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NEWS RELEASE

SUCCESSION PLANNING: BUYING AND SELLING WEALTH MANAGEMENT PRACTICES

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Originally Published By Lewis Schiff, Investment Advisor

As noted in the lead story of this special section on succession planning, "Planning for Your Future, 2010 could be the biggest year ever for mergers and acquisitions in the financial advisory industry, but the players and strategies are different than they were prior to the market turndown. Previously, large banks and financial firms aggressively pursued successful wealth management firms with affluent clients. Those buyers have been replaced by more selective RIAs looking for a variety of arrangements including complete buyouts, slow sell-offs, mergers, hiring advisors from the wirehouses, formal networks, and mutually beneficial strategic alignments.

Consolidation among RIA firms has increased for several key reasons, according to Tiburon Strategic Advisors, which foresees a 40% increase in merger and acquisition activity between 2007 and 2012:

The average age of firm principals has increased from 51 to 55, so these baby-boomer advisors will seek ways to monetize their practices as they approach retirement.

Younger advisors are seeking ways to increase profitability by reducing overhead, so combining practices is very attractive.

For firms that have a focus on high-net-worth (HNW) and ultra-high-net-worth (UHNW) clients, activity has occurred in four major directions, according to industry observer Chip Roame, Managing Principal of Tiburon Strategic Advisors:

- More wirehouse reps joining existing larger RIAs
- Success of some networks among larger RIAs
- Former wirehouses executives hired to recruit for large RIAs
- Emergence of firms allowing advisors to retain ownership of their book of business when they join and later permitting them to sell their business without the restrictions common in wirehouses.

Movement trends

Looking at retaining some equity position rather than selling outright for a succession plan, more wealth managers are structuring deals with internal firm partners to sell part of their equity initially and retain the rest as a slow sell-off over several years. In this way, the seller gets some cash upfront but participates in profits during the rest of the term. The total value the owner receives can be far greater by this kind of arrangement. The growth in the equity portion will generally grow faster than the cash part invested in the stock market.

"At any given time, advisors just reach the point where they're ready to retire," notes **Daniel Seivert**, CEO & Managing Partner, **Echelon Partners**, Manhattan Beach, California, an investment bank and consulting firm focused exclusively on the wealth and investment management industries. "Some people are just ready to retire when it becomes a bad time to sell. Most of them just wait it out until the markets recover and then sell. So now, there's some pent-up supply as a result of that, but they're not settling for less attractive partners. They usually have pretty flexible time frames, so most of them are waiting around and being selective about whom they do a deal with."

Sellers do have some advantages at this point, however, advises Seivert. If you're eager to transfer ownership to family members, partners, or employees, lower valuations make it a good time to sell equity while minimizing taxes. Today's buyers are better grounded in the wealth management model than many of the buyers before 2007, some of which no longer exist or have shrunken value. In the push toward independence from large firms, especially from the wirehouses, disgruntled advisors seeking to merge with existing RIAs will find custodians, attorneys, investment bankers, and others able to facilitate these deals.

These unhappy advisors are reconsidering their options for several reasons, according to Echelon Partners. The strong drives to leave include:

- firm reputations tarnished in the down market
- firms with tough rules and bureaucracies that attempt to own the client
- firms with uncertain futures and leadership
- firms where a new culture focused on producing business has replaced an old culture based on trust and relationships.

Buyers today

In the run-up of interest and valuations that went on from 2004 to 2007, banks, investment banks, insurance companies, broker/dealers, and private equity firms were very interested in buying the larger wealth managers. Since that time, many of those institutions have instead had to focus on their own houses—restructuring their priorities and organizations, working on damage control and cleanup. Regulators, capital requirements, paying back government loans, lawsuits, merger integration, downsizing, layoffs, and other factors have increased in priority as acquisition of RIAs have dropped precipitously.

"I think that a lot of the old players are viewed by sellers as kind of suspicious," says Seivert. "They're not really coming back to the table. They say that they're interested, and they say that they want to do deals, but there's a big gap between their interest level and their ability to do something. Sellers are much more interested in doing deals with other larger RIA firms. The larger RIA firms are very well-positioned to be the preferred buyers in the whole M&A equation, given what's happened over the past couple years."

While the role of banks has declined, the active players have been mostly regional banks that managed to maintain healthy balance sheets or trust companies that continued to initiate deals to acquire RIA firms, according to *Real Deals 2009: Definitive Information on Mergers and Acquisitions for Advisors*, a study by FA Insight and Pershing Advisor Solutions.

In addition to the larger RIAs, aggregators are continuing to hunt for firms to buy. Some of these roll-up firms have been very successful, but others haven't, so advisors are looking at these deals more carefully.

Upheaval in the family office

One of the things that happened during the market turmoil was that a lot of multi-family offices lost AUM or lost clients. "The solution is really to just get more families, more often than not," observes Seivert. "They're also a little bit easier in terms of the merger candidates as well. They shouldn't have much difficulty merging with another multi-family office."

For single family offices, the practice economics have become clearer after the turmoil so some have had to adjust their practice models. Many have become multi-family offices or have developed arrangements with third parties to handle many of the responsibilities. Those that remained strong have long been well diversified, utilizing hedge funds extensively and even investing in timber and other traditionally institutional asset classes, according to Roame. Multi-family offices now seem to be following similar trends. In terms of M&A directions, single family offices rarely have any reason to merge, he adds.

Valuations

The recent trends in firm valuations shows that prices are trending down, observes Roame. The first problem is that assets are down for many firms, which directly affects valuation. "In addition, there are few legitimate buyers and even fewer willing to pay cash up front. Many larger RIAs have outgrown the succession plan route of employees buying out the equity holders, and competitors also generally cannot afford such a buyout when a significant amount must be paid up front. Small and middle size RIA businesses by and large lack plans, and their principals are aging so this is a concern that needs to be resolved, he concludes.

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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