December 2022

Annual RIA M&A Outlook

Advisors Expect Deceleration After Years of Rising Activity

DeVoe & Company

Introduction

RIA M&A activity and valuations will decline in 2023.

This is the broad consensus of advisor opinion, according to the results of the DeVoe & Company fifth annual RIA M&A Outlook Survey. The expectations are the lowest in the survey's history.

In this report, you will learn how advisors expect valuations, merger and acquisition volume, and succession planning activity to trend. Additionally, you will gain insights into their recent experiences, challenges, and motivations. Armed with this information, you can determine what prospective buyers and sellers may do next and why.

DeVoe & Company's annual RIA M&A Outlook Survey provides rich insights into how the changes in the economic and market environments affect the merger and acquisition thinking and actions of RIA leaders.

As always, we go beyond the numbers and supplement the findings with our best insights and guidance to help you make your own assessment.

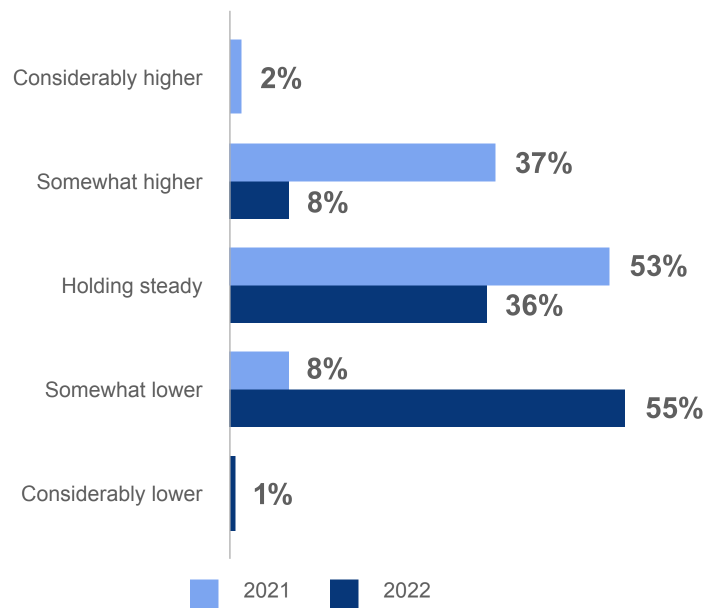
RIA Leaders Have Pessimistic View on Direction of Valuations

Survey respondents believe that the record high valuations of the past few years will likely decline. The optimism of yesteryear has given way to a more subdued expectation. Fifty-six percent expect *lower* valuations over the next year, compared to just 8% in 2021. Moreover, only 8% of advisors expect *higher* valuations over the next year, compared to 39% a year ago.

Their perspectives are likely grounded in history and logic. Seasoned advisors experienced periods of lower valuations following past cycles of volatile market conditions. Today's environment has many similar hallmarks: rising interest rates, ongoing global turmoil, and a looming U.S. recession remain significant threats. They've already caused a sharp downturn in financial markets this year, depressing advisors' assets under management as well as their revenues and profits. With these conditions, advisors expect valuations to decline.

The Influence of Valuation

Over the next year, how do you think valuations for RIA firms will trend



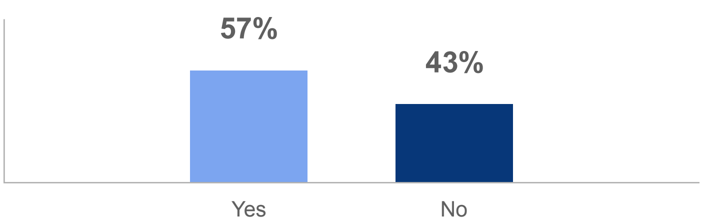
Despite this outlook, advisors are mixed on how a significant increase or decrease in valuations from January 2022 would affect their time frame for selling. Forty-seven percent said a 20% increase in valuations would *change their timeframe for a sale*, but a full 10 percentage points more (57%) said a 20% valuation drop would affect their sale timing, either by accelerating or delaying it.

For students of human behavior, this divergence in reactions is textbook psychology. Many studies have shown that the *pain of losing* is much more severe than the *joy of winning*. This human reaction is summed up in the theory of loss aversion. Investor behavior is a classic example. Left to their own devices, many investors sell a stock at the very worst time (at the bottom), as they can no longer stomach the concept of additional losses.

