
VALUE FOCUS

# Investment Management

## Third Quarter 2022 | Segment Focus: Asset Managers

### In This Issue


**Segment Focus:** Asset Managers — 1

**Market Update** One Step Forward, Two Steps Back: RIA Stocks Finish the Quarter Down 10% after a Fast Start — 3

**RIA M&A Update** — 5

**Investment Manager Multiples by Sector** — 7

**About Mercer Capital** — 8


In our third quarter segment focus, we discuss the state of the asset management industry and developments shaping the outlook and investor sentiment for RIAs.

Additionally, we cover recent pricing trends for publicly traded asset and wealth managers along with industry M&A trends and the factors driving the continued momentum in deal activity during the third quarter.

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**Mercer Capital's RIA Valuation Insights Blog**

# Segment Focus: Asset Managers

## Asset Management Without a Net

### This Time, There Is No Fed "Put"

When the economic mood soured in 2008, I called an older friend to get his thoughts on the credit crisis and what it would mean. "Jerry" had spent his career running a large heavy truck distributor, and he had visceral experience in more than a few economic cycles. Jerry told me two things on that phone call that have stuck with me.

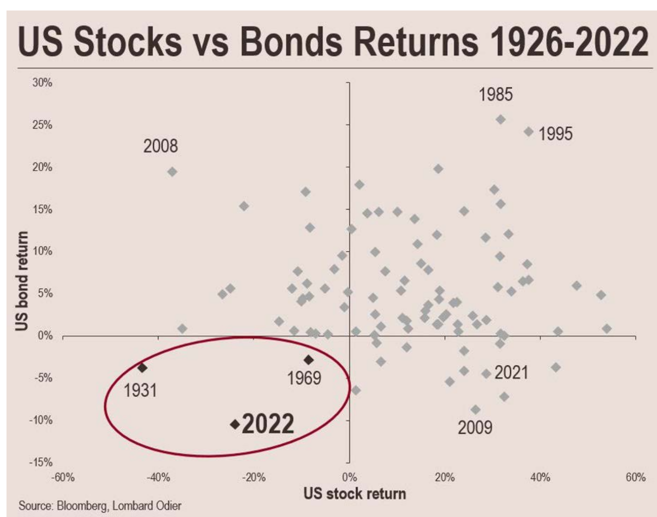
"My manufacturer's rep called last week and asked me 'what would I have to give you to put some of my trucks on your lot.' I answered: A lobotomy." Jerry then explained that most people are blinded by their own optimistic leanings to underestimate how bad things can get in a recession, and how long they can last.

As September of 2022 came to a close, the asset management industry was experiencing one of the most challenging years in history. Losses were both deep and widespread. The consequence is a tough quarterly letter to pen to investors, a hit to revenue, and an even bigger impact on profitability.

**A few notes on where things stand:**

- U.S. equities experienced their third straight quarterly loss, which hasn't happened since 2008.
- The S&P 500 has lost a quarter of its value this year. The Nasdaq is down a third.
- Many indexes hit new lows on September 30.
- Bonds are having their worst year since 1976, with the U.S. Core Bond index falling 16% through September 30.
- Asset correlations are high, leaving no path for escape through diversification. The classic 60/40 portfolio is said to be having its worst year since 1980. Even TIPS (Treasury Inflation Protected Securities) are down YTD.
- 30 year U.S. mortgage rates are hovering around 7% for the first time since before the credit crisis.
- The U.S. dollar has surged against other major currencies, eclipsing parity with the euro and threatening parity with the British pound. The dollar has also blasted through previous resistance levels with the Japanese Yen and the Chinese Yuan.
- Currency fluctuations are straining economies and asset prices globally.

The breadth of the financial market strain is not without precedent, but you have to look far back to find a market as bad or worse for so many investors. Asset correlation was a tremendous issue in the credit crisis, and this bear market is seeing deep drawdowns across most asset classes. This doesn't bode well for industry margins, as AUM declines coupled with fee pressure hit revenues, and inflationary increases in RIA expenses don't offer a cushion for profitability.



