DeVoe & Company

RIA M&A Maintains Strength in Q1, But Trends Downward

The COVID-19 Crisis Likely to Dampen Activity in the Mid-Term

The RIA industry posted a strong first quarter of RIA M&A activity, though the monthly trendline decreased through the period. At 34 transactions, this was the third successive quarter with the same activity, maintaining the record (34) set in Q3 2019. The on-pace total was spurred by breakneck pace in January. The 18 transactions in the month were the most the industry has ever seen. But that was followed by a steep drop-off to nine transactions in February and seven In March.

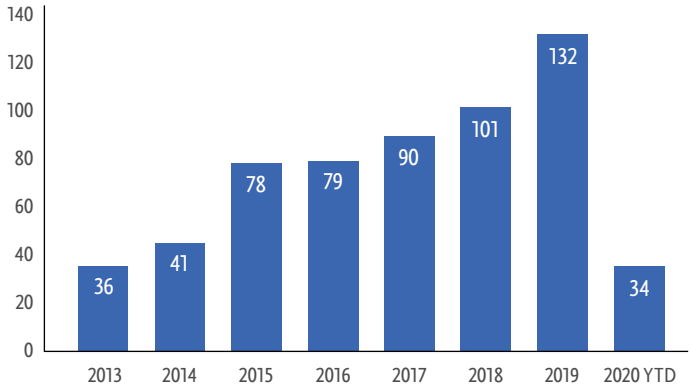
Although the emergence of COVID-19 in the period was not the culprit for the slowdown, it will have profound implications on future activity. The pandemic has now affected the health of hundreds of thousands of Americans and the day-to-day lives and emotional well-being of the entire country. In addition to the impact on the stock market, the crisis has affected the activities of every advisor, as they work diligently to support their clients though this downturn.

"In times like this, advisors add the very most value to their clients – working day and night to support them," said David DeVoe, Founder and Managing Director at DeVoe & Company. "When advisors are evenually able to shift their focus back to their business, they will be looking at their business through a different lens."

RIA businesses of all shapes and sizes will be directly and indirectly affected by this evolving situation. M&A activity will be part of that broader dynamic.

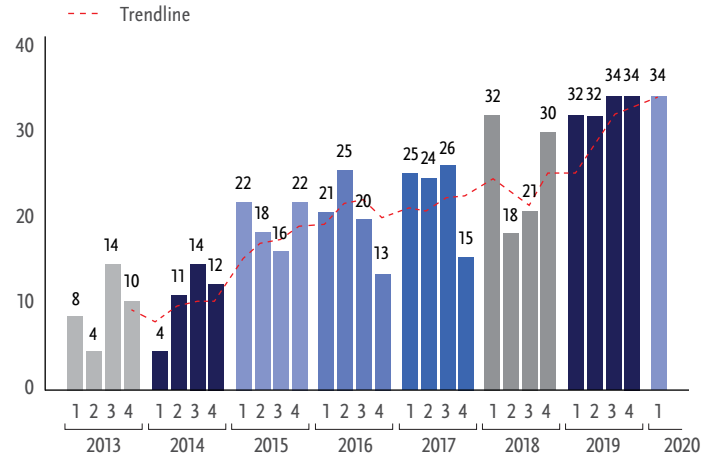
M&A Activity Starts Strong in 2020

Annual M&A activity



First Quarter Total on Par with Recent Trends

Number of transactions executed per quarter

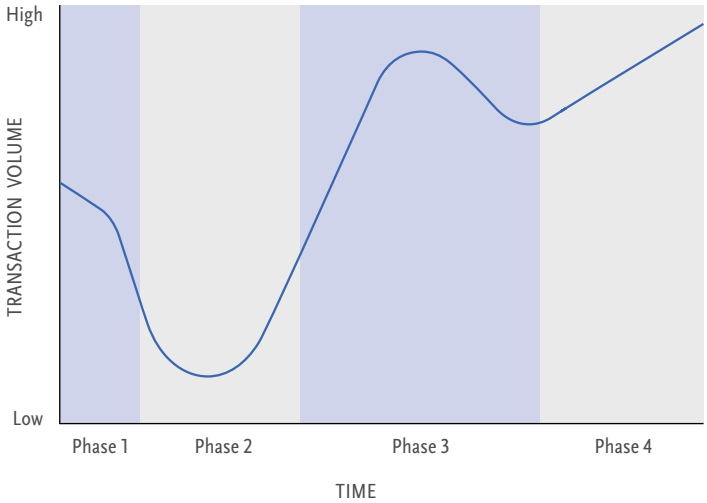


Four Phases for RIA M&A Following the COVID-19 Crash

The current environment leaves many RIAs questioning what's next for M&A—including their own plans for a sale, acquisition or succession. DeVoe & Company's team of eight senior consultants—six who have run $1B+ RIAs through past downturns—have been actively assessing the situation and offer the following perspective on what RIAs can anticipate.

