VALUE FOCUS

Investment Management

Third Quarter 2024 | 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 asset management firms and deal activity across the sector. In the public markets, all sectors of RIAs we reviewed outperformed the *S&P 500,* with alternative asset managers seeing the largest increase in share price over the quarter. In the private market, year-to-date deal count has declined over the same period in 2023, but average deal size has increased while valuations have remained stable during this time.

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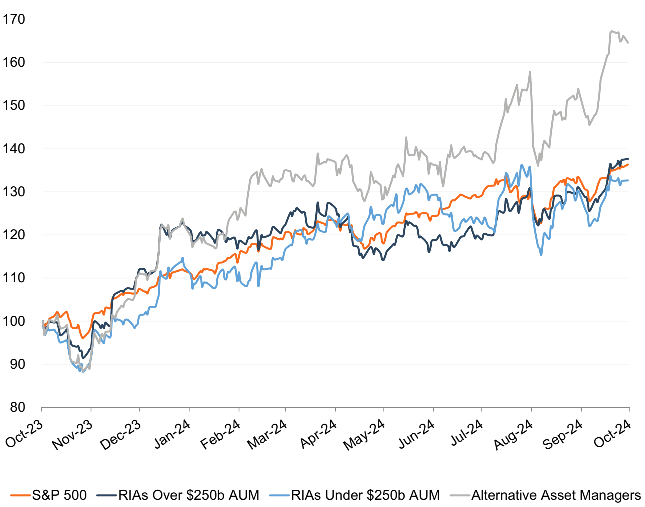
Segment Focus: Alternative Asset Managers

Alternative asset managers fared particularly well during favorable market conditions for the RIA sector. Over the past year, both alternative asset managers and large RIAs (with assets under management, or AUM, exceeding $250 billion) outperformed the *S&P 500*, achieving gains of 64.6% and 37.7%, respectively. In contrast, smaller RIAs (AUM under $250 billion) underperformed relative to the broader market, posting gains of 32.7%. RIAs have directly benefited from improved market conditions, which have boosted AUM.

Investment Manager Performance by Sector
Twelve Month Ended September 30, 2024

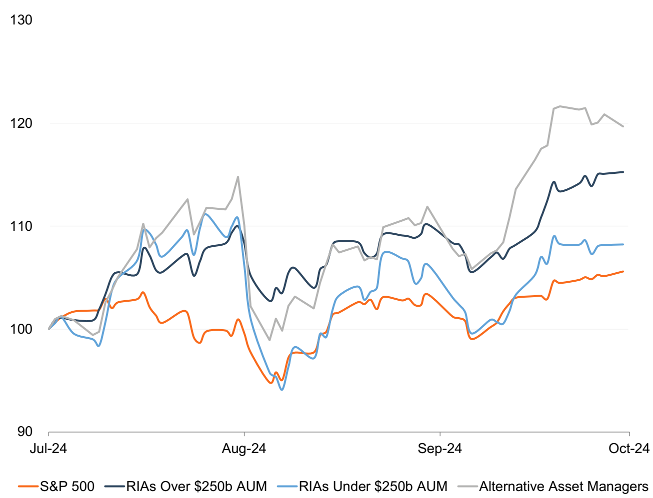


Source: S&P Market Intelligence

Recent quarterly data shows a similar trend. In the third quarter, alternative asset managers surged 19.7%, significantly outpacing the *S&P 500's* 5.6% gain over the same period. Larger RIAs also performed well, increasing 15.3%, while their smaller counterparts posted an 8.2% increase. The divergence in performance illustrates the continued strength of alternative asset managers, whose investment strategies—frequently insulated from short-term market gyrations—provide stability during periods of heightened volatility.

Since 2020, increased volatility has driven fluctuations in AUM, drawing heightened interest in the stocks of alternative asset managers. This interest can be attributed to the long-term nature of their investment vehicles, such as private equity funds, which typically lock in capital for extended periods (often 10-12 years). This structure provides a more stable and predictable revenue stream, largely insulated from short-term market fluctuations. As a result, alternative asset managers tend to exhibit lower correlations with broader market conditions, enhancing their appeal during periods of uncertainty.