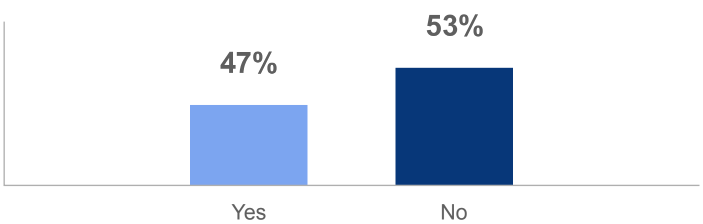
Advisors, too, seem to be affected more by market losses than gains in their decisions on when to sell their firms. A considerably larger number of RIA leaders indicated they would change the timeframe for selling if valuations drop 20% than if valuations rose by that same amount.

Prospective Sellers Sensitive to Market

If RIA valuations dropped 20% from January 2022, would it change your timeframe for selling



If RIA valuations increased 20% from January 2022, would it change your timeframe for selling



RIA Leaders Expect a Shift in M&A Activity

The outlook for RIA M&A activity has also shifted dramatically from a year ago. The growing economic and political turmoil coupled with increasing market volatility are likely culprits behind the 21% drop in expectation for M&A activity to increase.

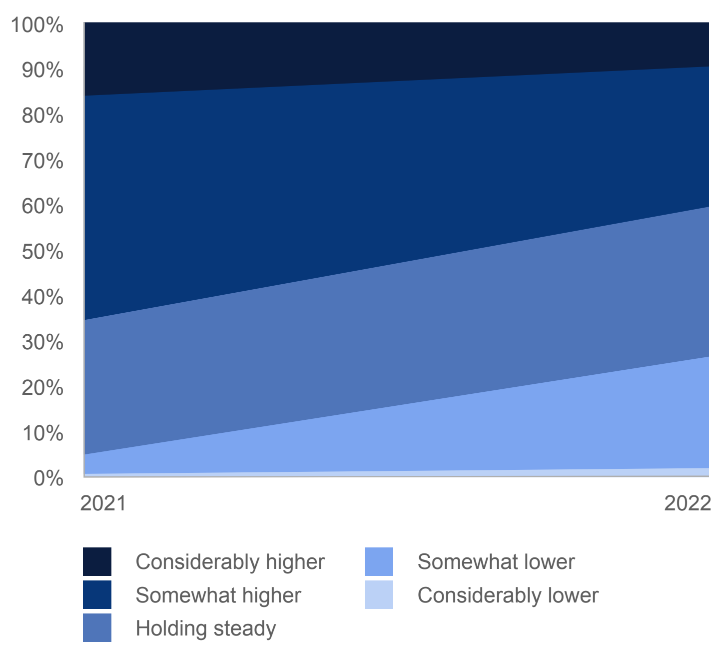
Only 42% of advisors expect RIA M&A activity *will increase* over the next year, with 35% selecting *rise somewhat* and 7%, *rise considerably*. This is a 21% drop in expectations from a year ago when 63% indicated activity would *increase*.

Expectations that activity will decline also increased 21%. Strikingly different from last year, one-fourth of respondents believe that M&A activity will be *somewhat lower* or *considerably lower* (23% and 2%, respectively). Last year, only a sliver (4%) forecasted that activity would *decline.*

Those expecting the activity to hold steady well…held steady. One-third of advisors (33%) expect activity to *hold steady*, equal to last year.

M&A Trend to Flatten or Reverse in 2023

What are your expectations for the trend in volume of industry-wide RIA M&A activity over the next year?



Another Record Year of RIA M&A but Deceleration Trend Starting

Alongside these findings is the RIA M&A landscape in 2022, which will finish as another record year of activity. More than 200 transactions were posted through the first three quarters. Although 2022 will set another record for M&A volume, the year over year increase is expected to be far less than the 50% year over year increase last year. Activity dropped in the fourth quarter – whether this will prove to be a sustained slowdown, or a blip is yet to be seen.

The decelerating RIA M&A transaction volume is due to the different economic and market environment. Interest rates have surged to their highest levels since 2008. Economic growth has slowed. Recession fears are looming. Market volatility and global uncertainties have increased.

This altered backdrop has affected some of the dynamics at the negotiating table. “It’s definitely been a very active year, but it’s harder to get deals done,” said Bob Oros, chairman and CEO of Hightower, who spoke at the DeVoe M&A + Succession Summit in September 2022.

Dave Barton, Vice Chairman, Mercer Advisors, added, “There are firms coming to the market that are not ready. They don’t know their story.” He elaborated that many of a seller’s elements for a buyer to make an assessment are often not solidified upfront and a buyer may need to spend more time on due diligence. All of this means timelines are extended.

The composition of RIA sellers has also changed. The number of large sellers with more than $1 billion in assets under management has dropped and been offset by a surge of smaller sellers (under a billion in AUM). In the current environment, RIAs with assets under $500 million are the most prevalent sellers. DeVoe & Company predicts that this segment will remain among the most active seller segments over the next several years.

