment advisor, and the client. The trust company avoids competition with investment advisors, who are often their best referral sources. The investment advisor's relationship with their client is frequently written into the trust document. And most importantly, this model should result in better outcomes for the client because its team of advisors is ultimately doing what each does best—its trust company administers trust assets, and its investment advisor is responsible for investment decisions.

Succession

In our experience, the ownership profile at independent trust companies is often similar to what we see at wealth management firms, where ownership succession is often a topic of conversation. Ownership issues can include concentration at the founder level or even extensive ownership held by outsiders who helped capitalize the firm's startup. As with most investment management businesses, independent trust companies tend to be owner-operator businesses, so conversations about equity ownership are frequently centered around finding effective ways to provide equity incentives to the individuals most impactful to the firm's future.

As we've written about in **articles**, **blog posts**, and **whitepapers** on buy-sell agreements, the dynamic of a multi-generational, arms-length ownership base can be an opportunity for ensuring the long-term continuity of the firm, but it also risks becoming a costly distraction. As the trust industry ages, we see transition planning as potentially being either a competitive advantage (if done well) or a competitive disadvantage (if ignored).

Outlook

The independent trust industry has showcased resilience and strong performance in recent years, even amidst market turbulence and evolving industry dynamics. Demographic shifts and increasing visibility as an attractive alternative to bank trust departments present an encouraging outlook for independent trust companies' growth in the foreseeable future. As these trends continue to shape the financial landscape, prudent planning, innovation, and adaptability will be crucial for trust companies aiming to thrive in the competitive investment management arena.

Performance of Publicly Traded Asset / Wealth Management Firms

RIAs underperformed in the second quarter of 2024, with even the largest asset managers facing a decline in stock price in spite of a stronger asset base on which to collect revenue. Despite the price drop, all groups examined experienced growth in fundamentals year-over-year. We explore further below.

Changes in Price

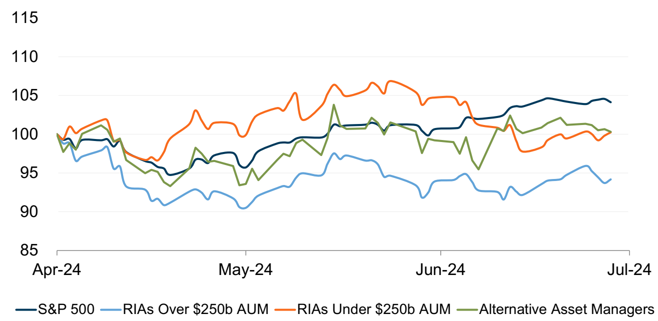
Despite continued market growth in Q2, many RIAs faced unsteady performance. Alternative asset managers and smaller RIAs (AUM under $250 billion) ended the quarter with a price increase below 1% while larger RIAs (AUM over $250 billion) saw an aggregate market cap decrease of almost 6%. These measures can be contrasted against a 4% gain for the S&P 500 during the quarter.

Year-over-year performance was positive for all groups of RIAs, as well as the S&P, especially so for alternative asset managers which saw a price increase of over 50% on signs of easing inflation and rate hike expectations. Other classes of RIAs didn't fare so well and underperformed the S&P over the year.

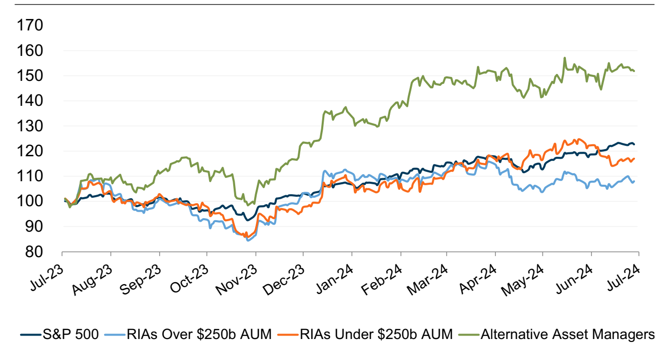
Changes in Valuation

The median Enterprise Value to LTM EBITDA multiples for public RIAs increased modestly during Q2, but remained the same for smaller RIAs. After trending downwards for most of 2023, multiples began to increase with the overall market during the fourth quarter of 2023 and the first half of 2024.

