DEVOE & COMPANY

RIA M&A Declines Again

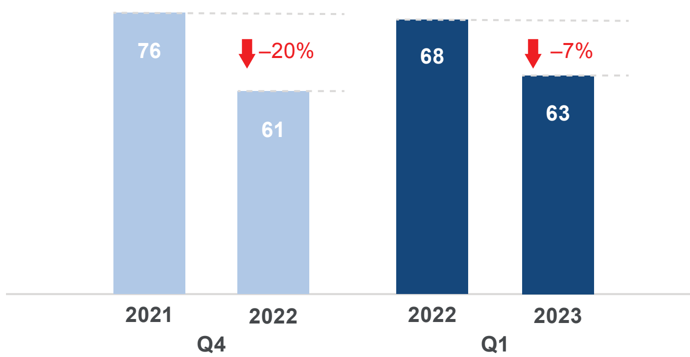
Confluence of factors extended the slowdown

2023 started with a whimper. For the first time since 2014, the year opened with a weaker first quarter than the previous year. With 63 transactions posted in the period, M&A activity was 7% lower than the 68 transactions in Q1 2022.

This slowdown extended the 20% decline of Q4 2022 — and is the first six-month downturn that the industry has experienced since 2018. The RIA M&A transaction volume that plateaued in 2022 has sustained itself into the new year.

