

RIA M&A OUTLOOK STUDY



# The Shifting Perspectives of RIAs on M&A

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*September 2020*

*Third Annual Report*

## Executive Summary

Despite the disruptive impact and unsettling risks of the COVID pandemic, few advisors plan to accelerate their succession plans. As a matter of fact, for every one advisor accelerating their plan, seven plan to delay their transition.

Advisors responding to DeVoe & Company's third annual RIA M&A Survey also expect merger and acquisition activity to continue at a pace similar to recent trends. Additionally, the likelihood to sell internally jumped significantly from last year. Advisors' perspectives on these topics and many others, including the key drivers for transactions, are covered in this year's report.

### RIAs Expect COVID to Slow M&A Activity

COVID has affected the lives of every American. We live in a new world, which seems surreal and has been ever-changing. Every time we get used to a new 'reality' of day-to-day living, the rules of the game change yet again (both figuratively and quite literally, as laws change at an unprecedented pace). Every time we sense we have an increasing degree of clarity on the current situation and the future, a new development or implication of this virus pushes us back into uncomfortable ambiguity.

Individuals who own and run RIAs have clearly been affected. But the impact is magnified beyond the day-to-day activities of their lives, reverberating into their businesses, the lives of

their employees, and the welfare of their clients. Advisors have worked around the clock to recalibrate their clients' wealth planning to this dynamic world – and have done so while recalibrating their entire businesses.

In the midst of this chaos, DeVoe & Company surveyed the RIA community to better understand the impact of this black swan event. Many perspectives reinforce certain assumptions and expectations. Others are unique. And some seem out of sync with what has since unfolded. The information that follows includes exclusive insights into the dynamic and ever-changing world we are all currently experiencing.

Advisors reacted to COVID with a degree of conservatism. Overall, they expected a sustained deceleration of M&A activity. They expected valuations to drop – and many seemingly see this as an increased opportunity to sell internally. They prioritized putting their house in order before they move aggressively into acquiring firms – or even selling for that matter. Not surprisingly, advisors responded with thoughtful temperaments, as opposed to opportunistic urgency or fearful reactions.

*“COVID is a shot across the bow for any advisory firm that is operating without a succession plan. We now live in a world where going into the office can be a life or death decision.”*

*David DeVoe, Founder / CEO, DeVoe & Company*

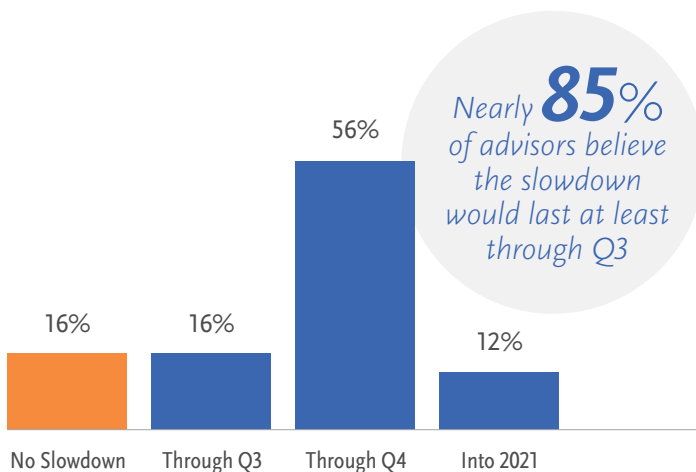
## The Expectation of an RIA M&A Slow Down

The vast majority of RIAs responding to the survey indicated that the pandemic would cause a slowdown in M&A activity. Most surveyed advisors don't foresee disruption in their own succession planning timelines.

The majority of polled advisors anticipated that M&A activity would slow for a few quarters before it bounced back to the historic active clip. More than half of advisors indicated that the slowdown would draft through year-end, and 12% indicated a slower time period would prolong into 2021. Only 16% indicated M&A would persist at a steady state with no slowdown whatsoever. And none predicted an increase.

Yet, as of this writing, it appears that the industry only took a short breather. The slowdown lasted months, not quarters, before bouncing back. Perhaps the industry is more resilient than expected, or an active stock market solves many problems. The resurgence in M&A activity arrived faster and stronger than expected. We'll discuss this in more detail below.

Do you expect a slowdown in RIA M&A due to COVID? If so, how long?



