# Wipfli And Gladstone Dive Deep On RIA M&A Amid The Market Downturn

**CHRIS LATHAM**


Chris Latham, Deputy Managing Editor, Wealth Solutions Report

***Paul Lally* Of *Wipfli* And *Derek Bruton* Of *Gladstone Group* Share Insights On How RIAs Can Navigate The M&A Landscape Despite Recession And Falling Valuations**

Is the M&A landscape for independent wealth management firms finally cooling down after years of blazing hot growth, and if so why is that happening? Depends on where you look, and whom you ask.

"The slowing down of deals can be attributable to the current market volatility," said **Paul Lally**, Principal & Wealth & Asset Management Industry Leader at accounting and business consulting firm **Wipfli**.

"In 2023, I expect to still see transactions being completed. However, I believe many firms that were contemplating selling prior to the market downturn will pull back in a wait-and-see mode," Lally said. "Also, many other firms will work to stabilize or right-size during this time to remain viable, as to better position themselves for when the market turns around."

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A decade ago, it was easier for boutique RIAs with several hundred million dollars in assets under management (AUM) and a small staff to compete with larger rivals, according to Lally. He argues that evolving technology, a more complex compliance environment as well as broader product and service offerings have changed industry dynamics such that achieving the scale of a larger firm has become imperative for many RIAs.

**Derek Bruton, Senior Managing Director, Gladstone Group**

**[Derek Bruton](), Senior Managing Director at [Gladstone Group](), a wealth management-focused M&A advisory and strategic consulting firm, sees reason for optimism in the long term, even for RIA owners who may feel frustrated with their prospects to achieve an optimal liquidity event during a potential recession.**

**"Trees don't grow to the skies. At Gladstone, we see this more measured pace akin to the market taking a breath as opposed to a slowdown with a predictable timeline," he said. "The underlying drivers for convergence – aging owners seeking succession, need for scale, monetization of life's work, additional resources and capital for growth – have not changed."**

> "Nothing has seriously slowed down the secular trend of combinations in the space." - Derek Bruton, Gladstone Group

**"There is always volatility at varying levels – COVID, market corrections, kinetic military conflicts, threats to tax treatment of capital gains and carried interest. Nothing has seriously slowed down the secular trend of combinations in the space," Bruton said. "But as much as financial advisors recommend their clients take long-term perspectives on their portfolios, often advisors have a hard time swallowing their own medicine when it comes to their own business."**

**Market Data & Analysis**

RIA M&A market data shows growth slowing

Late last month, **DeVoe & Company's** third quarter **report** on the state of mergers and acquisitions in the RIA space revealed that deal flow stayed steady throughout the first three quarters of 2022, although the pace of activity fell somewhat.

A week later, the **ECHELON Partners** third quarter **report** revealed that deal volume is on track to reach another annual record despite slowing deal flow, while strategic acquirers, consolidations, private equity firms and wealthtech players continued to make big moves.

> **DeVoe and ECHELON reported that total transactions in each of the first three quarters of 2022 were lower than total transactions in the fourth quarter of 2021, after quarterly deal volume trended upward throughout the previous two years.**

Although their raw numbers differ somewhat, both reports agree that total transactions in each of the first three quarters of 2022 were lower than total transactions in the fourth quarter of 2021 after quarterly deal volume trended upward throughout the previous two years.

Overall Q3 had 68 transactions, on par with the 67 deals in Q2 and 68 deals in Q1, after 76 transactions occurred in Q4 2021, DeVoe reported. Overall Q3 had 84 wealth management transactions, compared with the 91 deals in Q2 and 94 deals in Q1, after 99 transactions occurred in Q4 2021, ECHELON reported.

According to DeVoe, firms conducted 23% more transactions during the first three quarters of 2022 than the same time period last year. Small and midsize firms fueled that record deal volume, with RIA sellers under $1 billion in AUM accounting for 54% more transactions than the same time period in 2021. Consolidators conducted 52% of all transactions in the first three quarters of 2022, compared with 54% of deals during all of 2021, DeVoe found.

According to ECHELON, in the first three quarters of 2022, 71% of acquirers also bought another firm. Average AUM per deal fell to $1.73 billion during the first three quarters of the year from $2.09 billion in full year 2021 and $1.75 billion in 2020.

Strategic acquirers and consolidators accounted for 42% of the total deals in the first three quarters of 2022. However, most strategics and consolidators are themselves backed by private equity firms, ECHELON found.

Many wealth management firms are experiencing lower revenues and profits because their performance is correlated to the financial markets while their internal expense structures have remained largely the same, according to Lally. Furthermore, since the industry trades on multiples of free cash flow, lower free cash flow is resulting in lower valuations for firms.

Acquirers are spending more time evaluating targets

**Bruton argues that this has led to some healthy slowdown in getting deals done as potential acquirers spend more time evaluating targets, getting to know their business models, analyzing their numbers, meeting key personnel, and distinguishing true growth from market-driven growth. Longer due diligence from buyers makes sense in this environment, even as some sellers express remorse that they did not execute during higher valuations, according to Bruton.**

**Private Equity And Strategic Acquirers**

Given that economic uncertainty and stock market volatility are impacting client AUMs and RIA valuations, it is worth considering the current appeal for potential M&A targets among private equity firms and strategic acquirers.


**The answer is clear for Bruton: "Smart money loves predictable revenue streams and inefficient markets – thousands of relatively small businesses competing with a handful of large, branded banks, brokerage firms and insurance companies – in a market where demand for financial advice actually accelerates in bear markets."**

**"With that said, higher interest rates and capital costs combined with the recent sales of many $1 billion-plus AUM RIAs are pointing PE-backed acquirers towards smaller firms, which are plentiful and typically command lower multiples than mega-firms," Bruton said.**

**Bruton also pointed out that attractive targets – meaning businesses with relatively strong cash flow, sticky client bases, efficient platforms and top talent – still receive ample inquiries from private equity firms, strategic acquirers and consolidators. However, sellers would benefit from enhancing their value proposition by cleaning up their bookkeeping and accounting, adopting technology stacks that help minimize weaknesses, and recruiting strategically to maximize strengths, according to Bruton.**

Private equity firms typically invest in institutional businesses with a defined growth plan supported by efficient operations and scalable infrastructure, according to Lally. But the continually shifting and unstable economic environment has impacted asset values and somewhat disrupted normally profitable and predictable fee income, presenting a stark reminder that wealth managers are not completely in control of revenue streams.

> **"What are your core competencies that will still be valuable even as the markets underperform?" - Paul Lally, Wipfli**

Strategic acquirers, on the other hand, often look at a target as the solution to a business problem within their current organization, Lally argues. This problem could be one of geography, technology, skills, relationships or some other issue. Either way, the acquiring firm will want the target to help the combined entity grow ever more profitably post-transaction.

"For those individuals interested in selling to one of these two groups in the near term, you should be asking yourself how you can meet these needs and position yourself accordingly, said Lally. "What are your core competencies that will still be valuable even as the markets underperform? Showcase those and work with your investment banker to demonstrate how they could deliver additional value for both types of acquirers."

***Chris Latham, Deputy Managing Editor at Wealth Solutions Report, can be reached at [clatham@wealthsolutionsreport.com](mailto:clatham@wealthsolutionsreport.com)***