



# DeVoe RIA M&A Outlook Study™

September 9, 2019

## RIAs Expect M&A Activity to Continue to Increase for the Next 5 Years

### *Valuations and affordability for G2 driving external sales*

RIA principals believe that the current record level of M&A activity is just the beginning. Most advisors expect M&A volume to continue increasing for more than five years, according to new findings in the 2019 DeVoe RIA M&A Outlook Study. And the high valuations are bringing them to the negotiating table. Nearly 40% report that valuations are affecting their decision to consider a sale. The survey also paints a bleak picture of the potential for internal transition.

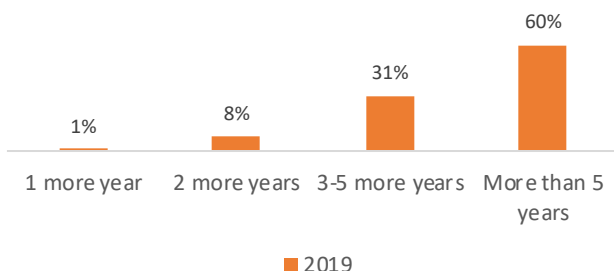
“It’s not surprising that valuations have a strong influence on M&A discussions. The bigger story relates to the challenges for advisors who are still focused on internal succession,” said David DeVoe, Managing Director at DeVoe & Company. “There’s a new revelation that succession planning needs to start much earlier to account for timeframes when next-gen advisors can work up to an ownership stake. If advisors wait too long, an external sale often becomes the only answer, like it or not.”

### RIAs Expect M&A Activity to Climb for Several Years

More than half of 168 advisors surveyed (60%) expect M&A to continue for 5+ years. Many industry observers and M&A experts have projected that mergers are likely to occur at a high clip for the next 5 to 7 years; advisors themselves agree with the premise. The \$1B to \$3B segment has an even more upbeat perspective: Nearly three-quarters of these principals (74%) expect the momentum to continue for the next five years.

#### RIAs expect M&A activity to climb for years

Do you expect RIA M&A activity to continue increasing for:

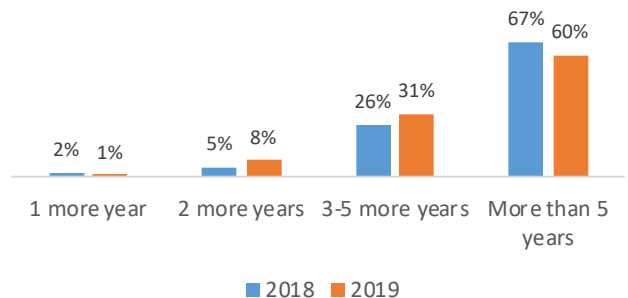


“M&A is now frequently considered a strategic initiative for advisors seeking to achieve scale, succession or growth,” said DeVoe. “Industry dynamics, including a need for scale with technology and scope of services, will likely continue to drive increasing activity.”

But while the conviction is high among advisors for an increase over a 5-year period, response to this question dropped 7 points from the prior year’s survey. The number of respondents selecting ‘more than 5 years’ declined from 67% in 2018 to 60% in 2019. The decline in ‘5+ years’ was primarily reallocated to the ‘3-5 more years’ category, as respondents overall shifted toward the midpoint.

#### Some shift in timing to 3-5 years

Do you expect RIA M&A activity to continue increasing for:

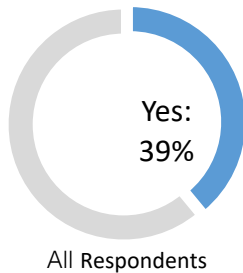


“Advisors across all segments see mergers as one of their strategic options, especially as they seek to reduce costs and enhance the client experience in the face of competitive pressures,” said Tim Kochis, Special Advisor, DeVoe & Company.