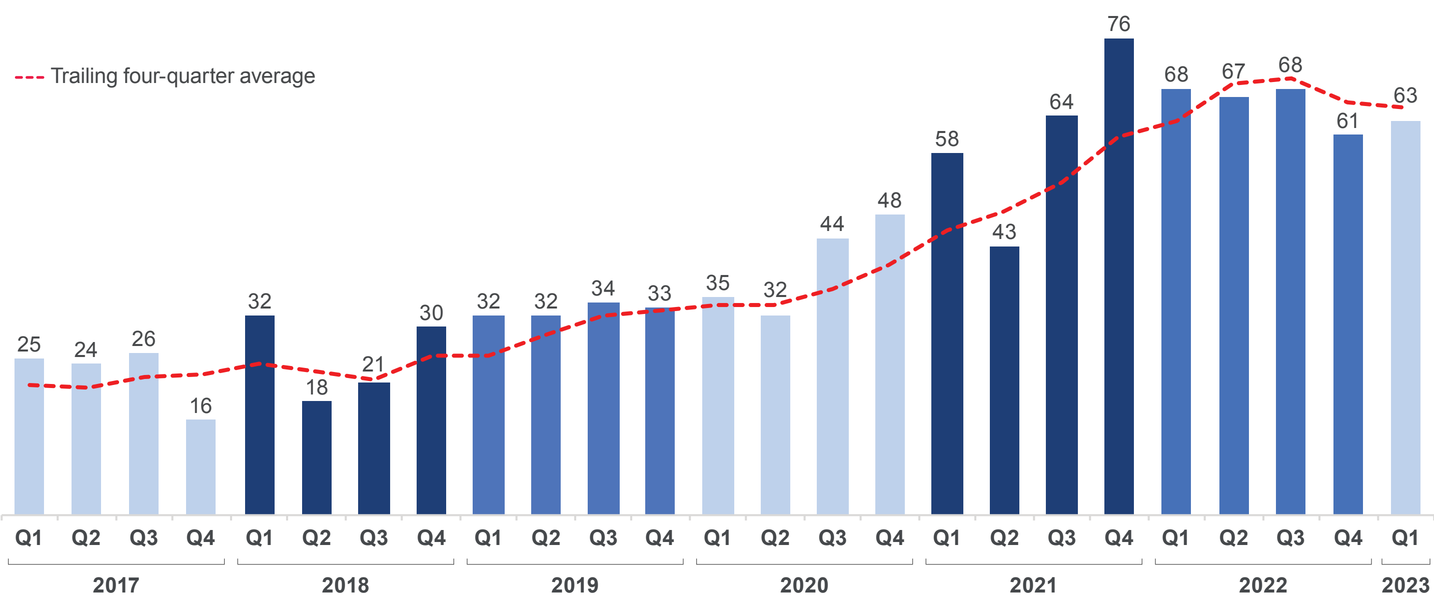
RIA M&A Two-Quarter Decline

Q4 and Q1 declines



After Years of Progressive Increases, Quarterly Activity Plateaued

Number of transactions executed per quarter



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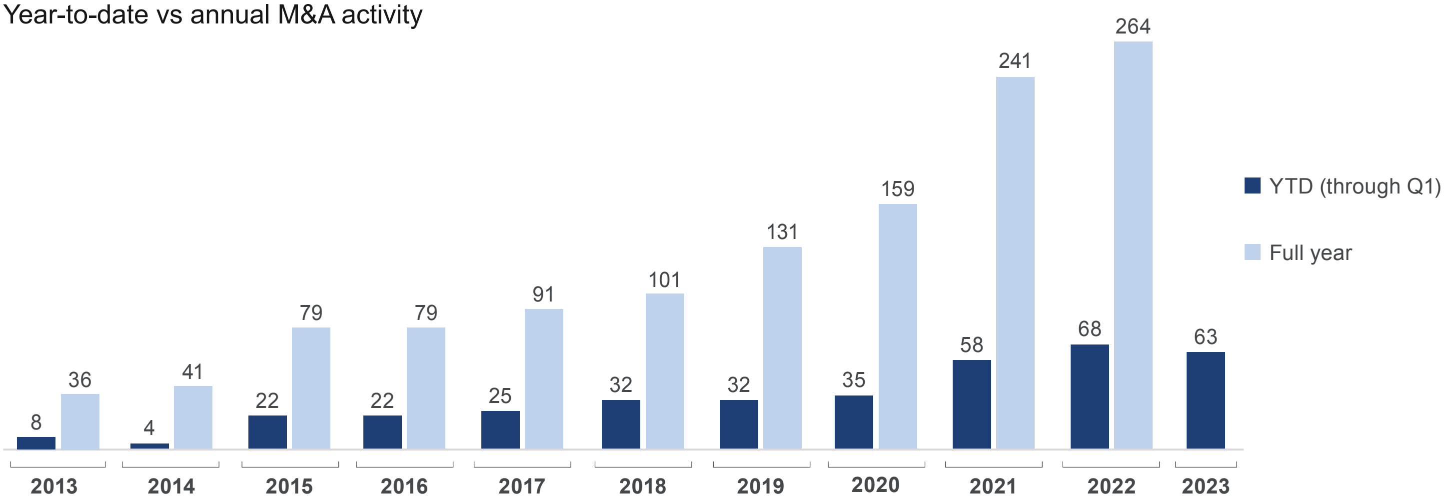
2023 First Quarter Is the First Down Q1 in Nearly a Decade

Year-to-date vs annual M&A activity



The slowdown was driven by a confluence of factors, some of which have historically directly impacted M&A, and others that likely fatigued sellers. A declining stock market and rising interest rates conspired to compress revenues and increase acquisition costs. While advisors also assessed these trends and developments to optimize their guidance for clients, they also were actively evaluating the implications of inflation, a stalled economy, human capital challenges and even a banking crisis. The confluence of slightly compressed valuations, increased transaction expenses and distracted sellers contributed to the deceleration. *Consolidators* even pulled back their standard level of activity, with some traditional buyers not completing transactions this quarter.

Despite the dampening effect of these factors, the slowdown in RIA M&A activity is more akin to the ebbing crest of a large wave, as opposed to receding waters. M&A activity in the industry remains extremely high on a relative basis in comparison to even recent years.

Focus Financial Partners: Returning to Private Ownership

Focus Financial Partners announced its expectation to be acquired by private equity firm Clayton, Dubilier & Rice (CD&R). The high-profile announcement came less than five years after the $350B+ AUM aggregator's groundbreaking IPO. Although it will be their first transaction in the wealth management space, CD&R is one of the oldest private equity firms in the world and has acquired high-profile companies such as Hertz, Kinkos and Uniroyal Goodrich.

The all-cash offer of $53 a share values Focus at roughly $7 billion, including debt. Stone Point Capital and Kohlberg Kravis Roberts & Co. took Focus public in 2018 with a first-day close of $38 per share. Stone Point will retain an investment in the company and provide new equity financing.

Despite its scale and brand, Focus' valuation was perceived by some to be undervalued — at least compared to the multiples recently paid for smaller, privately held consolidators. Assuming $538 million of full-year EBITDA as of December 31, 2022,* the company was trading at a 13 multiple — a far cry from the 20s that other consolidators have recently received. A case could be made that taking Focus private could create a future arbitrage opportunity.

