RIA M&A: What's Next in Early 2020?

Deal volume is likely to slow, but that gives advisory firms the chance to get educated and position for the future.

by Brandon Kawal for ThinkAdvisor

Many RIAs are spending time taking care of their clients and employees while assessing the financial impacts of COVID-19. As the industry gets used to working remotely and adjusting to market volatility, new questions about macro RIA trends have surfaced.

What will happen to RIA M&A?

There were 139 M&A transactions in 2019 compared to 97 in 2018, according to **Fidelity Investments**. At the beginning of 2020, the RIA industry appeared poised for another banner year in M&A, as Fidelity reported 13 transactions in January. Everything seems to have changed in a matter of weeks.

No industry participant has a crystal ball, so the best approach is establishing verifiable truths about the RIA M&A market and building a reasonable case on how to best position for the months ahead.

- The capital options are more diverse than ever before.
- There are more acquisition brands competing for opportunities.
- The succession problem isn't going away.

The M&A market has never been more diverse and accessible, so historical downturns provide little guidance. Instead, these truths point to some practical implications that all RIAs should consider for the next generation of RIA M&A.

A Chance to Prioritize

Deal volume is likely to slow considerably in the coming months. Buyers will evaluate deal structures, and sellers will consider the timing of the transaction.

Late-stage transactions may proceed as planned, but deals in the early stages will likely pause. The length of this volatility is a key concern, and the impact on deal flow may be felt for the next one to two quarters.

Suppressed deal flow presents a good opportunity for potential buyers and sellers. Why approach the M&A market at all? Is the juice worth the squeeze?

RIAs should take the opportunity to consider how M&A efforts perpetuate the broader objectives of an advisory firm. The firms that are playing long-ball will continue evaluating M&A for access to talent, capabilities, and geographic expansion. The coming months provide an opportunity to get educated and position for the future.

Adjusting Deal Structures

Our inaugural release of The RIA Deal Room research showed that deal structures were emphasizing down payments with over 60% of cash consideration paid at closing.

Our upcoming 2020 release will show that deals in 2019 followed a similar trend. This market is likely going to tilt structures away from cash guarantees and put emphasis on shared risk/reward.

Creating more balance in transaction structures is not surprising at the end of a bull market and there are opportunities for participants to evaluate a potential strategic relationship based on its long-term merits.

We expect the coming wave of transactions to focus on shared outcomes for clients, employees, and owners by emphasizing scale and flexibility.

Softening Valuations

Valuations will be impacted due to the decrease in cash flow and tempered growth assumptions. Many transactions make explicit assumptions in pro forma financials that have been generally accepted in good markets. Pro forma earnings before interest, taxes, depreciation and amortization can be more than 30% higher than operating EBITDA in the average transaction.

Transaction models will likely factor more conservative growth assumptions, and heavily adjusted financials will receive greater scrutiny. Decreasing valuations is rarely a good news story, but participants emphasizing long-term outcomes are positioned to win.

Sellers looking for the highest valuation, with the least amount of risk, are likely moving to the sidelines. Buyers and sellers should take the opportunity to clearly define a durable deal model that emphasizes the win/win.

More Acquirers Needed

This market will reinforce that access to capital is not enough to differentiate. Acquisition brands have consistently separated themselves on their growth engines, robust platforms, and scale benefits.

Acquisition brands completed 46% of all RIA deals in 2019 and 42% of all RIA deals from 2016 to 2018, and we may see further deal count concentration as their value propositions are amplified.

The recent market volatility isn't going to change the fact that the industry is aging, and succession will drive assets into motion. In 2019, Cerulli and Associates estimated that $2.4 trillion in assets will go into motion over the next decade.

The RIA market is not prepared for succession; but an equally troubling question is, do we have enough qualified buyers to accommodate the flow?

Potential buyers should view this as an opportunity to evaluate the M&A market and appeal to more than "writing a check." Potential sellers can also take a step back and evaluate their succession plans more closely. Build, outsource, or partner should take center-stage for many RIAs.

What Should RIAs Do?

This is an opportunity to anchor to verifiable truths and determine how to best position for long-term success.

- Take the opportunity to get educated; is M&A the right tactic for you?

- Understand who is winning and why; can you contribute to the long-term health of the industry? (The industry needs more buyers and sellers in the coming years.)

- Don't make any sudden movements. Determine what's best for clients, employees and owners. Is there an opportunity to leverage the M&A market to create better long-term outcomes?

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