Advisory Firms Retain Their M&A Allure

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Demand to buy financial advisory firms remains strong despite a drop in the value of assets under management and turmoil in the financial markets.

The fact that most deals are small and that banks never were a factor in advisory firm financing "means the credit crunch has had minimal effect on demand and transactions," said David Grau Sr., president of FP Transitions, a Portland, Ore.-based consulting firm that specializes in the evaluation and sale of advisory firms.

"We're receiving 30 to 50 inquiries for every firm going up for sale and getting two to four full-priced offers," Mr. Grau said.

The current market also has spawned a 30% to 40% rise in merger activity among advisory firms, said **Daniel Seivert**, chief executive and managing partner at **Echelon Partners**, a Manhattan Beach, Calif., investment banking and consulting firm.

"The merged firms don't exchange capital," he said. Instead, the principals "figure out how to split the equity and cash upfront or develop a dynamic approach based on their production and contributions to a new firm's development."

Through the third quarter, Schwab Institutional in San Francisco has observed more than 50 advisory-firm acquisitions, which is "on track" to break last year's record of 80 deals, said David DeVoe, senior director of mergers and acquisitions for the firm.

"Most sales and acquisitions are quite small and don't require a lot of capital either upfront or for the entire deal," said Mr. Seivert, noting that the majority range from $500,000 to $10 million in value and are largely seller-financed.

For an advisory firm with $50 million in assets under management, buyers typically put down 20% to 40%, although down payments have declined since the financial crisis began in September, industry dealmakers said.

Buyers typically have three to five years to repay the note, although repayment periods are lengthening by about a year.

"We have seen the number [of years of the loan term] increase over the last few months," said Jody Young, senior managing partner of the Atlanta Capital Group, which has bought two advisory firms in the past year and is negotiating to buy one or two more in the next six months.

On average, seller financing currently is in the 6% to 7% range, but outside financing can be "all over the map," ranging from 8% to 15%, depending on factors such as the quality of a firm and whether the seller is "distressed," said David Goad, president of Newport Beach, Calif.-based Succession Planning Consultants.

Despite the plummeting stock market, multiples for deals have remained steady, industry experts said, although they warned against a "one size fits all" number, stressing the unique nature of each deal.

Nonetheless, gross revenue re-mains popular as a multiple benchmark, and Mr. Young said firms with managed money "bring the highest multiple, at or about two to two-and-a-half times trailing 12-month revenue."

According to Mr. Grau, "the typical multiples for an advisory firm with $50 million in recurring fee-based revenue are between [one-and-a-half] and [three-and-a-half], and sometimes higher for firms with a substantial infrastructure."

Multiples also are based on net operating profit, known as "owner's compensation," Mr. Goad said. Current advisory practice multiples are four to five times non-recurring NOP and six to seven times recurring NOP, he said.

Mr. Goad also said he has seen a sharp rise in internal-succession sales during the past year. Those transactions "are all about the client, and not gross revenues," he said.

"Most sellers receive full-price offers, and most are paid their full value if a good match between owner and successor is established," Mr. Grau said.

Sharing risk and reward between buyer and seller is critical, he added.

For example, lending or earn-out arrangements are often based on revenue generated from transferred client accounts, and deals also may take into account fluctuating assets under management.

"We usually do a six- to 12-month look-back based on the amount of assets or sometimes based on the number of clients still with us," Mr. Young said. "The typical provisions will reduce the total purchase price [if the numbers decrease]."

WAIVING RISK AND REWARD

But assets can also rise, of course. According to Mr. Seivert, "most sellers have traditionally waived the risk and reward associated with up and down markets after the sale. To the extent sellers have been protected from downward price adjustments due to market declines, they typically have to forgo upward price adjustments due to market increases."

Advisers who have been selling their firms this year generally have been nearing retirement age, according to Mr. DeVoe. The seller's average age is about 58, and the buyer's about 43.

The number of registered investment advisers acquiring other RIA firms has risen from approximately one-third of all transactions two years ago to more than half of all transactions this year, Mr. DeVoe said.

"Putting logs on the fire," is the way Mr. Young, 32, describes the acquisition strategy of his firm, whose other principals are David Millican, 35, and Jeffrey Shaver, 38.

"Buying assets at today's prices makes sense for the long term," he said.

In fact, market conditions have strengthened demand for adviser practices, Mr. Seivert said.

"Distribution is king," he said, citing advisers' "ownership of the one-to-one client relationship.

Given all the turmoil at the wirehouses, the RIA rollups, independent broker-dealers and banks, people are salivating at the opportunity to grow market share and become bigger."