

RIA M&A (Finally) Slows Down

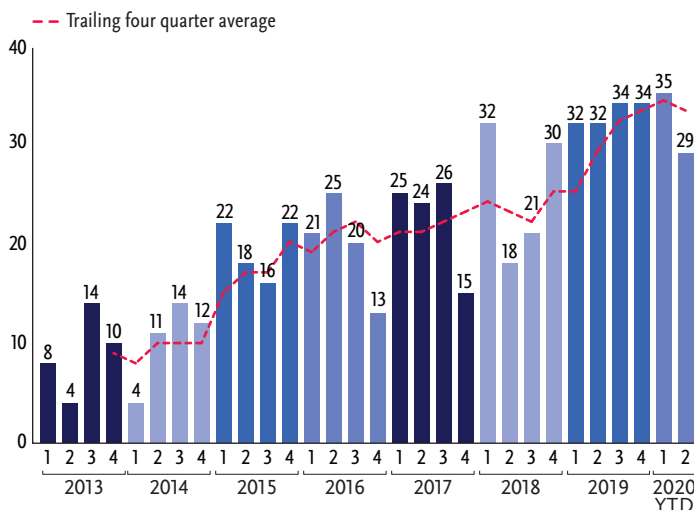
COVID has diverging effects across the RIA spectrum

After six years of consecutive record highs, the RIA M&A market slowed down. As COVID-19 impacted the lives of all Americans, advisors focused intensely on supporting them, rebalancing their portfolios and recasting their financial plans. Dedicating time and effort to client care is what the RIA community is wired to do — particularly in times of crisis. As a result, many advisors pulled back from their efforts to sell.

RIA mergers and acquisitions dropped to 29 transactions, marking the slowest quarter in nearly two years. The activity in the quarter was a 17% drop from the 35 transactions in Q1 2020 and a 9% decline from the same period a year ago.

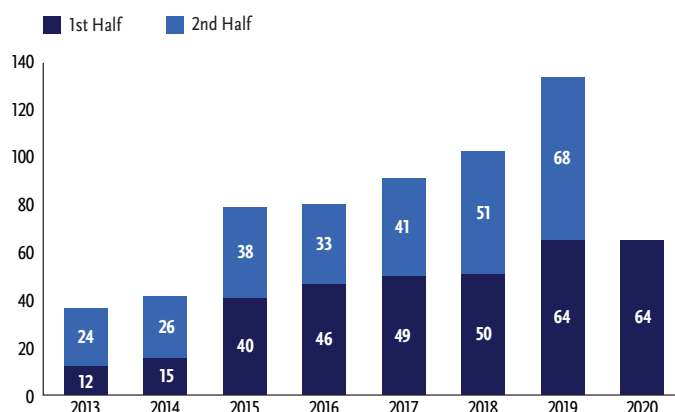
COVID Drives Drop in Second Quarter Activity

Number of transactions executed per quarter



M&A Activity YTD in Line with First Half 2019

Annual M&A activity



Expanding to the year-to-date numbers, 64 transactions were executed through June 30. Coincidentally, this is an exact match of the volume for same period in 2019. The record Q1 offset the slower Q2 to yield a tied record high for the first six months of a year. The first half of 2020 has also been a period of extremes: January was the most active month on record, which was then followed shortly thereafter by two of the slowest months. The industry also did a “180” on average seller size, reversing a five-year downward trend. And, we saw sales for one half of the RIA market actually go up, while the other half went down (more on that below).

“Advisors, acting as true fiduciaries, focused on taking care of their clients through this unprecedented time. M&A was deprioritized whenever there was a choice to make — and rightly so,” said David DeVoe, Founder and CEO, DeVoe & Company. “Now that the precious resource of time is becoming more available, we see advisors starting to engage in M&A with greater conviction.”

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The Impact of COVID: Smaller Deals Stall, While Large Deals Spike

The Q2 drop in M&A activity is not nearly as steep as one would have anticipated. A 17% decline is surprisingly light, given the potential magnitude of the COVID environment. With advisors working around the clock to first support their clients, and then re-assess how to run their business in this new world, shouldn't M&A activity have been lower? Well, it actually was — at least for one sizable segment of advisors. One key characteristic created two different trajectories.

The majority of RIAs are run by principals who split their time between managing client relationships and managing their business. Nearly all firms under \$1 billion in AUM fall into this category: They are not 'professionally managed' — they don't have executives who are fully devoted to managing the business. So, when clients need extreme support — like in a crisis — these advisors shift 100% of their time to supporting clients. Strategic initiatives — like M&A — get pushed to the back burner. That is precisely what happened.