* Source: Focus Investor Relations Fact Sheet

Perhaps more importantly, private ownership can enable management to take on more debt and, therefore, acquire more aggressively. Public markets often raise eyebrows with debt-to-EBITDA ratios exceeding 4x. By contrast, private firms often creep up to 7x or more. Going private will increase the option set for acquisition capital.

The implications of the Focus sale are unclear for the partner firms within its network. Focus has over 85 partner firms in more than 38 states and operates in four other countries besides the U.S. Among its best-known partners are Buckingham Wealth Partners and The Colony Group.

Consolidators Still the Top Buyers, But Losing Share

Though their share of acquisitions has recently declined, *Consolidators* continue to be the dominant buyers of RIAs. DeVoe & Company defines *Consolidators* as companies whose business models are predicated on making RIA acquisitions, or active acquirers with inorganic growth as a core plank in their business strategy.

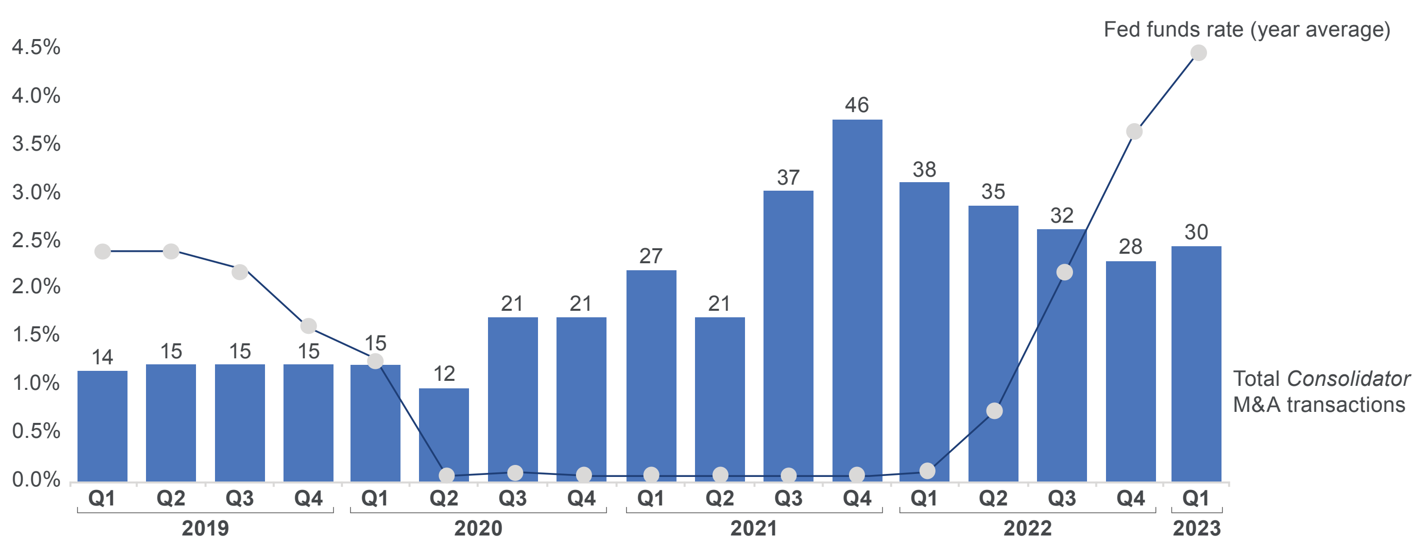
Consolidators' share of transactions deflated to 48% in the first quarter of this year from 50% for full-year 2022 and 54% for 2021. On a numerical basis, transactions in the first quarter dropped 21% from 38 in Q1 2022 to 30 in Q1 2023.

Consolidator models are sensitive to interest rate increases, which indirectly contributed to their slowdown. Commonly backed by private equity and leveraged with debt, these major acquirers are affected by rate increases in several ways. The higher rates increase the cost of financing current transactions. Additionally, and perhaps more importantly, the debt service on the loans from their historical transactions balloon. These costs not only erode future profits but can also limit access to additional capital or, at worst, threaten debt covenants. As mentioned previously, these debt-to-EBITDA and other leverage ratios can affect a number of options and decisions related to raising more capital.