### High Valuations Put Pressure on Internal Succession

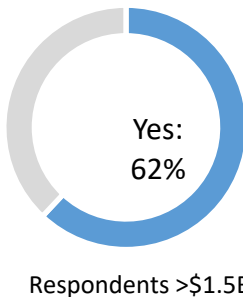
Key survey findings, including valuation levels leading to more openness to considering an external sale and the affordability concerns for next-gen, reveal growing challenges for RIAs who are planning to use internal succession as their preferred eventual exit strategy. First and foremost, respondents told us that high valuations are having a sizable impact on the consideration to sell. Thirty-nine percent indicated that high valuations affect their consideration of a sale in some way.

Are high valuations affecting your consideration of a sale in any way?



For respondents of firms over \$1.5B in AUM, the number jumps to a significant level of 62%.

Are high valuations affecting your consideration of a sale in any way?



As a point of context, in the Q2 DeVoe M&A Deal Book™, we went on record stating valuations are at an all-time high. “Record valuation levels are not lost on RIAs as they contemplate potential sale timing and the possibility of expediting plans”, said DeVoe. “We know that advisors don’t put economics as the top decision driver, it’s a factor.”

“[M&A] will increase for a few more years while older firms take advantage of the increased valuations,” said one respondent. Many advisors believe demographics and firmographics, such as age and firm size, are bigger drivers for consolidation than the economy or valuations. For some, valuation may be a small to minimal driver. “We are in early innings for the original RIA founder group to move on,” highlighted one respondent. And firm size also affects staying power. “With the number of smaller firms [in the industry], M&A will go on for many years,” said another.

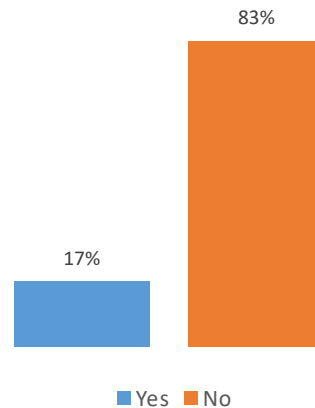
### Stock Market Less of a Factor

Surprisingly, the expectation of a stock market decline is not influencing consideration of a sale : Only 17% say it is affecting their decision.

Advisors highlight that they won’t be able to control the market when they need to sell; however, they acknowledge that a bear market, which would cause valuations to cool off, might create a slowdown.

### Stock market less of a decision criteria

Is the expectation of a stock market decline influencing your consideration of a sale?



“Declines will happen, so the market will only be a factor if a deal is imminent in the short-term, accelerating a transaction if the market was at a high,” noted one respondent. The reverse is also true if advisors anticipate a prolonged market downturn. “DeVoe & Co doesn’t encourage advisors to time the stock market; however, advisors who reflect on 2008 understand the market’s effect on valuations,” said DeVoe. “At that time, valuations moved from an all-time high to an all-time low within a matter of months, resulting in a natural slowing of activity. As history shows us, steep market declines or sustained volatility can dampen M&A activity *and* have a profound implications on business fundamentals.”