The result? The activity for these sub-\$1B firms plunged a dramatic 35% percent versus Q2 2019. Suddenly, the impact of the pandemic seems more reasonable. The industry — at least a core component of it — experienced a greater lull than the headline numbers indicate.

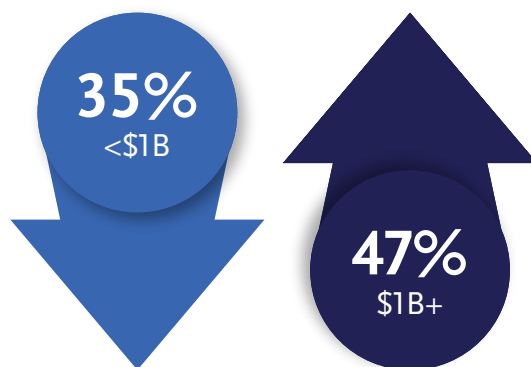
By contrast, larger firm M&A activity did not slow down. It actually sped up. Transactions for \$1B+ RIAs were *up* nearly 50% for second quarter 2020 vs second quarter 2019.

Firms over a billion in AUM typically have professional management in place. So, during a crisis, they aren't splitting their time with clients. And over the last five months, these full-time managers were able to stay focused on running the firm, assessing how to do business in a remote environment, and focusing on other strategic initiatives — like M&A.

A profound dynamic emerged that diverted RIA M&A activity in opposite directions: Overall, professionally managed firms increased their sales and mergers, and the typical RIAs simply had to delay.

A Tale of Two Cities

Q2 2020 vs Q2 2019: Number of transactions <\$1B and \$1B+



This trend underscores the power of and rationale for the industry's slow but steady movement toward being *professionally managed*. Over the last two years, scale has been the number one reason for selling. Professional management is a key component of that scale. And the extreme work environment brought on by the crisis further underscored this potential value.

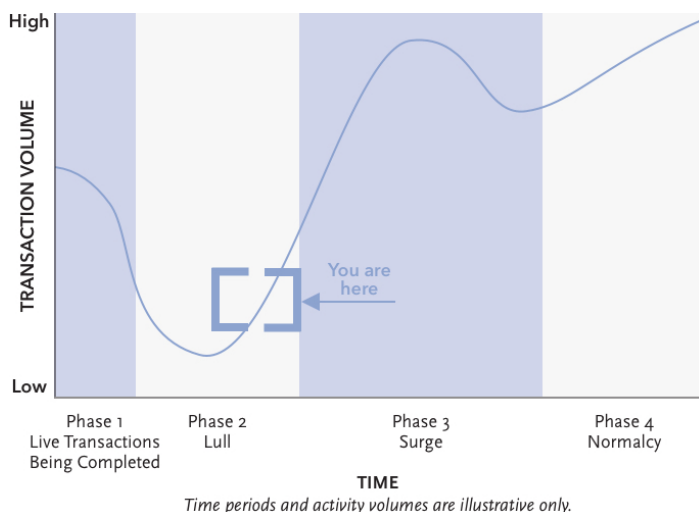
As a \$1B DeVoe & Company client who is in final negotiations of selling to a larger enterprise said: "I wish we did this deal before COVID. We are working around the clock rebalancing portfolios, adjusting financial plans, and communicating with clients. I know that this process would have been so much easier if we had access to their capabilities." And then he noted, "And, we are a \$1B firm! We are one of the bigger ones."

RIA Industry in Phase Two of DeVoe's Four Phases of Post-COVID M&A

DeVoe & Company projected four distinct phases of M&A activity following the crisis in last quarter's RIA Deal Book™. We forecasted an arc from *Live Transactions Being Completed* (Phase 1) to a *Lull* (Phase 2), followed by a *Surge* (Phase 3) and eventually a *Return to Normalcy* (Phase 4).

As anticipated, most of the transactions that were in motion prior to COVID have been signed. Though a few remaining ones will come to completion soon, Phase 1 is now behind us.