2022 represents a brave new world for RIA M&A activity and sets the stage for a different future. Industry leaders and survey respondents concur.

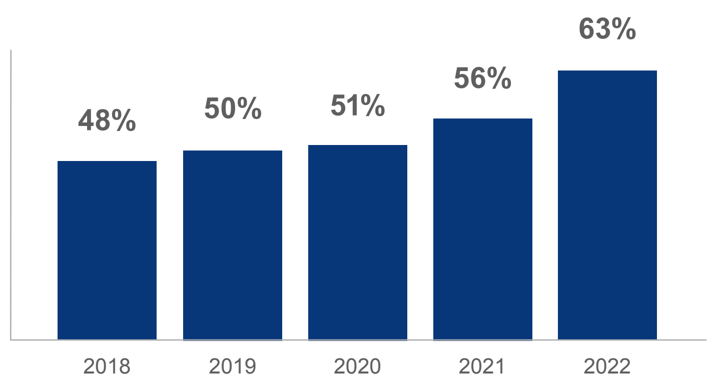
Internal Succession: An Aspiration but Not Reality for Many

Although financial advisors are in the business of helping clients plan for their future, not enough of them plan for their own. Succession planning is an ongoing and growing problem for an industry whose average owner is estimated by DeVoe & Company to be over 62 years old.

This uncomfortable reality is a concern for a growing number of advisors. Sixty-three percent of advisors this year see the lack of succession planning as a *BIG problem* for the future of the industry, up from 56% a year earlier and near 50% in the previous three years. Another 30% said the lack of succession planning was a *minor problem*. In total, 93% of advisors surveyed view the lack of succession planning as a problem for the industry.

Succession Planning: A Big Problem

Believe the lack of succession planning is a big future problem for the industry

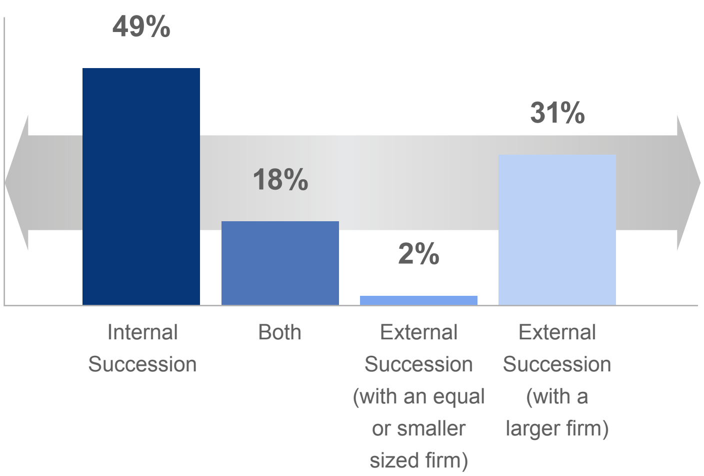


Despite the current lack of planned succession, 49% of the advisors we surveyed indicated they would prefer to sell internally. They want to pass their businesses on to the next generation of advisors. These are people they hired and groomed, and they may even spend time together as friends outside the office. Such a succession plan may also extend the legacy of those advisor leaders after they step away from the business.

On the other hand, 31% indicate a preference for *external succession with a larger firm*, where they would gain resources or scale. This barbell effect shows the continuum of choice – either staying with their team in a leadership role or joining a bigger company. Many RIA leaders start their succession journey with strong conviction on one end or the other of this continuum. Eighteen percent believe they will work through both options over time, likely some internal equity will change hands early in this process and later, an external sale will become a desired or necessary option.

Two Ends of the Solution Spectrum

If you have already gone through a transition or are working through one, which option did you choose?



Readiness and Affordability Gaps

Our research indicates that the lack of succession planning isn't simply a matter of inertia or procrastination. NextGen readiness and affordability gaps among the NextGen of RIAs put pressure on internal succession plans. Execution becomes strained and often stalls.

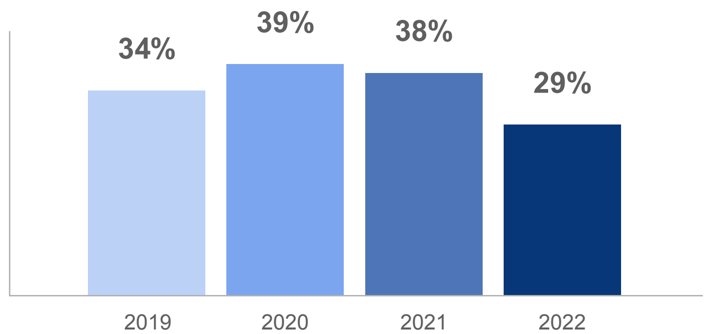
Many owners don't believe their NextGen are ready to take the reins. The DeVoe 2022 RIA Talent Management Study found that 68% of RIA leaders believed that second and third generation employees of their firm were *not ready* to take over management and leadership roles.

