FINANCIAL SERVICES INDUSTRY GROUP

M&A TRENDS IN WEALTH MANAGEMENT:
2024 & BEYOND

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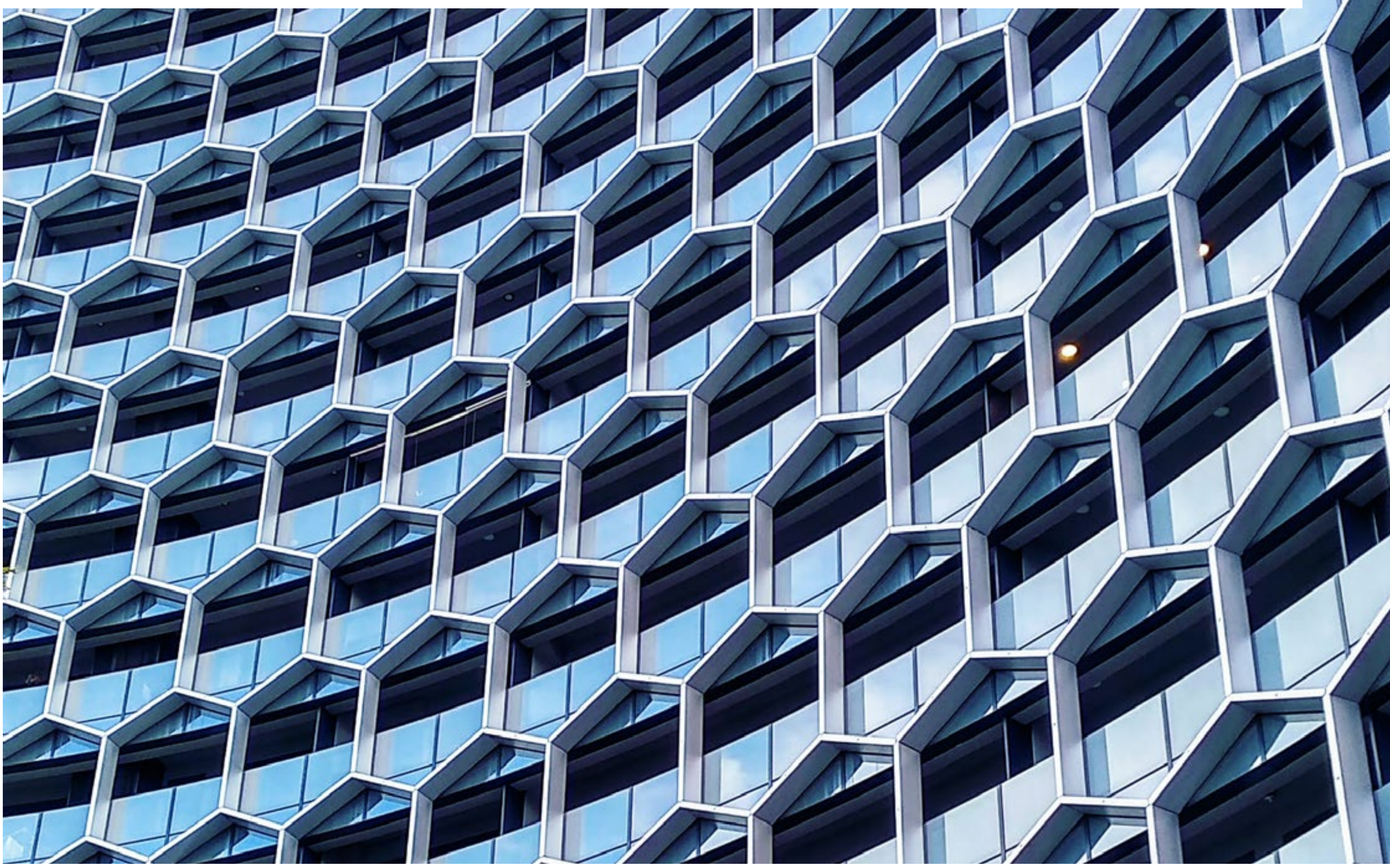
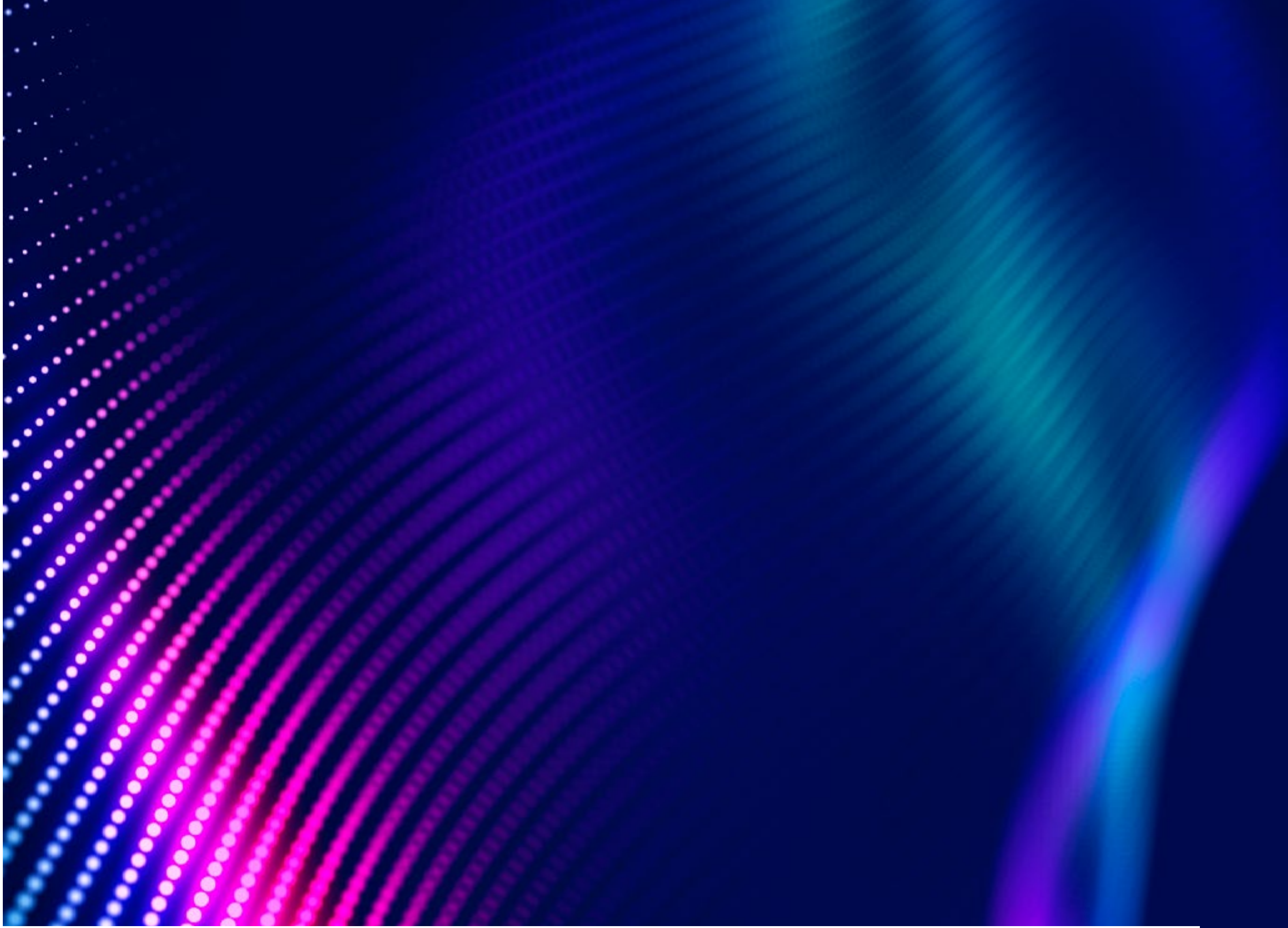
INTRODUCTION