Quarter-Over-Quarter Price Index

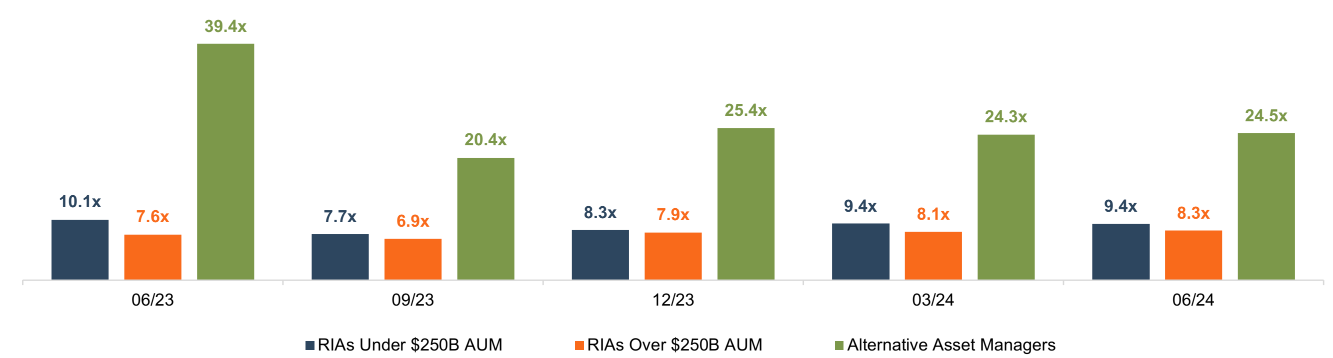


Year-Over-Year Price Index



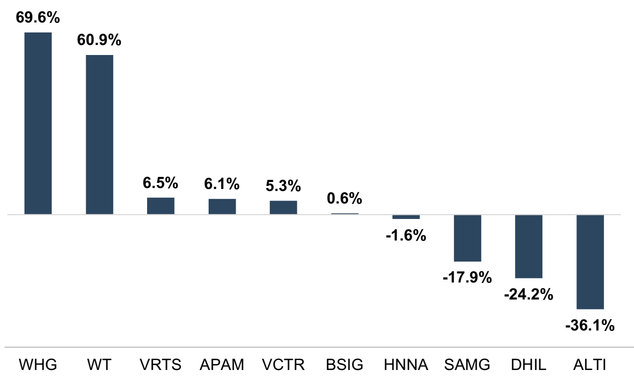
Source: S&P Market Intelligence

Enterprise Value to LTM EBITDA

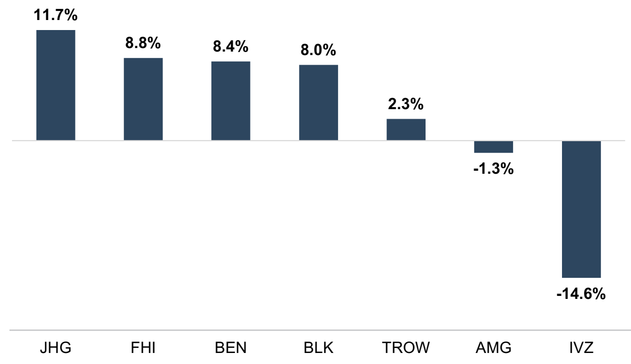


Winners and Losers

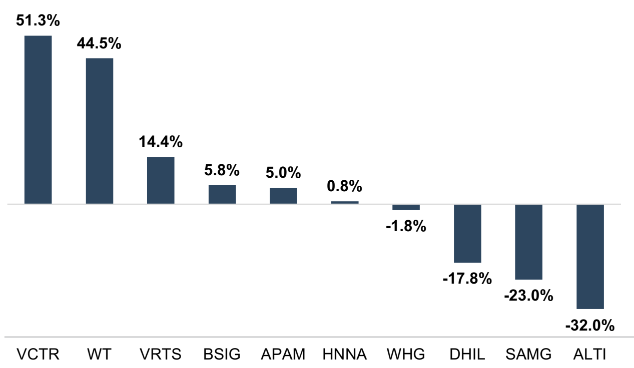
YoY EBITDA Growth (RIAs Under $250B AUM)



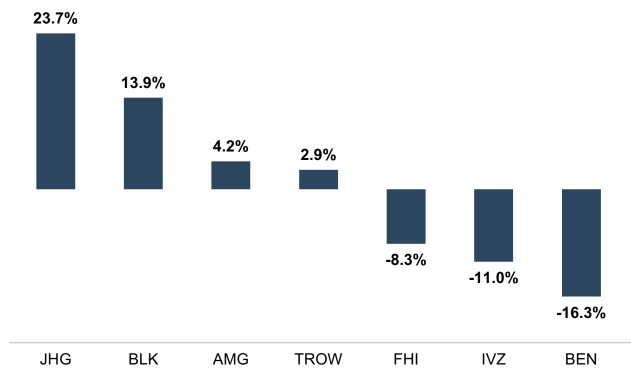
YoY EBITDA Growth (RIAs Over $250B AUM)