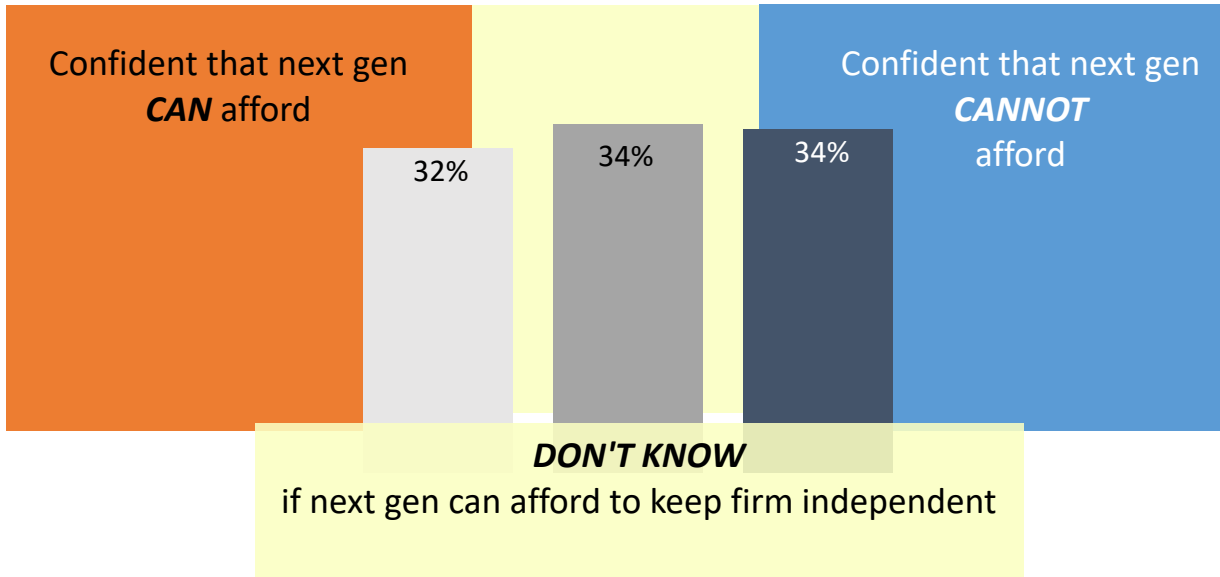
### Low Confidence in Next-Gen Ability to Buy Out Founders

Only 32% of RIAs are confident that next-gen advisors at their firm can afford to buy out the founders. “For an industry that generally wants to sell internally, this is a shocking number,” said DeVoe.

At the other extreme, 34% of respondents are confident that the next generation of potential owners (G2) cannot afford the firm. These respondents indicated conviction that the RIA has become too expensive and / or the timeframe is now too short for Gen2 to raise or finance sufficient capital to buy out G1.

“These findings provide a wake-up call for those who seek to maintain independence. Start planning today. Start selling shares tomorrow. Especially if you aren’t sure, if you want to execute an internal sale, you need to start much sooner than you think,” said Kochis.

### Is the next gen of your RIA able to buy-out the founders?



The remaining third of advisors simply do not know if the next generation can afford them. This explains DeVoe & Company’s recent spike in ‘cap table engineering’ engagements, where this complex equation is solved. “Whether on the back of an envelope or with a 10,000-cell DeVoe Excel model, advisors who seek to maintain independence should determine the feasibility soon, so they can understand their option set and move forward,” explained DeVoe. “If there is a potential path for internal succession, the sooner the process starts, the more likely it can happen.”

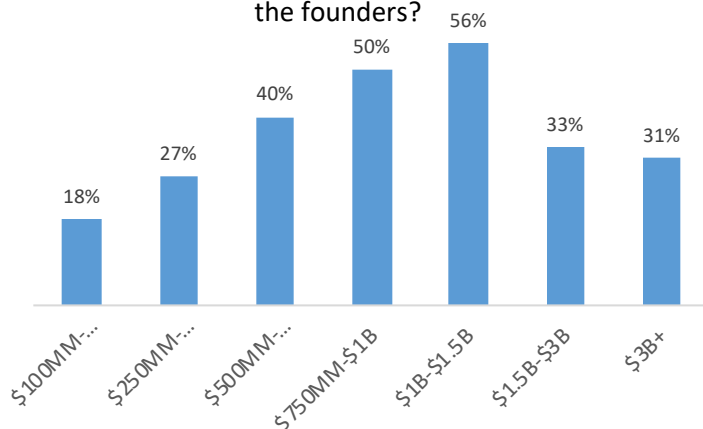
Advisors often underestimate the potential risks and barriers on the path to succession. “We typically see that one in four advisors who are invited to buy shares, select not to do so. In other cases, simple fatigue of some version of annually scheduled buy-ins will surprise founders who had modeled a ‘perfect scenario’ of x% of their ownership being sold each year,” said DeVoe. “Either one of these situations can upset the apple cart, and suddenly founders will be grudgingly putting a ‘for sale’ sign on the front door.”