"We expect that RIA M&A will progress through four distinct phases as a result of the COVID-19 crisis," said DeVoe. "Given the rapidly evolving characteristics of the situation, we will continue to evaluate the magnitude and timeline associated with each phase." This analysis is rooted both in historical trends (the 2008 decline, in particular), as well as our assessment of the ever-changing dynamics of this particular crisis.

4 Phases for RIA M&A after COVID-19 Crash



Time periods and activity volumes are illustrative only.

Phase 1: Live transactions get completed

The first stage is focused on live transactions. Most will get done. Some will not.

With 30+ transactions executed in any quarter, there are always a number of transactions in the works at any given time. The pandemic and the market decline are a shock to the system, which affects the psychology of both buyers and sellers. We believe that despite this shock, most transactions that are currently in a later stage of the process will be signed and closed. "Buyers and sellers are moving forward and working with each other in the spirit of the new partnership," said DeVoe. "In most cases, these are strategic transactions that create value for both parties, as opposed to opportunistic deals that can be easily disrupted."

"The successful completion of transactions during this crisis will also serve as a strong foundation for the merged firms," said Vic Esclamado, Managing Director at DeVoe & Company. "They will have experienced – together - what will likely be the most profound challenge this industry has ever faced."

Some in the marketplace have raised a concern that a number of the private equity-backed consolidators may blanche at the current situation and retreat from their strategies or holdings. We don't expect this to be the case. DeVoe & Company is confident that both the major acquirers' management teams and their private equity backers fully anticipated a market decline at some point. Updates to consolidators' business plans and private equity investments were made during the latter part of our country's longest bull run. Undoubtedly, the decline came sooner or faster than anticipated and in a form few imagined. But, we can safely assume that a potential market decline was part of their forecasted scenarios.

So, will this steep market decline bring M&A to an immediate standstill? That is not likely to be the case.

However, many transactions currently in *earlier stages* of negotiation will likely stall. COVID-19 is a reality. Transactions and strategies that had not progressed to signing a Letter of Intent are at greater risk of slowing. These retreats will contribute to the trend we will see in Phase Two.

Phase 2: A lull in activity

The second phase will be marked by a noticeable slowdown in M&A activities.

M&A takes time. From the time you get started — planting the seed to sell — it takes about six months of effort to bear the fruit of a signed purchase agreement.

Many of the seeds that were planted in early 2020 have now been washed away by the COVID-19 storm. Shifts in the psychology of advisors (such as fear and discomfort with ambiguity), as well as shifts in their activities (such as devoting all their time to taking care of clients and staff) have withered many early-stage M&A initiatives. So, logic dictates that the near-term crop of transactions is going to be lighter.

Looking more broadly at the RIA space, there are quite literally thousands of advisory firms that need to do something about succession. Surveys clearly show that 70% of RIAs do not have a written succession plan, despite their best intentions to put one in place. The 11-year bull run didn't help. It's easy to procrastinate important but non-urgent initiatives when the growth engine is hitting on all cylinders.

Enter the COVID-19 monkey wrench.

This monkey wrench thrown into the works will expose the implications of this lack of succession planning.

The shock of this new environment will potentially drive advisors into action. "There is a silver lining in this for advisors: The pandemic and its frightening economic impact serve as a wake-up call to the industry about the importance of executed succession and transition plans," said DeVoe. "Hopefully, the *COVID-19 crisis* helps avert the *succession crisis* that is looming over our industry."

In anecdotal conversations, it seems like the alarm is being heard. Many advisors are realizing that a) they should have done something already, and b) they don't have the luxury of 'waiting this decline out'. Back in 2008, many RIA owners who were in striking distance of selling during the height of valuations suddenly found themselves with compressed values and uncertain futures. A vast majority of the population decided they would 'work a few more years' while they waited for the economy and market (and valuations) to return to normal. They didn't realize that valuations would take five years to return to 'long term averages' and a dozen years to return to 2008 levels.