Additionally, many NextGen advisors cannot afford to buy out current shareholders. The high valuations commanded by RIAs in recent years often preclude younger advisors from buying out current shareholders – especially for medium-sized or large firms. The rise in interest rates has further contributed to the affordability challenge, even if valuations compress due to the economic environment. As a result, confidence that the NextGen can afford to buy out RIA owners dropped dramatically. Less than one-third of advisors surveyed (29%) are *confident* that the next generation of advisors can afford to buy out the current owner or owners of their firms, down from 39% two years ago.

The affordability challenge is real. Planning early is the best potential way to combat it. Starting equity migration, management coaching and leadership development will add exponential value to any organization. Even if NextGen advisors cannot afford the whole firm, these actions nearly universally make a strong firm – and a more valuable company.

Confidence in NextGen Buying Power Declined in 2022

Confident that the next gen of your RIA can afford to buy out the founders



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A Changing Buyer Profile

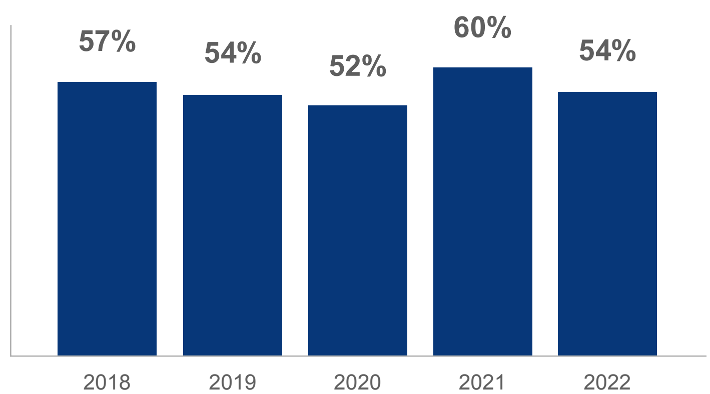
RIA leaders continue to view inorganic growth as a fast path to reaching a new size or level of success. More than half the respondents in this year's advisor survey said they expect to *acquire another RIA within the next two years*. But interest in this path has declined. Fifty-four percent said they plan to acquire during that time frame, a six-point drop from the prior year but in line with historical responses from the annual survey.

A severe decrease occurred amongst respondents from larger firms ($1B+) in particular. Fifty-nine percent of these firms expect to buy an RIA within the next two years, down sharply from 74% a year prior. These larger firms may simply be absorbing their recent acquisitions or assessing the impact of rising interest rates on their buying power. Larger buyers still dominate the RIA M&A marketplace. We do not expect to see their dominance shift anytime soon. Anecdotally, several serial acquirers have told DeVoe & Company that their pipelines are robust. In some cases, they may schedule closings into mid next year.

On the other end of the spectrum, interest in acquiring from respondents of firms sub-$1 billion in AUM increased five percentage points to 47%. These respondents may view inorganic growth as a fast track to a heightened level of scale.

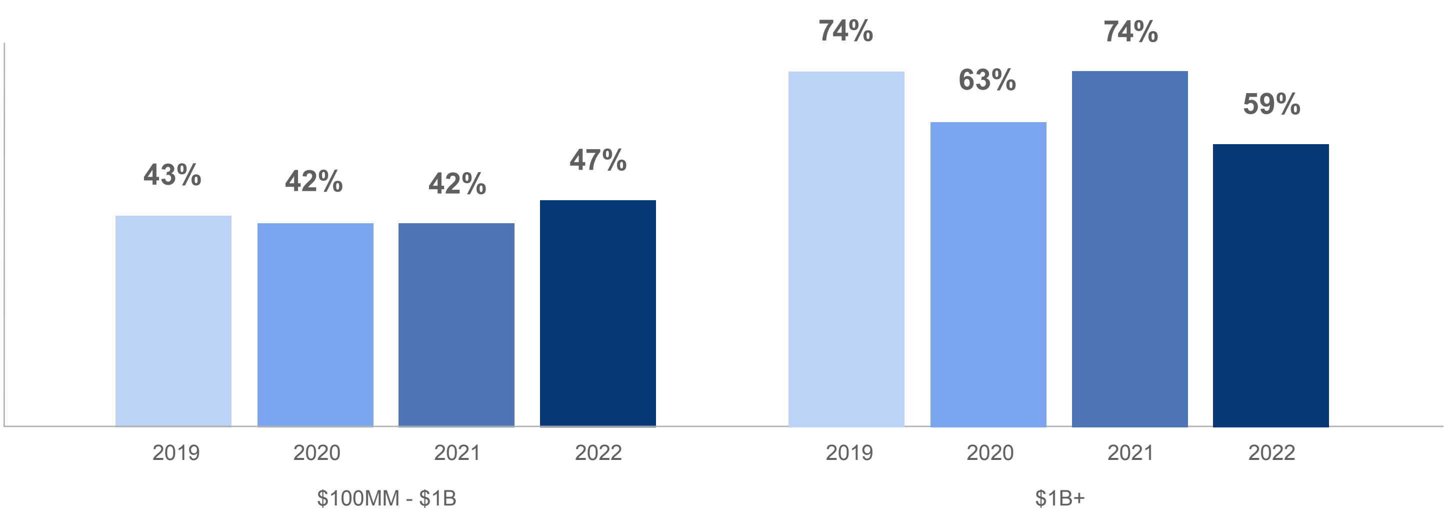
More than Half of Respondents Expect to Acquire Another RIA

