VALUE FOCUS

Investment Management

Fourth Quarter 2021 | Segment Focus: Alternative Asset Managers

In This Issue

In this issue, we review public market performance across the investment management industry, which varied by sector amidst heightened market volatility spurred by concerns of the omicron variant and rising inflation.

In our fourth quarter segment focus, we discuss the tailwinds that have bolstered alternative manager performance over the past year and into the most recent quarter. Alternative asset managers faired particularly well during 2021 and outperformed in the fourth quarter as year-to-date total return topped 100% before trending down slightly along with a modest market pullback in the public equities market.

Also in this issue, we address industry M&A trends and factors driving record-breaking deal activity which gained momentum in the fourth quarter. As demand for RIAs reaches new highs, an arms race for deals advantages a handful of RIA aggregators who continue to shape the M&A ecosystem.

Asset Management Firms See Strong Performance in 2021

The investment management industry fared well in 2021 against a backdrop of rising markets and improved net inflows. Strong performance in equities was a major contributor to this performance. The S&P 500 index was up nearly 30% during the year, suggesting that many investment management firms saw significant increases in AUM driven by market movement and ended the year with assets (and run rate revenue) at or near all-time highs.

As investment management firms are generally leveraged to the market, stock movements tend to have an amplified effect on investment management firm fundamentals. Our index of publicly traded asset/wealth management firms reflected this in 2021, ending the year up just over 30%. While multiples saw modest improvement over this period, much of this outperformance was driven by rising fundamentals.

Our index of asset/wealth management aggregators also improved significantly during 2021, ending the year up nearly 40% driven by strong performance in the underlying businesses in which aggregators invest. Alternative asset managers led the way, however, with this index increasing nearly 90% during 2021 driven by strong net inflows due to increasing investor demand for risky assets.

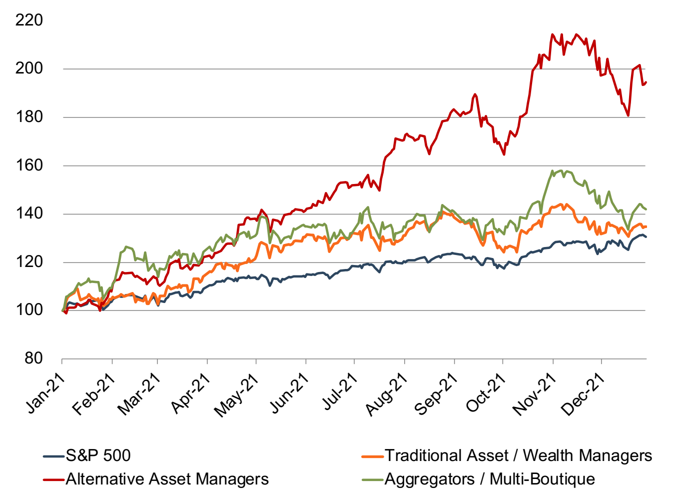
Return of Organic Growth

While market movement is often the dominant contributor to changes in AUM over a particular time period, it affects all investment managers across asset classes and is largely outside of a manager's control. Organic growth, on the other hand, 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 time periods.

Many investment managers have struggled with organic growth in recent years, in part due to rising fee sensitivity and the influence of passively managed investment products. Despite these headwinds, organic growth for our index of publicly traded asset/wealth management companies improved modestly during the nine months ending September 30, 2021 relative to the same period in 2020 (see Exhibit 2).

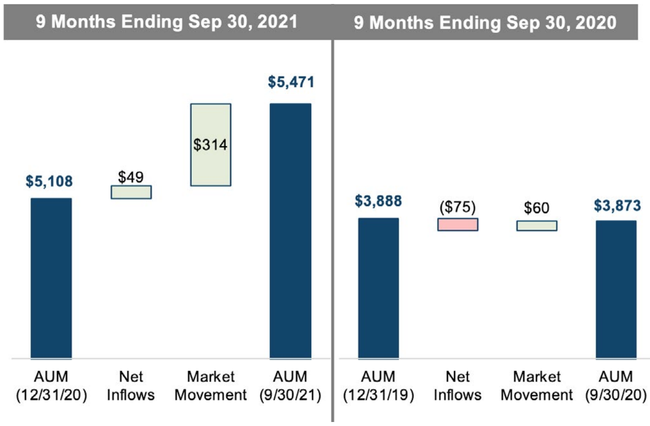
In aggregate, these firms saw net outflows of $75 billion during the first three quarters of 2020, compared to aggregate net inflows of $49 billion during the first three quarters of 2021. While this improvement in organic growth is modest in absolute terms, the switch from net outflows to net inflows is a positive sign for the industry, indicating that these firms were able to grow AUM on an aggregate basis even in the absence of market movement.