Today, many firms don't have the luxury of *waiting for 'normal' to return*. The average age of RIA owners back then was much younger than it is today. The demographics of today's owners will naturally move a great number of principals toward making these critical decisions in the near term.

"We estimate the average age of RIA owners today to be 62 years old and yet only a minority have a proper succession plan in place," said DeVoe. "As owners delay succession, the available options shrink. Advisors are now regularly realizing that the valuation of their firms exceeds the grasp of what next-gen advisors can afford."

Beyond succession, the interest in achieving the benefits of scale is another key driver that will continue to bring transactions to the table. Some advisors are grappling with the extreme operational demands created by the current situation. They realize being part of an enterprise level firm would have eliminated much of this distraction. We expect this strain to nudge a segment of firms that have been considering selling for scale, to start moving forward with greater conviction.

While a lull on reported transactions might lead some to believe that all M&A activity has slowed, it is only a lagging and surface indicator. During this decrease in signed deals, the actual *activity* – early- and mid-stage M&A activity — will be at heightened and intensive levels. Despite fewer announcements, plans are being executed, meetings are taking place, negotiations are occurring, and LOIs are being drafted. The seeds planted in the second phase are likely to be vast, and they will be setting the stage for a bumper crop of transactions.

This brings us to the third phase.

Phase 3: A surge of activity

In the third phase, a surge of activity is expected to drive RIA M&A back to record highs. Delayed deals will come to market. Advisors who were shocked into action will have their deals signed. Advisors will also join enterprise level firms to both gain access to better capabilities, as well as have some potential shelter in an uncertain world. In 2010, M&A volume spiked 54%, following the lull in 2009. Given the different dynamics of the new world, one might expect a similar or even larger increase.

Although valuations will have likely compressed to some degree, deal structures will be more dynamic. The high down payments, which the industry saw rise through the 2010s, will give way to greater contingencies. This will enable buyers to mitigate risk and conserve cash. But, it will also enable sellers who might otherwise seek to 'wait until the market comes back' to get a deal done. They'll decide to move forward with transactions that are strategically best for them, while having an economic structure that provides them with as much upside as if they 'grew their market through the storm'.

Consolidators, serial acquirers, and private equity firms are expected to sustain their interest in the RIA space. The likely compression on valuations will also attract new entrants, both buyers and private equity. Some will be good for the industry; others may be bad.

Overall, the marketplace will go through a period of heightened activity as the pent-up supply of sellers from Phase 2 converges with the demographic realities of the aging RIA owners. Ideally, history repeats itself and we see yet again that the years following a market crash yield some of the highest growth rates for leading RIAs, as they gather new clients from wirehouses and other non-RIA advisors who didn't provide appropriate care.

Phase 4: Return to normalcy

Eventually, the steep arcs of the lull and surge move back toward a degree of 'normalcy'. The structural underpinnings of the M&A trend remain. Any industry with 10,000 firms whose owner demographics skew toward retirement age should expect a steady march of sellers toward the exit. The power and importance of scale will continue to increase and attract more sellers. DeVoe & Company anticipates that following these first three phases, RIA M&A will eventually return toward the steady upward trajectory that the industry has seen for the last six years. And that this trend will continue for several years to come.

RIAs and *Consolidators* Continue to Dominate as Buyers

As a sharp contrast to the uncertainty and volatility of the current environment, Buyer Categories maintained the relative stability that we have observed now for several years.

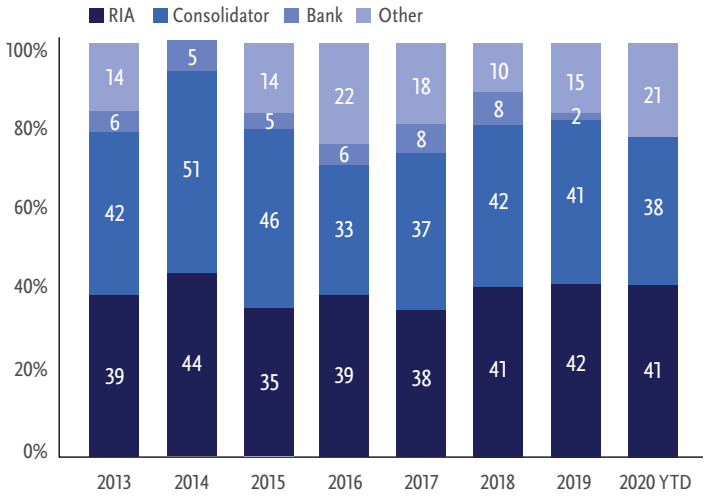
RIAs, as a buyer category, held their leading share of all transactions. With 41% in the first quarter, the market share of RIAs has sat around 40% since 2016. They still sustained a few percentage points lead over *Consolidators* in the first quarter.