| U.S. Category Group | Active 1-Mo ($Mil) | Active TTM ($Mil) | Active Assets ($Bil) | Passive 1-Mo ($Mil) | Passive TTM ($Mil) | Passive Assets ($Bil) |
|---|---|---|---|---|---|---|
| U.S. Equity | (17,327) | (197,846) | 4,792 | 11,087 | 332,070 | 6,369 |
| Sector Equity | (1,743) | (25,507) | 434 | 4,978 | 10,665 | 773 |
| International Equity | (3,860) | (28,235) | 1,886 | (1,396) | 118,785 | 1,496 |
| Allocation | (1,881) | (37,837) | 1,352 | 343 | (493) | 9 |
| Taxable Bond | (10,685) | (211,940) | 3,013 | 23,893 | 175,030 | 1,908 |
| Municipal Bond | (1,579) | (75,173) | 813 | (1,031) | 18,349 | 81 |
| Alternative | 1,568 | 42,382 | 166 | 98 | 211 | 21 |
| Commodities | (41) | 6,915 | 56 | (2,664) | (552) | 125 |
| Nontraditional Equity | 2,254 | 17,925 | 48 | 598 | 7,584 | 11 |
| Miscellaneous | 266 | 1,329 | 3 | 1,939 | 30,104 | 79 |
| All Long Term | (33,029) | (507,987) | 12,562 | 37,845 | 691,752 | 10,871 |

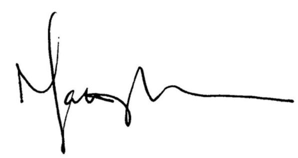
Source: Morningstar Direct Asset Flows. Data as of Aug. 31, 2022. TTM is trailing 12 months

According to Morningstar, U.S. fund flows have been net negative so far in 2022, after a reasonably strong performance in 2021. Risk asset flows like equity and high yield have been hit particularly hard, both domestic and foreign. With a few exceptions active funds continued to lose AUM to passive funds, after better performance in 2021. Fixed income has lately been attracting more AUM than we've seen in recent memory, as the risk-off mood of the market manifested in asset rotation. Also for the first time in recent memory, there appears to be a pivot from growth to value.

One bright spot for asset managers in 2022 is that many **more active managers** are beating passives. So far in 2022, Morningstar reports that nearly two-thirds of large cap value PMs are beating the Russell 1000 value index, and just over half of large blend managers are beating the S&P 500. Unfortunately, this "beat" means being less down than the index, and despite the win passive strategies are having more success in attracting funds.

Perhaps the best metaphor for the moment is a video of Cathie Wood, CEO of Ark Invest, offering an open **letter to the Federal Reserve.** Wood accused the Fed of misappropriating data to rationalize policy errors which she believes will over-correct and cause damaging deflation. Wood has personal experience with asset deflation; her Ark Innovation Fund (ARKK) ended the third quarter with a year-to-date loss of more than 60%.

Unfortunately for Wood and others who worry the Fed is moving too far, too fast, Fed Chair Jerome Powell has repeatedly stated that the Federal Reserve understands the damage potentially caused by their rapid increase in short term interest rates, but that they think it's worth it to contain inflation. In other words, no matter how far asset prices fall, this time there will be no Fed "put."



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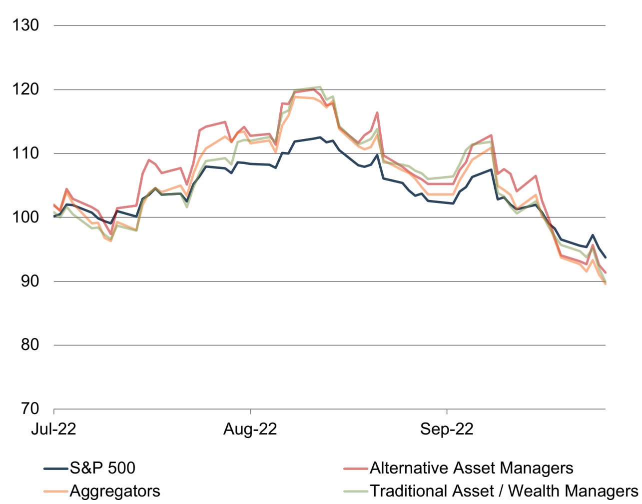
# One Step Forward, Two Steps Back: RIA Stocks Finish the Quarter Down 10% after a Fast Start

## Most RIA Stocks Have Lost Nearly Half Their Value Since Peaking Last November

The RIA industry extended its losing streak last quarter with all classes underperforming the S&P, which also continued its decline.