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



Interest in Acquiring Rises Among Smaller Firms and Declines Among Larger Firms

Percentage that expect to acquire a firm within the next 24 months by size



Changing Mix of Motivators

The key drivers for making acquisitions are also changing and are surprisingly different from a year ago. All the drivers of acquisitions cited by RIA leaders attracted less interest this year. Overall, the numbers were more muted and no one driver separated itself from the pack. RIA leaders essentially showed a much more balanced approach to their reasons for acquiring. The core differences may be market-related.

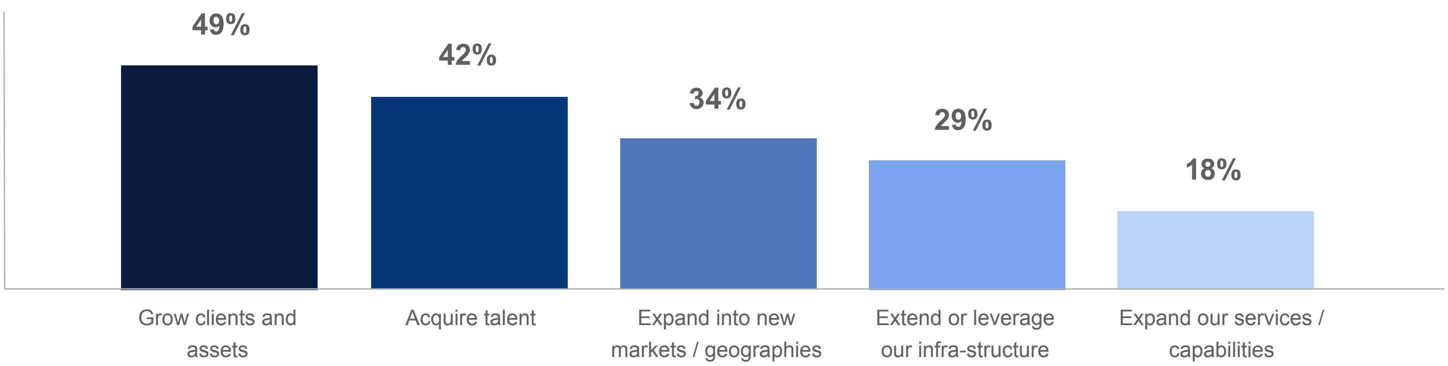
Growth and Talent: Top Drivers for Buyers

Growing clients and *assets* is the number one driver for buyers, cited by 49% of RIA leaders compared to 72% a year ago. While *growth* has dropped a bit in its importance as the top driver, it will always be a top driver for firms making acquisitions. Many firms are combining inorganic with organic growth strategies to maximize how quickly they can grow.

Acquiring talent, by far the top driver in 2021's survey, is now in the number two position. *Talent* was cited by 42% compared to 76% a year ago. Talent's continued presence near the top of the drivers list is not surprising for an industry where people are the lifeblood. Yet, the 34-point drop in 2022 could reflect a less urgent need to add people at a time when declining markets are compressing revenues, and growth rates are expected to fall in the intermediate term. Improvements in technology and scale could also help firms weather the slowdown and reduce the need for robust hiring.

Acquisition strategies appear to be rooted in multiple desired outcomes – *talent, new geographies, scale and expanding services and capabilities*.

If your firm were to acquire an RIA, what would be the main drivers?