Given the consensus on an extended lull, it is not surprising that many echoed this expectation in their forecast of the number of RIA transactions for the year. Three-quarters of respondents predicted 2020 to be the first down year for M&A in a long time. Another quarter of advisors indicated that 2020 would be about the same as the 132 deals in 2019. Fortunately, Las Vegas has been closed for several months, as surveyed advisors would not have done well in the casinos. Not a single advisor indicated that 2020 would likely be above 2019, yet that is precisely the current course. Based on a solid first half of the year and a very strong July and August, DeVoe & Company is officially on record predicting that 2020 will be another banner year. As we have all learned, things move quickly during periods of crisis.

## Advisors See Lack of Succession Planning as a Big Problem

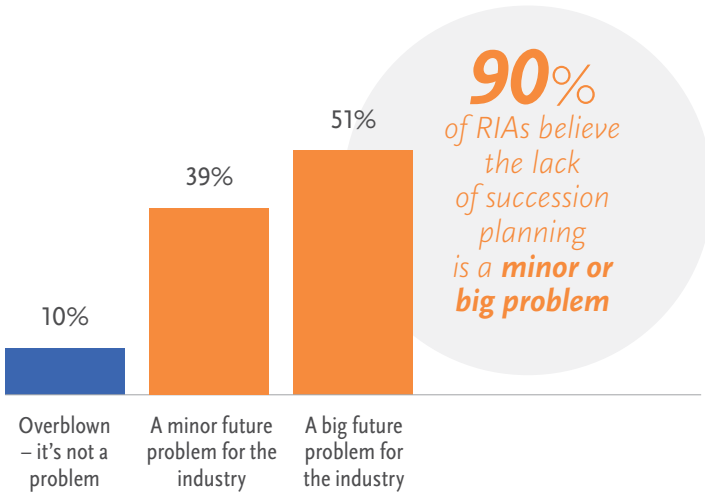
COVID or not, advisors emphatically believe that succession planning – or the lack thereof – is a critical challenge for the industry. Despite the headline sessions on the topic at every industry event and the consistent media coverage about this exposure point for the industry, the number of advisors implementing written succession plans doesn't seem to bud. This is not a good thing. And advisors know it.

A full 90% of advisors believe the *cobbler having no shoes* is a problem for the industry – and the majority state that it is a big problem. From DeVoe & Company's perspective, this is perhaps the greatest exposure point of the industry. Without a substantial increase in transition planning on an accelerated timeline, this industry faces the potential risk of a succession crisis. A crisis of this kind would likely lead to too many sellers coming into the marketplace at once.

The alarm among advisors about succession planning has slowly and steadily become louder. Today, the concern is the highest that we have tracked. Each year that DeVoe & Company has surveyed advisors, they have pushed another percentage point or two further into the big future problem column. Advisors feel growing pressure on the system.

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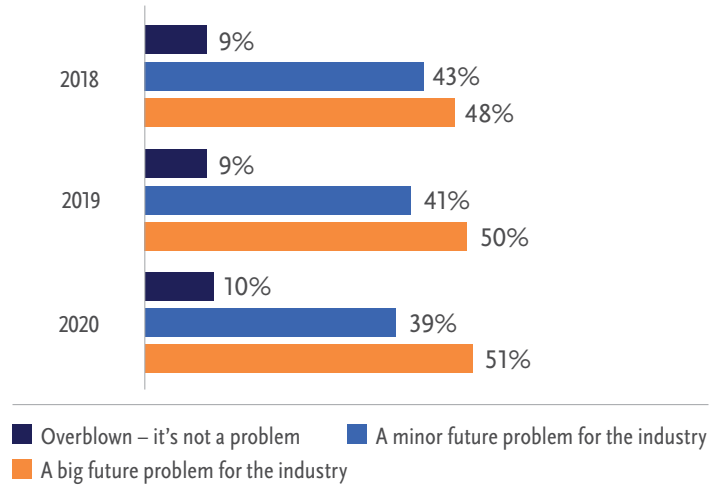
### Is the lack of succession planning...



