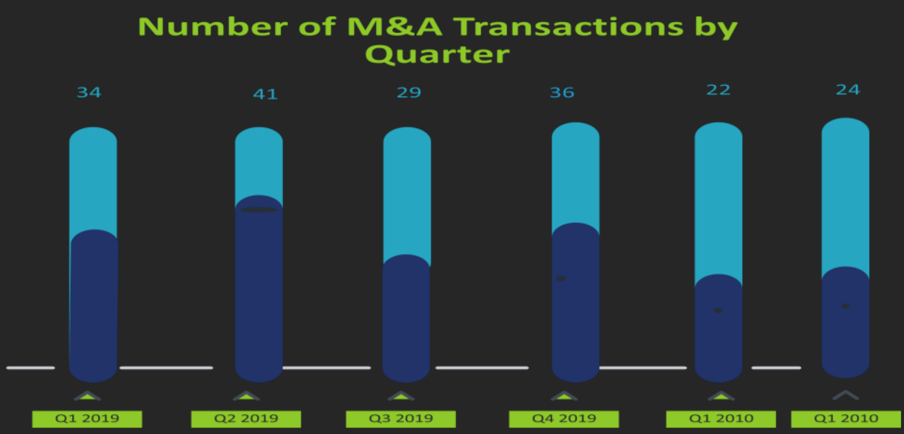
Gulfstream Mergers & Acquisitions

solutions brief

M&A FOR SMALL RIA FIRMS IN THE TIME OF COVID



Source: Fidelity Wealth Management M&A Transaction Report

For owners of independent RIA firms the continuation of the COVID-19 pandemic continues to have a volatile effect on their business and their clientele both qualitatively and quantitatively. Much of the information and coverage on M&A and exits revolves around larger RIA's and their acquirers. For example, see the chart above by Fidelity reflecting the difference in deal completions before Covid to the second quarter of 2020. This gives a picture of what is happening with the big firms but what about the smaller independent RIA's where the majority of our deals originate? Because most smaller deals involve privately held operations their deals often fall under the radar and are not reported. But we do have information from various stakeholders like lenders, M&A advisors, and industry surveys that relay some of the trends.

Business Challenge-

"HOW HAS COVID IMPACTED SMALLER RIA FIRMS EXITS AND WHAT CAN THEY EXPECT NEXT?"

2019 RECORD YEAR FOR M&A

Coming into 2020 M&A for RIA's were on a tear, in 2019 we saw a record number of transactions and deal valuations were up. The strong economy, growing capital markets, and the advent of new buying institutions created a wave of deal activity, especially among the big firms.

2019 SMALLER FIRMS ALSO REALIZING BENEFITS OF A HOT MARKET

While most of the deal value involved the larger firms with over 500m of assets under management the competitive atmosphere trickled down to smaller RIA's as acquirers were looking for less competitive waters to swim in. We dealmakers began to see new buying groups like private equity and family offices reaching out to us seeking deal flow from the under 100m AUM crowd. More lenders also viewed this area as a ripe niche and funding became more readily available. We also saw a growing trend of "breakaway" activity, advisors moving from the big boys into the independent ranks.

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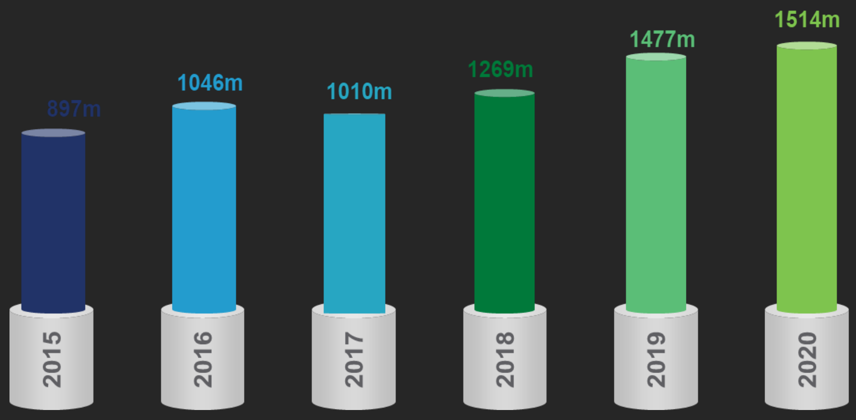
2020 AND COVID 19
STRONG START, THEN THUNDERDOME

