
## VALUE FOCUS

# Investment Management

### Second Quarter 2021 | Segment Focus: Alternative Asset Managers

### In This Issue



In this issue, we review public market performance across the investment management industry as the stock market continues its bull run. AUM balances grew with the market while some sectors benefited more than others. Alternative asset managers and traditional asset/wealth managers both outperformed the S&P 500 while aggregators trailed slightly.

In our segment focus for this quarter, we look at the performance of alternative managers which have fared particularly well in the recent quarter. As public market equity valuations continue to reach new highs and optimism grows, alternative investment vehicles have become more attractive.

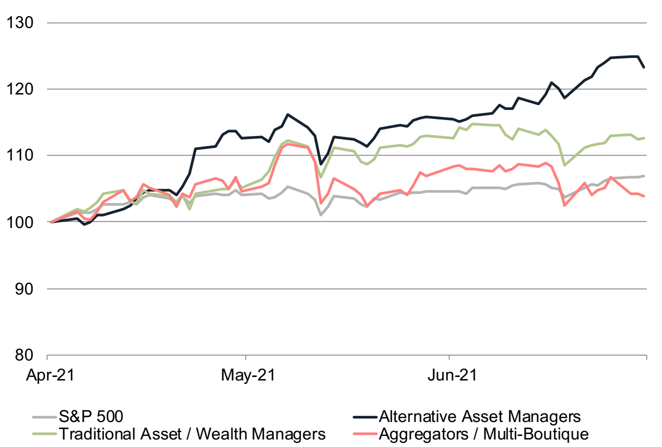
Also in this issue, we address industry M&A trends and factors driving deal activity. Record deal activity continues to be supported by favorable capital markets and fears of impending tax code changes.

# Asset / Wealth Management Stocks See Another Quarter of Strong Market Performance

## Publicly Traded Asset / Wealth Managers See Continued Momentum Through Second Quarter as Market Backdrop Improves

RIA stocks continued to have strong performance during the second quarter, with most individual stocks in our indices hovering near 52-week highs. Performance varied by sector, with alternative asset managers faring particularly well over the last quarter. Our index of alternative asset managers was up 26% during the quarter, reflecting bullish investor sentiment for these companies based in part on rising allocations to alternative assets. The index of traditional asset and wealth managers rose 15% during the quarter, with performance driven by rising AUM balances and favorable market conditions.

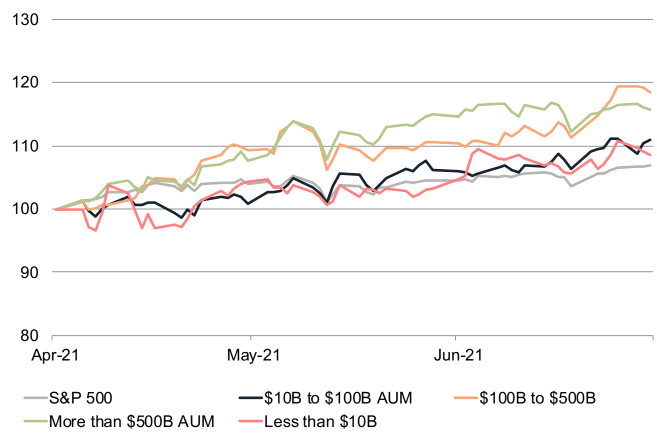
**Investment Management Performance by Sector: Q2 2021**




*Source: S&P Global Market Intelligence*

The stock price performance of RIA aggregators trailed other categories, with the aggregator index increasing only 6% during the quarter. Weak relative performance for the RIA aggregators may be reflective of mixed investor sentiment towards the aggregator model. While the opportunity for consolidation in the RIA space is significant, investors in aggregator models have expressed mounting concern about rising competition for deals and high leverage at many aggregators which may limit the ability of these firms to continue to source attractive deals.