Four Phases of Post-COVID RIA M&A

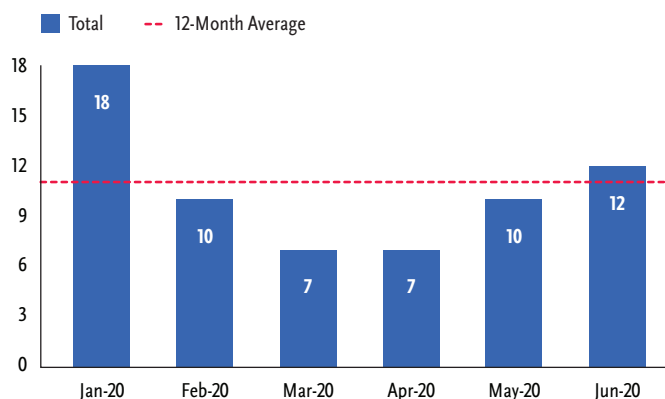


The industry is now solidly in Phase 2, which is characterized by a slower period for mergers and acquisitions. The Phase 2 lull of M&A activity hit the industry well before the second quarter. As a matter of fact, the slowdown started in February. Although Q1 was a record quarter, January was solely responsible for that milestone. With 18 transactions in 31 days, this is the strongest month on record for the industry. The activity dropped nearly 50% the next month, as the M&A market began a steady descent. At the mid-year point, we now have five consecutive months of tepid activity for firms under \$1B.

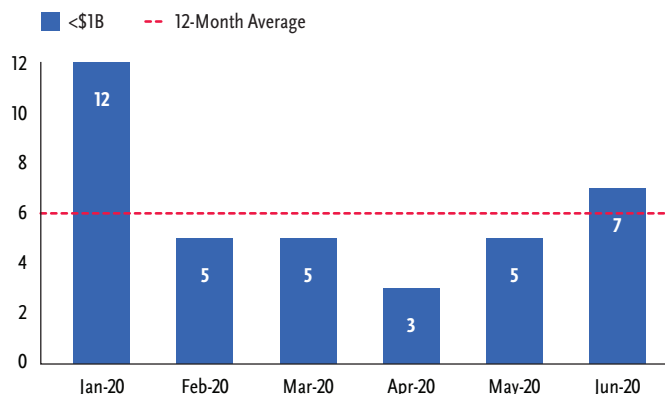
The question is: How long will Phase 2 last? That remains to be seen. Reviewing the monthly data, a pattern has emerged. A clear 'V-Curve' is outlined by the declining months from January through April, and then creeping back up in May and June. In fact, June broke through the trailing 12-month average.

Year-to-Date M&A Activity: A V-Curve Pattern

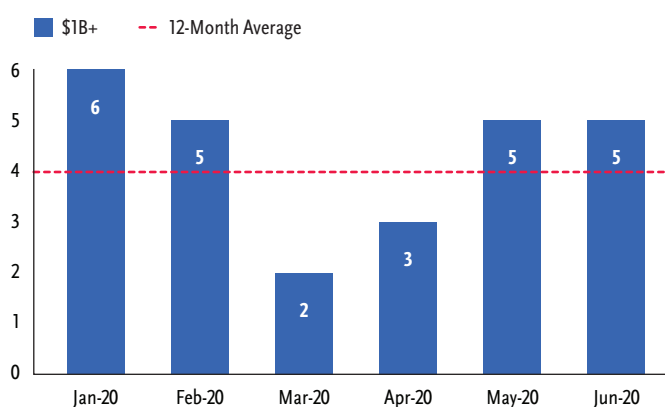
Number of monthly transactions – All RIAs



Number of monthly transactions for firms under \$1B



Number of monthly transactions for firms greater than \$1B



So, seemingly one of two things is taking place: Either the compression occurred very quickly and we have already moved through Phase 2 and are on our way to the Phase 3 *Surge*. Or, we may experience the ‘dead cat bounce’ where activity trends back down for an extended lull before the anticipated rapid expansion.

In either case, one can expect that we will enter Phase 3 later this year. Each month of compressed RIA M&A activity puts additional pressure on future transaction volume. This is an industry with nearly half the owners over 60 and only a third with a written succession plan. The volume of sales was already projected to steadily grow for the next five to seven years.

The coronavirus pandemic has been a shot across the bow that intuitively should drive an increase in succession planning — both internal and external. DeVoe & Company’s recent Human Capital survey indicated that most firms (57%) expect that an internal transition to G2 would be bumpy at best — which seemingly might make external sales a more attractive solution than before the strain and implications of the pandemic. Next quarter may or may not be the beginning of the *Surge* — but one is coming.

Valuations Hold Steady, While Deal Structures Shift

Valuations maintained their resilience through 2020’s year-to-date volatility. No small feat, given the laundry list of risks in today’s world: Stock market volatility, compressed profitability, record unemployment, a shaky economy, and a surreal pandemic. Instability and risk are not friendly to high valuations. Yet, the industry’s record high valuations that were set in cheery 2019 still hold fairly steady in gloomy 2020.

