Strategies in M&A and Succession Planning

Understanding Motivations, Deal Structure, and Effective Practices for Financial Professionals

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Avantax

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Member of the Finance and Senior Leadership Team at Avantax
- Leads M&A team for employee-based RIA segment
- Leads succession planning team for independent broker-dealer segment

Experience
- Launched hedge fund with peak portfolio of ~$400 million, achieved top-tier returns
- Founding partner at investment bank acquired by Nomura for >$100 million USD
- Former equity analyst at Goldman Sachs, specializing in special situations research, IPOs, and secondaries for private equity-owned companies
- Started small and mid-cap research group at Goldman Sachs
- First alternative energy analyst at Goldman Sachs
- Prior experience: Strategy consultant at Accenture, CPA at Arthur Andersen

Education:
- MBA in finance from The University of Chicago, MSc in decision science from The London School of Economics, BS in accounting from Rutgers University
- Designations: CFA charterholder, former CPA (Certified Public Accountant), CMA (Certified Management Accountant), and CFM (Certified in Financial Management)

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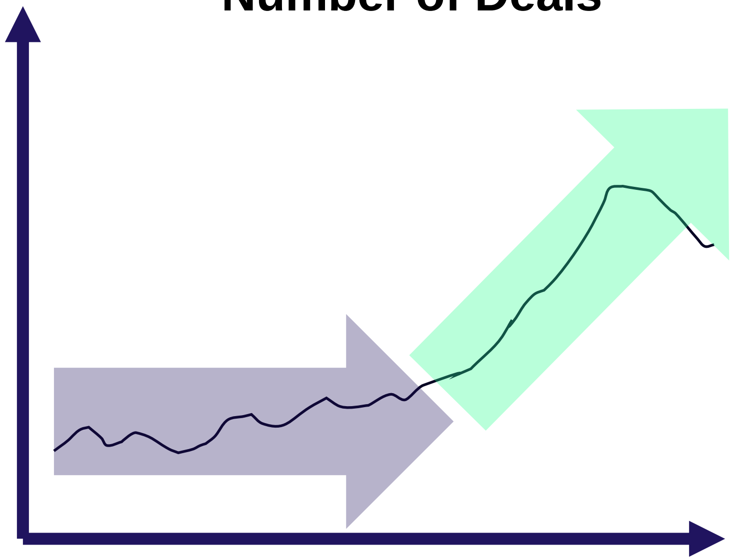
Question 1:

Why are deals happening in the wealth management space?

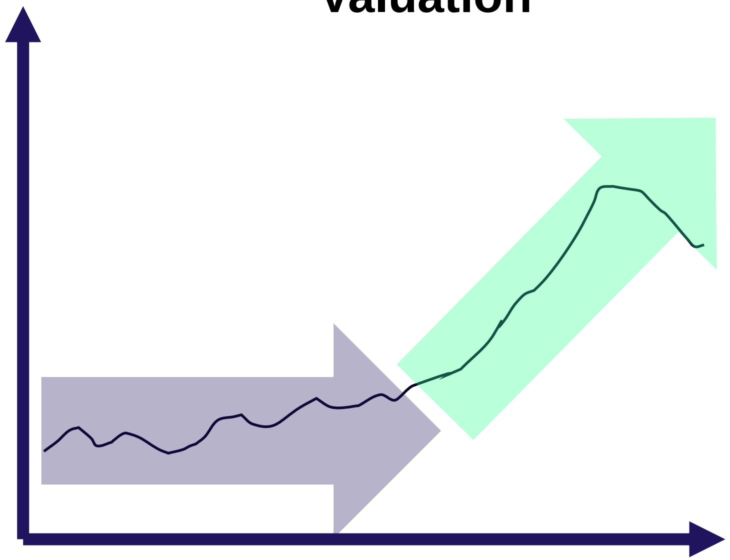
First, What is Going On…

Number of Deals



Number of mergers and acquisitions worldwide
Data Source: Statista

Valuation



Value of mergers and acquisition transactions worldwide
Data Source: Statista

In the past 10 to 15 years, the number of deals AND valuations have skyrocketed.

But Why? First, It is a Fragmented Market…

There are many thousands of financial advisors in the market. And with all the M&A and consolidation, it STILL is growing in numbers, not declining.