Investment Manager Performance by Sector - Q3 2024



Source: S&P Market Intelligence

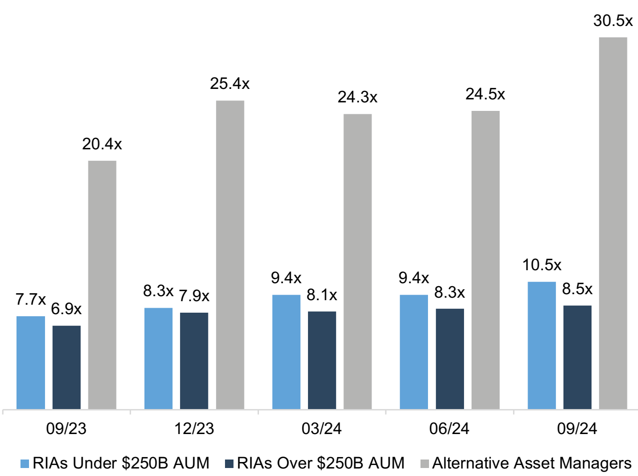
The attractiveness of these firms lies not only in their ability to weather volatility but also in their capacity to capitalize on it. Many alternative investments, like private equity and hedge funds, are positioned to thrive in environments of market dislocation, offering both downside protection and opportunistic growth when traditional asset classes falter.

Valuation Trends and Earnings Multiples

From a valuation perspective, the market's sentiment towards alternative asset managers is clearly reflected in the evolution of their earnings multiples. After a downward trend throughout much of 2022, EBITDA multiples for alternative asset managers rebounded sharply in 2023 and so far this year.

However, it's important to note that many publicly traded alternative asset managers carry significant investment assets on their balance sheets—investments in their own funds—which are factored into their stock prices. When comparing firms within this space, it's often necessary to adjust earnings and implied enterprise values to account for these balance sheet investments.

Enterprise Value to LTM EBITDA



Source: S&P Market Intelligence

SEC's Private Fund Adviser Rules Vacated

In August of 2023, the SEC adopted new **Private Fund Adviser Rules**, attempting to tighten the regulatory oversight of private fund advisers. These new rules mandated quarterly performance disclosures, annual audits, and enhanced reporting for certain transactions. These rules were expected to significantly increase compliance costs, especially for smaller alternative asset managers.

However, in June 2024, the U.S. Fifth Circuit Court unanimously **vacated the rules**, stating that the SEC had overstepped its regulatory authority. This ruling was a significant win for alternative asset managers, removing the prospect of steep compliance costs that could have strained smaller firms. Going forward, this ruling may have set a precedent for future SEC efforts to regulate private funds and may give rise to challenges to other SEC rules that rely on similar authority.

Implications for Your RIA

While the valuation of publicly traded asset and wealth managers offers insights into broader investor sentiment, direct comparisons with privately held RIAs require careful consideration. Publicly traded firms, particularly smaller ones, often focus on active asset management, which remains vulnerable to fee compression and capital outflows toward passive investment products. This trend has put pressure on publicly traded asset managers, especially those who rely heavily on active strategies.

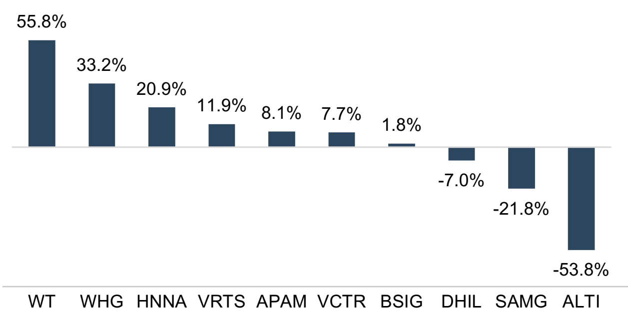
In contrast to public asset/wealth managers, many smaller, privately held RIAs, particularly those focused on wealth management for HNW and UHNW individuals, have been more insulated from industry headwinds. Their fee structures, asset flows, and deal activity reflect this more favorable backdrop.