After years of record-breaking M&A activity coming from private equity backed (“PE”) aggregators, opportunistic distressed acquisitions and team lift-outs, dealmaking in the wealth management space appears to be stabilizing in 2024. The Registered Investment Advisor (“RIA”) space continues to be the most active M&A wealth management segment. In the DeVoe & Company RIA Deal Book, it was announced that there were 251 RIA deals in 2023, a 5% decline from 2022 and the first time in a decade that M&A dropped. However, while the larger M&A market was down 30 percent in 2023 (mostly due to high interest rates and global economic uncertainty), wealth management deals held firm further heightening the value proposition.

Wealth management firms continue to allure PE sponsors for several reasons. The streamlined and scalable business model is attractive to investors. Both can generate steady cash flow and can be platforms bolt-on deals in the highly fragmented US wealth market. In addition, many founder-owned wealth management firms are motivated to sell as a succession strategy as owners look to retire or otherwise exit. Broader macro trends, including ongoing market, interest rates, and regulatory uncertainties, have temporarily swayed PE investors away from other financial services sub-sectors, like banking or specialty finance, in favor of more stable sectors like wealth management and insurance distribution.

Looking ahead to the remainder of 2024 and beyond, we believe M&A activity will continue to be robust, shaped by several key themes and emerging trends.





KEY THEMES AND EMERGING TRENDS

01 DICHOTOMY IN ADD-ON ACTIVITY:

Throughout 2023 and into 2024, we observed a dichotomy in the M&A approach amongst acquisitive wealth management firms. Some shops continued full-steam ahead with add-ons of firms with up to ~$10B in AUM and multiples generally holding from 7-15x. Most of these firms had deals already in the pipeline, either through opportunistic conditions such as bankruptcy, responses to acquiree-led processes, or acquisition of firms that were part of a more strategic geographic or service expansion.

Conversely, other firms, particularly those that were feverishly active with add-ons in 2021 and 2022, have temporarily slowed or paused their inorganic growth mandates. With financing conditions becoming less favorable due to higher interest rates and stronger covenants, these firms have focused resource capacity and capital on fully integrating newly acquired teams and margin expansion initiatives.