**Investment Management Performance by AUM Size: Q2 2021**

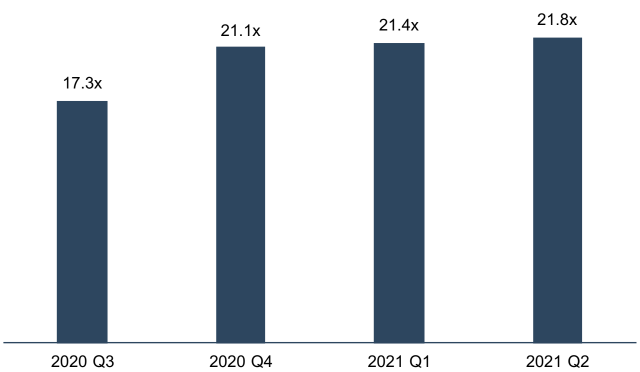



*Source: S&P Global Market Intelligence*

The upward trend in publicly traded asset and wealth manager share prices over the last quarter is promising for the industry, but it should be evaluated in the proper context. Many of these public companies continue to face headwinds including fee pressure, asset outflows, and the rising popularity of passive investment products. These trends have especially impacted smaller publicly traded asset managers, while larger scaled 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 during the second quarter was generally better for larger firms, with firms managing more than $100B in assets outperforming their smaller counterparts.

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. LTM earnings multiples for publicly traded asset and wealth management firms declined significantly during the first and second quarters last year—reflecting the market's anticipation of lower earnings due to large decreases in client assets attributable to the overall market decline. Multiples have since recovered as prospects for earnings growth have improved with AUM balances.

**Median Price to LTM EPS for Traditional Asset / Wealth Managers**




*Source: S&P Global 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 privately-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. Many smaller, privately held 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.

The market for privately held RIAs has remained strong as investors have flocked to the recurring revenue, sticky client base, low capex needs, and high margins that these businesses offer. Like the public companies, value likely declined during the first quarter of last year, but these were largely paper losses (not many transactions were completed based on value during the height of the downturn). Likely, not more than a quarter or two of billing was impacted last year by the market downturn. Since then, revenue and profitability have recovered rapidly, and value has likely improved as well.

## Improving Outlook

The outlook for RIAs depends on a number of factors. Investor demand for a particular manager's asset class, fee pressure, rising costs, and regulatory overhang can all impact RIA valuations to varying extents. The one commonality, though, is that RIAs are all impacted by the market.

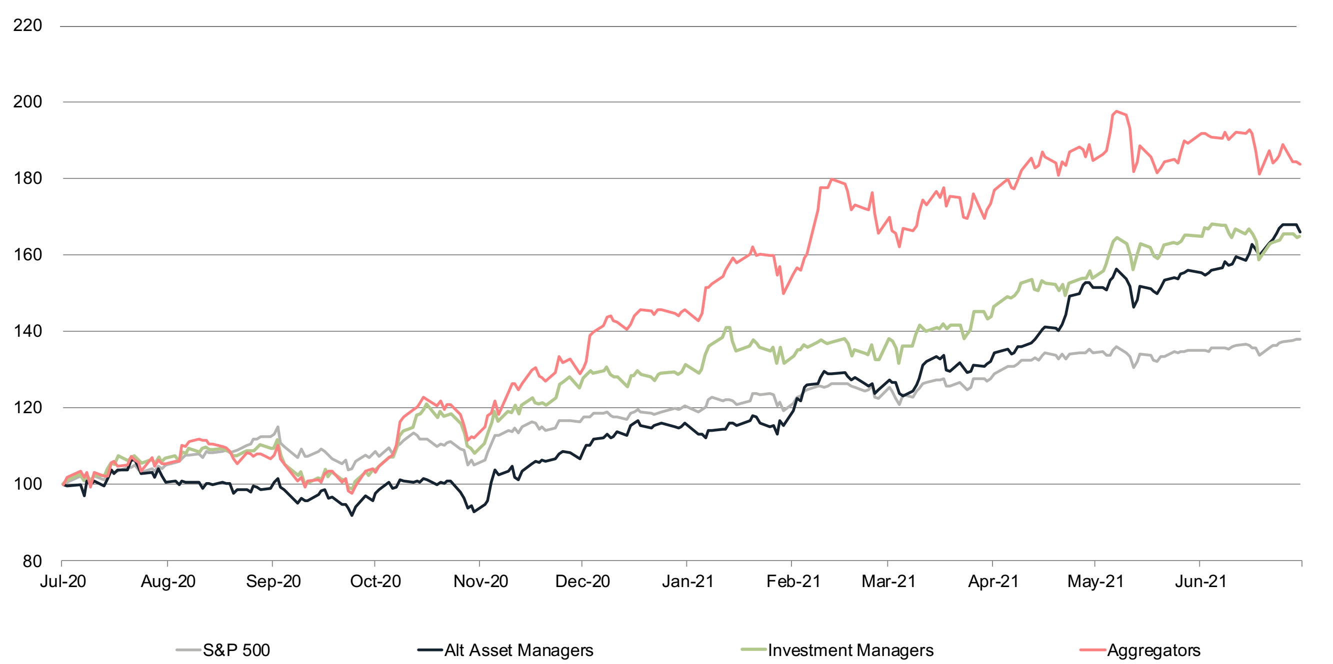
The impact of market movements varies by sector, however. Alternative asset managers tend to be more idiosyncratic but are still influenced by investor sentiment regarding their hard-to-value assets. Wealth manager valuations are somewhat tied to the demand from consolidators while traditional asset managers are more vulnerable to trends in asset flows and fee pressure. Aggregators and multi-boutiques are in the business of buying RIAs, and their success depends on their ability to string together deals at attractive valuations with cheap financing.