Notably, the market for privately held RIAs remained relatively strong in 2024 despite macroeconomic uncertainty and elevated interest rates. As noted in our **Q3 M&A Update**, deal activity has slightly lagged the levels seen in 2023 (down 11%), however, there has been a 168% increase in total transacted AUM over the same period. A main contributor to this increase in transacted AUM has been RIAs partnering with private equity firms. According to Fidelity's September 2024 Wealth Management M&A Transaction Report, private equity backing was involved in 63% of September transactions. Per **Echelon's Q2 2024 RIA M&A Deal Report** (latest available), private equity acquirers directly invested in twelve wealth managers with an average AUM per deal of $54.6 billion in the second quarter of 2024.

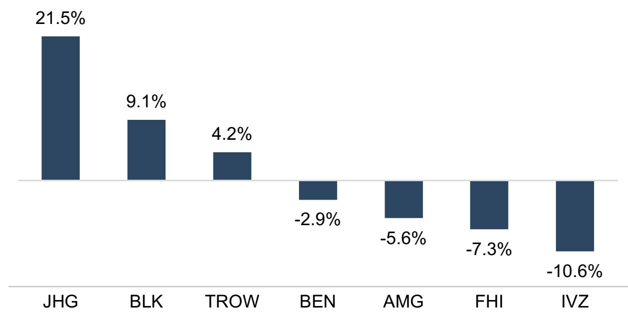
As these dynamics continue into Q4 2024, the outlook for continued multiple expansion and robust deal activity for alternative asset managers remains favorable.

Winners and Losers

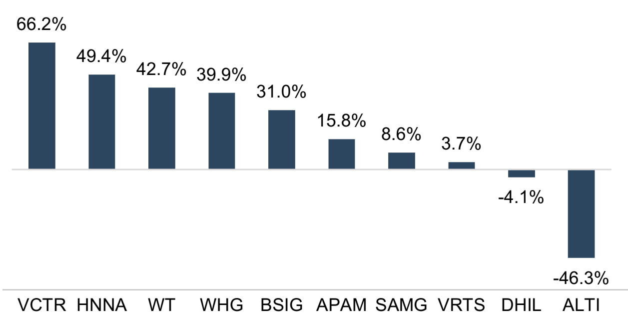
YoY EBITDA Growth (RIAs Under $250B AUM)



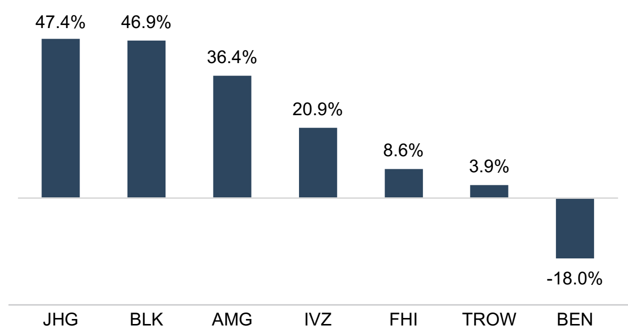
YoY EBITDA Growth (RIAs Over $250B AUM)



YoY Price Growth (RIAs Under $250B AUM)



YoY Price Growth (RIAs Over $250B AUM)