Exhibit 1: Investment Manager Performance by Sector
Year Ended 12/31/21



Source: S&P Global Market Intelligence

Exhibit 2: Aggregate Asset Flows for Index of Publicly Traded Asset/Wealth Managers (billions) (1)



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

Fund Flows by Sector

While overall organic growth improved in 2021, there were significant variances by asset class. Fund flow data from Morningstar (see Exhibit 3) shows that total net inflows across active funds for the year ended November 30, 2021 were approximately $287 billion (relative to net outflows of $188 billion in 2020). The aggregate inflows in 2021 were concentrated in fixed income, alternative assets, and international equity funds, while US equity funds shed nearly $200 billion in assets over the period. For perspective, all categories of actively managed funds except taxable bonds and municipal bonds saw net outflows in 2020.

Notably, passively managed funds continued to outpace active funds in terms of net new assets in 2021. This trend will likely continue to pose a challenge for many types of active asset managers in attracting new assets.

Exhibit 3: Estimated Net Flows by Active/Passive: U.S. Category Groups

	Active			Passive		
U.S. Category Group	**Nov 2021** ($Mil)	**TTM** ($Mil)	**Assets** ($Bil)	**Nov 2021** ($Mil)	**TTM** ($Mil)	**Assets** ($Bil)
U.S. Equity	(17,526)	(197,994)	5,940	36,999	304,239	7,134
Sector Equity	(456)	6,931	536	4,473	103,285	884
International Equity	667	34,955	2,377	15,231	200,396	1,720
Allocation	1,810	(5,642)	1,536	88	2,241	13
Taxable Bond	3,884	301,306	3,559	21,914	288,612	2,030
Municipal Bond	5,805	97,352	985	1,026	17,258	73
Alternative	2,748	30,314	140	20	260	2
Commodities	(383)	10,185	42	1,470	(7,540)	130
Nontraditional Equity	980	8,488	33	687	4,999	8
Miscellaneous	396	1,625	3	1,098	11,498	143
All Long Term	(2,075)	287,521	15,151	83,006	925,248	12,137

Source: Morningstar Direct Asset Flows. Data as of Nov. 30, 2021. TTM is trailing 12 months

Improving Outlook

The outlook for investment 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 string together deals at attractive valuations with cheap financing and on the performance of the underlying businesses.

On balance, the outlook for investment managers has generally improved with market conditions over the last year. AUM has risen with the market over this time, and it's likely that industry-wide revenue and earnings will as well. Modest improvements in organic growth are also a positive sign for active asset managers that bodes well for continued strong performance in 2022.

Segment Focus: Alternative Asset Managers

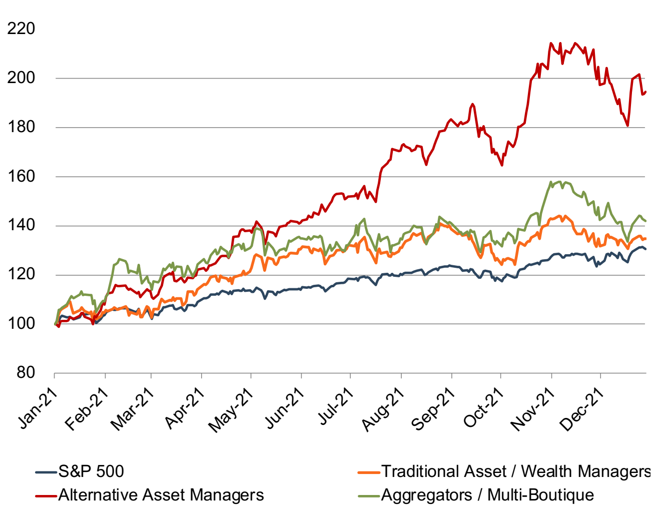
Alt Managers Best the Market Along With Other Types of RIAs During a Strong Year for Investment Management Firms

Publicly Traded Hedge Fund Managers and PE Firms Nearly Doubled in Value During 2021

Alternative asset managers fared particularly well during favorable market conditions for the RIA sector. Access to cheap financing and heightened market volatility spurred significant gains for private equity firms and hedge fund managers during 2021. Other types of investment management firms also benefited from another solid year in the equity markets as traditional asset managers and RIA aggregators outperformed the S&P 500 with 30% to 40% gains on average.