As advisory firms grow, this dynamic escalates. The inability to afford to buy out the founders increases with firm size: 56% of firms managing \$1 to \$1.5 billion say this is the case, compared to just 27% for firms with \$250 to \$500 million.

“With a growing firm, a buyout by the next gen is now nearly impossible,” said a survey respondent representing an RIA managing between \$750 million to \$1 billion in assets. Firms might have a very different result if the equity transition begins earlier as the profit distributions could fund the wherewithal to buy more. “But ironically, growing size itself may solve the problem,” said Kochis. Firms bigger than \$1.5 billion report much lower concerns. “We suspect that those are firms that began the process some time ago.”

### RIAs confident that next gen CANNOT afford the firm

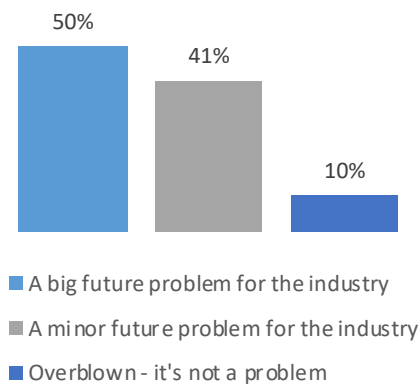
#### Is the next gen of your RIA able to buy out the founders?



## Lack of Succession Planning Recognized as a Big Problem

Across the industry, there is broad-based recognition that few firms have formalized an equity succession plan. According to the survey, a full 50% of RIAs sees the lack of succession planning as a big future problem for the industry. “Next gen’s frequently reported inability to afford a buy-out coupled with low participation in formal succession planning across the industry creates a perfect storm for advisors,” said Stacy Orff, Managing Director, DeVoe & Company.

Houston, we have a (big) problem  
Is the lack of succession planning:



## External Buyers Have an Upper Hand

“Aging advisors get to a place where they are left with few options,” said Orff. “RIAs who had planned to transition the business to next-gen employees often find that they can’t afford it and need to look for a buyer who will bring the right culture and care for their employees and clients.”

As one survey respondent shared, “It’s a problem for those not prepared; an opportunity for those prepared.” Some respondents noted that in this environment, consolidators and private equity firms, with new entrants all the time, are in a position to acquire at negotiated valuations.

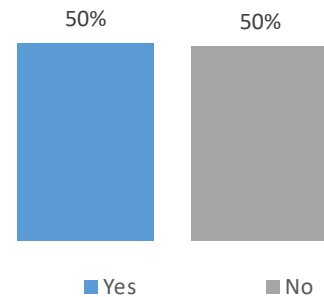
“Firms without successful succession planning are likely to result in being acquired, especially as many more firms join the buyer playing field in the industry,” said a respondent.

## 50% of Advisors Open to Selling to External Party

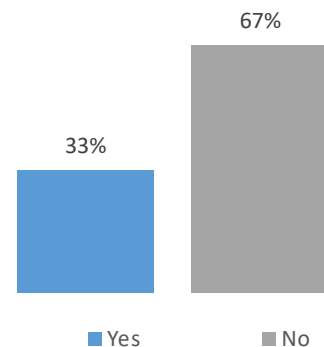
Willingness to sell to an external party has increased significantly from two years ago, with 50% of respondents saying they are open to it today vs. only 33% indicating in this year’s survey that they were open to this option just two years ago.

“Rising costs, particularly technology, make me not want to go at it alone,” said one respondent. Still, advisors note the sensitivities of this decision with one respondent saying, “We are open to a discussion, but would only take action if there is a cultural fit.”

Are you open to a discussion to sell an external stake in your company today?



Were you open to a discussion to sell an external stake in your company two years ago?



