ADVISORS

BECOMING A PROFESSIONAL BUYER
Part 2

Harnessing RIA M&A Strategies for Growth

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INTRODUCTION

Welcome to the latest white paper in PFI Advisors' ongoing series of industry content designed to help advisors build successful businesses. With the RIA industry setting itself up for further consolidation based on the macro trends impacting the industry, the opportunity for peer-to-peer M&A activity is increasing dramatically.

Multiple industry studies[1] are anticipating record levels of deal making in 2018, with volumes expected to increase dramatically in the years to come. The macro trends of aging advisors, increased competition from new technology players, pricing pressures and increasing client demands are putting stress on smaller advisors' business models. So much so, that many industry experts suggest that firms under $200 - $300 million in AUM may not be sustainable over the long run and will need to seek out a larger partner. Scale is becoming critical for RIAs to be able to continue to invest in their businesses, so they can build out centralized infrastructure, deploy the latest operational technology systems, hire professional management and embrace a digital client service experience to match the most successful firms.

As a result, many larger and more established RIAs are now actively pursuing inorganic growth strategies to take advantage of this industry consolidation movement. However, being a successful buyer is not a simple matter. In fact, if done incorrectly, "buying badly" has the potential to derail firms from their stated missions, distract them from their current business of serving existing clients, as well as unnecessarily increase financial and compliance risks that are often unknown until after the deal has closed.

Therefore, an inorganic growth strategy should not be embarked upon blindly. It should be a thoughtful process after firms have shored up their own technology systems, infrastructure, workflows, and service models so they have both the management and operational capacity to efficiently integrate acquired or merged clients and employees.

To provide a solution to this growing industry issue, we are pleased to continue our research into the best practices of inorganic growth by profiling the best in class approaches of the industry's largest and most successful firms in this second edition of our groundbreaking series on how to become a professional buyer (For first edition, click here).

We would like to thank Aspiriant, Beacon Pointe Wealth Advisors, EP Wealth Advisors, Mercer Advisors and Parallel Advisors for sharing their stories, ideas and approaches so that the entire industry can benefit from their experience and wisdom.[2]

To view PFI Advisors' previous white papers, click here.

[1] ECHELON Partners, DeVoe and Co., Cerulli Associates, Fidelity Investments, Charles Schwab, and TD Ameritrade Institutional 2017 research reports

[2] Disclaimer: PFI Advisors has consulted with several of the firms profiled in this report

INDUSTRY TRENDS

In the first installment of our "Becoming a Professional Buyer" research, we highlighted some industry trends that are driving consolidation within the RIA space, most notably the aging of the advisor population. According to industry researcher Cerulli Associates[3], the average age of advisor-owners is nearing 60, and there are currently more advisors over the age of 80 than under 30.

These baby boomer RIAs are typically lacking a viable succession plan, leaving the future of their firms in doubt. Combined with their desire to retire and a more brutally competitive marketplace, the opportunity to merge these firms into a larger organization is becoming the rule these days, rather than the exception from just a few short years ago.

Also creating urgency for firms is the continued evolution of the RIA industry from a sleepy corner of the larger financial services sector to a high-focus area for both incumbents as well as outside technology disruptors to raise the overall industry-wide competitive response. As a result, the stakes for RIAs are getting higher. This heightened competitive environment is leading to troubling trends such as pricing pressures and slowing growth. According to the latest research from the 2017 Fidelity Benchmarking Study[4], "60% of advisors are regularly discounting their fees by 20-30 basis points to attract and retain clients." Additionally, per the same study, organic growth for firms has been steadily declining to 3% from 6% just two years ago.

This margin compression and slowing growth are symptoms of a larger problem for a majority of the industry: lack of operational leverage, scale, and a systematic growth engine. The current, decade-long bull market has been artificially propping up many firms whose overall profitability and sustainability will be challenged when the markets eventually cycle into an extended down market.