Drilling down into the most recent quarter, we see more mixed results with positive gains for all sectors, but traditional asset managers and aggregators lagged the market as investors weighed the impact of the omicron variant and rising inflation on the sector's prospects. Alt managers continued to benefit from higher allocations to risky assets despite some weakness across all sectors during the back half of the quarter.

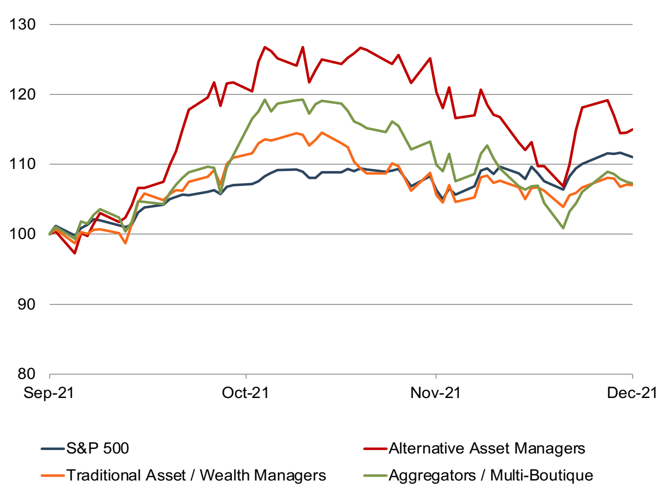
Investment Manager Performance by Sector for 2021



Source: S&P Global Market Intelligence

RIA aggregators exhibited outsized volatility during the quarter but ended on a positive note with the stock market in the last week of the year. Because the aggregator model is levered to the performance of the RIA industry generally, recent volatility for RIA stocks has triggered mixed investor sentiment towards the RIA 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.

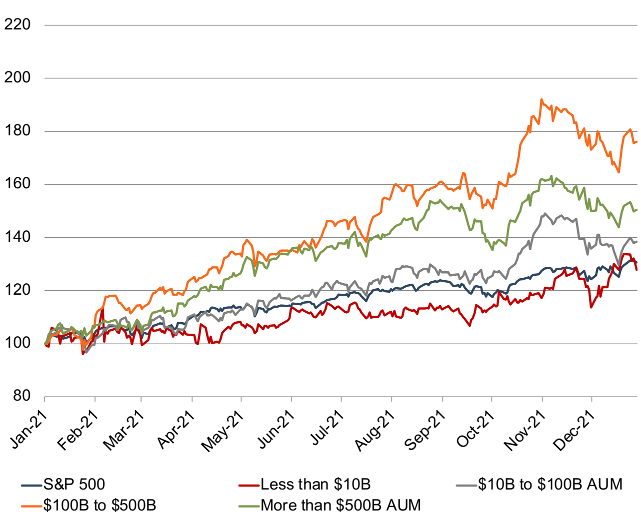
Investment Management Performance by Sector Q4 2021



Source: S&P Global Market Intelligence

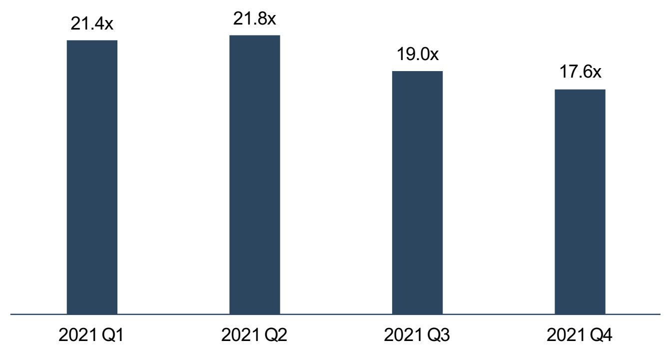
Performance for many of these public companies continues to be impacted by headwinds including fee pressure, asset outflows, and the rising popularity of passive investment products. These trends have especially impacted smaller publicly traded RIAs, while larger asset managers have generally fared better. 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 over the last year has generally been 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. After steadily increasing over the second half of 2020 and first half of 2021, LTM earnings multiples for publicly traded asset and wealth managers declined moderately during the most recent quarter, reflecting the market's anticipation of lower or flat revenue and earnings as the market pulled back modestly in September and November.

Investment Manager Performance by AUM Size LTM Ended 12/31/21



Source: S&P Global Market Intelligence

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.

