Behind the M&A Buying Spree

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The red-hot M&A market for RIAs shows no sign of slowing down. Yet.

Deals are being transacted at a record pace, capital is pouring in and strategic buyers, led by well-financed RIAs, are frantically plotting to consummate more acquisitions in 2018.

There are approximately 10 to 20 qualified buyers for every seller, according to industry estimates. Through the third quarter of 2017, the most recent data available, deal volume for the year was on track to set a record with over 150 transactions, reports research and investment banking firm **ECHELON Partners**. The record is 138 transactions in 2016.

Deals have also gotten bigger: The average size of an RIA transaction the past three years has topped $1 billion in AUM, according to Schwab Advisor Services.

Like nectar attracting bees, the highly desirable assets, recurring revenue, talent and clients of advisory firms have a magnetic appeal to deep-pocketed suitors seeking to turbocharge growth.

Indeed, top-tier private equity firms are investing heavily in the independent advisory space, with an especially keen interest in consolidators. Last year, KKR and Stone Point Capital acquired a majority stake in Focus Financial Partners, and Thomas H. Lee Partners made a $100 million investment in HighTower Advisors. Genstar Capital continues to fund an aggressive growth push by Mercer Advisors.

M&A AS ACCELERATOR

Scrambling to keep pace, independent RIAs committed to leveraging M&A for growth are tapping their own sources of capital — and are poised to go on buying sprees this year.

"We have the ability to grow organically around 10% to 15% a year," says Neal Simon, chief executive of Bronfman Rothschild, a $5 billion advisory firm backed by capital from the two billionaire families that provide its name, along with other private investors. "But we want to grow faster than that, and M&A is a way to accelerate that process."

Advisor scarcity is also spurring the M&A frenzy, according to Brent Brodeski, CEO of Savant Capital Management, a $5 billion--plus RIA based in Rockford, Illinois.

"Acquisitions allow me to partner with top advisor talent and hire more qualified people, because now I have greater resources," Brodeski says. "For the same amount of time and energy that it takes to open a new office, I come out ahead if I buy one."

Savant is one of a number of billion-dollar-plus RIAs that have recapitalized with an eye to expanding their footprint this year. In 2016, Savant's M&A war chest was fattened by a $50 million infusion from an array of private investors including an asset manager, a merchant bank and three large single-family offices.

After a buying hiatus last year, Savant expects to complete two to three smaller deals in Wisconsin, Washington, D.C., and Illinois through mid-2018, says Brodeski, followed by an acquisition in the $750 million to $1.5 billion range to establish a beachhead in a new market.

In Leawood, Kansas, Mariner Wealth Advisors will also have ample resources as it pursues advisory firms in 2018.

The sale of an asset management firm owned by the RIA's parent company, Mariner Holdings, is expected to add around $1 billion to Mariner's coffers. After sitting on the sidelines for nearly three years, Mariner plans to make seven to 10 acquisitions this year, according to CEO Marty Bicknell, targeting firms across the country with between $250 million and $1 billion in assets.

CASH OR EQUITY?

The high-profile executive Ron Carson avoided dealmaking last year after a switch of vendors to Cetera Financial Group from LPL Financial.

But new funding from Carson Group's largest shareholder, the private equity firm Long Ridge Equity Partners, signals a buying spree this year. "We will have plenty of financial resources to be an aggressive buyer and plan to be very active in the M&A market," Carson says.

Neal Simon, CEO of Bronfman Rothschild, wants to accelerate his firm's growth by M&A.

Beacon Pointe Advisors in Newport Beach, California, is also strongly committed to increasing growth through acquisitions. But unlike many of its competitors, it relies entirely on equity, not cash, when making deals.

"The fact that we don't want to cash people out makes us more attractive than our competition," says Matt Cooper, Beacon Pointe president. "We're not offering a short-term financial transaction. We're offering equity to smaller firms who want to contribute to a growing enterprise for the long term."

The firm, which has acquired four companies since 2015 with a cumulative AUM of around $865 million, is targeting RIAs with $200 million to $550 million in AUM, and hopes to do three or four deals in 2018, Cooper says. He and the other RIA acquirers hope to capitalize on being part of the advisory fraternity.

Indeed, Bronfman Rothschild's Simon believes advisors considering a sale will be swayed by the "real operational synergies" a fellow RIA can offer. "Unlike an aggregator — which is a collection of silos — or a private equity deal, firms who merge with us will be part of one investment team, one brand, one back office," he says. "We offer cash and equity and have more deals on the table today than we've ever had."

NO SLAM DUNK

But successfully wooing a like-minded RIA in this market is hardly a slam dunk.

RIA buyers are also confronting an increasingly crowded market of well-funded buyers hunting for similar sellers. The roll-up firm United Capital received a cash infusion from an Australian life insurance company that will boost its already relentless M&A efforts.

Captrust Financial Advisors, which specializes in retirement planning services for institutions, was one of 2017's most active buyers, with seven deals totaling over $1 billion in assets. The firm plans to double its national footprint to 35 metro markets in 10 years, says CEO Fielding Miller.

Also pursuing an aggressive M&A strategy is Wealth Partners Capital Group, a newly formed RIA aggregator founded last year by the executive team that ran the highly successful wealth management division of Affiliated Managers Group.

Wealth Partners is targeting small and midsized RIAs across the country via three regional firms in which it has already invested.

Banks are also in the mix as buyers with deep pockets. Although their share of M&A deals has dipped to single digits in recent years, banks have accounted for approximately 13% of RIA acquirers through the third quarter of 2017, according to ECHELON Partners.

ROOM TO RUN?

Can the hot M&A pace — and the resulting seller's market — continue? For starters, buyers and sellers are keeping a wary eye on the stock market.

In addition, assets, earnings and revenue would all drop during a correction, making advisory firms worth less. A spike in interest rates would be another red flag for the market, industry observers say.

As Brodeski puts it: "Leverage is like adding octane to your gas. A little bit can boost your fuel, but too much can blow your engine."

As demand for sellers rises, they are also getting choosier, notes Matthew Matrisian, senior vice president of strategic initiatives for AssetMark, an industry service provider.

"If an acquirer has a system in place, it's simple to integrate the seller's asset base, and the economics are beneficial to the buyer because they can take the revenue stream and drop it into their EBITDA with little overhead," Matrisian explains. "It makes sellers very attractive right now."

A potential headwind for buyers "is the fact that sellers are getting much smarter about what they want to accomplish," he says. "They have leverage now and have more ability to dictate terms when picking a buyer."

Nonetheless, RIA buyers remain remarkably optimistic.

"Even if there's an economic event, I think it will only have a very short-term impact on the market," Mariner's Bicknell says. "The supply of sellers will still be there. Those who haven't solved the succession issue will be looking for partners for growth. And those doing financial deals today will lose their appetite. That leaves buyers like us in a good place."

Cooper, Beacon Pointe's president, agrees. "The forces driving this market, including changing demographics and the rising cost of compliance, regulation, technology is so strong," he says, "that I'm not concerned it will slow down anytime soon."