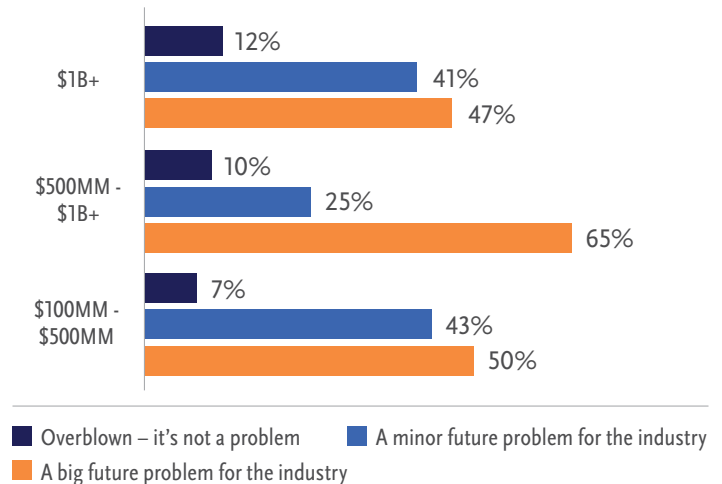
Interestingly, advisors in the \$500MM to \$1B segment voice the greatest concern, with 65% indicating it's a big problem. Perhaps these individuals are reflecting on their own situations, as firms in this zone are commonly grappling with the ability of G2 to buy out G1. This is both an economic struggle and a coaching challenge. Can G2 afford the increasing valuations of the firms for which they work? More on that below. Can G2 take the reins and run the company? It's a concern. In a December 2019 DeVoe & Company survey, a full 57% of respondents indicated that if forced to transition to G2 immediately, the transition would be bumpy at best.

Regardless of the size or situation, a succession plan is of paramount importance, especially when we have an epidemic that has claimed nearly 200,000 American lives. COVID was a shot across the bow for any advisory firm that is operating without a succession plan. We now live in a world where going into the office can be a life or death decision. The increasing realization of the magnitude of this succession problem is good for the future of the industry. Action is needed. Awareness of a problem is the first step to address it. A silver lining is that COVID will likely drive more RIAs to take action.

### 2018-2020 – Is the lack of succession planning...



### By Segment – Is the lack of succession planning...



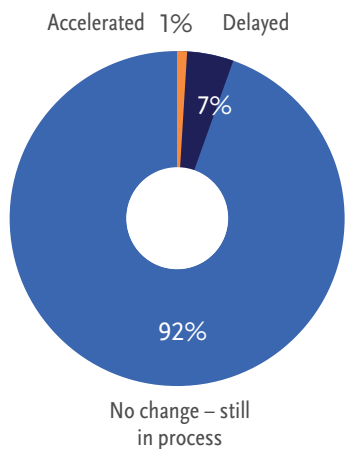
A succession solution can come in one of two ways: Some advisors will decide that it is (finally!) time to put that internal succession plan in place. Time to get some equity and leadership into the hands of the G2 leaders who have so patiently waited for this glorious day. Other advisors will decide (or be forced to decide) that an external path is best for the firm. They see the power of scale. Or see the premium valuations that might exceed the grasp of their employees. Or both.

## Advisors Stay the Course with Internal Successions

For firms that are actively engaged in internal succession, the vast majority (92%) are staying the course with their efforts and timeline despite the pandemic. With a steady hand on the wheel, most firms are methodically putting their plans in place or implementing the migration to the next gen. Seven percent, by contrast, plan to delay internal succession. This is likely driven by the reality of post-COVID RIA management. Nearly all advisors that indicated a pending delay are under \$500MM in AUM, and these organizations are most impacted by COVID. The owners of these organizations split their time between running the business and caring for clients. When the pandemic hit, they shifted all of their energy toward helping clients. That is the DNA of the RIA community. With their clients stable and financial plans updated, they shifted greater attention to the business and staff. They focused on running an efficient business in this new environment. The reality is that strategic decisions – like succession planning – simply have to take a back seat for firms that are run by owners wearing several hats.

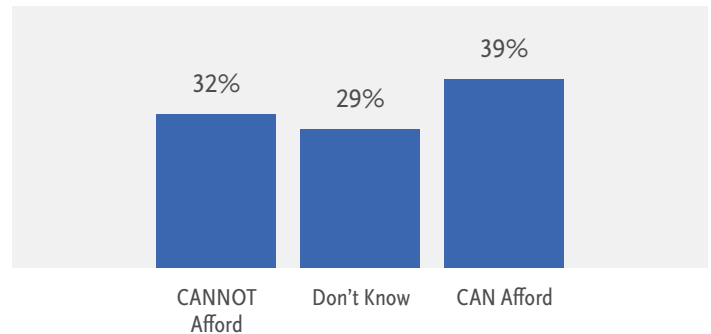
By contrast, larger firms are typically professionally managed – they have staff who are fully dedicated to running the organization. Consequently, their senior management teams are not distracted from strategic decisions and have the bandwidth to focus on succession planning and other key initiatives. As a result, larger advisors have not indicated expected delays on their transition activities, while smaller firms have.

