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EXCLUSIVE INTERVIEW: Talking Wealth Management M&A With Silver Lane Advisors

Joe Reilly
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Family office consultant Joe Reilly interviews Elizabeth Nesvold, the founder and managing partner of Silver Lane Advisors, about the current M&A landscape; how to make money in the wealth management business; and what it is like having a husband and wife together at the same firm.

Joe Reilly: There seems to be a lot of current interest in wealth management M&A, but are you seeing quality or just quantity right now?

Liz Nesvold: It's both. We manage a proprietary transaction database in house, and by our count, the number of deals in 2016 was up 10% year-over-year and hit a new all-time high. The size of deals is growing, as well, as is the number and type of buyers. The output from all these variables is that there's never been more succession planning alternatives for the wealth management industry. We spend considerable time upfront understanding the motivations of a potential seller and, based on that, we often can find a custom-tailored solution. It's an exciting time to be an investment banker in the industry.

Joe Reilly: What are the top one or two reasons people are transacting today? Has this changed over the past few years?

Liz Nesvold: The two biggest reasons to transact today are succession planning and the need to achieve critical mass. Client demand for ancillary capabilities (e.g. trust, banking, financial planning, family office solutions) is a close third. The industry perspective on what level of AUM equates to critical mass keeps going higher. When I started out in the business, longer ago than I care to mention, it might have been $250 million. Ten years ago, that figure was probably $750 million. Today, for a wealth management business to truly be institutionalized the industry perspective is probably at or around $1 billion of AUM but that number no longer implies industry viability or presence.

Joe Reilly: Do you feel there is a new family office model emerging based on the examples of Point72, David Shaw and Ray Dalio?

Liz Nesvold: There is. We are seeing investment-oriented family office platforms come to the market. They may be heavy on the alternatives, or style biased (for example ESG bent). We've seen a few with a real estate / real assets bent. This is the beauty of this industry…it is highly fragmented and there is room for new quality players at the table.

Joe Reilly: How do you think about valuation when it comes to a single family office? That is, a true family office with only one client family?

Liz Nesvold: A single family office with only one client family is clearly difficult to value. There will be value to some buyers, particularly if the seller is willing to contractually keep the assets with the buyer for a certain number of years. But even then, it depends largely on the types of services the family office is providing, what capabilities they bring to the table, and what assumptions on added costs (or opportunities for cost savings) are present. So, for instance, a single family office that is willing to sign a five-year commitment with a sizeable RIA, and brings to that RIA deep expertise in real estate/real assets and a dedicated CIO? Sure, that could be interesting.

Joe Reilly: Should single family offices even be thinking about valuation? Is there a ready market for them?

Liz Nesvold: It's a fair question. Any time you're selling the equity of a business, it's reasonable to ask about valuation. But valuation should not lead the discussion for the sale of a single family office. These are truly unique businesses; as one of our board members once said, "If you've seen 1,000 family offices, you've seen 1,000 family offices." Meaning, they're all different. The discussion really needs to begin with culture/values and then pivot quickly to capabilities. If the cultures don't mesh, the deal will never work. After that, it's more of a strategic discussion – how can you help me grow my business and vice versa? If the cultures mesh and you have a shared vision for growth, ok now we can talk about how we share the rewards among all the constituents.

Joe Reilly: You noted at a recent conference that $3 billion MFOs are not really competitive. Why do you see this being the case? Why do you think many advisors stall out before they reach this threshold?

Liz Nesvold: Thank you for reminding me why I try not to make too many definitive statements publicly! In all likelihood, there are probably a few $3 billion MFOs out there that are competitive. But I would reiterate that it's very difficult to consider that level of AUM to be full scale, unless they are investment-oriented (i.e. the family outsourced CIO). We could probably do an entire interview based on this question alone, but one area where many sub-$3 billion

MFOs are not yet fully developed is their expertise and access to preeminent alternatives capabilities.

Joe Reilly: What should wealth management firms be thinking about pre-liquidity/pre-transition to drive their valuations? What are the key controllable indicators of enterprise value for wealth managers?