Predictably 2020 began with a strong start continuing the momentum from the previous year. Even before Covid hit we predicted the beginning of the year to be the most active period with a modest cooling off in the third quarter, this was after all an election year. Traditionally this uncertainty to the market drives participants to hustle deals in early and to ease off as November approaches.
Of course no one predicted the devastating effect on our national health and economic strength that came with the Cornavirus. Suddenly the uncertainty of an election year became quaint as the market plummeted and both advisors and their clients were scrambling to make sense of things.
Understandably wealth advisors who are at the economic front lines of the pandemic went into triage mode trying to protect and preserve their clients portfolios as well as their own positions. M&A and succession planning became a secondary concern for most. Though we did observe that deals that were already in motion found there way to an completion at an accelerated pace.

SOME STABILIZATION BUT UNCERTAINTY LURKS

The impact of the devastating loss of life, wealth, and effect on the economy was shocking. But unlike 2008, we are much better capitalized to weather a blow, and the markets recognized this was a situational failure not a systemic one(though the jury may still be out on this one). Remarkably the government acted quickly with the stimulus plan and the financial markets managed to recover most of their losses. Once the markets appeared to return so did M&A and we again saw an onslaught of deals closing at the end of the second quarter.
But where did the deals come from? According to the data most of these deals once again came from the larger firms. At the end of the second quarter the second the average deal size actually increased, this data further illuminates the fact most deals came from the big boys. Again most smaller deals are unreported but according to surveys of independent RIA's, the , and the lenders, deal appetite for the smaller firms waned, at least temporarily.



Average AUM per M&A Deal
Average Deal Size Actually Increases

Source: Echelon

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What Does It Mean For RIA'S Under 100M AUM?

DEAL FLOW WILL CONTINUE

Clearly we are still in for stormy waters ahead as we see the resurgence of cases overtaking the country. With no relief in sight for the next six months, and oh by the way the election, there is great cause for concern for our economic stability. Guessing whether the markets will hold up is well beyond my pay grade. What we do know is that many smaller RIA's have a high concentration of their high net worth clients coming from business owners. Many of these owners have businesses in vulnerable sectors of the economy , and some will suffer tremendously which will have a downward effect on RIA firm valuation.

For many advisors, particularly those that were contemplating retirement , or simply a transitional move to sell their practice but continue to operate under new ownership, this crisis has fortified their resolve to make a move. Buyers still have access to capital and will now need to fortify their positions even more through acquisitions as organic growth may become more challenging.

VALUATION MULTIPLES MAY DROP BUT NOT DRASTICALLY

Because one of the primary value drivers of RIA's is the asset value of their clientele, a precipitous drop in that value will certainly impact valuations. But as we have conveyed, the increased demand for acquisitions from new players, the new more sophisticated access to acquisition capital, and the need for growth from strategic players, will keep the market competitive enough to maintain deal multiples.

TOUGHER DUE DILIGENCE AND DEAL STRUCTURE

Their will be much greater scrutiny on deals in the Covid Era as buyers will want to analyze their risks more carefully , this will be equally important to the lenders. Also for smaller operators, they can expect to see more contingencies placed into the deal. They should expect less cash on closing and more payment tied to future revenue streams from their existing portfolios. Buyers are paying for recurring revenue streams and will want protection if the market crashes again.

Though it may be a bit self serving, we highly recommend RIA owners to contact exit and M&A professionals to discuss their firm valuation and exit options. The more prepared you are the better your chances for attaining the deal value you deserve.

Michael Weihl
Gulfstream Mergers

Gulfstream has active buyers seeking to acquire independent RIA firms. Contact us to schedule a confidential no obligation meeting to discuss how we can design a program to perform your ideal exit or acquisition .

Gulfstream also works together with wealth advisors, accounting firms, legal firms and other advisors with a referral service to business owners.

Office:**+1 (704) 892-5151**
Miami Direct:**+1 (786) 395-3862**
info@gulfstreammergers.com
www.gulfstreammergers.com
Offices
Charlotte / Miami / Atlanta /Boston / Philadelphia