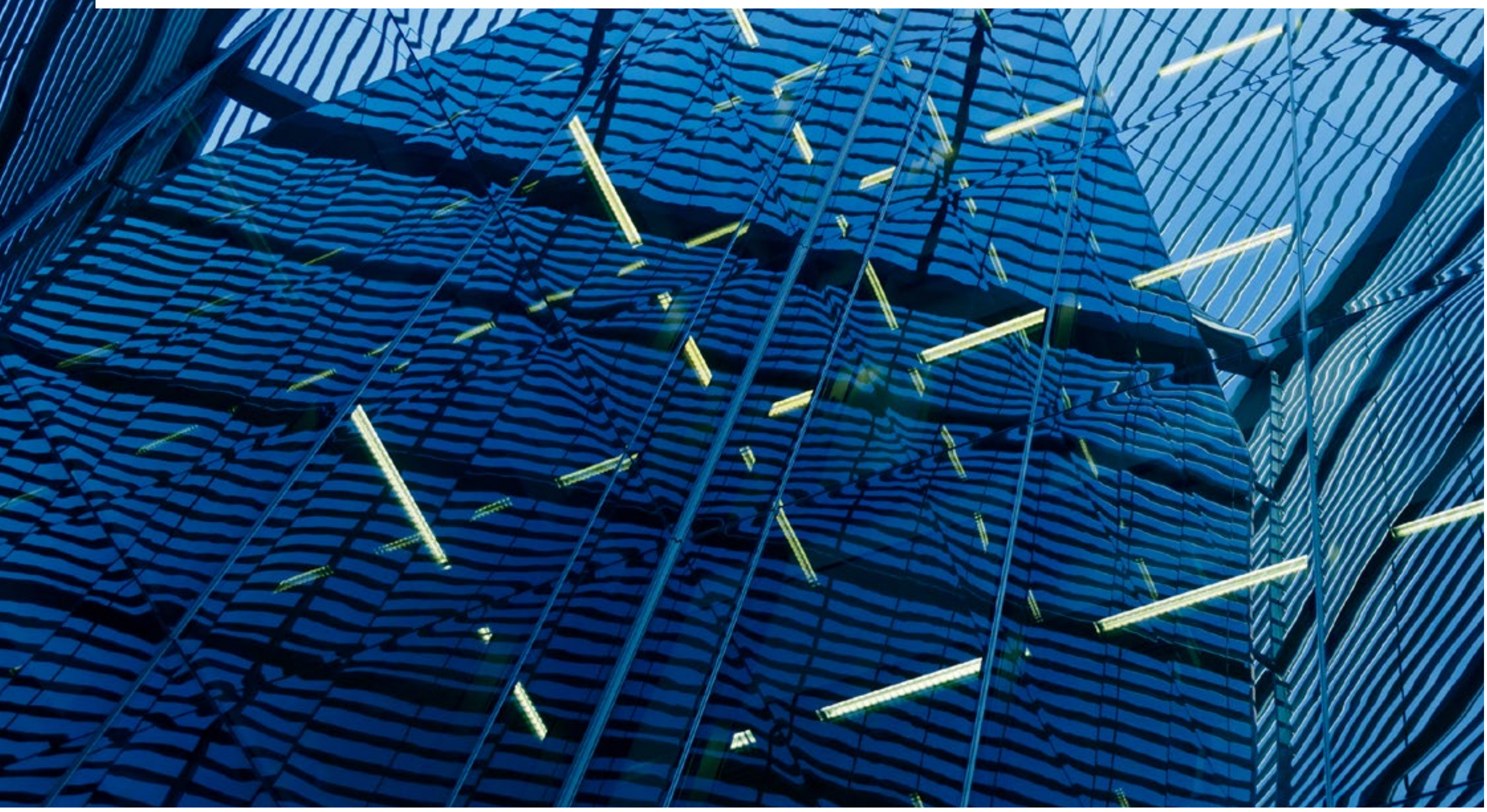
Employees in finance, technology and operations enhanced integration processes and defined target state operating models in order to speed up their post-transaction plan and monitor synergies. Expenses such as headcount and office footprint was reevaluated, and projects to increase revenue such as pricing initiatives, improving cross-sell, or launching new services (e.g. cash management, insurance) were considered.

02 HEIGHTENED SCRUTINY FOR LARGE PLATFORM DEALS WITH HIGH MULTIPLES:

While there continues to be a strong appetite for platform deals at attractive valuation multiples from a broad pool of potential investors, buyers are exercising increased caution when evaluating potential acquisitions. We have observed that some large wealth management firms with over $30B in AUM are achieving valuation multiples in the 18-25x range, but this has been limited only to those with a demonstrated playbook for organic growth.

Across the industry, organic growth broadly slowed (and, by some measures, shrank) in 2023, and prior years' growth was, in many cases, primarily attributed to market conditions (rather than net new clients or revenue). Buyers are dialed in during pre-close diligence, specifically digging in to understand drivers of organic growth and profitability, and getting comfortable that these KPIs are accurately reported in the target's systems.