Has the global pandemic and resulting market environment changed the timeline for your internal succession?



A surprisingly small number of firms – only 1% – are planning to accelerate their internal succession because of the effects of the pandemic. These owners are taking action – moving with conviction to shore up this risk. All of the respondents who said they are accelerating their internal plans are at firms between \$100MM and \$500MM in size – firms that are most exposed to the COVID threat.

How confident are you that the next gen of your RIA is able to buy out the founders?



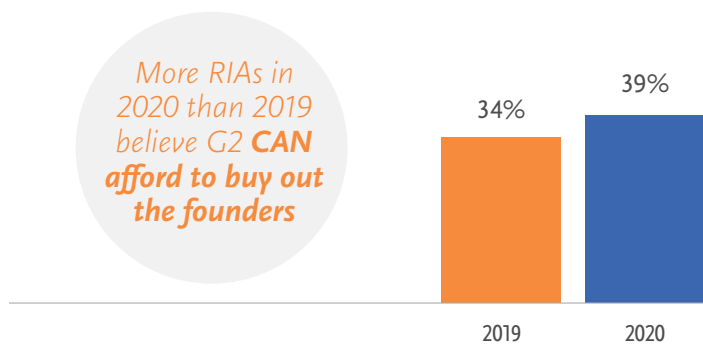
Advisors in the current environment have increased confidence that G2 can afford to acquire the firm. The percentage of advisors indicating that G2 can afford to buy out the founders has increased to 39% in our 2020 survey from 34% in 2019 – a significant uptick. Given most owner’s bias to keep their firm independent, this is a positive development. We believe this shift is related to advisor expectations on RIA valuations. The confidence in affordability is even more profound for mid-size firms, with 60% of respondents in the \$500MM to \$1B segment indicating next gen can afford to buy out the founders. In this middle range of RIA size, there may be a “sweet spot” where preparedness and capacity converge.

*The future of your RIA is quite literally your NextGen employees. Migrating ownership today will increase your valuation tomorrow.*

A natural outcome of the rising value of RIAs is that a growing proportion are exceeding the grasp of internal buyers. As a matter of fact, 32% of advisors state with confidence that G2 cannot afford to buy out the owners. Continued procrastination of succession planning ultimately will doom these aspirations. The remaining 29% of advisors are living in limbo: They simply don't know if G2 can access the needed capital to buy out founders at a fair price. If you are in this category, we encourage you to contact a firm like ours or start crunching the numbers yourself. These windows of opportunity have expiration dates, so prompt attention can be the difference between an internal and external sale.

Next-gen advisors' ownership transitions are complex; each case is unique. One respondent noted: "Affordability is less appealing to G2 at the moment (it's a difficult time to write a check or take on more debt)." Another respondent shared that it's as much about preparation and presence than financing alone: "If G2 is present and connected to the client, the money will be there for a buyout."

### Confident that the next gen of your RIA can afford to buy out the founders



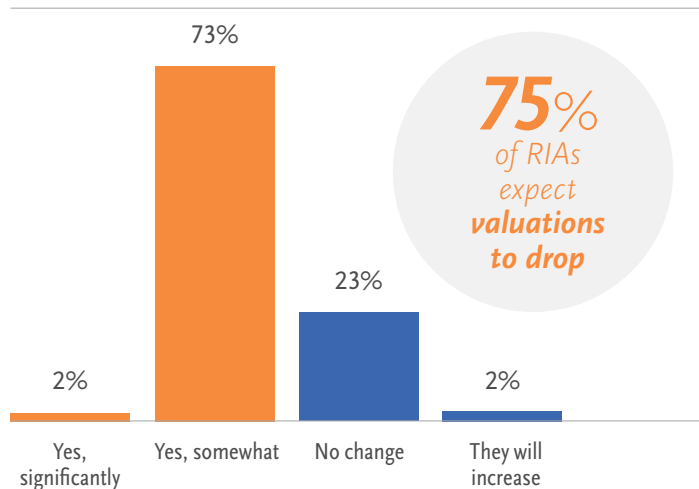
DeVoe & Company believes that the rosier perception of affordability is likely linked to expectations about valuations post-COVID. A heavy majority of respondents stated that valuations would fall because of implications from the crisis. Seventy-three percent expect that valuations will fall 'somewhat', with a small 2% believing a significant drop will occur. Given the scar tissue so many advisors have from watching their valuations erode quickly and significantly following the 2008 crisis, it's not surprising that advisors would have concerns about valuations decreasing.