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, and the fee structures, asset flows, and deal activity for these companies have reflected this.

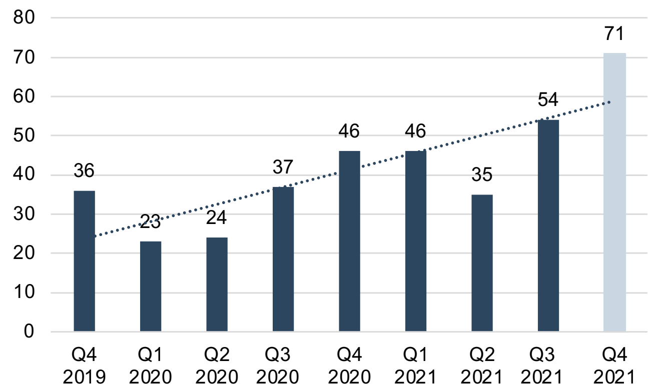
Notably, the market for privately held RIAs remained strong in 2021 as investors flocked to the recurring revenue, sticky client base, low capex needs, and high margins that these businesses offer. Deal activity for these businesses continued to be significant in 2021, and multiples for privately held RIAs tested new highs due to buyer competition and the shortage of firms on the market. As these dynamics continue into 2022, the outlook for continued multiple expansion and robust deal activity remains favorable.

RIA M&A

Aggregators Continue to Drive Deal Volume in 2021

Deal count is projected to reach new highs in the fourth quarter of 2021 as market activity continues to gain momentum, likely rounding out another record-breaking year for the RIA industry. In keeping with the rest of 2021, deal volume was driven by secular trends and supportive capital markets. As market activity remains robust, competition for deals continues to favor RIA aggregators such as Mercer Advisors, Mariner Wealth Advisors, Wealth Enhancement Group, and Focus Financial Partners (FOCS), to name a few.

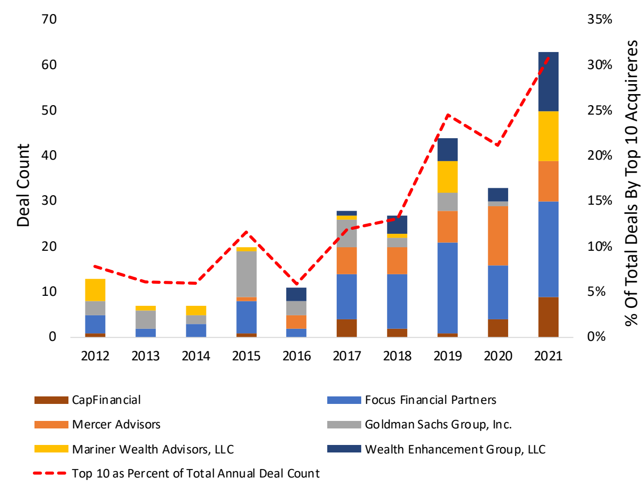
Deal Count



Source: Fidelity, 4th quarter estimated by Mercer Capital

Over the past decade, deal count has grown approximately 5% annually and has accelerated in recent years. Deal volume, while more variable, has also risen significantly. Despite a growing appetite for investment managers, transaction market share has become increasingly concentrated among a hand full of RIA aggregators. As these firms have amassed more scale, it has become harder for smaller RIA firms to compete, resulting in a crowding out of traditional RIA-to-RIA acquisitions. As a result, 2021 RIA-to-RIA transactions as a percentage of total deal volume is expected to be at a ten-year low while deal count by the top ten acquirers in 2021 grew to 31% of total transactions, up from 21% in 2020 and 8% in 2012. Focus Financial Partners was once again the market leader in annual deal count, ending the year with over 20 acquisitions.

Deal Count By Major Acquirer (2012-2021)



The RIA aggregator model largely developed in the wake of the RIA boom after the Great Recession and has since culminated into nearly a dozen firms, each with their own vision of how to marry the independence and client experience of an RIA with a national brand. Over the past couple of years, aggregators have gained private equity sponsorship which has fueled their dealmaking capabilities. As we discussed in last quarter's **RIA M&A Transaction Update**, this trend has only gained momentum in 2021, with private equity capital infusions at all-time highs.

Aside from branding, industry consensus suggests some legitimate tailwinds encouraging consolidation in the RIA industry, which likewise support the aggregator model. One such trend is a lack of succession planning by RIA founders, which we have written about extensively in **prior blogs**. With immense experience and resources, aggregators offer a streamlined deal process and post deal integration, making many aggregators a convenient solution for principles looking to exit.