This relationship between interest rates and acquisition appetite shows degrees of correlation in the chart below. Interest rates were near zero when *Consolidator* transactions reached a high of 46 for Q4 2021. Since then, activity has steadily declined as rates have risen.

Consolidator Activity Declined with the Rise in Interest Rates

RIA M&A transactions (*Consolidators*) vs interest rates



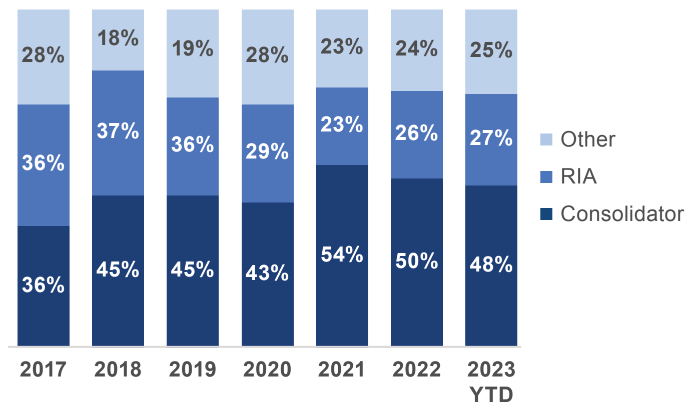
Buyers are also refining deal structures in ways that benefit sellers. Many firms have altered deal structures such that more consideration is added to earnouts. The new structures are designed to enable today's sellers to benefit from tomorrow's expected stock market increases. These structures can ameliorate resistance to selling while the stock market is compressed.

For the first quarter, the most prominent acquirers for the category (and overall) were Wealth Enhancement Group, Cerity Partners and Beacon Pointe, each completing four transactions. Prime Capital was just behind those leaders with three transactions in the quarter.

The slowdown in *Consolidator* activity has been offset by increased *RIA* acquisition activity. During the last three years, acquisitions made by *RIAs* has increased from 23% of the market to 27% in Q1. The first-quarter acquisition activity of this group is also more than double the group's representation in the first quarter from a year ago, when *RIAs* had a mere 12% share. Acquisitions by *RIAs* totaled 17 in the first quarter of this year versus eight in Q1 2022. The increase in activity among *RIAs* may indicate a rise of new *Consolidators*. Many *RIAs* dip their toes into an inorganic growth strategy and then lean into it with conviction.

Consolidators'* Recent Declines Have Been Absorbed by *RIAs

Percentage of acquisitions by buyer category



Buyers in the *Other* category acquired the remaining 25% of sellers in Q1 2023. This category, which includes private equity, insurance/benefit companies, diversified financial services, broker-dealers, asset managers, accounting firms and now banks, executed 16 deals in the period.

DeVoe & Company previously classified banks as a separate buyer category. Given their negligible activity as buyers in recent years, banks have been moved to *Other* as a subcategory.

Private Equity and Insurers Top Subgroups Within the *Other* Category

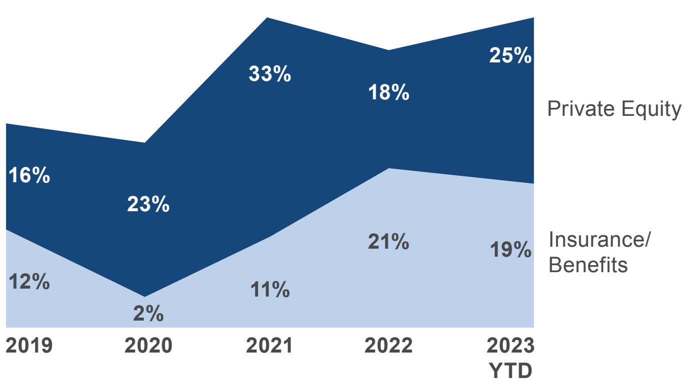
Within the *Other* buyer category, private equity continued to dominate, accounting for 25% of transactions in the category and 6% of all RIA transactions in the first quarter.

Of the four private equity transactions in the first quarter, all involved sellers with more than $5 billion in assets. The largest was Pathstone, with AUM north of $80B. Private equity, often referred to as ‘smart money,’ maintains its heightened interest in the independent wealth management space.