**Investment Manager Performance by Sector**
**Q3 2022**

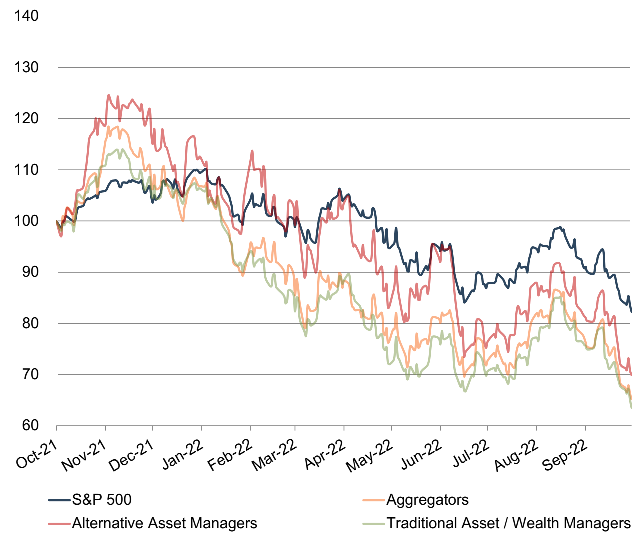



*Source: S&P Global Market Intelligence*

The market itself is part of the problem as this industry is mostly invested in stocks and bonds, which have been down considerably since the first of the year. The additional **under-performance** for asset and wealth managers is likely attributable to lower industry margins as AUM and revenue fall with the market while labor costs continue to rise. **Rising interest rates** have exacerbated this decline for alternative asset managers and RIA aggregators, who frequently employ leverage to make investments.

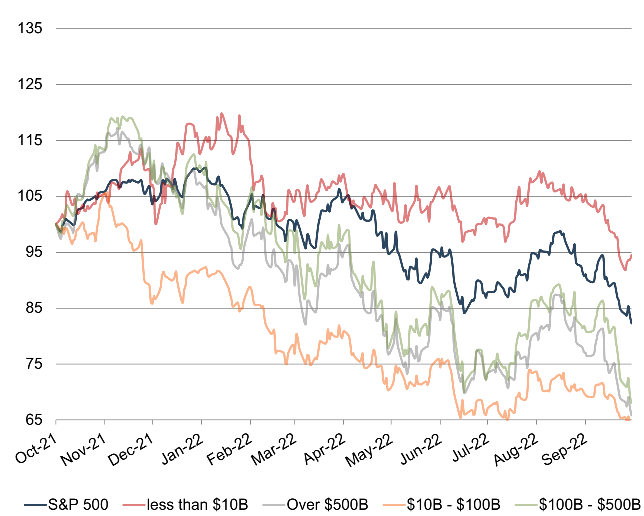
The one bright spot for the industry is the group of smaller (under $10 billion in AUM) publicly traded RIAs, which is the only segment to outperform the market over the last year. This group is still down over this time but holding up relatively well due to the lack of aggregator firms in its composition.

**Investment Manager Performance by Sector**
**Year ended September 30, 2022**




*Source: S&P Global Market Intelligence*

**Investment Manager Performance by AUM Size**
**Year Ended September 30, 2022**

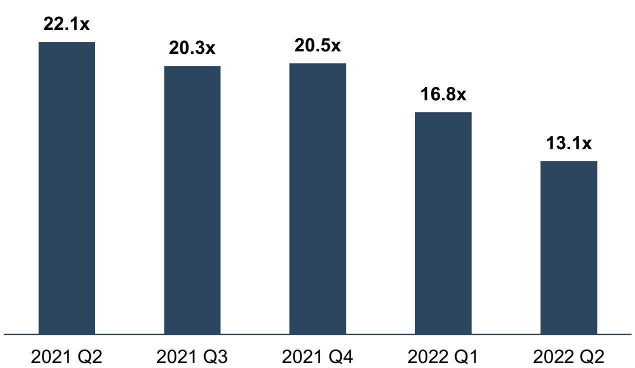



*Source: S&P Global Market Intelligence*

These smaller firms have also tended to trade at more modest multiples with higher dividend yields, so these lower-duration stocks have held up reasonably well in a rising interest rate environment.

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 throughout 2021, LTM earnings multiples for publicly traded asset and wealth managers have dropped nearly 40% this year, reflecting investor anticipation of lower revenue and earnings from the recent market decline and rising cost structure.

