M&A Outlook for 2010: What's on the Horizon

Originally Published By **Daniel B. Seivert**, Transitions Magazine

With the markets on an upswing after taking a torrid roller coaster ride over the past two years, the merger and acquisition (M&A) landscape for wealth managers has been infused with a healthy level of optimism. Higher cash flows, recovering valuation multiples, and continued demand to buy wealth management firms, among other things, have laid the groundwork for much greater deal activity than was apparent during the recession-afflicted years of 2008 and 2009. In fact, we believe that M&A activity should pick up meaningfully in 2010, as more wealth managers pursue succession plans, advisors move away from challenged larger firms, and mergers become an attractive way to facilitate growth and create value.

Though 2010 will represent a significant step up in activity from the past two years, it should be noted that it will have some clear distinctions from the freewheeling period of 2004 to 2007, when seemingly everyone wanted to buy a wealth management firm and there were no shortage of options to pursue whether you were looking to acquire or looking to sell. Instead, the opportunities will be more subtle and selective, though they could afford wealth managers some substantial payoffs if they are willing to roll up their sleeves a bit.

In the report we recently published on the subject, entitled M&A Trends and Opportunities for Wealth Managers in 2010, we assess in depth the M&A landscape in 2010. But, for the sake of brevity, we will provide a few of the salient points of the report in this article, in an effort to facilitate your decision-making for the upcoming year, as your firm contemplates the direction that it's headed.

Number of Companies for Sale/Advisors in Motion Primed for Increase

We measure the supply of two key types of "sellers": wealth managers (also referred to as RIAs, financial planners, HNW boutiques, family offices, etc.) and advisors in motion (which are advisors moving out of or between wirehouses, independent broker dealer, financial planning firms, etc.) who are looking to start their own firms or affiliate with other firms in hopes of improving their business freedom, compensation, equity, and/or lifestyles.

In general, we believe that the supply of these sellers in 2010 will depend on the performance of the markets.

The supply of advisors in motion will likely increase to new highs as advisors: a) feel more comfortable moving their investor clients now that their asset levels have recuperated a bit; b) move to business models where they can realize the full equity value of their books of business upon a sale (whether that coincides with retirement or not); c) gain more flexibility with regard to the way in which they run their operations and/or phase out of the business, and d) look to find relief by getting away from organizations, people, structures, rules, and demands that they believe to be a poor fit with themselves and their clients.

If markets are flat to down in 2010, the supply of wealth management sellers and advisors in motion will be moderately higher than what was experienced in 2009, but deal activity will be slower and more cautious.

Opportunities for Sellers: Valuations Down, Mergers Up, and Buyers Solid

With valuations still low, now is a great time to sell equity to employees, partners, family members or investors in cases where you are looking to get equity in their hands at attractive prices or give them equity and minimize the associated gift taxes. Many advisors fear that higher capital gains rates are around the corner. If you are in this camp, then you may also want to sell shares now to the parties above in hopes of avoiding higher tax tariffs for yourelf in the future.

At no time in history have there been so many professionals looking to facilitate these deals, including custodians, consultants, attorneys, investment bankers, and recruiting firms. The tools and support to go independent or join other firms are at all time highs.

Also, sellers in 2010 will actually have the opportunity to conduct deals with a higher quality and more genuine set of buyers than in years past. The 2003 to 2007 time period was flush with buyers and it seemed as though everyone wanted to own or purchase a wealth manager. As it turned out, many of these firms were actually dangerous to consummate a deal with, since they did not have the business model required to withstand changes in the market and/or to justify the prices they were offering. Some of those firms no longer exist, while many others have decimated valuations and are far from industry leadership. By contrast, in 2010, wealth managers will have the opportunity to conduct deals with more rational buyers that have a better chance of sustaining and preserving the important client and employee relations that most selling entrepreneurs want to protect.

Demand by Firms Looking to Buy, Merge, and Recruit: Still Strong but REAL Demand to Remain Well Below Peak

The desire to buy wealth management firms never really ebbed much in the economic downturn, but authentic buyer demand certainly did.

As many other aspects of the financial services business cratered, wealth management retained and - in certain respects - improved its relative attractiveness. In the 2003 to 2007 time period, just about every type of financial services firm wanted to get into the wealth management business, often opting to do this through acquisitions. This group of firms included banks (global, national, regional, community, trusts, thrifts, and credit unions), insurance companies, investment managers, financial technology firms, pension consultants, investment banks, advisory platforms, hedge funds, private equity firms, broker dealers, family offices, and custodians.

What’s different in 2010? Most of these firms still want to get into the business and in a bigger way. However, they just have too many internal problems/distractions to deal with, they don’t have the financial resources to conduct transactions, and many sellers now don’t trust most of these types of buyers.

Therefore, there will be far fewer firms involved in making real bids for sellers. Sellers should also expect a much higher percent of the bids received will be in the form of suggested mergers or structures where the deal is essentially consummated by nothing more than the cash flows of the company. Any firm can consummate a deal using such structure, but in the past few of these deals ever won competitive processes. Given that more sellers may want to hold equity longer, these deals may actually come into vogue, and will simultaneously cause sellers to place much more importance on the qualitative attractiveness of the buyer/succession partner than was previously the case.

Opportunities for Buyers: A Mixed Bag

The past two years have not been the best time for buyers looking to buy other RIA practices. Even though valuations had fallen significantly during this time, few firms were willing to sell at those low levels and therefore never put their businesses on the market. However, in terms of buying, recruiting, or merging with advisors in motion, the last two years were the best the industry has ever seen. 2010 will continue to be an unprecedented opportunity for wealth managers to hire, purchase, merge with or partner with advisors that have opted to explore the opportunities beyond the status quo at wirehouses and many other types of broker dealers or investment product distributors.

Many private equity holders are looking to simplify their holdings and move into lower risk and more diversified investments. Now is a great time for entrepreneurs to create a win-win situation by purchasing their own equity from these parties.

2010 also presents an excellent opportunity for entrepreneurs to buy back their firms all together. Whether you sold your firm to a bank, insurance company, large financial institution, rollup firm, etc., many of these players are looking to focus on their core competencies and unload non-core business or ones that are meeting internal "hurdle rates", a classification that may fit your firm. History is filled with firms that have sold themselves at high valuations to larger companies only to buy themselves back at a fraction of the price. 2010 may be a great time for you to look into a management buyout, management buyback, or restructuring of the deal you have with your equity partners.

***

Daniel B. Seivert is CEO and Managing Partner of Echelon Partners. Prior to founding the firm, Mr. Seivert was one of the initial Principals of Lovell Minnick Partners (previously Putnam Lovell Capital Partners) in 1999, following a career at The Capital Group, where he held executive and operating positions. Mr. Seivert is one of the leading financial and strategic advisers to CEOs, other senior executives, and boards of directors in the investment management and wealth management industries. www.echelon-group.com

Daniel Seivert

Managing Director

dseivert@echelon-group.com