RIA M&A: Cash Deal Now or Opportunity Later?

Cash might be king but accepting cash-heavy deals now may come at the opportunity cost of more options in the future.

By Brandon Kawal for WealthManagement.com

After the year we've had so far, not many of us would say no to some more stability in our lives. That counts double for the RIA industry. A graying workforce weighs its options for exit plans, and the pressure to compete makes inorganic growth an attractive prospect. After spending hours combing through the terms of dozens of M&A transactions for our annual RIA Deal Room Report, I realized buyers and sellers last year showed a greater hunger than ever for the perceived safety of cash deals.

From 2015 to 2018, cash made up 47% of the average acquisition. Last year, it leaped to 70%, and we expect cash will play a significant role in deals to come. The flight to certainty is real, but is it the whole story? And what does it mean for the future of M&A in our industry?

It's easy to understand. Banks are more than willing to offer the debt capital, and the liquidity of cash deals is attractive to advisors looking to retire. By contrast, firms do not lightly part with expensive equity capital, and after a decade of market lift, 2020 has forced firms to take a hard look in the mirror to figure out how much of their worth is intrinsic and how much comes from a historic bull run.

But at the same time, you have acquirers who are likely to walk away from all-cash deals. No equity means no skin in the game, no long-term commitment once the ink dries and money changes hands. This creates a challenge around keeping the next generation engaged and puts heavy emphasis on career-pathing and compensation. When Advisor Growth Strategies surveyed 96 firms between March and May of this year, 56% said finding talent was their top concern. Successful cash-heavy deals will need a plan to capture next-gen interest.

While we can't deny the popularity of cash-heavy deals, there is room for everyone to compete. Half of the firms we surveyed this year cited a preference for growth and scale as a reason to do M&A, while the other half prized liquidity and succession. Whichever path they choose, the approach will have to be more precise as 51% of survey respondents cited being unprepared and 16% only modestly prepared to engage in M&A.

We see the imminent wave of retirements and pressure to scale dividing the deal landscape into two camps: firms that put a premium on the liquidity and certainty of cash today, and those who are willing to chart long-term plans and position themselves for more opportunities to come. Neither of these camps is "better" than the other, but we believe advisors who approach their M&A needs in an intentional, proactive way will find they have more options at the bargaining table. To put it another way, if an RIA hasn't figured out what it needs, it may have to settle for what it gets.

Although we see glimpses of green shoots, deal flow in recent months has slowed considerably. The demand for buyers and sellers is still there, but firms hanging up a "For Sale" sign will not conjure the line of suitors they might have expected in the past. Likewise, the days of competing solely on access to capital are far behind us. We've observed a lot of firms that have hit the brakes on deals in progress, hoping to see valuations and confidence return to pre-pandemic levels. That is hardly a guarantee.

The best thing an RIA could do now, in my opinion, is to study the market, understand what it wants and understand what their business has to offer. A firm that can't articulate its value to prospective partners may have to swallow Faustian equity bargains. And cash might be king, but accepting cash-heavy deals now may come at the opportunity cost of more options in the future.

Brandon Kawal is a principal at Advisor Growth Strategies. Follow him at @BKawal_AGS.