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




Source: S&P Market Intelligence

## Implications for Your RIA

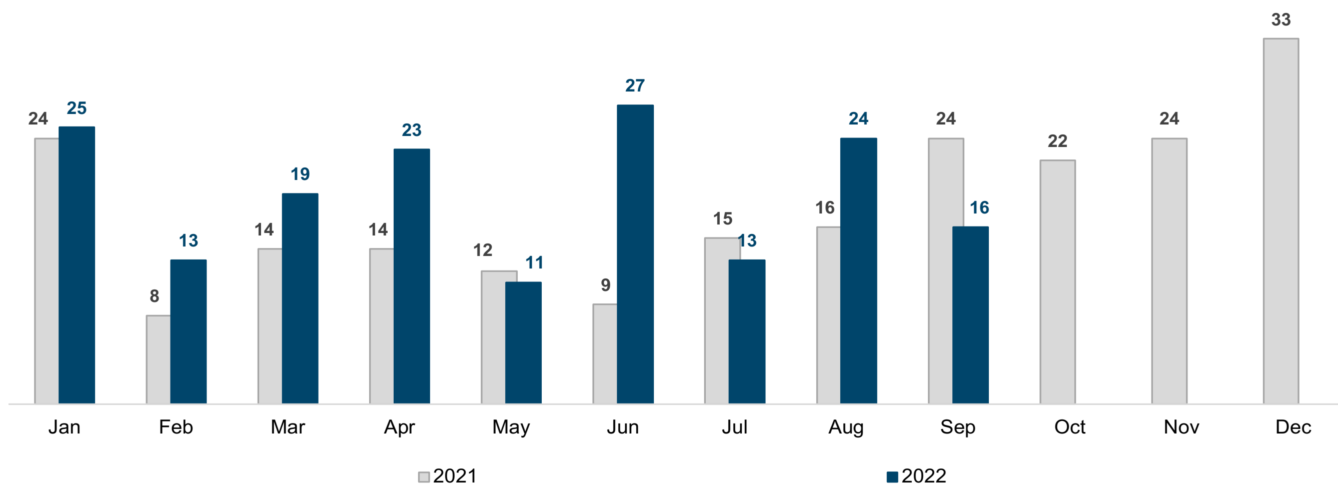
The value of public asset and wealth managers provides some perspective on investor sentiment towards the asset class, but strict comparisons with closely held RIAs should be made with caution. Many smaller publics are focused on active asset management, which has been particularly vulnerable to the headwinds such as fee pressure and asset outflows to passive products. Also, most closely held RIAs are smaller than their public counterparts and often transact at lower multiples because of the heightened risk profile associated with smaller businesses.

Despite industry headwinds, the M&A market for the **RIA industry** has remained strong though valuations have started to level off a bit. M&A is often viewed as a lagging economic indicator since deals take several months or even quarters to complete, so we may not see multiples start to come down for a few more months. As always, we'll keep an eye on it and report back next quarter.

# RIA M&A

## Third Quarter 2022

**Number of RIA M&A Transactions, 2021 vs 2022 YTD**




*Source: Fidelity*

Year-to-date RIA M&A activity has surpassed last year's record levels in 2022, even as macro headwinds for the industry continue to mount. Fidelity's August 2022 Wealth Management M&A Transaction Report listed 155 deals through August of 2022, up from 112 during the same period in 2021. These transactions represented $212 billion in AUM, up 16% from 2021 levels.

The continued strength of RIA M&A activity amidst the current environment dominated by inflation, rising interest rates, and a tight labor market is noteworthy, given that all these factors could strain the supply and demand dynamics that have driven deal activity in recent years. Rising costs and interest rates coupled with a declining fee base will put pressure on highly leveraged consolidator models, and a potential downturn in performance could put some sellers on the sidelines until fundamentals improve.

But despite these pressures, the market has proven robust (at least so far). Demand for RIAs has remained strong, with professionalization of the buyer market continuing to be a theme driving M&A activity. Serial acquirers and aggregators increasingly drive deal volume with dedicated deal teams and access to capital. Mariner, CAPTRUST, Beacon Pointe, Mercer Advisors, Creative Planning, Wealth Enhancement Group, Focus Financial, and CI Financial all completed multiple deals during the first eight months of the year.

While the current market environment has prompted some serial acquirers to temper their pace of acquisition activity (CI Financial's CEO Kurt McAlpine remarked on the company's first-quarter earnings call that their pace of acquisitions has "absolutely slowed down"), we've not yet seen that borne out in reported deal volume. Multiples in the industry remain high, although the upward trend in multiples has reportedly leveled off.

On the supply side, the current market environment is likely to 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 significantly 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.

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 for 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 in a downturn. And despite years of record-setting M&A activity, the number of RIAs continues **to grow**—which suggests the uptick in M&A activity is far from played out.