Among the *RIA* buyers in the first quarter, large seasoned acquirers made up a bulk of the list. Creative Planning, Savant Capital, Cresset Capital and Frontier Wealth Management all had one transaction (DeVoe & Company represented Frontier in their acquisition of Highwater Wealth Management). Fiduciary Trust Company International ($25B), a wholly owned subsidiary of Franklin Templeton, made two acquisitions in the quarter: Athena Capital ($6B) and The Pennsylvania Trust Company ($4B).

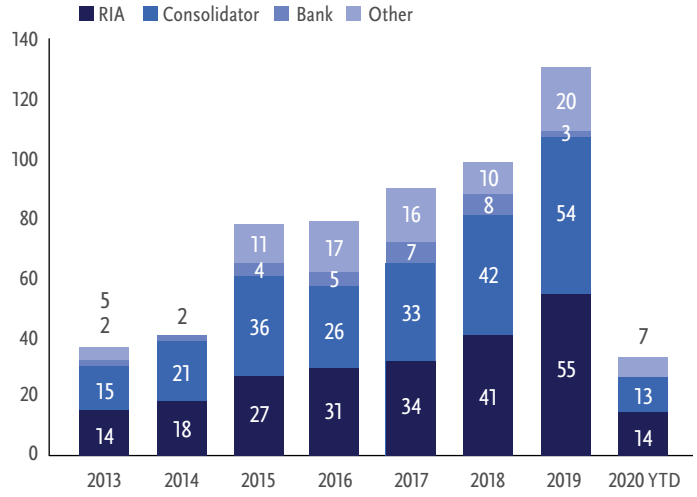
In the period, *Consolidators* represented 38% of the acquisition volume, down just slightly from 41% for 2019 as a whole. Their models continue to resonate with advisors seeking to sell, providing a wide breath of options with varying characteristics.

RIAs Maintain Dominant Share as Buyers

Percentage of acquisitions by buyer category



Number of acquisitions by buyer category



Several firms in this category made two acquisitions in the quarter:

- Mercer Advisors ($18B), which has Oak Hill Capital as a private equity partner, acquired First Ohio Planning ($350MM) and CCP, Inc. ($140MM). Mercer has made a whopping 27 transactions in the last five years.
- EP Wealth, whose aggressive acquisition strategy has vaulted them into the *Consolidator* category, acquired Guidant Wealth Advisors ($261MM) and International Research & Asset Management ($394MM). With these two under their belt, EP Wealth has made 11 acquisitions in five years.
- Cerity Partners acquired two $1B+ RIAs: EMM Wealth ($3B) and Sullivan & Serwitz ($1B)
- CAPTRUST acquired Fountain Financial Associates ($654MM) and Welch Hornsby, Inc. ($1.8B)

The *Other* buyer category -- comprised of private equity firms, asset managers and other non-RIAs – spiked in Q1. At 21% of the volume, the activity of this group increased from 15% for all of 2019.

Private equity firms grabbed some headlines as they took positions in two high profile companies. In early March, Beacon Pointe Advisors ($11.5B) sold a minority stake to Abry Partners (DeVoe & Company introduced the parties and provided valuation analysis in the transaction). The investment provides Beacon Pointe capital for continued acquisitions and other growth initiatives. Simultaneous to the announcement of Abry's minority stake, Beacon Pointe announced its acquisition of Ferrell Wealth Management ($460MM), its fourth acquisition in the past 4 years.

Creative Planning ($42B) also added a private equity partner during the period. The company sold a minority stake to General Atlantic in February. The transaction provides Creative Planning with dry powder for future acquisitions in in good markets and bad. CEO Peter Mallouk publicly stated "if I want to do this for a long time, I want to have a big pile of money on the side so we can continue growing even in down markets."

Additional notable transactions in the Other group included Franklin Templeton's acquisition of Legg Mason and accounting firm BDO acquiring RIA Biegel Waller Investment Advisory Services ($512MM).