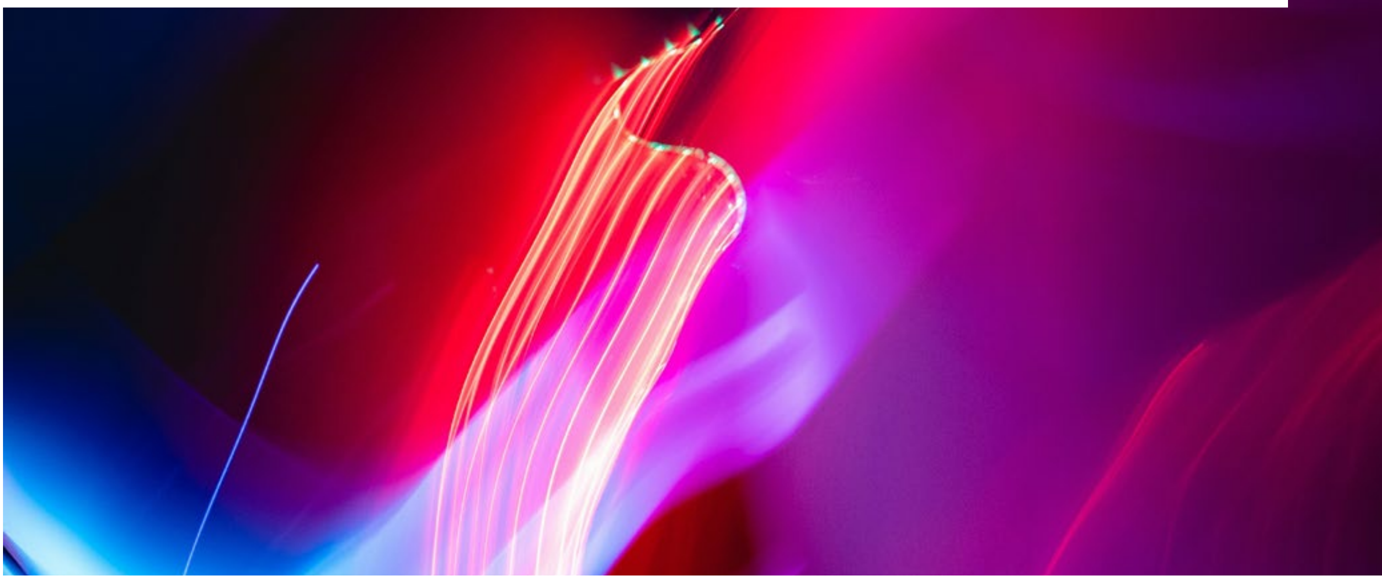
Firms that have sustained organic growth across diverse and multiple businesses are distinguishing themselves amongst their peers and are seeing high valuation multiples in return, whereas firms with flat or negative organic growth are generally not receiving as much interest from potential investors. Moreover, firms that are fueled by Gen X, Millennials, and Gen Z – in terms of both advisors and clients – are receiving higher valuations due to the assumption of being able to attract the potential for intergenerational wealth transfer and assist with succession planning of retiring employees.



03 INCREASE IN ADVISOR LIFT-OUTS:

Throughout 2023 and into 2024, we've seen an increase in volume of advisor lift-outs. Under a lift-out model, firms onboard seasoned advisors (e.g., from a wirehouse), with existing books of business. This acquisition model is attractive as the integration process is streamlined and the purchase consideration is often based on a multiple of annualized revenue, typically ranging from 1-3x, which can vary, but is substantially less than a traditional asset purchase.

Integration of team or advisor lift-outs is usually more streamlined, without the need to rationalize centralized services or employees, merge systems and databases or review large number of vendor or referral contracts. The Federal Trade Commission's April 2024 ruling banning non-compete agreements could remove some legal red tape that has historically complicated advisor lift-outs. Further, regional bank failures of 2023 and 2024 increased willingness of those forced into a new home to consider exercising self-determination on where they look to continue servicing their clients and growing their business.



04 SERVICE EXPANSION VIA M&A:

Over the last year, we've seen an uptick in acquisitive wealth platforms targeting companies with complementary service offerings, including tax consulting, workplace solutions, trust services, estate planning, and institutional consulting. This strategy equips firms with more opportunities to capture new clients and a broader range of cross-sell opportunities for existing clients, while increasing overall financial robustness.

Wealth management firms with diverse revenue streams can experience an approximate threefold increase in impact. Additionally, acquiring these incremental services directly (e.g., tax-focused accounting firm) can often be accomplished at a lower multiple than buying a wealth management firm with these services already integrated, thereby increasing the probability of returning debt to PE investors while mitigating against market performance driving organic growth.