On balance, the outlook for RIAs has generally improved with market conditions over the last several months. AUM has risen with the market over this time, and it's likely that industry-wide revenue and earnings have as well. With markets near all time highs, most RIAs are well positioned for strong financial performance in the back half of the year.

# Segment Focus: Alternative Asset Managers

## Strong Quarter Propels Alt Managers to New Highs

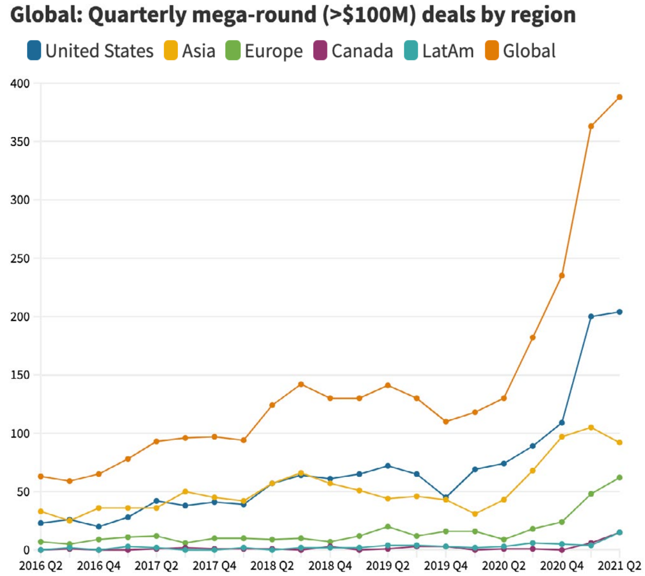
**Investment Manager Performance by Sector - LTM ended June 30, 2021**




The second quarter was especially kind to the alt manager sector, which benefited from favorable market conditions and growing interest from institutional investors. Heightened volatility creates more opportunities for hedge funds to generate alpha (when their positions aren't concentrated in meme stocks), and market peaks often spur interest in alternative asset classes like private equity and real estate. These trends initially took root last Fall before gaining considerable momentum in the second quarter.

Much of this momentum is attributable to the VC space as investors turn to private equity and start-up tech firms for higher returns than more traditional asset classes. According to CB Insights, a record 249 firms achieved the $1 billion "unicorn" valuation status in the first half of 2021, almost doubling the total tally from last year.

