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Pace of M&A among RIA firms starting to pick up

But motivations are suspect, and desperation may be driving some deals, bankers say

By **Jed Horowitz**  
October 18, 2009

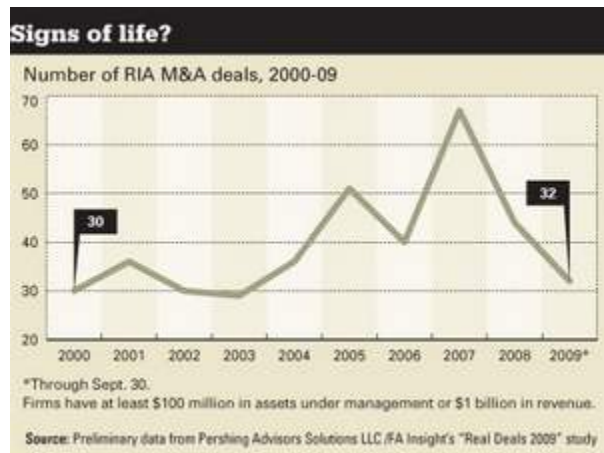
The drought in mergers and acquisitions of independent-wealth-management firms and investment advisers appears to be ending, but few investment bankers expect a quick return to the pre-recession days when cash-dominated payments at high valuation multiples were common.

In the first three quarters of the year, 32 mergers or acquisitions of registered investment advisers were announced, matching last year's average pace of 11 deals per quarter but well behind that of 2007, when a total of 67 were completed, according to "Real Deals 2009," a forthcoming study from Pershing Advisor Solutions LLC and FA Insight.

The study likely missed some smaller transactions, including acquisitions of breakaway broker teams and buybacks from consolidators, because it focused on firms with at least \$100 million in revenue or \$1 billion in assets under management, said Dan Inveen, a principal at FA Insight.

The Charles Schwab Corp. had tracked 50 M&A deals year-to-date through the end of September, down from 88 in all of 2008, according to a published report. Representatives of Schwab did not return several calls for comment.

"Buyers and sellers woke up around the end of July" as markets rebounded from their March lows, said James Tennes, president of InCap Group Inc. The investment-banking boutique's first two deals of the year are at the term sheet stage. "Sellers who felt things were wildly underpriced may be accepting a new reality that their firms are worth 70% of what they were in 2007, while buyers are starting to believe that the March numbers weren't a reality."



But the biggest driver of recent deals has been fear, with activity dominated by revenue-challenged RIAs combining to cut expenses, according to several bankers. They called it a disturbing trend in which firms are combining without taking into account crucial factors such as compatible cultures and complementary advisory strengths.

“Never have I seen so many bad decisions,” said Elizabeth Nesvold, managing partner of investment bank Silver Lane Advisors. “People are feeling stretched by their infrastructure, but there are so many other nuances that have to be addressed to make mergers work.”

Ms. Nesvold said she has seen many shotgun marriages in the fund-of-funds and multi-strategy hedge fund areas in order to build critical mass.

“I worry the same thing is starting to spill over to the wealth management space,” she said.

Paul Lally, president of investment-banking boutique Gladstone Associates, agrees.

“We are seeing a lot of Las Vegas weddings where they get together on Friday night, think they're in love, get married on Sunday and will likely be heading to divorce by the following weekend,” he said. “They feel they can't continue with the status quo, but the ability to match culture and synergy doesn't happen overnight.”



**Elizabeth Nesvold:** Sees a "hot pipeline" of undervalued RIA firms.

The Pershing study offers evidence that smaller firms rather than large acquirers are fueling much of the activity. The percentage of deals involving so-called serial buyers that tend to buy larger RIA firms plummeted from 36% last year to about 25% this year, it found. And several of those deals involved RIAs who repurchased their firms from roll-up companies and other consolidators that are starved for capital, said John Temple, a managing director at investment bank Cambridge International Partners.

Some observers expect deal activity to continue growing in 2010 as founders of older RIAs refocus on exit strategies after the crisis of the past 18 months. Opportunistic buyers, meanwhile, are beginning to take advantage of lower valuations and increasingly favorable deal structures. Such deals are weighted to small upfront cash payments and "earn-outs" three to five years after closings that are geared to hitting profit and client retention targets.

"The demographics of founders looking to monetize their firms, the drive for operational scale and new entrants to the market will lead to a measurable and appreciable acceleration of M&A activity in 2010," said Ronald Fiske, executive vice president of client solutions at Fidelity Investments' institutional wealth services unit for RIAs.

Few are expecting a tidal wave of deals, however, because credit for acquirers remains tight, and buyers have become more discerning about the quality of wealth and asset managers.

"Two years ago, if a target had underperformed the market by 5%, it wasn't an issue, because their clients weren't leaving," said Thomas Miller, a managing director of Quist Valuation. "Buyers today want decent performance and strong client retention."

Valuations remain depressed, he said, estimating that deal prices have contracted about 20% over the past 18 months. Mergers among advisers looking to combine through stock swaps often founder over disagreements about the respective worth of their stocks, Mr. Miller added.

But he and others also said buyers in the United States and abroad remain intrigued by the continuing migration of wealthy individuals to independent advisers. Quist Valuation this year worked with potential buyers in China and Japan that weighed acquiring some large West Coast RIAs, though the deals weren't consummated, Mr. Miller said.

"It's not all doom and gloom," Ms. Nesvold said. "There are some strong buyers who understand the temporary imbalance in valuation. It may not go back to the rip-roaring '90s and mid-2000s, but there is a hot pipeline."

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