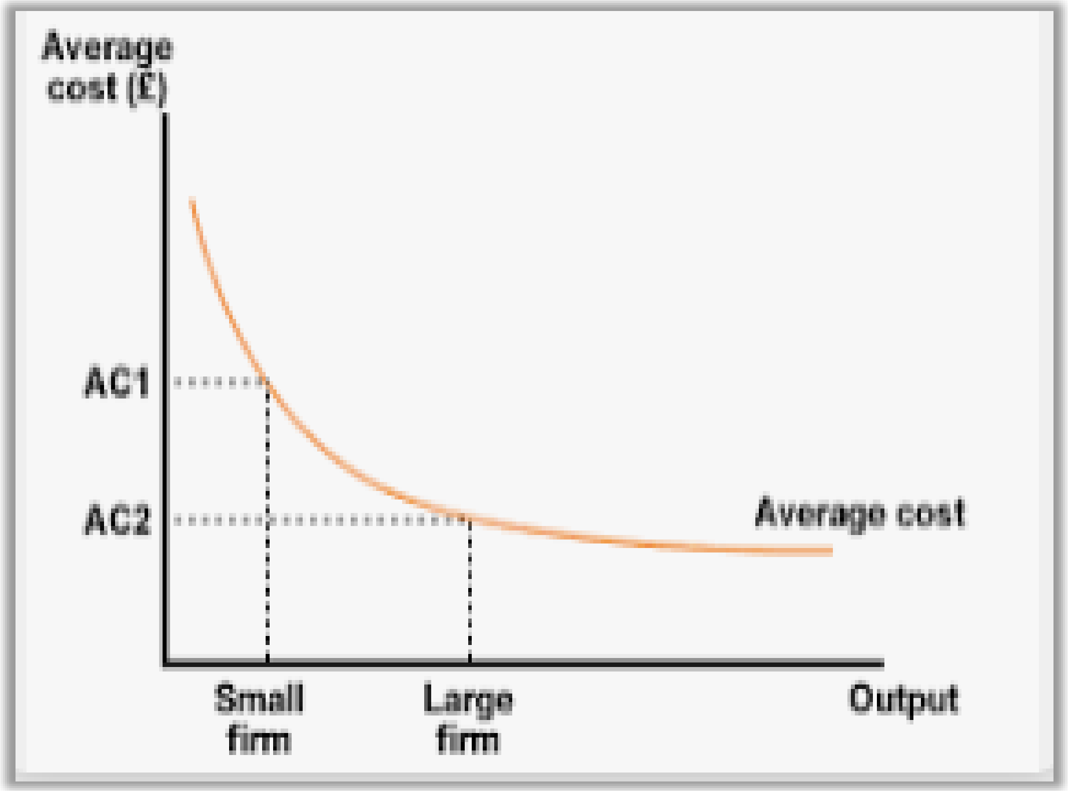
Population Density Map of the United States
Source: Visual Capitalist

And Many Advisor are At Retirement Age…

Over the next decade, more than 100,000 advisors plan to retire. This represents 37% of industry headcount and 39% of total assets. This also represents $12 trillion in assets that will be in motion (source: Cerulli).