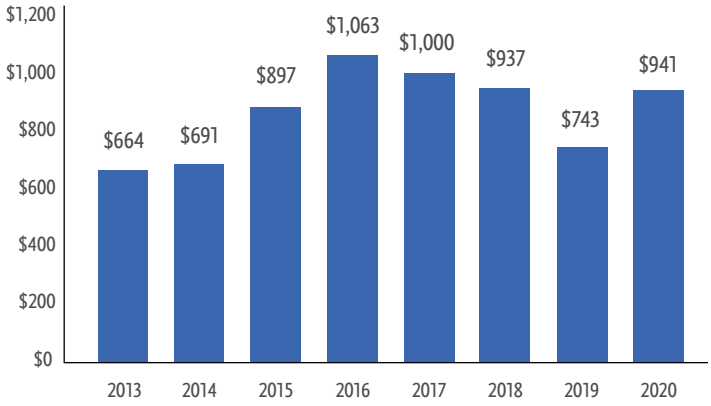
Banks did not make the scoreboard in the first quarter, continuing a decline in activity since 2018.

Average AUM of Sellers Nears $1B

The average size of RIA sellers for a quarter reversed course to nearly $1 billion in AUM ($941MM). After four years of a downward sloping trend, the first quarter's average seller size jumped 27% from the 2019 average of $743MM. The new average seller size is on par with 2018 ($937MM) and just below the $1B record averages reached and maintained in 2016 and 2017.

Seller Size Increases After Four Year Decline

Average AUM of sellers (with over $100MM and less than $5B)



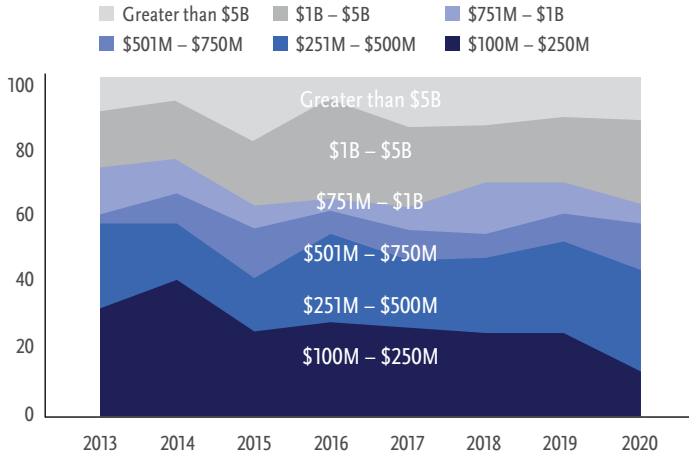
Although it is only a quarter of data, the significant shifts at the two ends of the barbell conspired to drive this significant increase in average AUM of sellers.

Larger transactions supported the trend. Sellers with $1B to $5B under management made up 24% of acquisitions in Q1, up from 19% of transactions in 2019.

At the other end of the spectrum, smaller transactions in the $100MM to $250MM range dropped significantly in share for the first time in years -- at 15% for Q1 vs. 26-30% of transaction volume since 2015. Transactions in the $250MM to $500MM range, hit a peak of 29%, just slightly higher than the 2019 share of 27% and a steady climb from the 23% average of the share since 2016.

Larger Firms Dominated the Seller List

Percentage of transactions by seller AUM



Conclusion

We've now experienced year after year of record RIA M&A. And the good news is that we have had a strong run of *healthy M&A*. However, M&A in our industry has not always been executed with the best intent or outcomes.

In the early 2000's it was common for advisors to sell for succession. Or perhaps more accurately: Sell for *immediate* succession. Back then, an advisor might decide it was time to retire, and then sell their company to the highest bidder and exit the company as quickly as they could – often six months or less. This is not *healthy M&A*.

Over the last dozen years, RIA M&A has been much healthier. Advisors implementing transitions shifted their paradigms to be more methodical and their timelines longer, realizing it was better for all parties - including themselves. And as a bonus, the economics were even better.

More recently, the interest in gaining the power of scale through selling to a bigger firm has eclipsed succession as the primary reason advisors are selling. This is another example of *healthy M&A*. For over two years now, advisors have improved their businesses and lives by carefully selecting larger firms that can help them better achieve their business – and personal – goals.

The industry is now at a pivotal point. The lack of succession planning in the industry, combined with the aging demographics of RIA owners, raises the threat of an *unhealthy M&A* environment in the future. If we continue on the current path without a marked increase in transition planning, we can expect an eventual deluge of sellers entering the market with such volume that it exceeds the capacity of qualified buyers. Many sellers would find themselves without buyers, others would sell to sub-optimal or suspect buyers, and valuations would plummet.

