Cash reigns as king in RIA M&A deals

The trend is expected to continue through the year as buyers' appetite for certainty outweighs cost of capital

by Nicole Casperson for InvestmentNews

Mergers and acquisitions in the registered investment adviser industry were dominated by cash transactions last year as buyers favored such deals over more expensive and risky equity capital amid historically low interest rates.

M&A activity showed a shift away from equity in 2019, according to the 2020 RIA Deal Room study released last Thursday by Advisor Growth Strategies.

Cash increased to 70% of total consideration, according to the study of 31 transactions that closed last year.

"In the M&A environment, it's really on both sides," said Brandon Kawal, principal at AGS and author of the study. "Sellers are looking for a lot of confidence in their outcomes and buyers are preferring cash as well."

Mariner Wealth Advisors, for example, leverages a 100% cash transaction structure, said founder and Chief Executive Marty Bicknell. The RIA closed nine M&A deals last year alone and 22 since 2012 — all cash only.

"We pay 75% upfront and 25% over the next 12 months based upon the retention of the assets," Bicknell said. "So we don't do earn-outs, meaning [the transaction] is a fixed amount and doesn't fluctuate. It's based upon the assurance that what we think we bought is what we bought."

With cash injections becoming more common, there is an expectation that the number of cash transactions will go up.

"Banks are more willing to lend to the industry than ever before," Bicknell said. "Private equity is coming in with capital and is willing to get behind acquisitions. Three to five years ago, when [RIAs] were trying to do deals, they would get creative with some sort of merger or combining of the two entities."

Today, the opportunity in the M&A space is to create the simplest deals possible, Bicknell said. "People can understand [cash] versus putting formulas that would drive the split of the combined entity or a formula based on growth rate during the next few years — that just complicates things."

By comparison, the previous study by AGS, which examined 55 transactions between 2015 and 2018, found that cash made up just 47% of total consideration.

From a competitive standpoint, Mariner Wealth Advisors may be ahead of the curve, but more RIAs shifting toward cash-heavy deals could make for a more competitive M&A landscape.

“In the future, potential sellers are going to have to be really precise with how they’re driving value and what they want out of a transaction because the market is showing that there’s a preference toward using cash,” the study noted.

As a result, balance sheet strength will become a focus for prospective acquirers, according to the study. Potential sellers will need to carefully consider their ideal fit in a transaction as long-term considerations, such as equity, are harder to find.

“There’s no shortage of opportunities,” Bicknell said. “In 2020 and 2021, the number of deals are going to continue to surpass the year before. I see no slowing down of opportunities — not just for Mariner, but the industry overall.”