Particularly in today's more challenging and competitive marketplace, these RIAs will be hard pressed to go it alone for much longer, creating yet another tremendous opportunity for better resourced firms to step in and provide a transition solution for these advisors, their employees and their clients. The entrance of private equity investors is also pushing this tipping point in the industry. These sophisticated buyers are flush with cash and are arming some of the mega-RIAs with capital to continue the consolidation trend.

So, how are larger RIAs closing so many deals? We have found RIAs that have a successful M&A track record tend to showcase their capitalization, centralized infrastructure, family office services, tax expertise, professional management and investment solutions that ultimately will enhance the selling firm's client experience.

Additionally, they stress that transitioning advisors don't necessarily have to retire and exit their firms just because they have been acquired. Our research with leading RIAs shows that these selling advisors are able to free themselves from day-to-day business issues and resume focus on better serving and growing their client base. In fact, they often report that they are rejuvenated, energized and see a clear path to becoming highly productive again in servicing their client base within their new firm after being acquired.

[3]The Cerulli Report, U.S. RIA Marketplace 2017: Ascendance of the Billion-Dollar Firm

[4]The 2017 Fidelity RIA Benchmarking Study

POLISHING THE PITCH

For RIAs who are seriously interested in pursuing inorganic growth, our research with top firms active in the merger and acquisition game reveals some very direct next steps that need to be implemented before jumping into the M&A arena.

Many industry consultants, investment bankers and financiers suggest that there should be even more deals executed based on the industry demographics and trends, however there is much improvement needed in the buyer community. Simply put, there are a lot of ill-equipped buyers out there.

Accordingly, acquiring firms need to have a powerful benefit message that is easily understandable and appeals to the selling advisors' long-term future and business continuity aspirations. This message needs to be substantially different from the pitch advisors make to clients and prospective clients.

To be successful, an acquiring RIA's pitch needs to focus on the reasons advisors got into the business in the first place: to serve clients and ensure they are taken care of in a way that they had always envisioned. As part of that personalized approach, selling advisors often didn't foresee the operational responsibilities and back office management that they would inherit from running their own business – something that larger, better-resourced RIAs can quickly and easily absorb, freeing up the advisors to better cater to their clients.

Acquiring RIAs need to have a proven client service model, efficient operations infrastructure, and access to additional planning and investing resources so that the selling advisor's clients will have a better experience than they are currently provided. After all, this is their life's work and if they are going to hand over their clients' faith and trust to a new firm, that acquiring RIA needs to be able to demonstrate these capabilities and communicate them appropriately. Additionally, being able to showcase the ability to market for them via custodial referral programs, systematized marketing approaches and other growth strategies inherent in the firm go a long way to demonstrating why they, their staff, and their clients will be better off as part of a larger organization.

Thus, before heading down this path, it is critical that potential RIA buyers have an efficient infrastructure, professional management, best in class technologies, institutionalized client service models and an airtight compliance process. A good next step is to engage industry operations and technology consultants to perform a "pre-M&A diagnostic" to highlight areas that need improvement and actions to take to be on par with, or differentiate from, the other sophisticated professional buyers out there.

"GETTING DEALS DONE IS CHALLENGING IN EVEN THE BEST OF CIRCUMSTANCES. IT'S A LONG-TERM GAME AND PROFESSIONAL BUYERS UNDERSTAND THIS. FOLLOWING A DISCIPLINED M&A PROCESS WITH A CLEAR UNDERSTUDYING OF ONE'S M&A STRATEGY IS A PROVEN APPROACH TO NAVIGATING THE CHALLENGES."

– DAVID SELIG, CEO
ADVICE DYNAMICS PARTNERS, LLC

M&A GROWTH STRATEGY REQUIREMENTS

Based on extensive interviews with top firms who have been successful with their approach to M&A, we've identified the following areas that aspiring buyers need to have in place, prior to engaging with prospective sellers.