Clearly, this scenario is not the recipe for *healthy M&A*.

Hopefully, 2020 becomes the 'Year of Succession Planning' for the RIA industry. Perhaps COVID-19 is the wake-up call the industry needed. It's a common human reaction to reevaluate and reprioritize the most important things in life after a traumatic experience. This valuable evolutionary behavior helps us step back and reflect on our priorities.

We all know the critical importance of succession planning. Proper transition planning benefits clients, staff and owners. It is time to take action. And put these plans in place. As Leonardo da Vinci wisely said, "Knowing is not enough; we must apply. Being willing is not enough; we must do."

We are here to help

DeVoe & Company is now offering a variety of ways to help advisors through this crisis. If you simply want to talk to our team on an hourly basis to have a second opinion on decisions you are making, or you need a more comprehensive engagement tailored to how to manage your business through this uncharted time, we are here for you.

To schedule a time to talk, contact Lynn Kennerly at 415-813-5066 x5 or **lynn.kennerly@devoe-co.com**

Our Methodology and the Focus of the RIA Deal Book™

The DeVoe RIA M&A Deal Book seeks to track and analyze the trends of RIA mergers and acquisitions. Leveraging our founder's experience tracking RIA M&A for over 16 years — longer than anyone in the industry — DeVoe & Company reports on activities and analyzes the trends to bring you deeper insight.

The RIA Deal Book's purview is to focus primarily on the acquisitions and mergers of true RIAs, and only on transactions of $100 million or more in AUM. Our reporting draws the line at $100MM to optimize the statistical accuracy of our reporting. We seek to screen out the SEC-registered hedge funds, IBDs, mutual fund companies and other companies that aren't operating as traditional RIA firms. We also exclude the "advisors joining RIAs" category. We will touch on this category, when appropriate, but these transactions are not our focus.

There's a lot to cover with transaction events in the pool of 5,000+ RIAs managing $100MM+ or more. We hope you find valuable nuggets that drive your strategy.

About DeVoe & Company:

DeVoe & Company is a goal-based consulting firm and investment bank focused exclusively on guiding wealth management and investment management companies to a higher level of success. We provide consulting, M&A, and valuation services to help you accelerate the achievement of your business goals. Leveraging our team's 200 years of combined experience in RIA business consulting and management, we develop solutions tailored to your unique goals, needs and situation.

The wealth and investment management industries are highly dynamic and evolving at a fast pace. DeVoe & Company can help you better understand your options, determine your optimal path, and craft an implementable plan for you to capitalize on the opportunities.

What We Do

Our mission is to help you achieve success on an accelerated basis. Our services fall into three broad categories:

- Business Consulting
- Investment Banking
- Valuations

Who We Are

Founded and led by RIA thought-leader David DeVoe, our team has grown to ten professionals with 200 years of combined experience. Our consulting approach is a reflection of the team's background: An ideal balance of analytically rigorous theory and real world experience. Half our team is McKinsey-trained management consultants and the other half is former COO's of $1B+ RIAs. As a result, we are positioned like no other consulting firm to provide you advice on any strategic challenge you may face. Our breadth of experience enables us to be your complete partner.

How We Do It

DeVoe & Company executed more than 500 engagements in the last several years, supporting firms managing $50MM to over $8B in AUM

DeVoe & Company creates transformational change for our clients through a unique, highly focused approach. Most engagements begin with our proprietary strategic planning process: StrategicContext™. During the StrategicContext™ stage we gain a detailed understanding of your business, professional and personal goals. Through this methodical approach a strategic "North Star" for the engagement emerges. This North Star provides the management team with a consistent point of alignment for the myriad of the decisions throughout the process. As a result, the outcome will be deeply rooted in the company's core goals and integrated into a cohesive plan.

Our Insights

We regularly publish white papers, are quoted in financial publications and create other thought leadership pieces that we make available on our website at www.devoeandcompany.com.

A few of our most recent articles / white papers include:

- *Succession Planning: Planning Your Future*
- *Putting Strategic Context Around Your Succession Plan*
- *M&A Surges: Why, and Will it Continue?*
- *Options, Options, Options*
- *Tailor-Made Successor*
- *True Value: Learn to Focus on the Things that Drive Up the Value of Your Practice*

Engaging DeVoe & Company

For more information or to engage our services call us at 415.813.5066 or send an email to info@devoeandcompany.com.

Follow us on Twitter
@DavidDeVoe1 and @Devoeco

DeVoe & Company