**Global: Quarterly mega-round (>$100M) deals by region**




*Source: CB Insights Venture Trends Q2 2021*

**Investment Manager Performance by Sector: 2/19/2020 - 7/31/2020**


*Source: Mercer Capital (Pricing data from SNL Financial)*

Growing interest in the sector also stems from the fact that alt managers are often better positioned during a prospective downturn than their traditional asset management counterparts. Alt assets aren't directly correlated to market conditions and are often held in illiquid investment vehicles, which means their investors are locked up for years at a time with no withdrawal rights.

While sticky assets can provide cushion for alt managers in a downturn, the longer-term performance of many of these managers depends on their ability to raise new funds and put that money to work. Raising institutional capital is often a long and involved process in the best of circumstances. For many managers, the economic interruption of last year's global shutdown presented challenges to their fundraising process that often involves extensive in-person due diligence. And if new funds are raised, there is the question of how fast managers can put that money to work without sacrificing proper due diligence. M&A declined significantly in the second and third quarter of last year, leaving deal teams at many PE firms on the sidelines before rebounding sharply over the last nine months or so.

It's also important to keep in mind that these alt managers and their assets are still vulnerable to bear markets. Public alt managers were particularly affected during the selloff last March, reflecting the decline in portfolio asset values and reduced expectations for realizing performance fees.

From February 19, 2020 (the prior market peak), our index of alt managers declined nearly 45% in just over a month. Since then, an outsized recovery has pushed the index back to all-time highs.

Such a sharp gain in alt manager stock prices means the market is increasingly optimistic about the sector's prospects. Performance fees and carried interest payments are likely to increase with rising asset prices. Strong investment performance also tends to entice inflows from institutional investors, which will buoy AUM balances and management fees for most of these firms. The market is therefore anticipating higher revenues for the industry, which should be accompanied by even greater gains in profitability given the sector's relatively high level of operating leverage (fixed costs).

Many alt manager funds also have high levels of financial leverage (debt) that can augment returns when things go well. The trouble is that both operating and financial leverage can exacerbate earnings when revenue dips or investments under perform. These attributes are what makes the alt management industry so volatile and is part of the reason why the sector lost nearly half its value last March before doubling over the next year. On balance, we believe the recent run-up is justified, but it's important to remember what can happen when alt asset prices go the other way. Expect volatility to remain as investors weigh the impact of a recovering economy and rising inflation on alt asset returns.

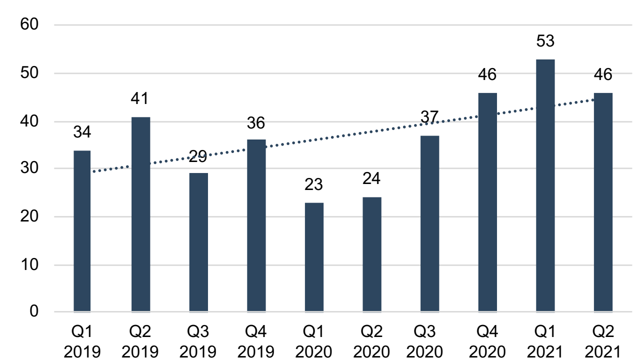
# RIA M&A

## Have Headline Deal Multiples Affected RIA Valuations?

RIA M&A activity slowed somewhat in the second quarter of Q2, but RIA markets are still on track to record the highest annual deal volume on record.

In the latest **RIA M&A Deal Report**, Echelon Partners attributes the pace of RIA M&A to (1) secular trends, (2) supportive capital markets, and (3) potential changes in tax code in the future.

**Deal Volume by Quarter**




*Source: Fidelity; Q1 estimate based on first 2 months of data*

As we discussed **last quarter**, fee pressure in the asset management space and a lack of succession planning by many wealth managers are still driving consolidation. But the increased availability of funding in the space, in tandem with more lenient financing terms, has also caused some of this uptick. Further, the Biden administration's proposal to increase the capital gains tax rate has accelerated some M&A activity in the short-term as sellers seek to realize gains at current tax rates.

But could some of this activity be attributable to the RIA rumor mill and the hype of double-digit multiples in the space?

