How Much is My RIA Worth?

By *Tyler D. Nunnally*

5 MIN READ

You might be wondering whether the global pandemic and subsequent market volatility has negatively impacted the valuation of your RIA business. The short answer is "not really." That is somewhat surprising given that the revenues of fee-based RIAs are tied-to market performance. It becomes less confounding if you understand the market dynamics.

The primary reason for cohesive valuations throughout this period of volatility is basic scarcity. There are still many more buyers of RIAs than there are sellers. Consequently, the competition for deals has propped-up prices despite the ongoing health crisis and socioeconomic uncertainties.

That is not to say that RIA M&A is immune from Covid-19. There is no doubt that market conditions have adversely affected deal flow. According to Fidelity, the number of M&A deals in Q1 2020 fell around 25% compared to 2019. As expected, though, deal flow has picked-up considerably since.

Factors Driving RIA M&A Market

If you look past the current environment you will see that fundamentally, little has changed. The factors driving the RIA M&A market to seven consecutive record-breaking years before the onset of the pandemic are the same factors that will drive it well into the future.

Demographics – Aging Owners

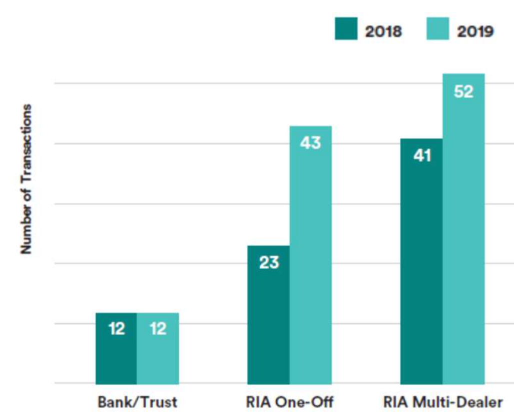
More than 20% of advisors are over the age of 60 while around half are older than 50. Aging advisors are a key source of supply for RIA M&A deals. Unfortunately you cannot escape old age, regardless of what is happening in the world around us.

Industry Evolution – Consolidation

The RIA market is rapidly evolving from 13,000 independent local shops to an amalgamation of large professionally managed regional and national firms. This shift has been brought about in large part by private equity backed RIA consolidators that are competing with one another for greater and greater slices of AUM market share.

These firms are slugging it out with multi-billion-dollar independent RIAs and a handful of banks to create dominant positions in their respective geographic markets. A recent study by TD Ameritrade shows how that trend is unfolding based on the number of completed deals by acquirer type in 2018 and 2019.

Number of Transactions by Acquirer Type, 2018 and 2019



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Types of Valuation Methods

Valuing RIA businesses is both an art and a science. There is no right or wrong way, per se. It really depends on who is making the valuation and the internal motivations driving the pricing decision. External factors such as fair market value, competitive pressures, and firm size play important roles as well.

Below are the valuation methodologies that are most commonly used by RIA acquirers:

12-Month Trailing Revenues

This method is straightforward. A multiple of 2x revenues gets bandied about quite often at industry conferences. Buy-side competition has pushed that multiple even higher now. Revenue-based valuations are common for firms under $250mm AUM.

Earnings Before Owner's Compensation (EBOC)

EBOC takes into account profitability versus revenues alone. It is a good indicator of how well an RIA is managed because it enables buyers to evaluate operating margins before owners take their share of profits. This method often applies to firms in the $250mm to $1bn range.

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)

Large RIAs that exceed $1 billion AUM are often valued at EBITDA. Buyers are taking on more risk when the stakes get higher, and thus the bottom line takes on much greater significance. A multiple of 7x EBITDA was around average, but the multiple is climbing with increasing demand. Larger firms with a billion-and-up AUM command higher multiples than smaller firms, partly because there are fewer available for sale.

Again, there is no universal measuring stick in terms of valuation methodology; it varies. There are other key risk factors that can determine valuation as well, including:

- Growth rate
- Operating margins
- Client attrition rates
- Average client age
- Client concentration risk
- Age of RIA owner(s)
- Next Gen advisors
- Firm talent
- Automation and tech usage
- Geographic location
- Compliance record

Money Isn't Everything

M&A is a lot like a marriage. No one goes into marriage expecting it to end in divorce. You should think of selling or merging in the same way. One of the biggest risks facing a seller is to get into a relationship with a buyer that turns sour. It can lead to legal problems, of course. But it can also be detrimental to your mental health. The stress and negativity that comes from constant conflict takes a toll on your quality of life, which in turn, has the same effect on those around you.

When choosing a strategic partner look to cultural fit first. Make sure that you share the same worldview, beliefs, investment philosophy and ethics. Also ensure that your short and long-term goals are aligned. By starting there, you can help mitigate the risk of seller's remorse. Sure, you want to maximize the value of your asset. But consider the bigger picture. If the coronavirus has taught us anything it's that life is short and can change in a heartbeat. There are no guarantees.

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About Nunnally International, Inc.

Nunnally International, Inc. provides strategic M&A services to RIA firms that are looking to buy, sell or merge their business. The company was founded by Tyler D. Nunnally. Prior to entering M&A, Tyler served as a strategist to leading advisor technology providers – including FinaMetrica, which was acquired by Morningstar. He began his wealth management career as an executive at Oxford University spin-off consultancy Oxford Risk. During his career he has consulted hundreds of RIAs on matters of risk as a frequent speaker at industry conferences, host of countless webinars and proficient author of journal articles. Tyler has been a key relationship manager to strategic partners at prominent institutions including SEI Investments, TD Ameritrade, LPL, Fidelity and Schwab, as well as leading advisor technology companies such as Redtail, Orion Advisor Services, eMoney, MoneyGuidePro and Fi360. As an industry thought-leader, he has been interviewed extensively by The Wall Street Journal, Bloomberg, CNBC, Smart Money, Kiplinger and InvestmentNews. Tyler holds a B.A. from the University of Georgia and a Master's in International Business with Distinction from the University of St Andrews in Scotland.

How We Work With RIAs

Nunnally International, Inc. works with RIAs in two ways. You can choose whichever option best suits your unique circumstances.

Option #1 – Referral Partnership

Nunnally International, Inc. can introduce your firm to prospective buyers through our existing referral partnerships. Our referral partners pay our fees, so it won't cost you anything. We work with a select number of referral partners that are all differentiated in terms of what they bring to the table. We don't partner with anyone that we wouldn't have manage our own money. We employ our expertise in investor profiling to find the best fit based on your firm culture, partnership criteria and strategic objectives. Naturally, this is done in consultation with you. If you decide that you would like to pursue a conversation with a group that we recommend, then we make the initial introduction and help facilitate the talks.

Option #2 – Engagement Agreement

RIA firms that want to sell or merge retain Nunnally International, Inc. through an engagement agreement. We lead the M&A process all the way from initial introduction to close. Our fees consist of a monthly retainer for six months, plus a success fee based on the closing price. This is a standard M&A advisor model for buy-side and sell-side engagements. We guide you through the M&A process by:

- Help define your strategic objectives.
- Identify the right prospective acquisition partners.
- Make introductions to prospective acquirers and solicit bids.
- Assist in preparation of necessary documentation.
- Facilitate conversations and information flow.
- Conduct due diligence on prospective acquires.
- Negotiating terms of sale and maximize valuation.
- Successfully close sale.

For more information call us at 404.492.2152 or send an email to tnunnally@NunnallyInternational.com

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