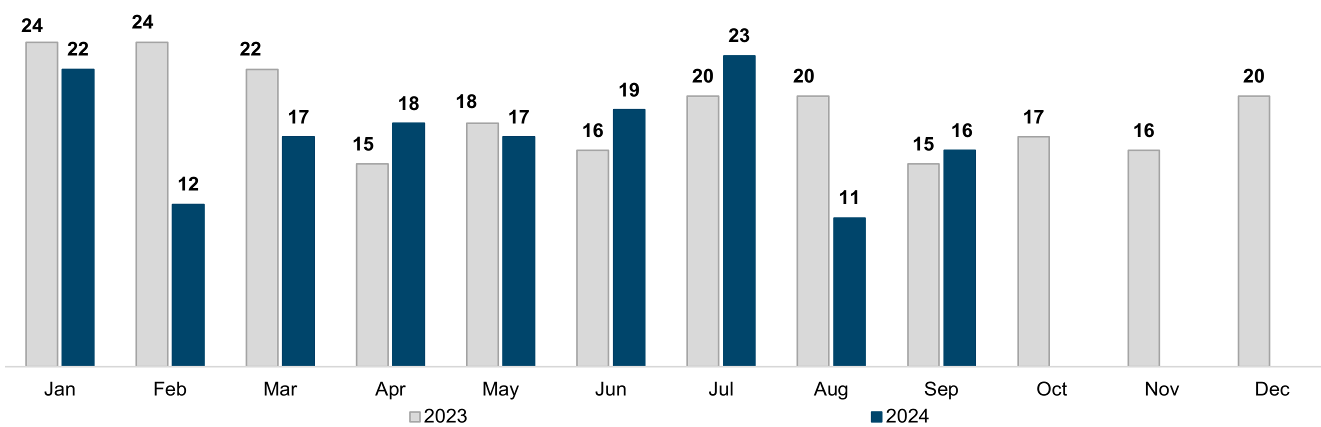


Source: S&P Capital IQ Pro

RIA M&A

Third Quarter 2024

Number of RIA M&A Transactions, 2023 vs 2024

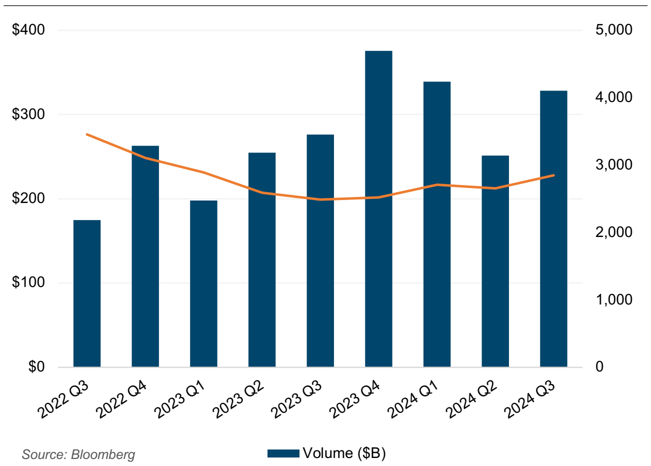


Source: Fidelity

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 September *2024 Wealth Management M&A Transaction Report* listed 155 deals through September, down 11% from the 174 deals executed during the same period in 2023.

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) increased 3% year-over-year through the first three quarters of 2024 (per Bloomberg), compared to a decline of 11% in the RIA industry.

Global M&A Activity (Excluding RIA Industry)



Source: Bloomberg

Despite the decline in the total number of deals, there was a significant uptick in total transacted AUM during 2024. Total transacted AUM through the first three quarters 2024 was $541.5 billion—a 168% increase from the same period in 2023. The average AUM per transaction during the first nine months of 2024 was $3.5 billion, a 201% 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 three years. The growth in deal size resulted from the completion of several significant transactions during 2024, coupled with the overall increase in AUM levels due to market performance.

Another contributor to the increase in deal size has been RIAs partnering with private equity firms. According to Fidelity's September 2024 Wealth Management M&A Transaction Report, private equity backing was involved in 63% of the M&A transactions reported in September. Noteworthy transactions backed by private equity in the third quarter include KKR's **acquisition** of Janney Montgomery Scott LLC from Penn Mutual Life Insurance. Janney is a leading wealth management and investment banking firm with over $150 billion in assets under administration, and more than 900 financial advisors across the U.S. KKR views this acquisition as a strategic move to strengthen its presence in the U.S. wealth management sector.

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 September of 2024. Focus Financial Partners, Wealth Enhancement Group, and Sequoia Financial Group all completed multiple deals in the third quarter of 2024.

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.

Another development that could stimulate M&A volume was the Federal Reserve's decision to cut interest rates by 50 basis points in September. This marks a shift after nearly three years of rate increases, which contributed to a slowdown in deal volume during that period. With expectations of further rate cuts ahead, cheaper capital would likely encourage more deal activity in the RIA M&A market. As capital becomes more accessible and consolidation trends continue, the RIA market could experience renewed momentum heading into 2025.