## Valuation & Speculation

During times of market exuberance, rumors of high-flying multiples seem to travel fast in the investment management community and often with minimal detail. Over the last few months, more of our clients are asking us about double-digit deal multiples and many owners of small firms are understandably confused when they see our comparably lower indications of value.

## Guideline Transaction Method

As independent valuation analysts, we are tasked with finding market transactions of privately held companies in the same or similar business that may provide a reasonable basis for valuation. Market transactions are used to develop valuation indications under the presumption that a similar market exists for the subject company and the comparable companies. Activity and earnings multiples developed using the market transactions method are used to capitalize appropriate estimates of AUM, revenue, and earning power for the subject company.

In most of our valuations of investment management firms, we seek perspective on the M&A market's pricing of closely held investment management firms by evaluating transactions involving acquired U.S.- based investment management firms with between $1 billion and $25 billion of AUM. However, given the lack of publicly available information for transactions in the industry, the data from guideline transactions has limited significance for making inferences.

Every transaction has different motivators that affect the buyer's willingness to accept a certain price and the seller's willingness to pay up. Most RIA transactions include some form of earn-out, which can skew the implied deal multiples. And more frequently, deals include some form of an earn-more consideration that may or may not be reasonable to include when calculating implied deal multiples.

Even when deal multiples are "known," they can be misleading. A transaction priced at nine times pro forma earnings – with normalized compensation, back-office synergies, anticipated changes in fee schedules, and other adjustments might be reported as fifteen times earnings. So, is the deal multiple nine or fifteen? Unfortunately, there is a perverse incentive to talk about the higher multiple. Sellers want to brag about their selling price. Buyers want to be seen as the most generous to attract other sellers into the process (reality can wait until after the LOI is signed). And in a market with a surplus of buyers, intermediaries (the investment bankers), naturally, want to encourage sellers however they can.

To be clear, the RIA market is very strong, and multiples are very high. But RIA buyers are, for the most part, very sophisticated, and not disconnected from reality.

Much of the confusion we see in expectations is being fueled by dozens and dozens of deal announcements with undisclosed terms. In the absence of real information, imagination fills the void. Although we have knowledge of the pricing of many undisclosed deals, we can't directly rely on this information in a business Appraisal (with a capital "A") – as it doesn't constitute known or knowable information to hypothetical buyers and sellers. But all this transaction activity and increased observed deal multiples has, nonetheless, impacted investment management valuations. This conflict between publicly available pricing information and rumored deal multiples makes it even more important to hire a valuation firm experienced in this space.

Because reliable guideline transaction information is scarce, it is essential to build the factors driving the volume of transaction activity and heightened pricing into projections and the cost of capital. Improved equity markets have been driving AUM growth. The inherent operating leverage in the business along with the realization over the last year that RIAs can operate just as efficiently with less or cheaper office space, is driving margin expansion. While it is harder to model increased demand for these businesses into a discounted cash flow model, it can serve to minimize risk and reduce discount rates. Overall, these changes to valuations are generally more subjective. But there is no debate that multiples across the investment management space have increased.