## 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 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 compared to 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. Naturally, valuation considerations are front of mind in internal transactions, as in most transactions. 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, there are also an increasing number of bank financing and other external capital options that can provide the 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 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, 2022 | | | |
|---|---|---|---|---|---|---|---|
| | Ticker | 9/30/2022 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 | 165.00 | 70.3% | 8.0x | nm | 1.85% | 5.5x |
| GAMCO Investors, Inc. | GBL | 17.05 | 57.2% | 6.5x | nm | 1.21% | 2.7x |
| Hennessy Advisors, Inc, | HNNA | 8.67 | 74.2% | 11.5x | nm | 1.49% | 4.1x |
| Pzena Investment Management, Inc. | PZN | 9.48 | 80.7% | nm | nm | 2.01% | 8.2x |
| Silvercrest Asset Management Group | SAMG | 16.35 | 72.1% | 18.7x | 10.6x | 0.83% | 5.0x |
| Westwood Holdings Group, Inc. | WHG | 9.63 | 48.2% | 21.5x | nm | 0.08% | 1.3x |
| **Group Median** | | | **71.2%** | **11.5x** | **10.6x** | **1.35%** | **4.6x** |
| **TRADITIONAL ASSET / WEALTH MANAGERS (AUM OVER $100B)** | | | | | | | |
| BlackRock, Inc. | BLK | 550.28 | 56.5% | 18.0x | 16.5x | 1.02% | 10.7x |
| Federated Investors, Inc. | FHI | 33.12 | 83.2% | 13.0x | 12.2x | 0.47% | 7.1x |
| Franklin Resources, Inc. | BEN | 21.52 | 56.2% | 7.7x | 6.1x | 0.95% | 4.8x |
| Invesco Ltd. | IVZ | 13.70 | 51.1% | 7.3x | 7.1x | 0.90% | 5.8x |
| T. Rowe Price Group, Inc. | TROW | 105.01 | 47.0% | 10.7x | 12.6x | 1.73% | 6.1x |
| Virtus Investment Partners, Inc. | VRTS | 159.52 | 47.1% | 6.9x | 5.7x | 0.84% | 3.4x |
| Virtus Investment Partners, Inc. | VRTS | 171.02 | 51.5% | 5.5x | 5.9x | 0.76 | 2.9x |
| **Group Median** | | | **53.7%** | **9.2x** | **9.7x** | **0.92%** | **5.9x** |
| **ALTERNATIVE ASSET MANAGERS** | | | | | | | |
| Apollo Global Management LLC | APO | 46.50 | 57.4% | nm | 8.8x | 6.05% | nm |
| Ares Management Corp | ARES | 61.95 | 68.8% | 73.1x | 19.3x | 7.64% | 21.0x |
| Associated Capital Group Inc | AC | 36.76 | 77.4% | nm | nm | 35.62% | nm |
| Blackstone Group Inc/The | BX | 83.70 | 55.9% | 34.8x | 16.0x | 8.26% | nm |
| Carlyle Group LP/The | CG | 25.84 | 42.6% | 5.8x | 6.5x | 4.43% | 9.2x |
| Cohen & Steers Inc | CNS | 62.63 | 61.9% | 16.9x | 16.6x | 3.47% | 11.9x |
| Hamilton Lane Inc | HLNE | 59.61 | 51.4% | 64.6x | 18.9x | 2.62% | 13.2x |
| KKR & Co Inc | KKR | 43.00 | 51.3% | nm | 10.9x | 18.21% | nm |
| Sculptor Capital Management Inc | SCU | 8.84 | 30.7% | 5.0x | 4.1x | 3.45% | nm |
| **Group Median** | | | **55.9%** | **25.8x** | **13.5x** | **6.05%** | **12.5x** |
| **AGGREGATORS** | | | | | | | |
| Affiliated Managers Group, Inc. | AMG | 111.85 | 58.4% | 13.5x | 6.1x | 1.14% | 6.2x |
| Artisan Partners Asset Management Inc. | APAM | 26.93 | 51.4% | 7.5x | 8.5x | 1.62% | 4.2x |
| Focus Financial Partners Inc | FOCS | 31.51 | 45.6% | 27.9x | 7.1x | nm | 8.3x |
| Victory Capital Holdings Inc | VCTR | 23.31 | 54.1% | 7.3x | 5.2x | 1.65% | 5.7x |
| Brightsphere Investment Group Inc | BSIG | 14.91 | 47.8% | 10.0x | 8.6x | 1.02% | 4.6x |
| **Group Median** | | | **51.4%** | **10.0x** | **7.1x** | **1.38%** | **5.7x** |
| **OVERALL MEDIAN** | | | **56.1%** | **11.1x** | **8.7x** | **1.65%** | **5.8x** |


*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 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

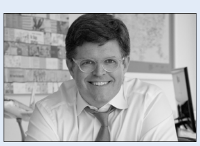
### Sectors Served

- 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

## Mercer Capital's Investment Management Industry Team

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