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Prospective Buyers Face Barriers

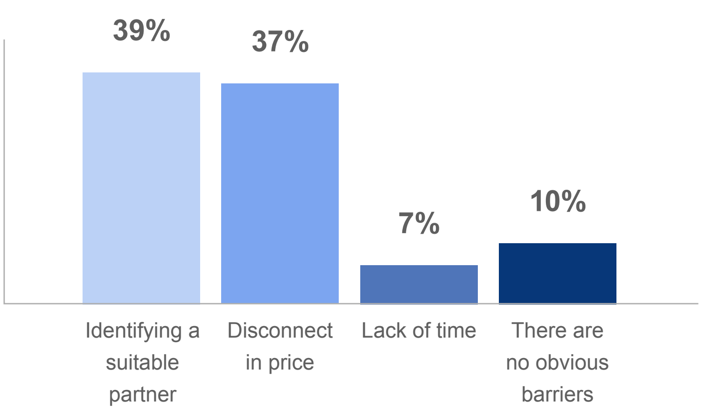
Despite a large interest in acquiring one or more firms, potential buyers of RIA firms are not always successful. Barriers abound. *Identifying a suitable* partner was the key reason respondents gave when asked about factors that would prevent an acquisition. Nearly 40% chose that answer.

Finding a suitable partner can take on a variety of characteristics. Investment approach, financial planning methodology, overall client experience, and team culture are just a few of the factors involved in making an assessment about a potential partner.

Additional barriers to acquiring another firm included a *disconnect in price* between buyers and sellers and *lack of time* to work on acquisitions. DeVoe & Company guides prospective buyers and sellers that a transaction can take 12 to 18 months and be a major commitment of an owner's time.

Identifying a Partner is the Top Barrier to Acquiring

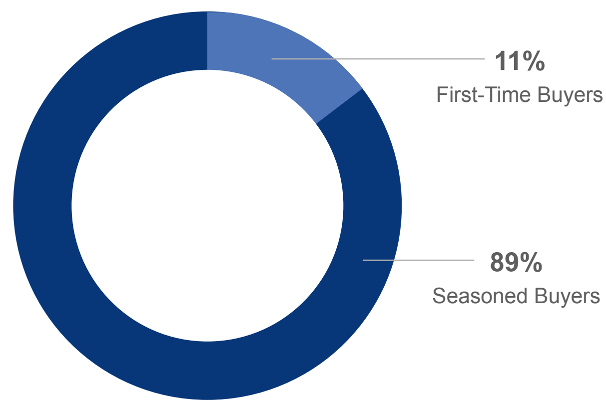
What are the key barriers, if any, that would prevent your firm from acquiring another firm?



Buying an RIA is not an initiative to be taken lightly. The low numbers of first-time buyers are proof of the challenge. They accounted for only nine percent of RIA purchasers in 2021 and close to 11% of acquisitions in 2022 (through the third quarter). A strong and methodical roadmap increases the likelihood of a first-time buyer completing a successful transaction. See "Preparing to be a Buyer" Sidebar.

Seasoned Buyers Dominate

Transactions by buyer experience level (2022)



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Becoming a First-Time Buyer: Readiness Tips

To help first time buyers increase their attractiveness and the likelihood of a successful transaction, DeVoe & Company has mapped out a variety of elements to help you plan.

The first step is shifting from *aspirational buyer* (a firm that decides they want to buy) to *qualified buyer* (a firm that has done the work to be able to actually execute a transaction). Here are a few components of what it takes to become a *qualified buyer:*

Timeline. Completing a process typically takes 12 to 18 months from end to end. This can be accelerated by working with an investment banker, cutting the time down to six months. Unfortunately, even after months of hard work, you may not end up as the finalist.

Internal team. DeVoe & Company has calculated that for every fully productive full-time employee you have dedicated to the initiative, you will likely get one transaction closed per year. So, if you plan to spend half of your time on M&A, you will be lucky to get a deal done once every two years.

External team. Qualified buyers will have lined up expert resources, including legal counsel, CPA / tax professional, and potentially an investment banker / valuation firm / consultant.

Capital. Assessing capital or lending options well ahead of time is critical. And suddenly, this challenge has become more challenging. Understanding your options will help ensure that you aren't caught flat-footed (or without the required capital!) when a seller is interested. It will also help you craft the deal structure you will offer to sellers.

Value proposition. Your story is paramount to your future success. It provides clarity and conviction regarding why someone should join your firm, and why you are better than anyone else for your design target.

Target seller profile. Carefully evaluating and documenting the ideal fit for your organization will save you hours of wasted prospecting and discussions.

Deal structure. Seek to understand typical deal structures, so that you can tailor-make your own optimal structure. One size does not fit all.

Operational infrastructure. Readiness includes ensuring your operations, technology, and infrastructure can support an integration.

Integration plan. A transaction doesn't end when the contract is signed. It's only getting started. Documenting an integration plan with roles and responsibilities, compensation, pricing, reporting, organizational structure, and more will support a smoother execution.