YoY Price Growth (RIAs Under $250B AUM)



YoY Price Growth (RIAs Over $250B AUM)

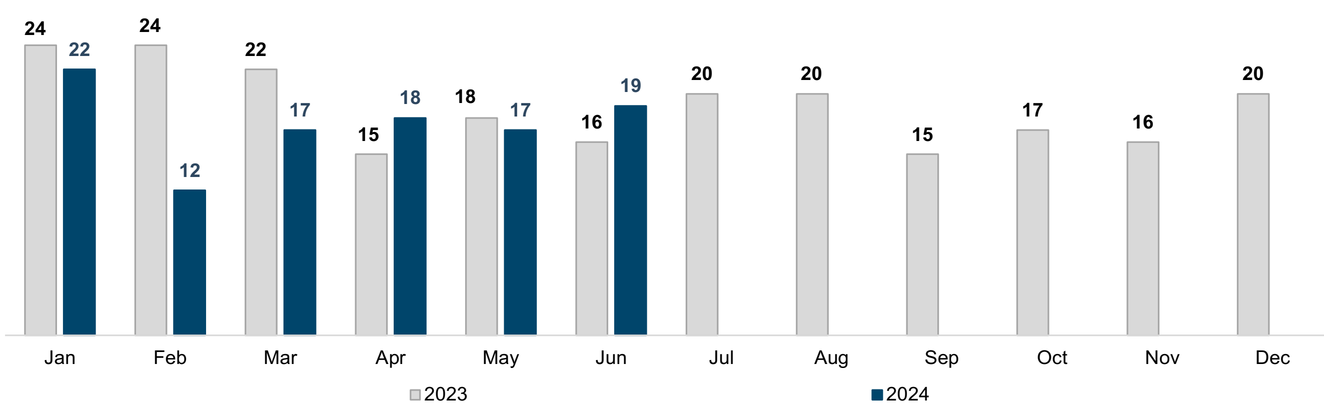


Source: S&P Capital IQ Pro

RIA M&A

Second Quarter 2024

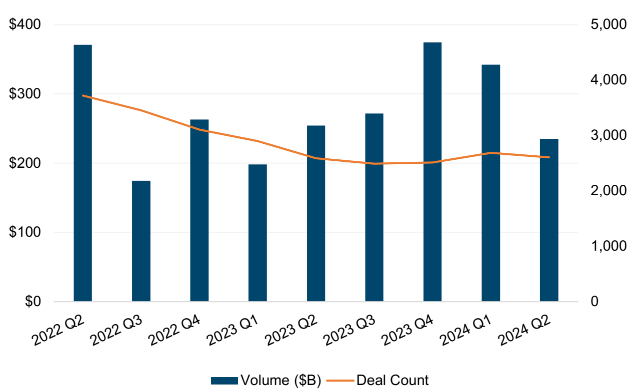
Number of RIA M&A Transactions, 2023 vs 2024



Source: Fidelity

Following a year where deal volume in the RIA industry nearly matched the all-time high of 2022, RIA M&A activity has cooled in 2024. Fidelity's May 2024 Wealth Management M&A Transaction Report (most recent available data) listed 86 deals through May 2024, down 17% from the 103 deals executed during the same period in 2023.

Global M&A Activity (Excluding RIA Industry)



Source: Bloomberg

While deal volume has been slow during the first half of 2024, there has been a slight pick-up in M&A activity in the second quarter. Fidelity's transaction report listed 35 deals in the first two months of the second quarter, representing a 6% year-over-year increase in deal count.

RIA deal activity experienced a greater decline than the broader M&A market. The number of M&A transactions for all industries (excluding the RIA industry) decreased 3% year-over-year through the first half of 2024 (per Bloomberg), compared to a decline of 17% in the RIA industry.

Despite the decline in the total number of deals, there was a significant uptick in total transacted AUM during 2024. Total transacted AUM through May 2024 was $358.0 billion—a 208% increase from the same period in 2023. The average AUM per transaction during the two quarters of 2024 was $4.2 billion, a 268% 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 two years.

The growth in deal size resulted from the completion of several large transactions during the first half of 2024, coupled with the overall increase in AUM levels due to market performance. In **Echelon's RIA M&A Deal Report**, the authors write that these conditions "[demonstrate] buyer resilience" and may precede increased deal activity "once macroeconomic headwinds, namely higher interest rates subside." Echelon also proposes that an increased volume of $1B+ deals may indicate increased creativity in deal structures.