**Investment Manager Multiples by Sector**

| | Ticker | 6/30/2021 Stock Price | % of 52 Week High | Pricing as of June 30, 2021 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 | 167.31 | 93.3% | 22.7x | nm | 1.53 | 6.2x |
| GAMCO Investors, Inc. | GBL | 25.10 | 83.8% | 9.8x | nm | 1.80 | 6.0x |
| Hennessy Advisors, Inc, | HNNA | 9.35 | 74.8% | 9.9x | nm | 1.46 | 5.1x |
| Pzena Investment Management, Inc. | PZN | 11.01 | 90.8% | 40.6x | nm | 1.74 | 11.0x |
| Silvercrest Asset Management Group | SAMG | 15.04 | 85.2% | 9.3x | 9.1x | 1.16 | 10.0x |
| Westwood Holdings Group, Inc. | WHG | 21.76 | 97.3% | nm | nm | 1.21 | nm |
| **Group Median** | | | **88.0%** | **9.9x** | **9.1x** | **1.49** | **6.2x** |
| **TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $100B)** | | | | | | | |
| AllianceBerstein Investments, Inc. | AB | 46.56 | 99.2% | 15.2x | 13.7x | 1.97 | 4.3x |
| BlackRock, Inc. | BLK | 874.97 | 98.3% | 25.9x | 23.3x | 1.53 | 17.2x |
| Federated Investors, Inc. | FHI | 33.91 | 97.9% | 10.7x | 11.6x | 0.57 | 7.3x |
| Franklin Resources, Inc. | BEN | 31.99 | 89.0% | 10.4x | 10.0x | 1.32 | 12.6x |
| Invesco Ltd. | IVZ | 26.73 | 90.0% | 11.1x | 9.4x | 1.48 | 14.3x |
| T. Rowe Price Group, Inc. | TROW | 197.97 | 99.5% | 16.8x | 15.9x | 2.85 | 13.8x |
| Virtus Investment Partners, Inc. | VRTS | 277.77 | 92.4% | 20.3x | 8.7x | 1.21 | 5.9x |
| **Group Median** | | | **97.9%** | **15.2x** | **11.6x** | **1.48** | **12.6x** |
| **ALTERNATIVE ASSET MANAGERS** | | | | | | | |
| Apollo Global Management LLC | APO | 62.20 | 99.4% | 7.9x | 21.3x | 7.37 | 6.7x |
| Ares Management Corp | ARES | 63.59 | 98.9% | nm | 28.5x | 10.87 | nm |
| Associated Capital Group Inc | AC | 38.86 | 91.7% | nm | nm | nm | 5.2x |
| Blackstone Group Inc/The | BX | 97.14 | 96.4% | 17.0x | 27.0x | 19.94 | 12.5x |
| Carlyle Group LP/The | CG | 46.48 | 98.3% | 8.8x | 18.7x | 6.98 | 6.2x |
| Cohen & Steers Inc | CNS | 82.09 | 99.6% | 31.9x | 23.7x | 4.59 | 26.6x |
| Hamilton Lane Inc | HLNE | 91.12 | 93.5% | 32.4x | 35.9x | 0.74 | 31.6x |
| KKR & Co Inc | KKR | 59.24 | 97.0% | 7.2x | 19.0x | 29.04 | nm |
| Sculptor Capital Management Inc | SCU | 24.59 | 90.7% | 6.3x | 6.6x | 5.49 | 7.1x |
| **Group Median** | | | **97.0%** | **8.8x** | **22.5x** | **7.18** | **7.1x** |
| **AGGREGATORS** | | | | | | | |
| Affiliated Managers Group, Inc. | AMG | 154.21 | 87.2% | 19.0x | 9.3x | 1.60 | 14.9x |
| Artisan Partners Asset Management Inc. | APAM | 50.82 | 88.2% | 13.5x | 10.4x | 2.04 | 7.7x |
| Focus Financial Partners Inc | FOCS | 48.50 | 85.7% | 24.9x | 12.7x | na | 19.1x |
| Victory Capital Holdings Inc | VCTR | 32.29 | 98.4% | 9.0x | 7.1x | 1.87 | 8.6x |
| Brightsphere Investment Group Inc | BSIG | 23.43 | 96.6% | 5.1x | 15.8x | 0.98 | 8.4x |
| **Group Median** | | | **88.2%** | **13.5x** | **10.4x** | **1.74** | **8.6x** |
| **OVERALL MEDIAN** | | | **93.5%** | **12.3x** | **13.7x** | **1.74** | **8.5x** |


*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 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 asset managers with annual ESOP valuations, fairness opinions, and appraisals for gift and estate tax compliance

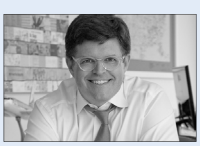
### Sectors Served

- 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

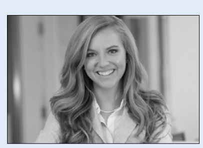
## Mercer Capital's Investment Management Industry Team

**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



**Taryn E. Burgess, CFA, ABV**
901.322.9757
burgesst@mercercapital.com

# Mercer Capital

www.mercercapital.com