To become a professional buyer, it is critical to have:

- **A Clear Value Proposition** – Having an easily communicable message about your firm and strategic direction is critical to explaining why a potential seller would want to work with you and transition their clients. Whether that is a scalable platform, an investment management specialty, better technology, nurturing culture or other reason, being able to articulate what you stand for is critical for successfully closing an M&A transaction.
- **Technology and Operational Expertise** – Having an up-to-date technology suite and operational excellence that you can showcase to the selling firm goes a long way to building confidence that their clients will be getting an upgrade in service and operating leverage for their advisors to be able to grow faster than on their own.
- **A Multi-Disciplined Leadership Team** – Having multiple owners with specific management responsibilities provides leverage and expertise so that selling firms know their clients will be better served. Not only do these "departments" allow a less-sophisticated advisor to offer more complex solutions to his/her clients, but by handing over "servicing" responsibilities to these respective teams, it allows the advisor to get back to growing their clients and not have to worry about the day-to-day servicing of accounts.
- **Management Capacity for Deals** – Successfully completing a transaction and realizing the promised synergies takes a full-time, focused effort by one or more management principals. Thus, it is critical that the acquiring firm has management capacity available to follow through on the many logistical details, legal issues, financial implications, negotiations, due diligence and client transition requirements. For even the largest firms, they typically do not do more than 2-3 deals per year.
- **A Transparent Compensation Structure** - In order for deals to go through, acquiring firms need to have a clear equity, compensation, buy-out/exit schedule that is transparent and easily communicable for the firm being acquired so that they know what they will receive over time, as well as expectations for their role and responsibilities as they transition their business.
- **A Strong, Defined Culture** – For many deals it often comes down to personality. Having a strong, defined culture is critical to ensure there is a good fit for both seller and buyer. Deals can quickly go astray and result in damage if personality compatibility is not a priority. Many firms often define their M&A success in terms of the "deals they didn't do vs. the deals they did do." Firms tend to spend all of their pre-close efforts focused on the economics of the deal, but it always seems to be the ever-elusive "cultural fit" that will ultimately determine whether the deal is a success or not.
- **Transition Support** – In order to harvest the promised synergies from an M&A transaction, it is critical that a majority of the clients transition to the new firm and have a good experience in order to ensure retention. Having a powerful post-M&A transition strategy, team, and onboarding resources ensures that client transitions go smoothly and are paramount for success. For many leading firms, bringing in outside consultants on demand to provide additional resources and expertise post-transaction can be a flexible, efficient and cost-effective approach.

CASE STUDIES OF SUCCESSFUL BUYERS

ASPIRIANT

Aspiriant At a Glance

Aspiriant's approach to growing inorganically is very different and unique in the industry, according to CEO Rob Francais. "We look for like-minded firms who share the same values that we do, have a client-first focus and want to join as partners, not as being acquired."

- **Founded:** 2008

Headquartered: Los Angeles, CA

AUM: $12 billion

Deal Activity: 5 mergers representing $6 billion

Aspiriant is solving the industry puzzle of mergers and acquisitions by capturing the value of organizations without creating conflicts; such as those that occur from strategic or financial buyers whose underlying interests often conflict with the needs and priorities of clients.

"We don't think of these as acquisitions at all," Francais notes. "You can't buy people, culture or cooperation – value is created when you share core values, a common commitment and integrate partners onto the team. We really consider these integrations as 'fold-ins' and we approach all opportunities as cashless mergers."

Aspiriant has been active in completing these types of large-scale mergers over the years to get to its size and scale, including one of the very first billion dollar+ mergers between RIAs that formed Aspiriant, along with the high-profile merger of Deloitte's wealth management business to create a national firm.

"The way we do mergers is stock-for-stock and no cash changes hands which has helped to create an institutionalized internal succession process to build the organization," Francais says. "Currently, we have 185 people, 65 of whom are partners."

Aspiriant's success, according to Francais, is their focus on aligning the interests of the parties involved and their focus on two pillars of strategy: aggregating talent as well as aggregating assets to gain scale and leverage on behalf of clients. "We want to bring in top talent in the form of CFPs, CFAs, CPAs, JDs and bring their collective wisdom to bear on client needs," Francais says. "Instead of having a lot of advisors doing different things and acting independently, we pool our wisdom and create a team-oriented single experience."