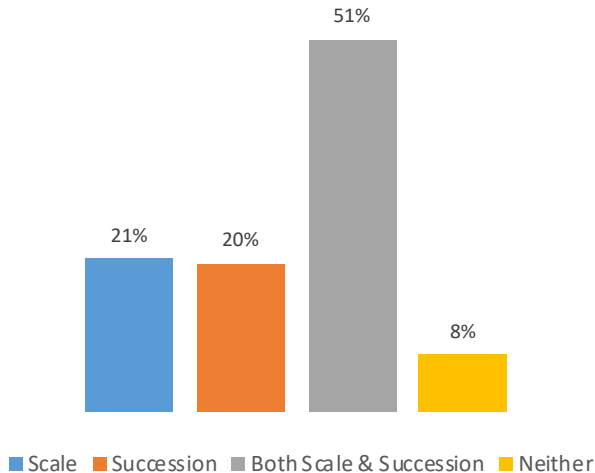
And the survey results back up that sentiment—meaning that openness to sell does not translate to actual transactions. Openness to sell to an external party is at 50%; and expectation to sell within two years is at 25%, slightly down from 28% in 2018.

## Scale and Succession Driving the Decision to Sell

Only 20% of advisors indicate they are seeking to sell *just* for succession. The old model of *selling to exit* is fading. And 71% of advisors are contemplating succession as part of the decision to sell. At the same time, nearly 75% are seeking scale as part of the transaction. The combination of scale and expanding the succession opportunity set is growing in importance – 51% of advisors selected this combination choice as the driver, marking 6 percentage point increase from the 2018 survey results of 45%.

### Scale now a big driver for succession

If you sold a stake of your firm to an external party, would it be for scale or succession? Or both?

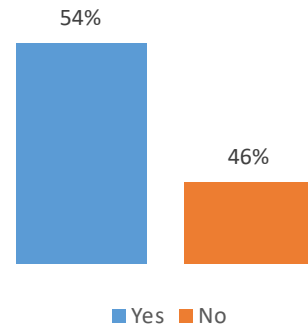


## More than Half of RIAs Expect to Acquire Within Two Years

With 50% of firms being open to a sale, they will need acquirers. The good news is they should be able to find one, as 54% of firms said they expect to acquire another firm within two years, down from 57% in 2018. Not surprisingly, expectations to acquire are even higher (75%) among larger firms with deeper pockets (those above \$1.5B AUM).

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## Do you expect to acquire a firm in the next 24 months?



The big get bigger as large advisors see M&A as key to their continued growth. “Our firm’s ability to enhance investment planning, tax and business consulting with 50% margins allows us to select RIAs in cities we want to grow into,” said one RIA responding that he expects his firm to acquire another firm in the next two years.

## Conclusion

The 2019 RIA M&A Study highlights the expectation among RIAs that M&A activity will continue to increase for years to come. Advisors increasingly see M&A as a strategic lever when seeking scale, succession or growth. The industry dynamics, including advisor age, rising costs, and the ability for consolidators and private equity firms to continue their interest in acquisition, all point to the increasing M&A activity. With openness to sell and expectations to buy at similar levels, firms should have opportunities to find willing partners for transactions.

“Many in the RIA community are showing an increasing sophistication in mergers and acquisitions and a greater comfort in using M&A as a path to achieve their goals,” said DeVoe. “However, a surprising number don’t have clarity on key questions like ‘can your next gen afford your firm?’ Overall, advisors have work ahead of them to determine how their succession will come together. As fiduciaries, advisors owe this information to clients and should have a plan sooner than later.”

## Methodology

The DeVoe RIA M&A Outlook Study is an annual survey of RIAs to gauge current and shifting perspectives about M&A within the industry. DeVoe & Company surveyed 168 RIAs in April and May, and at its RIA M&A Summit in June. Respondents were senior executives, principals, or owners of firms ranging in size from \$100 million to over \$5 billion in assets under management.