Another contributor to the increase in deal size has been RIAs partnering with private equity firms. According to Fidelity's May 2024 Wealth Management M&A Transaction Report, private equity backing was involved in all but one of the transactions in May. Noteworthy transactions backed by private equity include **Caprock's** acquisition of Grey Street Capital, **Mariner Wealth Advisor's** purchase of Fourth Street Performance Partners, and **GTCR's** acquisition of AssetMark Financial.

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 66% of transactions through the first half of 2024. Mercer Advisors, Miracle Mile Advisors, and Allworth Financial completed multiple deals during the first two quarters of the year.

Deal activity has also been supported by the supply side of the M&A equation, as the impetus to sell is often based on more than market timing. 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. 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. 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. Internal transactions don't occur in a vacuum, and the same factors driving consolidation and M&A activity have influenced valuations in internal transactions as well. As valuations have increased, financing in internal transactions has become a crucial secondary consideration 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

	Ticker	6/30/2024 Stock Price	% of 52 Week High	Price / Trailing EPS	Price / Forward EPS	Enterprise Value / AUM (%)	Enterprise Value / EBITDA
				Pricing as of June 30, 2024			
TRADITIONAL ASSET / WEALTH MANAGERS (AUM UNDER $250B)							
AlTi Global, Inc.	ALTI	5.21	56.5%	nm	17.9x	2.44%	nm
Artisan Partners Asset Management Inc.	APAM	41.27	88.3%	12.5x	11.5x	2.53%	12.6x
BrightSphere Investment Group Inc.	BSIG	22.17	93.8%	12.2x	nm	1.01%	8.1x
Diamond Hill Investment Group, Inc.	DHIL	140.75	74.8%	9.2x	nm	1.24%	10.9x
Hennessy Advisors, Inc.	HNNA	7.12	89.0%	10.5x	nm	0.89%	5.1x
Silvercrest Asset Management Group Inc.	SAMG	15.59	67.2%	16.6x	9.1x	0.60%	9.4x
Victory Capital Holdings, Inc.	VCTR	47.73	86.9%	14.1x	11.9x	2.35%	9.7x
Virtus Investment Partners, Inc.	VRTS	225.85	85.7%	13.2x	nm	1.07%	8.6x
Westwood Holdings Group, Inc.	WHG	12.18	89.4%	9.0x	nm	0.38%	7.5x
WisdomTree, Inc.	WT	9.91	96.5%	13.4x	15.3x	1.57%	17.0x
Group Median			**87.6%**	**12.5x**	**11.9x**	**1.16%**	**9.4x**
TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $250B)							
Affiliated Managers Group, Inc.	AMG	156.23	92.1%	7.2x	10.1x	1.10%	7.2x
Franklin Resources, Inc.	BEN	22.35	73.7%	13.1x	11.2x	0.82%	6.5x
BlackRock, Inc.	BLK	787.32	93.2%	19.8x	18.6x	1.14%	16.9x
Federated Hermes, Inc.	FHI	32.88	88.1%	8.7x	8.8x	0.32%	5.9x
Invesco Ltd.	IVZ	14.96	80.0%	nm	9.0x	0.75%	11.8x
Janus Henderson Group plc	JHG	33.71	96.4%	12.4x	11.8x	1.23%	8.3x
T. Rowe Price Group, Inc.	TROW	115.31	86.9%	13.3x	12.3x	1.58%	9.5x
Group Median			**88.1%**	**12.8x**	**11.2x**	**1.10%**	**8.3x**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management, Inc.	APO	118.07	98.6%	12.3x	14.6x	11.69%	nm
Ares Management Corporation	ARES	133.28	88.8%	58.6x	30.4x	10.11%	35.9x
Associated Capital Group, Inc.	AC	34.02	88.0%	21.7x	nm	21.85%	nm
Blackstone Inc.	BX	123.80	92.7%	43.7x	15.2x	10.77%	nm
The Carlyle Group Inc.	CG	40.15	82.7%	nm	10.3x	5.22%	nm
Cohen & Steers, Inc.	CNS	72.56	92.3%	28.7x	24.7x	4.41%	21.5x
Hamilton Lane Incorporated	HLNE	123.58	94.4%	35.6x	26.1x	4.20%	18.1x
KKR & Co. Inc.	KKR	105.24	92.4%	22.9x	26.2x	23.27%	nm
Group Median			**92.4%**	**28.7x**	**24.7x**	**10.44%**	**21.5x**
OVERALL MEDIAN			**88.8%**	**13.2x**	**12.3x**	**1.57%**	**9.5x**

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 startup 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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- ERISA Valuation

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