While all aggregators offer liquidity solutions, each aggregator offers a slightly different value proposition to potential sellers. Consolidators such as Mercer Advisors, Wealth Enhancement Group, Mariner Wealth Advisors, and Goldman Sachs would largely be considered strategic buyers. Strategic buyers acquire firms in order to unlock value through synergy. Systemic issues such as fee compression in the asset management space or the growing cost of operational platforms and overhead in the wealth management space are relieved by scale. Integrating with any one of the aforementioned firms should theoretically unlock value for buyers through higher profit margins and growth, but a strategic buyer may be a poor fit for a seller looking for a clean exit. Firms such as Focus Financial Partners lean towards the financial acquirer category in which acquisitions are primarily financially motivated investments. However, even aggregators like Focus provide many in house back-office solutions and additional service offerings to their partners.

Leading RIA Aggregators

Below are a handful of RIA aggregators that have led M&A activity in 2021.

Mercer Advisors was founded in 1985 as a planning-focused RIA and in the last ten years has become an industry leader in the trend towards consolidation, acquiring 45 firms in total and nine in 2021 alone. Mercer Advisors looks to integrate partnering firms intimately within the Mercer Advisor ecosystem to provide a homogeneous wealth management platform to clients. The Mercer Advisor deal team is led by David Barton, JD – former CEO and current Vice Chairman. Mr. Barton's transition from CEO to leading M&A development in 2017 highlights the firm's aggressive M&A strategy. The firm's sale to private equity group Oak Hill Capital in 2019 has furthered bolstered the firm's dealmaking activity.

Mariner Wealth Advisors. In April 2021, Mariner sold a minority stake to private equity group, Leonard Green & Partners, which has since propelled the firm into eleven acquisitions. Similar to Mercer Advisors, Mariner seeks to integrate investment teams within a larger ecosystem, potentially allowing partners to exit entirely overtime. In 2020, CEO Marty Bicknell announced a partnership with Dynasty Financial Partners creating Mariner Platform Solutions which looks to onboard advisors seeking independence from wirehouses and larger RIAs as well as partner with existing wealth management firms. Back-office services such as marketing, technology, compliance, and administrative support are handled by Dynasty Partners.

Wealth Enhancement Group. In 2019, Wealth Enhancement Group was acquired by private equity firm TA Associates which has resulted in 13 acquisitions in 2021 alone. Wealth Enhancement Group offers a full suite of wealth management services across a single platform, much like Mariner and Mercer Advisors.

Goldman Sachs's Personal Financial Management (PFM). While Goldman Sachs did not make any direct RIA acquisitions in 2021, speculation remains high regarding the investment bank's intentions to move into the wealth management market at scale. In 2019, Goldman Sachs **purchased** United Capital (Will Goldman Sachs Pay 18x EBITDA for Your RIA? - Mercer Capital), an RIA aggregator with 34 direct acquisitions to date, signaling Goldman's interest to become a leading RIA acquirer. Since the acquisition, Goldman Sachs has not leaned into the aggregator model like many had anticipated, but speculation rebounded in 2021 when Goldman hired former TD Ameritrade executive, Craig Cintron. The move suggests further development of Goldman's burgeoning custodian services. Goldman Sachs' historic brand and scale would make the firm a formidable competitor if it should choose to enter the RIA M&A ecosystem.

Focus Financial Partners (NASDAQ: FOCS). The Focus umbrella includes over 80 partner firms (550+ principals) and over $300 billion in assets under management, making it the largest RIA aggregator by most metrics. Focus proclaims to "preserve the autonomy of every partner firm who joins the Focus team," and as such, would likely be a poor fit for principles looking for a clean exit. For those looking to remain post acquisition, Focus provides a pay out along with operational scale for partners seeking to grow their firm or perhaps make acquisitions of their own. Accordingly, more partners who have joined Focus have made an acquisition than those that have not.

In 2021 alone, Focus Financial Partners made 21 acquisitions, nearly double its deal count in 2020. Looking forward, Focus's prospects are tied to the backdrop of continued deal availability, pricing improvement, or entry into international markets.

Implications for Growing Consolidation in the RIA M&A Market

The arms race for deals, catalyzed and perpetuated by RIA aggregators, favors experienced buyers who have dedicated deal teams and capital backing. For perspective, the typical advisor operates with eight employees and approximately $341 million in AUM compared to Focus's $300 billion in AUM and staff of 4,000. Focus currently staffs a team of about 80 transaction related professionals fielding acquisition targets and are responsible for integrating RIAs within the Financial Partners ecosystem. Nearly all aggregators have extensive capital backing, either through private equity sponsorship, public capital markets, or both.