The second strategic pillar Aspiriant has been pursuing is to use its asset size as strength to gain scale on their clients' behalf, such as being able to negotiate better pricing for clients and better access to sophisticated products. **"Our infrastructure that is centralized for investing, planning, operations, tax services and client support is a tremendous resource that enables us to institutionalize our values in delivering what's in the best interest for our clients."**

Francais believes that this values-based approach helps firms that are merging into Aspiriant feel comfortable in telling this story to their clients. "These firms are not selling to us, rather they are seeking to be part of a larger organization that has their interests aligned. We are committed to being 100% employee-owned, have only one class of stock and have not taken any private equity or investments from outside parties."

This values-based focus for Aspiriant has become a self-selection process for RIAs to align with the firm. "Our vision since way back in 2000 was to build an organization for the future. We actually sell a portion of the firm every year as retiring partners transfer their shares to the next generation of advisors, which is precisely what our clients want us to do."

Francais can envision the day somewhere in the distant future where Aspiriant has 100,000 employees and $1 trillion in assets all working together on behalf of its clients. "We offer a values-based pitch, not a financial pitch, and that has made all of the difference in attracting partners that are a cultural fit and durable," he says.

BEACON POINTE

- **Founded:** 2002

Headquartered: Newport Beach, CA

AUM: $7.7 billion

Deal Activity: 11 transactions representing $3 billion

Beacon Pointe Wealth Advisors At a Glance

Beacon Pointe Wealth Advisors (BPWA) is a partnership between Beacon Pointe and successful wealth managers across the country, focused on creating synergies, value and growth, certainty for advisors, their clients and their team.

According to Matt Cooper, founding partner and president, Beacon Pointe was founded in 2002 via a lift-out from an institutional consulting advisory firm. Over the years, the firm grew successfully organically, building up a solid foundation for the firm's infrastructure and service model. As the wealth management industry has evolved, Cooper and his team took notice in 2010 of the growing need for consolidation in the industry.

"There is definitely excess capacity in the industry, which is driving a lot of the activity out there," Cooper says. "Our approach, however, was not to be a roll up firm, but to take a different strategy and create a separate operating model that we believe makes us the strategic aggregator of choice."

BPWA is a separate RIA from Beacon Pointe that enables advisors joining the firm to have an immediate equity ownership in that entity which will provide a higher multiple than if they were on their own. "Not only do advisors joining us gain access to a better client experience and a scalable foundation to grow their business, but also they have a guarantee that when they want to retire, we will buy their business at fair market value."

As a serial acquirer, BPWA has a very unique and beneficial financial approach, in that they focus on "cashless mergers" that also include salary, percent of top line income, bonus on net income and profitability distribution. This structure has special appeal to the next generation of advisor, in that they now have a direct career path where the owner who may never have wanted to retire, now has a plan.

To make the transition process a smooth one, BPWA has invested in numerous resources to streamline the onboarding process. **"Our COO oversees all aspects of transitioning advisors into BPWA," Cooper notes. "All of our department heads play in the process, coordinating custodians, client packages – ultimately we have nine people dedicated so that the process is well thought out and smooth."**

According to Cooper, "Our model really appeals to advisors who want to grow, as we have access to all of the custodian referral programs. Additionally, if advisors really embrace letting go of the operational aspects, compliance worries and administration hassles, they can focus on clients and regain the fun they used to have. They can join something greater and still remain an entrepreneur."

ep wealth advisors

EP Wealth Advisors At a Glance

EP Wealth Advisors' fundamental principles are simplicity, transparency and purpose, an approach that has served the firm well since it was founded in 2004 via a merger of two previous wealth management firms.

According to Patrick Goshtigian, President of EP Wealth Advisors (EPWA), "Professional management is critical these days to ensure that advisors can truly work with their clients to meet their long-term goals and objectives, while enabling the firm to continue to grow and scale."