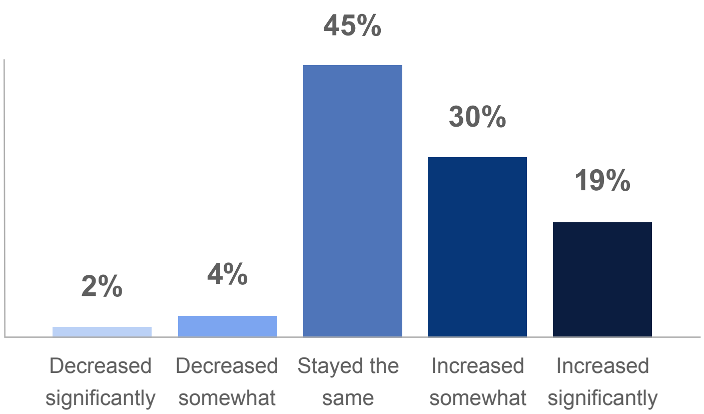
A Changing Seller Profile

In the coming years, many RIA owners will need to sell. The aging owner profile combined with the readiness and affordability gap explained earlier in this report will drive the M&A trend for years to come.

For those interested in selling, meeting potential buyers has been eased by active buyer outreach. Nearly 50% of RIA leaders surveyed indicated that inquiries about selling their firm rose *somewhat* or *significantly* this year. In our study last year, 62% said that inquiries had increased.

Inquiries Remain Inactive

Please share the best response about the number of inquiries about selling or merging vs previous years.



Seller Motivations Shifting

Sellers this year also cited slightly different priorities for why they would sell their firms.

Growth was the primary driver for sellers, just as it was for buyers. *Liquidity,* which was the key driver cited in last year's survey, moved to the number two position. *Succession* was the third most popular driver, followed by *Scale* – which reversed the order of last year.

Many advisors are just realizing the crucial need for accelerated and sustained organic *growth*. True organic growth across the industry declined from 9% in 2017 to 3% in 2020[1]. Previously, the lackluster growth rates had been hidden by a prolonged stock market rally. Things have changed. The sharp stock market drop is likely the primary reason more advisors are now focused on growth as the key reason to acquire other firms.

On the flip side, the same market decline may be why fewer advisors currently view *liquidity* as an important driver of acquisitions than they did previously. With AUM, revenues and expectations for valuation falling, more advisors may have decided to hold off on acquisitions for now.

Growth was the primary driver for sellers, just as it was for buyers.

The only driver for acquisitions that has held steady is *succession*. The need for RIAs to plan for succession of ownership and leadership is constant and approaching a critical level, because of an aging demographic. Close to 40% of U.S. financial advisors will retire in 10 years, according to a recent report from Cerulli Associates.

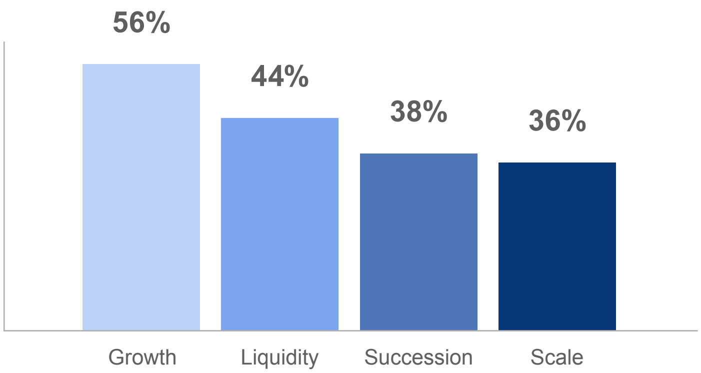
In today's environment, *scale* – a key driver for years – is taking a back seat to the more urgent growth objectives.

Beneath the surface of the main drivers of growth, liquidity and succession, advisors considering a sale are often spurred to action by other key motivating factors. Ensuring that *clients are cared for in the long run* was the most significant for RIA leaders, cited by 42% of respondents, followed by *current valuation* of the company (19%) and the *owner's retirement timing* (17%). None of these responses is surprising given the strong fiduciary responsibility of the industry, valuation of firms, which may be peaking, and the age of owners.