Perhaps the seasoned executives at large buyers have seen RIAs weather enough storms in the past to have strong confidence for the future. *Consolidators* have indicated that they will be a bit more selective going forward — both in terms of the deals they do and the higher valuations they pay. It’s easier to pay higher valuations when there are fewer risks in the future. And although cashflow has bounced back to a degree from the severe 40% Q1 decline (let’s not ignore that), if profitability stays below 25% margins for a sustained period, then valuations will likely begin to compress.

Economic deal structures, by contrast, changed overnight. The spike in risk associated with the post-COVID world

popped the inflated down payments that had ballooned over the years. Two decades ago, a typical down payment was in the 35% range. Five years ago, they crept up to 40–50%. And over the last two years, they shot up dramatically. DeVoe & Company has negotiated deals on behalf of sellers with 70%, 80% — even 100% down. These are structures that were unimaginable in the early 2010s. Immediately following the global shutdowns, buyers shifted toward down payments in the 50% range.

“Down payments have moved lower for good and rational reasons,” said Vic Esclamado, Managing Director, DeVoe & Company. “It allows buyers to appropriately mitigate risk — and share that risk with the seller. Smaller down payments also allow buyers to conserve cash, which can both benefit the balance sheet and provide more dry powder for future acquisitions or a sustained economic downturn.”

Consolidators Lead Buyer Categories; Renewed Activity in the Other Category

With a greater number of transactions above \$1B in AUM, it is not surprising that *Consolidators* maintained a strong lead among the buyer categories. In contrast, RIAs lost share as the *Other* category picked up speed. *Banks* posted a single transaction.

For the first half of 2020, *Consolidators* represented 44% of the acquisition volume, a slight uptrend from their 41 to 43% share of the last two years.

Notable acquirers within the *Consolidator* category in the first half of 2020 include:

- Emigrant Partners with three transactions, including a minority investment in \$14.5B Stratos Wealth Group,
- Mercer Advisors and CAPTRUST also with three transactions each, and
- HighTower Advisors and Allworth Financial with two transactions apiece.

RIAs, with 33% of the share, experienced a six percentage point drop from their 2019 level. Creative Planning topped the acquirer’s list with four transactions through the end of June. MAI Capital Management, Frontier Wealth Management, and the Mather Group posted two acquisitions each in the period.

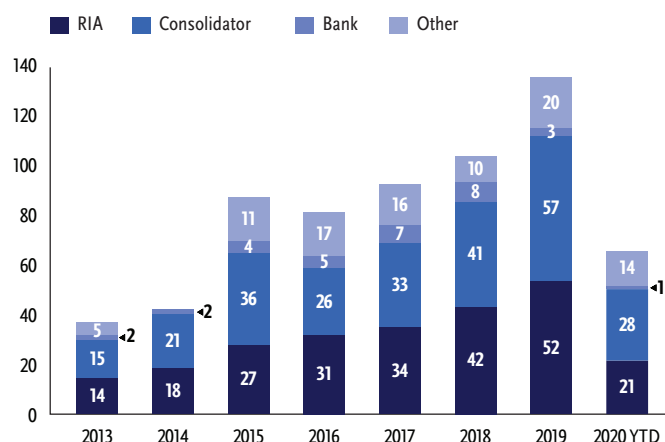
The *Other* category, at 22% of transactions, has climbed steadily from a 10% share two years ago and 15% share in 2019. Within this category, broker-dealers, including LPL Financial and Blucora, demonstrated interest in the RIA

channel. Canadian financial services firm CI Financial continued its entrée into the US RIA market with two transactions in the half. Private equity firms were also active, including Abry Partners' minority investment in Beacon Pointe (\$11.5B) and GTCR's minority stake in CAPTRUST (\$390B).