- **Founded:** 2004
- **Headquartered:** Los Angeles, CA
- **AUM:** $3.6 billion (as of 2/28/2018)
- **Deal Activity:** 4 acquisitions representing $670 million of client assets

This idea of having a dedicated effort to the running and managing the business has definitely paid off for EPWA, as they have successfully grown the firm from $200 million in 2004 to over $1 billion in 2011, when Goshtigian joined the firm, to $3.6 billion today.

As part of that approach to further grow the firm, EPWA has recently embarked on an inorganic growth strategy via strategic acquisitions of other independent advisory firms. "Providing fiduciary advice as an RIA started to gain popularity 20 years ago, and since then many advisors left broker dealers and wirehouses. This exodus left the market fragmented. Because of the average age of fiduciary advisors and the increasing complexity of running a business, we see the M&A trend accelerating to a point where the make-up of the RIA market is like a barbell: national and super regional RIAs on one end, and the rest of the smaller advisors on the other," Goshtigian says. "Our pursuit of providing advice in the best interest of clients has led us to invest in processes, technology, and referral channels that gives us the confidence that we'll be on the larger side of the barbell."

In order to accomplish this growth strategy, EPWA has partnered with an outside investor, Wealth Partners Capital Group, to be able to source deals and leverage their capital and expertise to close deals. "We've done 4 acquisitions in the last 3 years and are looking for M&A activities to be a bigger and bigger source of our growth going forward," notes Goshtigian.

Advisors joining EPWA note their ability to leverage the size and scale of the firm. **"They can take off all of those hats," Goshtigian says. "There are real burdens on advisors in terms of operations, investment management, financial planning, and more, so when we centralize those functions and they can tap into them, they immediately become happier as they are able to focus on what they love, working with clients."**

Goshtigian notes that there are other real benefits to working with a larger firm. "For advisors, it can be lonely out there all on your own; thus, having a collegial, collaborative environment is very important. Additionally, when it comes to larger clients – they don't want to be the largest client in a smaller firm – they find comfort in working with larger firms."

Another benefit that Goshtigian relates from the firms they have acquired is an increase in referrals from the clients of older advisors. "Clients stop referring to an advisor if they sense he or she is winding down the practice. However, when clients see that the advisor is now with a larger firm and has a succession mindset, the referrals now come more freely."

MERCER ADVISORS™

- **Founded:** 1985

Headquartered: Denver, CO

AUM: $12 billion

Deal Activity: 13 transactions representing $4.5 billion in AUM

Mercer Advisors At a Glance

Mercer Advisors has a long history of providing wealth management and family office services to high net worth investors. Through a fee-only, fiduciary focus, Mercer relied solely on organic growth reaching $6 billion of AUM as of June 2015 with much of that growth originating since 2011. As of June 2015, Mercer was one of the fastest growing RIAs in the country without doing any acquisitions.

In a thoughtful approach to spur that growth further, Mercer partnered with an M&A-minded private equity firm in 2015 to embark on an inorganic strategy that has truly transformed the firm.

“Since our first deal in early 2016, we have been an aggressive integrator of independent RIAs and have just surpassed $12 billion in AUM,” said Dave Barton, former Mercer CEO and now Vice Chairman focusing exclusively on leading Mercer’s M&A activities.

According to Barton, the key to Mercer’s success has been to focus first on cultural alignment. “To us, size doesn’t matter. We have done deals as small as $55 million in AUM and deals upwards of $2.2 billion. We are strong proponents of the fee-only, fiduciary financial planning, client-centric philosophy, so any potential partners we engage with truly must believe in that. It’s not enough to just have that statement in their Form ADV, it should be part of the firm’s soul.”

Barton emphasizes that Mercer is different from the other serial acquirers out there. “We are an integrator, not an aggregator,” he says. “In pretty much all our deals, the selling principal stays involved - this is not an exit strategy for that person. Rather, it is a career development opportunity not only for the seller, but also for his or her employees. They are not just cashing out; rather they see Mercer as a national organization where they and their teams can thrive. For us, we truly believe that there is a talent shortage in our industry and we are not just looking to acquire AUM, but also to add significant talent and capabilities to our organization.