05 GEOGRAPHIC EXPANSION IN RESPONSE TO MONEY IN MOTION:

Entry into new geographies through acquisition has been a continuing trend, especially in areas where populations have been migrating since COVID. However, the cost of real estate within the acquisition target should be more closely reviewed as part of the larger portfolio of expenditures. Domestically, new wealth hubs such as Florida and Texas have been emerging in response to increase remote work and tax incentives. Wealthy individuals are more likely to have an expanded geographic presence, increasing complexity of service offerings. International presence has been an area of differentiation within the wealth management market.

Wirehouses and traditional broker dealers have been exiting international geographies such as United Kingdom and Europe for over a decade due to heightened regulatory scrutiny, macroeconomic uncertainty, and overall complexity due to the size of their businesses. This provides an opportunity in the market for competitors such as RIAs to differentiate and service a growing number of expats and international clients.

M&A MOMENTUM:
WEALTH MANAGEMENT'S FUTURE TARGETS AND STRATEGIES

Taken together, we expect the factors described above to bolster M&A activity in the wealth management sector.

Firms with **less than ~$2B of AUM** will be interesting to watch, as they continue to consolidate and ultimately become a potential acquisition target for one of the larger players in the sector once reaching ~$10B in AUM.

Firms that are in the **$10-50B range** will continue to be prime targets, both for rollups on the lower end, and potential platform acquisitions on the high end.

Most intriguingly may be what happens with the largest firms in the space – i.e., those with **>$50B in AUM**. Many of these firms have already taken private capital, and while a limited number of sponsors will move these investments into perpetual vehicles, most will be looking for an exit within the next 3-5 years (maximum). We think there are **four plausible outcomes** for these firms, and two possibilities that we view as less likely:

01 Some of these firms will most certainly re-trade within the private market between PE firms. However, re-trading between PE firms cannot be an enduring solution, thereby necessitating other capital options.

02 The PE firms may look for sovereign wealth funds or pension funds as an exit strategy if employees are unable to support the balance sheet. This would allow for "forever" capital but sustain their position as positive cash flow, stable, high value vehicles for financial investors.

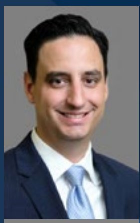
03 These firms may look to recapitalize through a combination of employee ownership and debt financing (likely structured to participate in the upside). This approach would require unique compensation / staffing models to pass the profitability to employees and put additional pressure on the firm's ability for top-line year-on-year organic growth to ensure they can service the debt.

04 There is likely going to be a turning point where some of the larger firms choose to merge, similar to what has previously played out in the banking and insurance sectors. This strategy will need to consider competing personalities of founders and firm cultures, regional differences in work / life balance, in-office / remote working preferences, and advisor affiliation models (e.g., 1099 vs. truly independent). However, a merger of these larger independent firm could create a platform that eventually brings up the bite-size for bolt-on acquisitions. If this comes to fruition, we may see $100B become the new $50B.

While IPOs and acquisitions by the wealth management giants are in theory a possibility, we expect these options to be significantly less likely. The number of wealth management firms going public is likely to be limited based both on the dearth of pure-play comparables and the overall state of the IPO market. On the other hand, the cultural differences of advisors within independent vs. established firms would likely make the road for a merger difficult (if not impossible), and retention of advisors would be a big question mark.

It is more likely for these firms to organically build independent channels through segmentation to serve similar advisor and client needs such as differentiated compensation models and unique product offerings. Acquisitions of wealth management firms by asset managers, insurance companies, banks, and technology firms are also certainly a possibility, but will likely be idiosyncratic and one-off, rather than a systematic trend within in the industry.

As a partner across all stages and segments of the wealth management M&A ecosystem, we look forward to supporting firms navigating these themes and trends.



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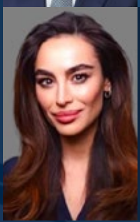

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