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 robust valuation multiples. 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 also influenced valuations in internal transactions. 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, increasing 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 September 30, 2024			
	Ticker	9/30/2024 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)							
AlTi Global, Inc.	ALTI	3.74	40.6%	nm	16.4x	2.30%	nm
Artisan Partners Asset Management Inc.	APAM	43.32	92.7%	12.9x	13.0x	2.61%	12.5x
BrightSphere Investment Group Inc.	BSIG	25.40	95.6%	13.8x	nm	1.08%	8.8x
Diamond Hill Investment Group, Inc.	DHIL	161.61	92.9%	10.8x	nm	1.44%	10.9x
Hennessy Advisors, Inc.	HNNA	9.95	83.0%	12.5x	nm	1.34%	6.8x
Silvercrest Asset Management Group Inc.	SAMG	17.24	95.1%	19.4x	8.6x	0.67%	10.7x
Victory Capital Holdings, Inc.	VCTR	55.40	97.9%	15.2x	13.7x	2.64%	10.5x
Virtus Investment Partners, Inc.	VRTS	209.45	79.5%	13.6x	nm	1.04%	7.7x
Westwood Holdings Group, Inc.	WHG	14.20	93.5%	19.3x	nm	0.57%	9.7x
WisdomTree, Inc.	WT	9.99	83.1%	19.3x	15.2x	1.56%	14.6x
Group Median			**92.8%**	**13.8x**	**13.7x**	**1.39%**	**10.5x**
TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $250B)							
Affiliated Managers Group, Inc.	AMG	177.80	93.7%	8.3x	9.5x	1.16%	7.9x
Franklin Resources, Inc.	BEN	20.15	66.5%	12.5x	10.2x	0.74%	6.1x
BlackRock, Inc.	BLK	949.51	99.7%	23.3x	22.5x	1.33%	19.6x
Federated Hermes, Inc.	FHI	36.77	98.2%	11.4x	11.0x	0.36%	7.8x
Invesco Ltd.	IVZ	17.56	96.1%	nm	10.9x	0.76%	11.9x
Janus Henderson Group plc	JHG	38.07	97.3%	12.8x	12.2x	1.35%	8.5x
T. Rowe Price Group, Inc.	TROW	108.93	89.1%	12.4x	11.6x	1.43%	8.6x
Group Median			**96.1%**	**12.5x**	**11.0x**	**1.16%**	**8.5x**
ALTERNATIVE ASSET MANAGERS							
Associated Capital Group, Inc.	AC	35.42	96.5%	22.7x	nm	27.29%	nm
Apollo Global Management, Inc.	APO	124.91	98.4%	12.4x	15.6x	12.43%	nm
Ares Management Corporation	ARES	155.84	97.4%	77.1x	36.9x	10.63%	43.3x
Bridge Investment Group Holdings Inc.	BRDG	9.87	97.2%	19.6x	3.8x	2.48%	45.8x
Blackstone Inc.	BX	153.13	95.0%	58.8x	19.9x	12.83%	nm
The Carlyle Group Inc.	CG	43.06	84.6%	nm	11.5x	5.55%	nm
Cohen & Steers, Inc.	CNS	95.95	98.3%	38.0x	33.0x	5.83%	28.4x
GCM Grosvenor Inc.	GCMG	11.32	97.6%	31.4x	28.2x	1.02%	18.0x
Hamilton Lane Incorporated	HLNE	168.39	99.6%	41.7x	36.7x	5.60%	22.6x
KKR & Co. Inc.	KKR	130.58	96.8%	29.9x	32.6x	26.98%	nm
P10, Inc.	PX	10.71	90.5%	476.0x	56.4x	6.32%	25.2x
Group Median			**97.2%**	**34.7x**	**30.4x**	**6.32%**	**26.8x**
OVERALL MEDIAN			**95.3%**	**19.3x**	**14.4x**	**1.50%**	**10.8x**

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

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