RIA valuations went from all-time highs to all-time lows within months, if not weeks. Subsequently, it took five or six years to get back to average valuation levels and a surprising 11 years to get back to the high.

Post COVID, about a quarter of advisors expect valuations to stay the same. This group may end up having the clearest crystal balls: To date it is the minority who seems to have made the best bets. As of this writing, valuations have barely budged, as 23% of advisors predicted.

While valuations have not been affected by the crisis, deal structures changed nearly immediately. The difference is largely seen in down payments. Two decades ago, a typical down payment was in the 35% range. Five years ago, they had ticked up to roughly 50%. More recently, DeVoe & Company had negotiated 70%, 80% – even 100% down – on behalf of sellers. But the world changed with COVID. And buyers made the prudent decision to share the risk of a cloudier future with the sellers. Down payments compressed back to the 50% range. Firms can still potentially receive full consideration, but if COVID – or other risks – manifest themselves soon after a deal is done, the buyers will not be absorbing all the downside.

### Do you think valuations will fall due to the impact of COVID?

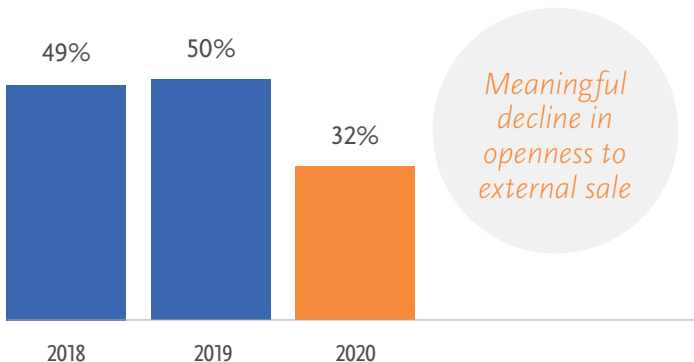


## RIAs Less Open to External Sales

Advisors today state that they are much less likely to sell an external stake than last year. In 2020, a third of advisors indicated openness to sell a stake externally, down from half of respondents a year ago. This significant shift in such a short period of time seems to be directly or indirectly related to COVID. The uptick in the expectations that G2 can afford to buy out founders, the perception that valuations will decline, and this decrease in interest to sell externally are correlated with one another. This is good news for junior advisors who have invested years in their firms, in anticipation of investing their personal capital in the business.

Respondents further explained that when they have the right people and resources already on hand there's no reason to sell. One respondent shared: "We have one of the youngest management teams in the industry. Why sell?"

### Are you open to selling an external stake in your company today



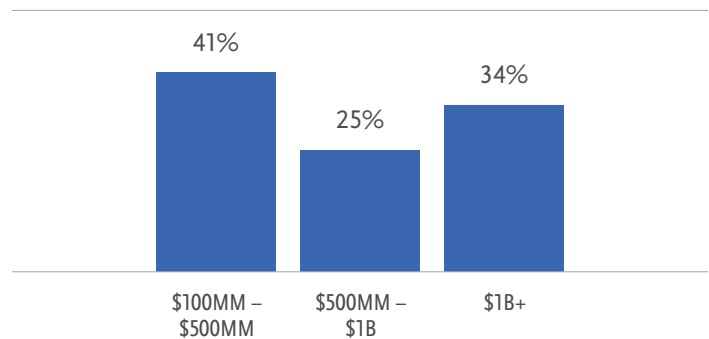
Among RIAs that seek to sell, scale remains a key driver. Running an RIA has become increasingly complex. RIAs need to consider technology, compliance, talent management, and investment management, among other functions. "COVID has sparked some casual internal discussions about if an external partner should be a legitimate consideration for us," shared one respondent. "The COVID climate puts a premium on technological and operational excellence, which is much easier to execute at scale," said another advisor.