As aggregators continue to bid up multiples, the sustainability of current M&A trends remains in question. While scale might favor a buyer's ability to make deals, the verdict is still out on the extent to which the RIA industry benefits from economies of scale. Despite consistent increases in M&A activity over the past decade, the number of RIA firms continues to grow, a fact that perhaps generally contradicts the aggregator investment thesis. However, the ever-increasing number of RIAs may continue to add fuel to current deal volume over the near future.

Investment Manager Multiples by Sector

				Pricing as of December 31, 2021			
	Ticker	12/31/2021 Stock Price	% of 52 Week High	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	194.23	90.5%	13.3x	nm	1.83	5.3x
GAMCO Investors, Inc.	GBL	24.98	84.0%	8.0x	nm	1.74	4.8x
Hennessy Advisors, Inc,	HNNA	10.67	90.2%	10.0x	nm	1.60	5.8x
Pzena Investment Management, Inc.	PZN	9.47	78.5%	13.9x	nm	1.45	6.7x
Silvercrest Asset Management Group	SAMG	17.17	99.7%	9.8x	9.3x	0.83	7.5x
Westwood Holdings Group, Inc.	WHG	16.94	70.1%	13.7x	nm	0.93	nm
Group Median			**87.1%**	**11.6x**	**9.3x**	**1.52**	**5.8x**
TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $100B)							
AllianceBerstein Investments, Inc.	AB	48.84	85.2%	13.6x	12.6x	0.62	3.6x
BlackRock, Inc.	BLK	915.56	94.5%	24.6x	21.6x	1.50	16.3x
Federated Investors, Inc.	FHI	37.58	98.4%	13.2x	12.0x	0.59	8.4x
Franklin Resources, Inc.	BEN	33.49	88.3%	8.1x	9.3x	1.41	9.5x
Invesco Ltd.	IVZ	23.02	78.5%	8.5x	7.3x	1.27	8.6x
T. Rowe Price Group, Inc.	TROW	196.64	88.5%	14.8x	14.6x	2.62	11.1x
Virtus Investment Partners, Inc.	VRTS	297.10	88.1%	12.0x	7.0x	0.60	4.6x
Group Median			**88.3%**	**13.2x**	**12.0x**	**1.27**	**8.6x**
ALTERNATIVE ASSET MANAGERS							
Apollo Global Management LLC	APO	72.43	89.9%	nm	14.1x	7.74	6.7x
Ares Management Corp	ARES	81.27	90.8%	50.9x	25.3x	9.59	31.5x
Associated Capital Group Inc	AC	43.00	93.3%	nm	nm	nm	6.0x
Blackstone Group Inc/The	BX	129.39	86.4%	17.3x	25.7x	23.43	10.7x
Carlyle Group LP/The	CG	54.90	90.6%	6.7x	13.4x	6.90	4.8x
Cohen & Steers Inc	CNS	92.51	92.3%	23.5x	22.3x	4.51	21.6x
Hamilton Lane Inc	HLNE	103.62	89.6%	24.4x	27.0x	0.75	32.3x
KKR & Co Inc	KKR	74.50	89.0%	8.2x	17.6x	30.08	nm
Sculptor Capital Management Inc	SCU	21.35	74.8%	4.0x	7.3x	5.08	4.3x
Group Median			**89.9%**	**17.3x**	**19.9x**	**7.32**	**8.7x**
AGGREGATORS							
Affiliated Managers Group, Inc.	AMG	164.51	85.9%	14.3x	8.0x	1.26	10.6x
Artisan Partners Asset Management Inc.	APAM	47.64	87.6%	10.0x	9.4x	na	7.0x
Focus Financial Partners Inc	FOCS	59.72	86.4%	23.6x	13.3x	na	24.4x
Victory Capital Holdings Inc	VCTR	36.53	85.2%	8.5x	6.9x	1.91	8.0x
Brightsphere Investment Group Inc	BSIG	25.60	82.2%	6.9x	11.6x	0.99	6.0x
Group Median			**85.9%**	**10.0x**	**9.4x**	**1.26**	**8.0x**
OVERALL MEDIAN			**88.3%**	**13.2x**	**12.6x**	**1.55**	**7.5x**

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

- 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

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