Insurers and benefit companies announced three acquisitions in the first quarter, accounting for 19% of transactions in the *Other* category and 5% of all transactions for the quarter. These acquirers have increased their M&A activity over the last few quarters and are an example of more market-adjacent players that will likely continue to enter the space. One Digital announced two transactions and Alera Group announced one during the quarter.

Private Equity and Insurers Rise in *Other* Category

Segment share: Private Equity and Insurance/Benefits as a percentage of *Other* transactions



Seller Size: Big Is Back

In the first quarter of 2023, all seller size segments increased activity at the expense of mid-size firms, which dropped dramatically. As a result, the average AUM in the first quarter jumped to $919MM, well above the $827MM average AUM for all of 2022.

Small firms with assets between $100MM and $500MM accounted for more than half (54%) of RIA sellers in the first quarter of 2023, a 16-point increase of share versus Q1 2022. Their sales numbered 34 transactions versus 26 in the same quarter last year. Firms in this size segment often realize the greatest benefits by joining a larger partner.

The biggest change in sellers during the first quarter involved mid-size firms with assets between $501MM and $1B. This group nearly fell off the chart. Only four mid-size firms were sold in Q1 2023, compared to 22 in the first quarter a year ago. Their percentage of first-quarter sales plunged to 6% from 23% for all of 2022, reversing a trend of double-digit representation among RIA sellers going back to at least 2017.

The drop in transactions by mid-size firms is likely due in part to the increase of smaller prospective sellers and sellers not being represented by investment bankers. These firms likely became fatigued by the implications of the unusual macro environment outlined earlier and chose to deprioritize a sale for the near term.

Large firms with $1B to $5B in assets surged to 29% of sellers in the first quarter, compared to 21% for all of 2022. Their sales totaled 18 transactions, three more than the first quarter a year ago.

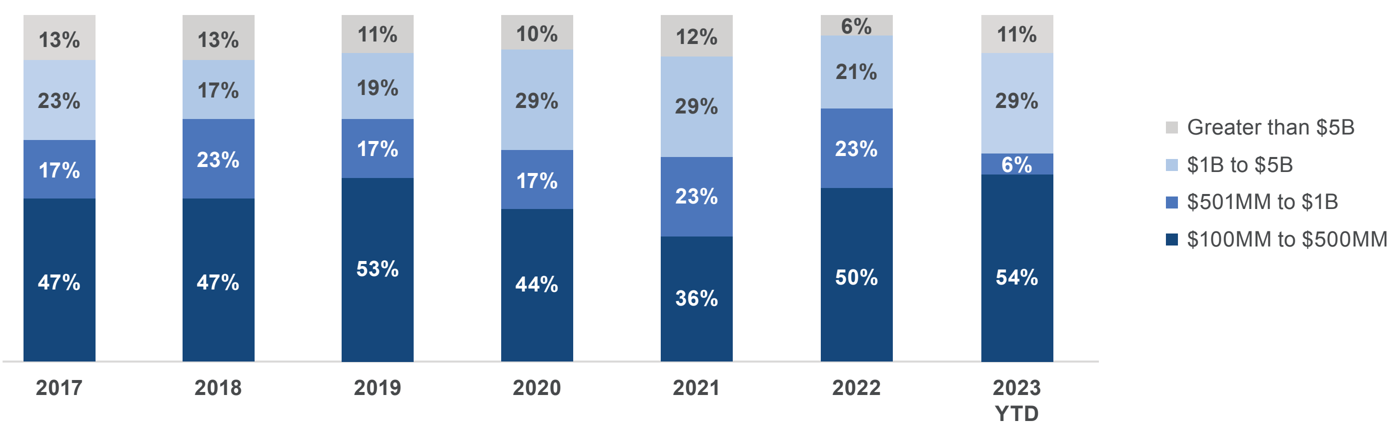
Examples of the $1B to $5B sellers that sold in the quarter included Equius Partners ($1B) joining Wealth Enhancement Group for scale and support structure for its next-gen team, and SteelPeak Wealth ($2B) selecting Emigrant Partners as a strategic partner to support its next phase of growth. DeVoe & Company advised both sellers.

This group has not been this active since Q3 2022, when $1B–$5B sellers accounted for 24% of transactions closed. In the most recent quarter, they have been crafting deal structures that appeal to sellers, allowing them to benefit from a future market comeback.

