Is there a Bubble in RIA Prices?

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Are RIA prices getting too rich?

At least two well-known names in the acquisition business, United Capital and HighTower Advisors, have backed away from buying established registered investment advisers while citing, in part, the high costs of the transactions.

Valuations vary widely, but around two-times revenue has been considered a somewhat fair price, depending on the age of clients, revenues and other factors. Those valuations, however, have started to come with added premiums.

In one prospective deal with United Capital, an RIA with around $2 billion in assets under management was asking for as much as four times revenue, more than what United Capital was willing to pay, according to Matt Brinker, senior vice president of acquisitions at United Capital.

"I just don't know who, at those levels, will pay that premium," Mr. Brinker said. "Generally, valuations continue to be incredibly rich."

FOCUS ON RECRUITING

Mr. Brinker said that shifting away from acquisitions and focusing more on recruiting was part of the plan since the firm's founding in 2006, but the timing made sense now given the cost of capital and having to issue new stock to owners of the acquired firm, which dilutes the value of existing United Capital shares in the short-term.

HighTower Advisors, too, last year said it was slowing down additions to its original partnership channel in which advisers receive equity in HighTower and become W-2 employees. Instead, the firm said it would focus on building out its network channel, with advisers paying for access to the HighTower platform but still running their own firm.

While that shift was always part of the plan, according to the firm's chief executive Elliot Weissbluth, banks and private equity investors have helped make valuations top heavy.

"If you're purely a financial seller and you're selling to a purely financial buyer, then I would agree that the pricing and structure have gotten a little ahead of itself," he said. "When a bank comes in and really decides they want something, and the price disconnects a little from the marketplace, it gets everyone's attention."

Even some private equity firms are backing away from investing in RIA acquirers, in part because of concerns whether they'll be able to recoup the cost of capital, according to Mr. Brinker.

"You haven't seen private equity fund a new venture," Mr. Brinker said. "I think the jury is still out on whether they [roll-ups] can create shareholder value."

But while private equity and some consolidators have slowed down, other factors could still push prices higher in the short-term. Banks, which make cyclical investments in buying investment advisers, are showing a renewed interest and may be willing to bid up prices, according to Mr. Brinker.

For example, Live Oak Bank, a small-business lender that funds adviser acquisitions, announced last July it had given out some $100 million in loans to investment advisers in the previous year since it had begun offering those loans.

Jason Carroll, managing director of investment advisory at Live Oak Bank, said that he doesn't see the number of acquisitions slowing down at all, although he did say it has been something of a sellers' market.

"There are so many buyers compared to sellers that people are willing to pay a premium for the book," he explained.

There's also a larger number of what Mr. Brinker called "regional" RIAs that have around $1 billion in assets and can self-fund an acquisition.

Daniel Seivert, who helps value firms through his company, **Echelon Partners**, argued that valuations still aren't high and that consolidators aren't backing out because of the cost of capital.

"They're just having a hard time finding people who will take their deal terms and work for their organizations," Mr. Seivert noted in an email. "Valuations are not at a high point."

And although some have slowed the pace of acquisitions, other consolidators are still in the hunt. Focus Financial Partners, a firm that has built its business model around taking equity stakes in RIAs in exchange for capital, is set to close one of their strongest quarters ever in terms of acquisitions, according to co-founder Rudy Adolf. Focus has picked up around 33 partner firms since it was founded in 2006.

Still, those who are still acquisition-hungry should be ready to open their wallets. To fuel its investments, Focus recently added to its war chest around $550 million in credit from major banks including SunTrust Banks Inc. and Bank of America Corp.