Smaller firms see scale as a path to compete more effectively – and a path for principals to focus more time on what they love to do. Among advisors associated with firms between \$100MM and \$500MM that intend to sell externally, 41% chose scale as a key driver.

Mid-sized firms may be complacent or even-keeled on the topic with only 25% of firms between \$500MM and \$1B choosing scale as a driver in a decision to sell. Firms in this range are struggling with whether to go through the process and compressed profitability of adding dedicated management teams themselves or deciding to sell externally and join an enterprise-level organization.

Larger firms have achieved degrees of scale on their own. Yet many seek the next level, as evidenced by 34% of \$1B+ advisors selecting it as a driver.

### Scale has become nearly as important for larger firms as for smaller firms



*"The COVID climate puts a premium on technological and operational excellence, which is much easier to execute at scale."*

*A survey respondent*

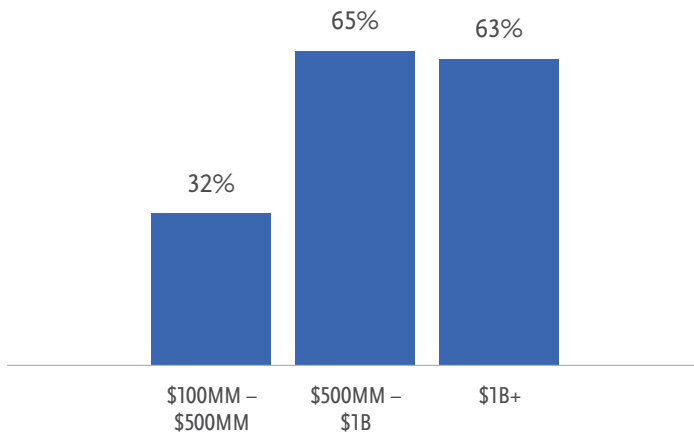


## The Majority of Advisors Plan to Acquire

About half of advisors plan to grow through M&A. 52% of advisors say they expect to acquire within two years. There has been a steady decline in interest, down from 57% in 2018 and 54% in 2019. Intent to acquire is much higher for larger firms, with nearly two-thirds of firms greater than \$500MM planning to acquire within two years. On the other end of the spectrum, only 32% of firms \$100MM to \$500MM in AUM plan to make an acquisition in that timeframe.

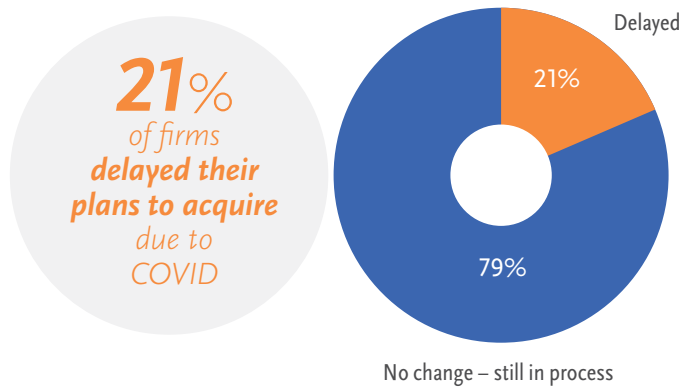
### Size does matter...

Percent of RIAs that plan to acquire by segment



And of those who plan to acquire, just above 20% indicate that they will delay their plans due to the pandemic.

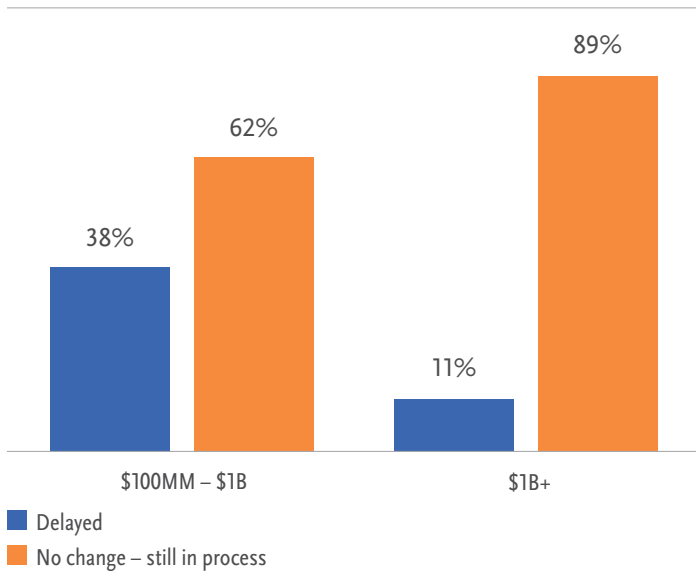
## Has COVID affected your plans to acquire RIAs?