Liz Nesvold: Here again, we could do a full interview on this question alone! Key drivers of value? Whether the business is truly institutionalized or if it's still more of a practice; average relationship size; average age of the typical client (and, frankly, the advisors leading those relationships); how deep the management bench is; whether client pricing is materially off-market (either too high or too low); how well distributed their business development efforts are; the profitability of the business; and so on.

Joe Reilly: You said in a much-read article a few years back that it was possible to make real money in the wealth management business by holding the line on fees. Do you see this happening?

Liz Nesvold: Fee pressure has been, and will continue to be, a fact of life. Today, those pressures are even greater than when I wrote that article, whether the source is passive investment products, automated offerings, the competitive nature of the industry, and so on. Plus, fees are downward sticky; once you lower them, it's very difficult to get them back. So keep in mind that clients that hire you purely because your fees are the lowest are not going to be the most loyal clients, and now you've sacrificed your pricing structure. In addition, you don't know the full scope and complexity of the relationship until you are in the trenches with the family for a period of time. By the same token, clients that are only chasing investment performance aren't long-termers. In contrast, clients that truly value your service and whose trust you have earned are going to pay reasonable fees for your offering. Provided that your client service is strong, the vast majority of clients understand that there's a cost to deliver that service. It's better to leave the business with some capacity to take on the next profitable client relationship, than sacrifice that capacity for a difficult, unprofitable one.

Joe Reilly: Do you see ESG and impact investing as having "arrived" and a significant part of the RIA business? If so, should firms be looking to develop talent in-house or through acquisitions?

Liz Nesvold: This is clearly a fast-growing segment of the market, albeit still off a low base. Demographic trends suggest that interest in ESG and impact investing will grow. It's partly a generational thing, but even many of us "old-timers" embrace the idea of "doing good while doing well." At this point in the movement's evolution, it's going to be a smaller percentage of accounts that care enough to make an advisor decision based on it. But some of those smaller accounts are actually quite affluent relationships. Large RIAs might consider adding some in-house expertise, whether organically or through acquisition. For smaller RIAs, it may be a challenging ROI decision – at least today – for additional personnel. In that situation, there are some outsourced solutions that might help that smaller RIA meet the clients' needs.

Joe Reilly: You started Silver Lane on your own in 2007 and have grown it considerably since then. What was the biggest challenge in building an investment banking business?

Liz Nesvold: The challenges change over time. We launched a financial services-oriented investment bank just as the financial crisis was starting. Clearly, the environment was the biggest obstacle. A close second in the early days was convincing clients why we, as a micro organization, were equipped to best serve their interests. That changed fairly quickly, when we had sealed a number of high profile deals and started signing publicly-traded companies on as our clients. As you ramp, the biggest challenge is resisting the urge to do everything yourself and to trust those that you bring on-board. I'm sure many entrepreneurs can relate.

Joe Reilly: Yours is the rare firm on the street that has a husband and wife on the team. Any lessons learned?

Liz Nesvold: Peter has been an informal advisor to Silver Lane ever since I launched back in 2007. My best friend and partner, Erika, actually suggested that he come onboard full time, as we were searching for an executive to run the day-to-day management. Still, it was a big step – both for the firm and for our relationship – when he officially did so back in 2013. Peter did a lot of research before he agreed to make that jump; we wanted to find examples of husband-wife teams in professional services and what best practices could we learn from them. The first lesson, which we practice religiously, is clearly defined roles. Peter and I sit at opposite ends of the floor; I manage clients and origination while he manages the firm; and we really only overlap in our weekly all-hands meetings. Also, any personal matters are only discussed behind closed doors. But, ultimately, it's great when you can place your complete trust in your business partners, and certainly that's how we feel about working together. The other big lesson is that, if you're going to be with your spouse both at work and at home, you both periodically need a "third space" for a little personal time. For me, it's my YPO (Young President's Organization) meetings. For Peter, it's either running in Central Park or his volunteer work with NYSSA.