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NEWS RELEASE

ROUGH EXIT AHEAD FOR WEALTH MANAGERS, STUDY CONTENDS

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All but 7% of the nation's 20,000 wealth management firms won't extract significant value from their business when their owners retire, because most do not have a sustainable profit model, a new report contends.

Even those able to create so-called enterprise value — which is loosely defined as what a buyer would be willing to pay for a firm — will resist doing so because of the cultural changes and expenses required, according to the report.

The 94-page report, "Creating, Measuring and Unlocking Enterprise Value in a Wealth Manager," which will be released today, was written by longtime asset management executive Mark Hurley and his colleagues at Fiduciary Network LLC, which finances internal buyouts of firm founders by their successor generations.

"A careful analysis of the industry suggests that only about 200 to 400 of its participants either have, or possess the potential to build, material enterprise value, and we believe only a fraction of those will ultimately succeed in doing so," the authors wrote in the provocative report. Another 1,000 firms "have the potential to realize value for their founders by selling to a large firm," leaving some 18,000 that "are unlikely to ever build" value.

Mr. Hurley, who a decade ago ruffled feathers with reports predicting that most wealth management firms would dwindle into insignificance, said that the new paper is meant to motivate an aging generation of entrepreneurs to plan in advance for transitions and understand the mechanics and structures of potential deals.

He also concedes that readers may see bias in the report.

Fiduciary Network, founded in March 2007, retains small equity interests in the firms it finances. It has completed 10 "internal transition" deals with such notable firms as Regent Atlantic Capital LLC, and Mr. Hurley said that the document may get him an audience with a limited number of future prospects.

But he insisted, as the report notes, that the study is primarily educational, as his firm's financings are "extremely specialized and inappropriate for more than 99%" of wealth management firms.

There are skeptics, however.

"Fiduciary Network is serving an important need because very few banks, if any, are offering financing for deals, but Mark's comments keep on taking us back to his firm's proposition," said **Dan Seivert**, managing partner of **Echelon Partners**, a small investment bank. He heard Mr. Hurley summarize parts of the report at a conference sponsored by TD Ameritrade Holding Corp. last week.

Mr. Seivert has reason for taking umbrage.

Investment bankers, according to the report, tantalize potential clients with "rule of thumb" valuations that are "marketing tools designed to encourage owners to believe that their firms can be sold for large amounts of

consideration provided that they retain the [investment bank] as their adviser."

Lawyers, too, are gored.

"An essential step to unlocking the enterprise value of a wealth manager is hiring legal counsel that is both sophisticated and experienced in mergers and acquisitions transactions in the wealth management industry," according to the report. But most advisers use local firms, often run by friends, that have no background in the mergers and acquisitions market and that lack the "resources and work ethics to complete a transaction in a timely manner."

Wealth managers themselves are praised as leaders who offer "value to their clients and communities in many ways [that are] much more important than the purely economic matters" addressed in the report. But in that arena, they are skewered as starry-eyed graybeards, who, despite deep-seated doubts about their businesses, are almost delusional about their worth.

The "overwhelming majority of firm owners cling to the same fantasy," according to the report. "In this shared dream, they are able to run their firms any way that they want to ... However, at the exact point that they want to retire, a strategic acquirer, perhaps a large, dumb public company ... will appear out of nowhere. The acquirer's management will be both unsophisticated and desperate to buy a wealth manager ... [for] substantial consideration with few conditions attached."

The unfootnoted report, which is based on Fiduciary Network's experiences with clients, prospects and industry sources, alludes at points to "careful" or "close" analyses that are neither described nor cited. However, it parses the structure of deals negotiated with private-equity-backed roll-up firms, small banks and large wealth managers, offers generic valuations for sales to each entity and outlines tips to follow in sales negotiations.

Among them:

- If selling to a roll-up — whose sole purpose the authors define as the near-impossible task of exiting in an initial public offering — demand a prenuptial agreement that lets you repurchase your firm via a predetermined value formula if the IPO isn't completed by a preset date.
- If selling to a bank, avoid all-stock deals because banks typically buy when their stock is overvalued. Also ensure that the stock received can be immediately sold.
- If selling internally, assume that the new owners who previously worked for you and who will likely be severely debt-constrained, will act in their own economic self-interest as they negotiate.
- If selling to a larger wealth manager, know that you have limited bargaining power."

The report also applies a gimlet eye to Mr. Hurley's own backyard.

"Legacy" transactions, where owners gradually sell stakes to successor generations and which are the most common avenue for sales, are "the most difficult to complete and involve many potential tradeoffs," the authors warn.

If negotiations fail, "there is a high likelihood that some of the professionals" will leave the firm, the report said.

Enterprise value is often subjective, the authors said, but a firm without a strong compliance culture and an institutionalized brand will never build it. Without those characteristics, their best hope from an outside buyer would be an "earn-out" where almost all their remuneration is tied to future profit or revenue targets.

Fee-based, or hybrid, firms are particularly low in enterprise value because their revenue model relies on product sales, which an owner might be skilled at but which is hard to replicate in successors, according to the report.

The report isn't much kinder to fee-only firms, saying that a typical registered investment adviser that manages less than \$300 million in assets and produces less than \$3 million in annual revenue isn't profitable.

Despite the obstacles, the report implores owners to create value by adopting rigorous business management, compliance and marketing processes.

ABOUT ECHELON PARTNERS

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

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