1. *After market performance and acquisitions are removed. Source: Dimensional 2015–2021 Advisor Benchmarks Study*

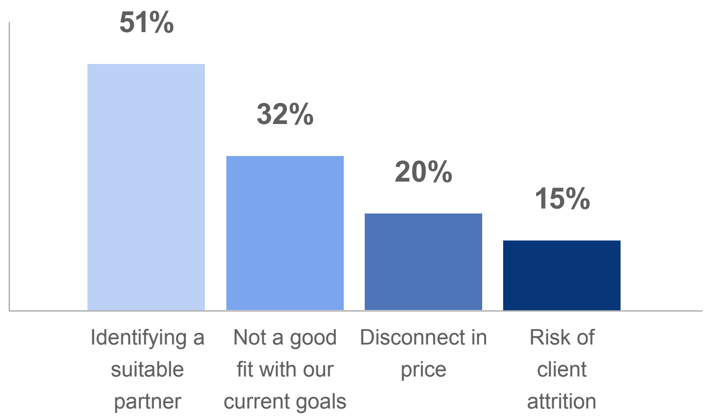
Growth Tops the List of Drivers for Selling

If you were to sell your firm (or a partial stake), what would be the main strategic business drivers?



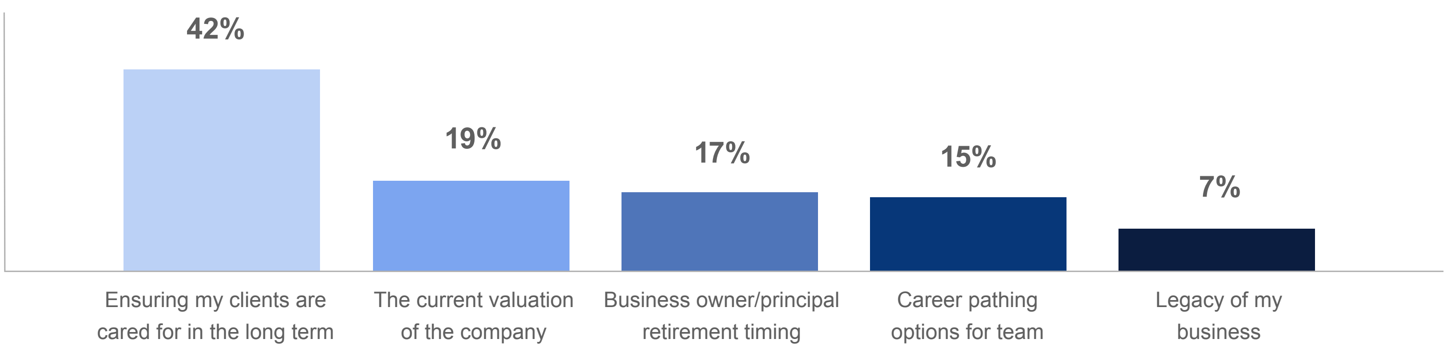
Key Barriers for Sellers

What are the key barriers, if any, that would prevent a sale or merger of your firm? (Try to limit your choices to no more than three that are most relevant to you.)



Client Care Top Motivator or Concern

As you consider a transition you've already made or one you make in the future, please share your top motivating factor



As for barriers to selling, the number one obstacle for sellers to engage in a transaction is the same as for buyers: *identifying a suitable partner*. Sellers cite finding common ground with a partner more than their buyer counterparts. More sellers than buyers cited the challenge of finding a suitable partner as the key obstacle to making a deal – 51% vs. 39%. Sellers also cited a *disconnect on price* between themselves and a prospective partner (20%) and *risk of client attrition* (15%) as key barriers to moving forward with a transaction.

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Conclusion

Today's M&A environment is evolving quickly. Although the pressure points for a slowdown in RIA M&A emerged months ago, the industry is only now experiencing an actual decline. The perspectives in this report from RIA leaders provide valuable insights into the shifting priorities of buyers and sellers. The insights can support decisions on specific transactions and help drive results for a larger acquisition strategy.

Despite this growing mosaic of information, detailed predictions on the broader RIA M&A market are challenging. The sensitivity to and unpredictability of the national economic situation makes near-term forecasts challenging, at best. Although DeVoe & Company expects that RIA M&A will continue to increase over the next five years, our crystal ball for the deal volume over the next few months is a bit cloudy. It will likely be bumpy in the near term, as the long term trends upward.

Amid this volatility, RIA leaders serve their companies best by anchoring themselves to constants. Management teams that focus on the fundamental building blocks of strategic thinking will be positioned to achieve their goals. Always move towards your destination with your goals and objectives as your anchor.

Methodology

The DeVoe RIA M&A Outlook Survey is designed to collect advisors' perspectives about a wide variety of merger, acquisition, sale and succession topics. DeVoe & Company surveyed 112 individuals between June and October 2022. Respondents were senior executives, principals, or owners of RIAs ranging in size from $100 million to over $10 billion in assets under management.

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 350 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 a 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 main categories:

- BUSINESS CONSULTING
- M&A GUIDANCE
- VALUATIONS

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