HighTower M&A Deal May Hinge on Retention Package

10/10/2017 Originally Published by Charles Paikert, Financial Planning

Whoever buys HighTower Advisors, the closely watched RIA juggernaut widely regarded by industry insiders to be for sale, had better be prepared to pay up to encourage the firms' nearly 200 advisors to stick around.

"A HighTower buyer faces a huge flight risk," says Tim Welsh, president of consulting firm Nexus Strategy. "Many of the advisors can leave at any time. They own the clients, not HighTower. Even having some equity may not be a reason to stay because we've seen advisors who had equity in the firm already leave."

M&A deals in wealth management are often plagued by flight risk. When broker-dealer Stifel bought Barclays' U.S. wealth management unit in 2015, nearly half the 180 advisors left for rival firms before the deal closed.

Barclays advisors went elsewhere in part because they perceived Stifel to be a poor fit for their clients or they got better offers from rival firms to move.

Potential buyers for HighTower include private equity firms, domestic or foreign banks and possibly a Wall Street financial services firm, industry insiders say. HighTower has hired J.P. Morgan as its investment banker, according to a HighTower partner, who asked not to be identified.

A spokeswoman for HighTower said the firm "has a policy of not responding to market rumors."

'BUYER HAS TO PONY UP'

While industry executives cite many benefits a HighTower buyer will receive —distribution, over $30 billion in AUM, steady cash flow and recurring revenues, scale, an established operational infrastructure and a fiduciary brand — the key to a successful acquisition, they say, is to make sure the firm's advisors stay put with an attractive retention package.

"The obvious challenge for the buyer is locking down all those teams that were acquired via the equity model [HighTower's original business model to attract breakaway brokers] and advisors that are using their platform services model," says Matt Cooper, president of Beacon Pointe Advisors in Newport Beach, California. "Failure to do so could make this a treacherous deal for a buyer."

Assuming "HighTower's operations are solid," says **Carolyn Armitage**, managing director of **ECHELON Partners**, an M&A investment banking and consulting firm, "a buyer can benefit from acquiring significant assets and being part of an industry that is on the upswing."

But, she adds, "whether advisors will stay or not depends on the retention package, and the buyer is going to have to pony up."

The HighTower partner agreed.

"There are a lot of advisors who can leave if they want," the partner says. "There has to be an attractive package with a very good number to make them stay."

The most likely retention package will include a forgivable loan and possibly a cash bonus, industry executives say.

"Failure to lock down all those teams could make this a treacherous deal for a buyer," says Matt Cooper, president of Beacon Pointe Advisors.

"The retention bonus is typically structured as a forgivable loan," says Jeff Spears, the former CEO of platform provider Sanctuary Wealth Services, who currently writes the Wealth Consigliere blog. "The loan multiple is in the range of 0.5 to 1 times the advisors' trailing 12 revenue and has a maturity of less than the typical recruiting loan, which is usually seven years. This will be important to HighTower advisors whose original deal was approximately 50% cash and 50% equity. If there are any issues with the company's equity, the retention deal can address that."

The forgivable loans, or promissory notes, provide advisors a strong incentive to remain with the firm for the duration of the loan. This is especially important in HighTower's case because owning HighTower equity may not be enough to prevent advisors from leaving, depending on the stock's valuation.

BREAKING RANKS

Indeed, a number of high-profile HighTower advisors have already parted ways with the firm, despite having sizeable ownership stakes.

Paul Pagnato and David Karp took their Reston, Virginia-based RIA, managing over $1 billion in assets, independent last year. This summer two more big teams broke ranks. Joel Guth left to form Gryphon Financial Partners in Columbus, Ohio, which has nearly $1 billion in AUM, and in Hunt Valley, Maryland, Kelly Wealth Management and its $2 billion in assets split to rebrand as Verdence Capital Advisors.

Nonetheless, an appealing retention package combined with other incentives may well persuade remaining HighTower advisors to stay, say industry observers.

"A PE firm may sweeten the pot and a bank could provide capital, leads for high-net-worth clients and lending capabilities," says one M&A executive who asked not to be identified. "But the buyer's best protection is inertia. Pulling up stakes and going somewhere else is a hassle."

What's more, many HighTower advisors appear to be satisfied with the firm, says recruiter Mindy Diamond.

"We've placed a number of HighTower advisors and haven't had any complaints," Diamond says. "A new owner may be well served to continue the firm's ongoing business model."

In addition, HighTower advisors who do have stock in the company stand to benefit financially from a sale, especially if the valuation is favorable, making it less likely they would leave. "That's a good retention package right there," says one executive familiar with HighTower who did not want to be identified.

ROLE OF 'INDEPENDENT SPIRIT'

HighTower declined to state how many advisors are currently under service contracts.

The firm — whose parent company, HighTower Holding, also owns a broker-dealer, HighTower Securities — has been hit by a string of high-profile losses from its top management team this year, including the departures of former president Michael LaMena; Mike Papedis, who headed RIA acquisitions for the firm; and Michael Parker, the former head of business development.

Nonetheless, HighTower continues to add advisors.

As an RIA acquirer, it bought WealthTrust, a Houston-based RIA aggregator with over $6 billion in assets and dozens of advisors earlier in the year.

HighTower's outsourcing platform business bulked up in the past week with two additional clients: True Wealth Advisory Group, a Miami-based breakaway firm led by CEO Marc Shachtman which oversaw $500 million while at J.P. Morgan and The Keith Group, a Lebanon, Pennsylvania-based wealth management practice led by Kevin Keith which oversaw $230 million in client assets at Merrill Lynch.

And HighTower's original business model has retained most of its legacy advisors. Pioneered by CEO and co-founder Elliot Weissbluth, HighTower was one of the first RIAs to cash in on the breakaway broker boom by recruiting corner office brokers well as successful advisors from other RIAs to become equity partners.

"Whoever buys HighTower gets an integrated platform made up of a cross-pollination of quality advisors that has considerable value," says Alois Pirker, research director for research firm Aite Group. "The company was designed with the client in mind, it's not product-oriented, and has a good fiduciary reputation.

"But the independent spirit may cut both ways for a buyer," Pirker cautioned. "If the advisors came to HighTower because they valued independence, how do you get them to stay if they're no longer independent? I think whatever happens after a sale is completed hinges on the people and what they decide to do."