Not surprisingly, the delays are correlated with the size of the firm. More smaller firms chose to delay their plans to acquire. Thirty eight percent of firms under \$1B in AUM indicated the pandemic delayed their plans to acquire another firm. The complexities of COVID conspired against these advisors who split their time between managing clients and running the business. Meanwhile, the professionally managed \$1B+ RIAs aren't missing a beat: only 11% of firms in this segment indicated a likely delay of game.



## Smaller firms more likely to delay acquisition plans



While \$1B+ firms are more likely to acquire a firm than their smaller brethren, their expectation to do so has dropped more than 10 points from a year ago. During a pandemic or not, an acquisition is a significant undertaking for RIAs of any size, and firms aren't taking it lightly.

Acquiring another firm is inherently about growth; yet, solving for talent expansion has emerged as a key driver. Two-thirds of advisors selected talent as a key driver for making acquisitions. Professionally managed firms (\$1B+) are at a size and scale where they recognize the significance of attracting the right talent at various levels of the firm. Seventy one percent of advisors in this segment chose it as a key driver.

“Scale, technology, talent development are all the keys to RIA success - even more so going forward,” shared one respondent to the survey. Underscoring the importance of talent acquisition, multiple respondents shared that it's difficult to find qualified advisors locally

## Conclusion

Since its emergence roughly 30 years ago, the RIA industry has supported American investors through a wide range of crises. These challenging points of time are when the model demonstrates its greatest value. The lower client-to-advisor ratio enables advisors to provide greater care to each individual client than wirehouses or independent broker dealer representatives. The fiduciary commitment ensures that advisors prioritize their clients ahead of themselves and their staff. The RIA community should take great pride in the fact that the foundational elements of the business model yield the greatest value to clients during their most vulnerable times.

As an unforeseen crisis, COVID highlights the importance of having a strategic plan and contingency plan to guide your decision-making in the best and worst of times. And although the initial implications of COVID to the industry have not been extremely destructive, the reverberations of the crisis will be felt for some time to come. We are not yet out of the woods.

When faced with adversity and challenge, we ideally grow and change in positive ways. The shock from the pandemic has been felt by all advisors. In many cases, it has shifted conceptual scenarios into realistic threats. The conceptual construct of being hit by the proverbial bus has taken on greater gravity in the face of now 180,000 deaths. The fragility of an unprotected business has become a realistic consideration.

The team at DeVoe & Company encourages advisors to engage with the emotional turmoil that may have emerged over the last several months. You may have felt regret for not taking actions sooner. You may be experiencing fear about the current situation or the future. We encourage you to engage with those uncomfortable emotions – and use them for good. Turn the emotions into motion and take concrete steps. COVID should serve as a wake-up call to the industry. We all know we have a succession crisis on the horizon. Take an inventory of your business. Determine the right plan for your organization. And execute. Reward your clients, your staff and yourself by putting the right plan in place.

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## Methodology

The DeVoe RIA M&A Outlook Study is an annual survey of RIAs to gauge current and shifting perspectives about M&A within the industry. This year's survey received 128 responses between late May and late June from senior executives, principals, or owners of firms ranging in size from \$100 million to over \$5 billion in assets under management.

## About DeVoe & Company:

DeVoe & Company is a goal-based consulting firm and investment bank focused exclusively on guiding wealth management and investment management companies to a higher level of success. We provide consulting, M&A, and valuation services to help you accelerate the achievement of your business goals. Leveraging our team's 300 years of combined experience in RIA business consulting and management, we develop solutions tailored to your unique goals, needs and situation.

The wealth and investment management industries are highly dynamic and evolving at a fast pace. DeVoe & Company can help you better understand your options, determine your optimal path, and craft an implementable plan for you to capitalize on the opportunities.

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## What We Do

Our mission is to help you achieve success on an accelerated basis. Our services fall into three broad categories:

Business Consulting
Investment Banking
Valuations

## Engaging DeVoe & Company

For more information or to learn about our services:

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