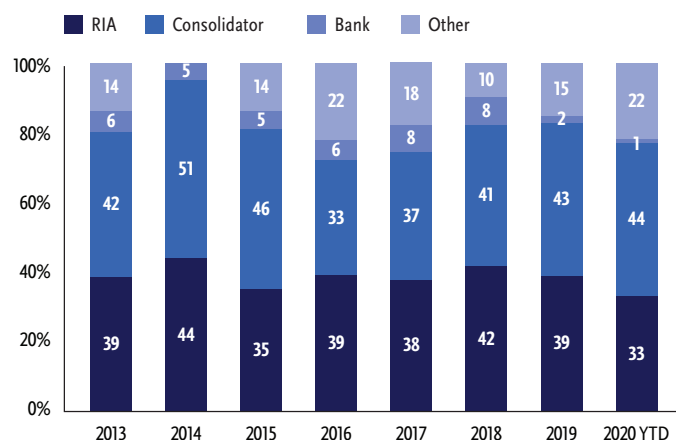
In fact, private equity firms are driving M&A activity both directly and indirectly. DeVoe & Company has tracked that private equity firms have been behind 44% of acquisitions through the mid-point of 2020. Their ongoing interest and investment signal their belief in the RIA model and expectation of the industry's continued growth.

Consolidators Lead Buyer Categories

Number of acquisitions by buyer category



Percentage of acquisitions by buyer category

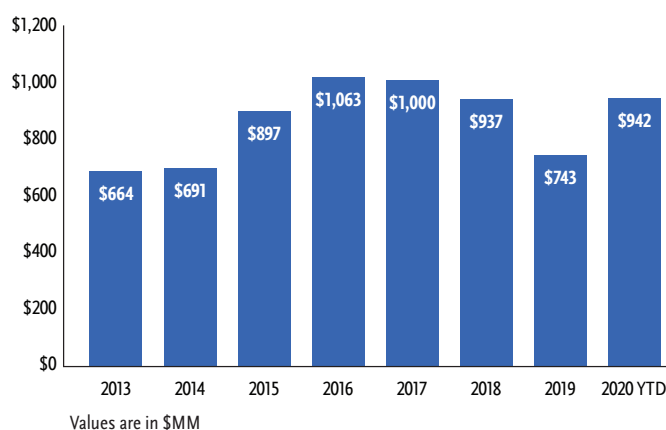


Larger Transactions Drive Up Average Seller Size

As a result of the forces at the two ends of the size spectrum, the average transaction size has shot up nearly 27% vs the 2019 average. At \$942MM for the year-to-date period, sellers trended much larger than the 2019 average of \$743MM.

Average Seller Size Reflects Trend in Larger Transactions

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



In fact, 13 transactions in the quarter were greater than \$1B and some of those were in the mega size category. AUM transacted for deals of \$1B or more in AUM skyrocketed. In the first half of 2020, a whopping \$303B was transacted for \$1B+ deals vs \$86B for the same period and segment last year. That's a 250% increase over the same period last year (although we have seen similar volume in the past; \$307B in AUM was transacted in the first half of 2018 for the \$1B+ group).

Larger transactions may continue to shape the numbers, but DeVoe & Company expects that smaller and mid-size transactions drag the average back down. Small and mid-sized RIA sales are the very core of the anticipated Phase 3 *Surge* in M&A activity. As these firms find the time to engage in strategic activities, such as sales to execute succession plans or capture the benefits of scale, their increasing numbers will naturally pull down the average AUM of sellers.

Looking Forward

At the mid-point of 2020, the RIA M&A marketplace — at least at the headline level — does not look dramatically different than it did this time last year. The transaction volume is in fact identical. And Q2 was not a steep decline. However, a shift below this placid surface has occurred.

The broader trendline of increasing RIA M&A has not changed. The core underpinnings — the aging of RIA owners, the lack of succession planning, and the natural ownership churn of a 10,000 firm industry — will drive M&A up for the next five to ten years. Now COVID will add a new layer of activity to this already growing swell.

Ultimately, the best buyer will be the one that optimally solves both business and personal goals. RIAs that have contemplated growing through acquisition should continue on that path. The RIA community will need more buyers, as external sales naturally increase. RIA sellers should be thoughtful and strategic about their plans. When M&A is done for the right reasons and with the right planning, the results are healthy and positive for buyers, sellers, and the industry.

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 17 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 limits our tracking to \$100MM+ RIAs 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, unless there are important developments.

Our goal is to provide the RIA community with the very best M&A data on the 5,000+ SEC-registered RIAs so that advisors like you can make more informed strategic decisions.

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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 300 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 300 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 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 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.

DeVoe & Company
executed more than 500
engagements in the last
several years, supporting
firms managing \$50MM
to over \$80B in AUM

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:

- *It's Time for a Human Capital Revolution*
- *DeVoe RIA M&A Outlook Study*
- *Succession Planning: Planning Your Future*
- *Putting Strategic Context Around Your Succession Plan*
- *Tailor-Made Successor*
- *True Value: Learn to Focus on the Things that Drive Up the Value of Your Practice*

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