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RIA Acquirers Pull Back on Deals in '08

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Merger and acquisition activity by consolidator firms that buy up independent registered investment advisors (RIAs) has dropped off in 2008. And it's unclear whether those companies whose main focus is making such deals will turn the corner and help to repeat 2007's record tally of 80 RIA deals.

While some indicators show deals for RIAs overall are on a comparable pace to last year, it's clear the poor financial markets have dampened the momentum of the aggregators, which operate under a variety of models and use varying strategies, including some that are pure acquisitions and others that purchase stakes, revenue share, or cash flow from independent advisor firms. The most active RIA acquirers – with several billion of dollars worth of client assets in deals from 2007 alone – have been New York-based Focus Financial Partners[1]; WealthTrust[2] of Nashville, Tenn.; Boston Private Financial Holdings[3] of Boston; New York-based Asset Management Finance[4]; United Capital Financial Partners[5] of Newport Beach, Calif.; **Fiduciary Network** of Dallas; National Financial Partners[6] of New York; and Signature Financial Management[7] of Norfolk, Va.

Other players in the high-net-worth market have watched these aggregator firms for their potential to provide a streamlined path for money managers and others to reach wealthy investors served by the RIA market, which has thousands of small firms that are otherwise hard to reach.

The first half of 2008 has seen 33 mergers and acquisitions in the RIA market, ahead of the pace of 30 from the same timeframe last year, says **David DeVoe**, strategic director for mergers and acquisitions at San Francisco-based Schwab Institutional[8], which tracks RIA deals. "[The first quarter] was weak, but M&A activity has really rebounded and took off in the second quarter," DeVoe says.

The pace also held for RIAs with more than $100 million in assets, DeVoe says. Of the 30 deals in the first half of 2007, 23 of them, or 77%, involved RIAs with more than $100 million, while 28 of the 33 this year, or 85%, were in that range.

But a big year-to-year difference emerges in who is making deals, DeVoe says. Whereas aggregator firms had a hand in transactions that involved 40% of the assets in last year's 80 RIA deals, those buyers were only active in deals amounting to 15% of assets so far in 2008, he says.

Deals by the aggregators – sometimes called roll-up firms or holding companies to reflect some of the business models – also appear to be down to **Elizabeth Bloomer Nesvold**, managing partner of Silver Lane Advisors[9], a New York-based investment bank that focuses on wealth management deals.

The downshift in activity by the RIA aggregators is significant because the 40% level of assets they hit last year was a peak after steady increases since 2003, when they only accounted for about 8%, DeVoe says.

DeVoe says while various factors may explain why the acquirers generally are staying on the sideline, the broadest may be the impact of tighter lending capital and more conservative revenue projections for RIAs due to the down markets. "On an aggregate level, the holding companies are analytical," DeVoe says. "That has put downward pressure on valuations, so while sellers may be focused on 2007 valuations, buyers are looking at [lower] 2008 valuations."

DeVoe says that an RIA with $100 million in client assets would historically have sold for four to six times its earnings before interest, tax, depreciation, and amortization, but now deals are at the lower end of that range. "As the market goes down, and their asset pool shrinks, they're collecting fewer fees on those assets," he adds.

Despite the pull back by RIA acquirers, DeVoe factors in a rebound – and a strong close to 2008. "I wouldn't count [the aggregators] out," he says. "They have solid pipelines and private equity backing them."

The expectation that RIA aggregators will be back in business underpins DeVoe's prediction that 2008 will beat the mark of 80 deals last year, which surged past the 58 deals in 2006 and 52 in 2005 tracked by Schwab. "In 2007, we had a strong second half of the year," he adds. "If we continue to see the momentum of [the second quarter], we'll have another record year in 2008."

But Nesvold is not as sanguine about this year's prospects. Her data shows RIA deals for firms with $100 million or more in client assets are behind last year's pace, and she predicts only 55 deals this year, well behind the 78 her firm counted in the industry for last year. "I am not as optimistic," she wrote in an e-mail. "We are predicting a 25% [to] 30% slide from last year's record number of transactions. Much of that is attributable to the slow down by the aggregators, however, a fair amount is also linked to the subprime exposure that many of the banks have faced in this market."

Nesvold says she looks forward to announcing a few deals later this year, and that while she is "hoping for a surge…I'm just not expecting it in this market environment."

Schwab's data shows that the primary acquirers in the market beyond the aggregators are other RIA firms, along with regional and national banks that are trying to bulk up their own wealth management teams. The slack for 2008 has largely been made up by other RIAs in Schwab's data, which DeVoe says is a sign of greater sophistication in the partners at these firms about knowing how and when to make deals, and about what kinds of partnerships make sense.

Whatever happens in 2008, the next five to 10 years should bring a higher level of merger and acquisition activity for RIAs, DeVoe says. Among the reasons for that trend he cites demographics – including the average age of RIA owners hitting 55 years, likely spurring sales of RIA businesses – as well as the awakening of potential buyers to the attractiveness of the fee-based advisory model as a revenue generator. "This consolidation trend should continue," he says.

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