Mega firms with more than $5 billion in assets were 11% of first-quarter sellers, nearly double their share for all of 2022 and in line with their average share in other recent years. Seven such firms sold in the first quarter versus five in the same quarter a year ago.

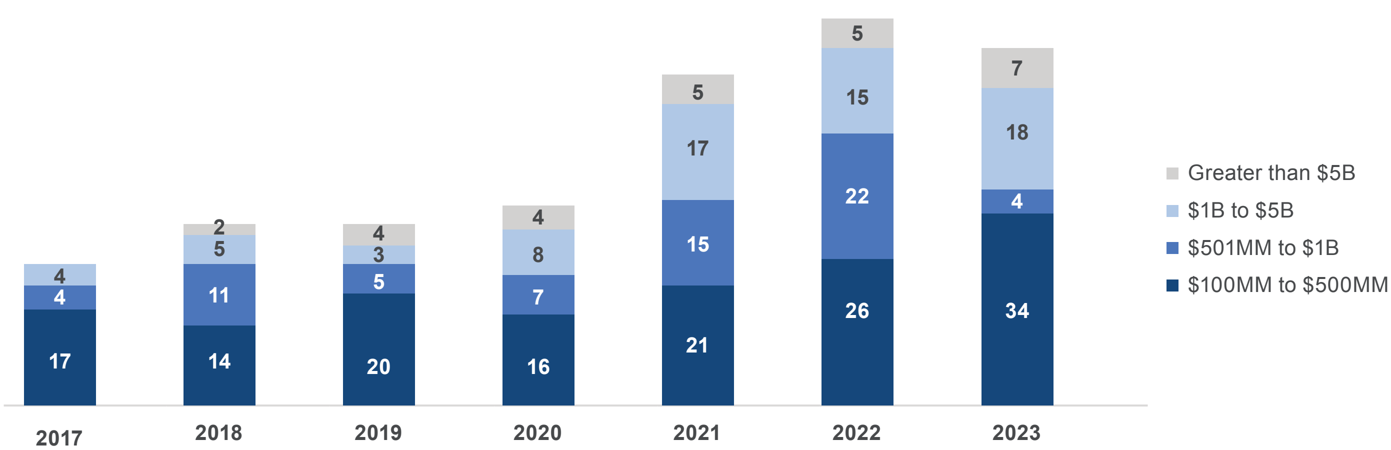
Mid-Size Firms Nearly Drop Off the Chart

Percentage of total transactions by seller AUM



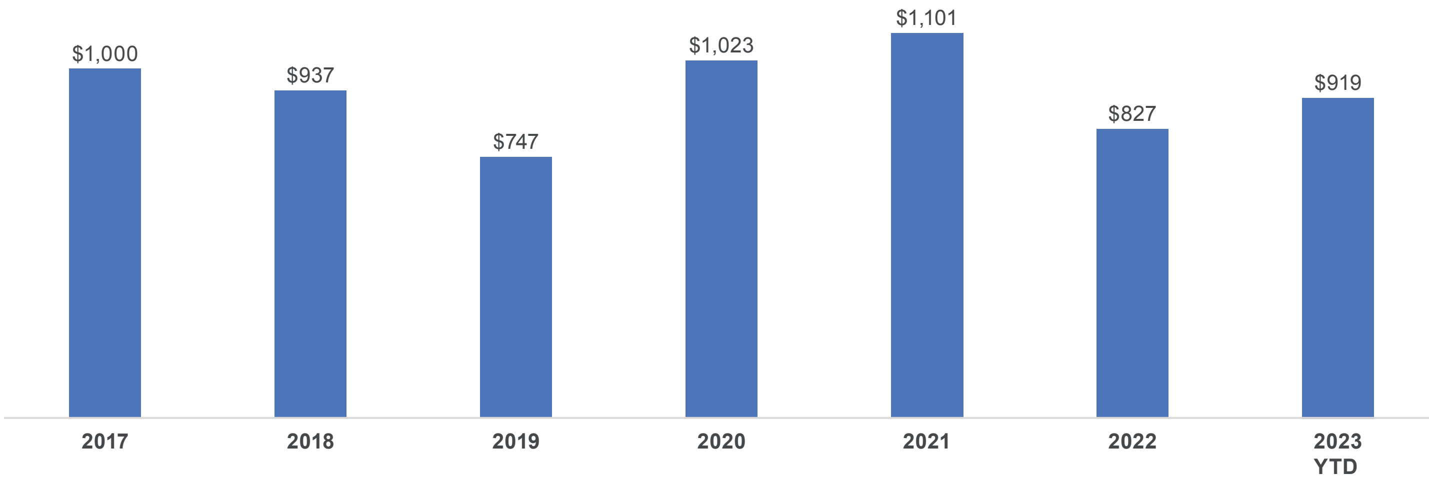
Small Sellers Increase Steadily over Four Years

