M&A Bottleneck Caused by Buyers Expecting Fire sale

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The mergers and acquisitions market for RIA practices is cruising for its second straight depressed year.

There were only 35 deals completed by Sept. 30, according to the 2009 Real Deals study released this week by FA Insight of Tacoma, Wash. and the study's sponsor, Pershing LLC. Only deals that include practices with at least $100 million of assets under management are counted.

This snail-like M&A market this year is on pace to equal the tally of 45 for all of 2008, according to the study. These totals for 2008 and 2009 are a letdown in light of the 67 deals completed in 2007.

The two-year M&A flu in the market of registered investment advisor practices is largely explained by the deep discounts expected by buyers and the unwillingness of sellers to go along with them.

Fire sale

"Buyers often expect fire sale prices while sellers are reluctant to adjust down from the more attractive prices RIA owners were offered just a few years ago," says the report.

Prices for smaller firms may be off as much as 25%. Prices for bigger firms – which are targeted more often for acquisition – have dropped less, about 15%, according to Dan Inveen, the principal at FA Insight who authored the Real Deals report. [Inveen also wrote the Real Deals report in 1998 as an employee of Seattle-based Moss Adams.]

To some extent, practice valuations follow the market because most RIAs earn revenues based on the quantity of assets that they manage. The S&P 500 closed yesterday [Dec. 10] at 1,102, up 23.7% from the 899 it closed at on the same day last year, 2008. The S&P 500 started off 2008 at 1,447.

The determination of sellers to keep to their asking prices for their firms – despite radically lower assets and profitability in many cases – explains why the RIA M&A market is stuck in the doldrums.

"There's a bottleneck," Inveen says. "By the middle of next year we'll see a rising level of deal activity" as markets stabilize.

Mark Tibergien, CEO of Pershing Advisor Solutions of Jersey City, N.J., agrees that there are some bright signs.

"In spite of the short-term hold-up in the volume, we're still seeing a tremendous interest [in M&A] because the growth opportunity is big," he says.

Indeed, the top reason given for doing deals is growth and sustainability in 2009, the Real Deals study states. The top reason given by surveyed firms in 2007 was valuation and profit, it adds.

That interest in growth from principals is translating into an M&A market dominated by RIAs buying other RIAs, Inveen says.

"You're working with people you're used to and who have walked in your shoes," Inveen says.

In your shoes

RIAs joining each other also have the advantage of doing deals with stock swaps that minimize the need for cash, he adds.

The marrying mood of RIA firms is a healthy development, according to Tibergien.

"Not only is it healthy, but it's a natural evolution to have RIAs merge with RIAs," he says. "You create more larger firms that create more career opportunities and a greater presence" for the RIA industry. "Bigger firms attract bigger clients," which leads to more growth, he adds.

There are two types of RIA marriages. In one, a bigger firm swallows a smaller one. In the other, firms of equal stature merge. Both types of deals are on the rise, the study finds.

All-RIA deals have another advantage over the some of the ones cobbled together by roll-ups. "That's the kind of model that has more sustainability," Tibergien says.

Daniel Seivert, CEO of **Echelon Partners**, an M&A firm in Manhattan Beach, Calif., believes that RIAs have a near-perfect set of market conditions for making a strategic acquisition and he explains his thoughts in: Why the time for advisors to buy other advisors is picture perfect.

Sidelines

The other reason that RIA firms are taking center stage in the M&A market is that the usual first-stringers – roll-ups and banks – have moved to the sidelines. Roll-ups were hurt by falling share prices and tightened credit. Banks have had less cash and also have suffered from depressed share prices.

Both of these sets of buyers have better prospects for 2010, the Real Deals study reports.

There's one more trend to be on the lookout for, Inveen adds.

"You may see some consolidation among the consolidators [i.e. the roll-ups or what the study refers to as serial buyers]," he says.

Daniel Seivert

Managing Director

dseivert@echelon-group.com