When discussing with potential partner RIA firms, Barton emphasizes the size, scale and depth of resources that Mercer can provide to their clients. **“Every advisor cares deeply about their clients and wants to ensure that they are well cared for. We demonstrate that clients will have an enhanced experience with Mercer via our family office services delivered by in-house CFPs, CPAs, CFAs, CTFAs, MBAs and attorneys – we feel this is truly our competitive differentiator.”**

Barton also emphasizes in his pitch to potential partners that Mercer has a national sales force that is marketing aggressively. “In just the last year, we brought in $1.3 billion from 900 new clients from our organic activities alone.

Additionally, Barton confirms that for many mid-sized RIAs, they are all looking for ways to get rid of the day-to-day headaches of managing their business and focus on what they truly enjoy. “For the first time, advisors joining Mercer are able to live the lives that they are planning for their own clients,” he wryly notes.

PARALLEL ADVISORS

- **Founded:** 2006

Headquartered:
San Francisco, CA

AUM: $1.9 billion

Deal Activity:
2 mergers representing $200 million AUM

Parallel Advisors At a Glance

Parallel Advisors was founded in 2006 as a "tech-savvy wealth management firm that leads with financial planning and asset allocation," says C.J. Rendic, CEO of Parallel Advisors. "We don't have a broker dealer affiliation, so we are truly independent and on the right side of our clients."

Rendic believes that, "bigger is better," when it comes to wealth management. "Powerful benefits of scale accrue to a larger firm in this industry, such as the latest technologies that delight clients, dedicated wealth strategists (lawyers, CFPs. LL.Ms) and centralized processes. Smaller firms simply don't offer these sophisticated services that high net worth investors require."

As part of that larger firm focus, Parallel is launching an inorganic growth strategy to capitalize on the success they have had with two earlier advisor mergers. "These firms were a very good fit for us as they had a similar focus on serving clients; However, they didn't want to have to deal with the business operations, compliance and technology responsibilities that come with being an independent firm," Rendic notes.

Once these advisors were able to leverage our investment and financial planning best practices, they quickly grew their businesses within Parallel. "Successful integration of advisors validated our model," Rendic says. Accordingly, Parallel has now brought on a new hire as their "Firm Development Director" to lead their recruiting efforts, for both new advisors as well as acquisition opportunities. "We are looking to bring on about 4 advisors and conduct 2 acquisitions a year."

Rendic's strategy focusses on maintaining Parallel's culture and recruiting like-minded advisors to join the firm. **"Relationships are key to our success," he says. "Not only with clients, but also within the firm. We've found that collaborating with the other professionals within Parallel actually helps deepen client relationships as advisors are able to bring a broader solution set to bear."** As a result, Parallel makes it a strategic priority to create a shared-equity model and to pay above market rates to maintain their aligned interest and further establish their firm culture.

Going forward, Rendic believes there will continue to be further industry consolidation and the firms that can invest, have professional management and a scalable infrastructure will be the winners going forward. "Our pitch to advisors is that we can sustain a high level of relationship management, while allowing advisors the autonomy and flexibility to manage their clients their way with our support."

PFI ADVISORS

ABOUT PFI ADVISORS

PFI Advisors, LLC ("Pure Financial Independence") was founded in 2015 with the following mission in mind:

To further evolve the RIA industry from a collection of "practices" to "businesses," and to be a continued voice in validating the industry as a legitimate landing spot for billion-dollar teams and their clients.

PFI Advisors is pioneering an operational consulting service that supports the unique back office, technology, and operational needs of RIAs in growth mode. PFI Advisors conducts Technology Assessments, manages Technology Conversions, and provides M&A Preparation and Integration Services. In addition, they offer COO Resource services to help RIAs in various stages of their growth cycle.

For breakaway advisors, PFI Advisors manages full RIA set up and transition to Independence, including office buildout, RIA infrastructure, client transition, and billing services, all for a simple consulting fee. There is no complicated long-term AUM fee structure or equity stake required to build the firm's future and provide advisors **Pure Financial Independence.**