Number of transactions by seller AUM: Q1 by year



Seller Size Above 2022's Average in the First Quarter

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



The Growing Popularity of Multi-Family Offices Inspires More Acquisitions

Multi-family offices (MFOs) are gaining greater visibility in the wealth management space due in part to recent M&A transactions. MFOs support families with multi-generational wealth — typically defined as $50MM or more in investable assets.

As large MFOs ($10B AUM or more) expand their reach and service offerings, smaller UHNW firms and MFOs are feeling some competitive pressure. In some cases, they are selling into their larger brethren to gain the benefits of scale and specialization. The acquiring firms are able to leverage and enhance their scale and are often using M&A to round out their service offerings, add sophisticated talent or expand their geographic footprint.

Recent transactions involving MFOs in Q1 2023 include:

- Sequoia Financial Group's purchase of Zeke Capital Advisors, which had $5B in AUM
- Kelso's minority stake in Pathstone, with over $80B in AUM
- Pathstone's purchase of Rex Capital Advisors, with $1.5B in AUM, coming just seven months after Pathstone announced the purchase of Dyson Capital Advisors, with $33.5B in AUM
- Stone Point Capital's minority stake in IEQ Capital
- Lazard Asset Management's acquisition of Truvvo Partners LLC, with $2.7B in AUM

Conclusion/Year Ahead

Buckle up and hang on tight: The uncertain backdrop for RIA M&A may make for an exciting 2023. The twists and turns of the macro environment — interest rates, the banking crisis, stock market volatility and the next unanticipated event — will contribute to twists and turns for RIA M&A activity.

And advisors seem to know it — or are at least divided about it. Nearly 45% of advisors expect M&A to increase in 2023, while 25% expect a decline, according to the surveyed RIA executives and owners in DeVoe & Company's most recent annual M&A Outlook Study. So far, it seems that they may both be right — it just depends on the day, week or month. There is no safe bet on whether 2023 will be another record year.

Despite the uncertainty, the pipelines of the major players are strong. DeVoe & Company and a dozen of the most active acquirers sustain strong funnels of sellers. Beyond 2023, we become more confident that M&A will trend upward. The structural underpinnings of the industry and the long-term trends point toward increasing activity over the long run.

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 18 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 RIAs, and only on transactions of $100 million or more in AUM. We limit our tracking to $100MM+ RIAs to optimize the statistical accuracy of our reporting and 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.

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 400 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 major categories:

BUSINESS CONSULTING
M&A GUIDANCE
VALUATIONS

Who We Are

Founded and led by RIA thought-leader David DeVoe, our team has grown to over 20 professionals with 400 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. Our team includes a McKinsey-trained management consultant and several former CEOs/COOs of $1B to $200B 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 **600** engagements in the last several years, supporting firms managing **$100MM** to over **$250B** 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 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:

- *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*

Engaging DeVoe & Company
For more information or to engage our services, call us at 415.813.5066 or send an email to info@devoe-co.com.

Capital Group's commitment to the RIA industry

Business management

We recognize the challenges facing RIAs. We stand ready to assist you with our wealth strategy solutions, benchmarking and elite engagement services.

Investment management

From due-diligence consultations to portfolio analysis to the latest market insights – we can equip you with information and solutions to help meet your clients' financial goals.

Client communications

Leverage our proprietary research on clients' attitudes and preferences. We have insights, tools and specialists to help improve your client relationships.

An online community exclusively for RIAs – RIAInsider.com

Enjoy curated insights and a community of peers and thought leaders. Access specialized tools relevant to RIAs, including advisor management platform Truelytics. And boost your brand with Marketing Lab, Capital Group's client-ready publishing tool.

A dedicated RIA team to collaborate with your practice

Contact your relationship manager or specialist directly, or call our RIA support line at **(800) 421-5450.**

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