Smarter Sellers, Buyers Bog Down RIA M&A Activity

1/30/2017 Originally Published Jeff Benjamin, InvestmentNews

The number of merger and acquisitions involving registered investment advisers fell by 25% last year.

The latest M&A report from Fidelity Custody & Clearing describes the 104 deals in 2016 as an anomaly, and projects transactions for the current year to be more in line with the 138 deals of 2015.

“I think the number of deals will pick up substantially from 2016,” said David Canter, Fidelity's executive vice president for practice management and consulting.

The report, released Monday, focuses primarily on the growing impact of large RIA acquirer models.

Its findings run contrary to other reports of record growth last year in RIA M&A due to parameters of the research. Fidelity's findings do not include asset manager transactions, registered breakaways, dually registered firms, minority investments, deals involving firms larger than $20 billion or deals where no assets are transferred. And investment bank **Echelon**, for example, which found mergers hit their highest level in 2016, included deals not publicly disclosed.

Mr. Canter said the slowdown last year in the deals it studied was partially due to growing gaps between what buyers are willing to pay and what sellers are seeking for their RIA businesses.

“The texture of the marketplace is changing, and what we're hearing from buyers is that there is still a gap in terms of what sellers expect the valuations to be,” he said. “Also, these more-sophisticated buyers know the kinds of firms they want, so they're being patient.”

Those smarter buyers are also coming up against the reality of better-informed sellers, according to **Daniel Seivert**, chief executive of **Echelon Partners**, an investment bank that also tracks M&A activity.

“Given the increased attention to the subject of M&A activity by conference providers, white paper writers, webinar sponsors and the media, there is a plethora of information available to help sellers understand the dynamics of deal making,” he said. “While all this information has likely created more questions than it has answered for would-be sellers, most entrepreneurial wealth managers know much more than they did 10 years ago.”

RIA business valuations generally hover between five and eight times earnings before the owner's compensation, but the Fidelity report underscores some of the things buyers have learned to avoid.

The things that will likely turn off a potential buyer is a history of limited assets-under-management growth, an aging client base, lack of talent, an immediate succession of the owner/adviser and a tainted compliance record.

“Nobody wants a firm with a 65-year-old founder and no next generation in line to takeover,” Mr. Canter said. “The acquirers have more road results under their belts, and of course, we also can't discount that some of the slowdown could be due to the macro environment, including the DOL rule and the presidential election.”

One factor that could create new challenges is the cost of acquisition capital if the Federal Reserve makes good on its plans to raise interest rates in 2017. Not only could higher rates hamper the number of deals, but higher borrowing costs could also push down sale prices.

“Over the past five or six years, the M&A activity has benefitted from a lower cost of capital, but that's likely to change as rates rise,” Mr. Canter said. “It's analogous to the housing market, where home prices can more easily rise because the cost of capital is less.”