There are Advantages to Scale…

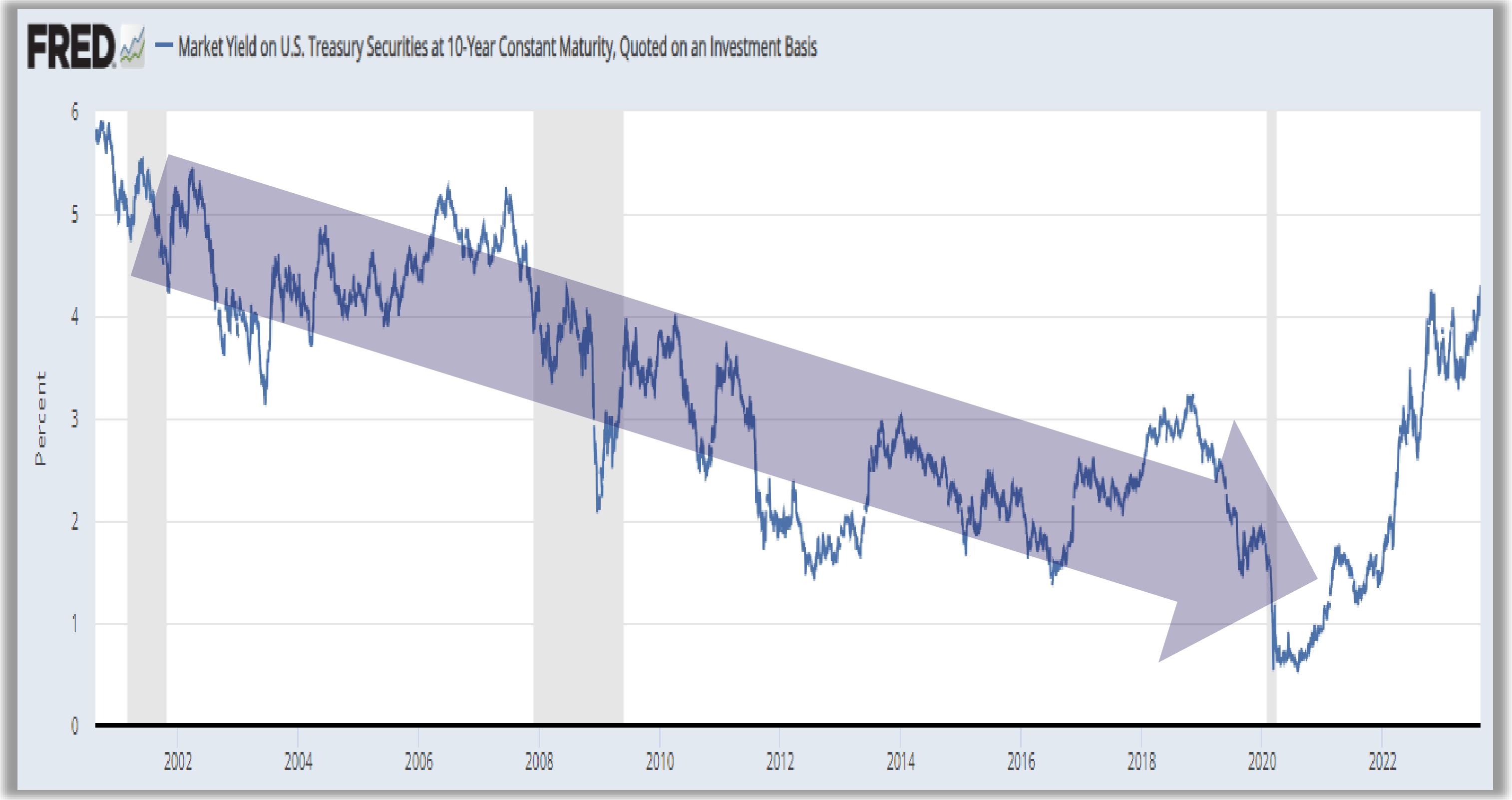
If managed well, larger firms can invest and develop scale to serve clients at a cheaper cost per client.



Economies of Scale illustration
Source: Corporate Finance Institute

Finally, Business Model + Low Rates…

Recurring revenue business models are highly predictable. Add that to an environment with lower rates means that consolidators (private equity or incumbents) can lever up to achieve high returns.



Market Yield on U.S. Treasury Securities
Source: FRED Economic Data

These Factors Make For a Robust M&A Market

Fragmented Market lots and lots of smaller companies	+	**Near Retirement** lots of firms will be in motion in coming yrs	+	**Advantages to Scale** cost to serve, ability to invest	+	**Model + Rates** recurring revenue plus low interest rates

= lots of buying and selling

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Question 2:

How are wealth management companies valued?
How are deals structured?

First, Beware the Attention-Grabbing Headlines

"My friend told me that ABC RIA got 10x revenue!"

"I heard that ABC private equity paid a massive amount for X…"

…the devil is in the details…

- Are there clawbacks? What is the exact contract language on exactly how that leads to cash flow to the seller?
- Does that include compensation for working there? How much in deal vs comp?
- How much of that comes at close vs in the earnout? What are stipulations of the earnout?

Bottom line: There are LOTS of opinions and bloggers and hearsay. Let's take a more logical and data-driven approach.

Deals Offer Differ a Lot But Consider these 3 Things

1. **Firm Valuation**
2. **Timing of Payments**
3. **Other Consideration**

If you seen one deal, you've seen just one deal. By that I mean, each deal has a nuance to it based on the parties involved. That said, there are some typical deal terms and structures that often come into play.

#1: Valuation

An example of the simple math

Sales multiple → 2.5x sales of $1,000,000 = $2,500,000

EBITDA multiple → 10x your EBITDA of $250,000 = $2,500,000

Discussion Points

- What determines a higher multiple? E.g., recurring vs non-recurring revenue, size, margins etc.
- The multiples are related, just like valuing a company in the stock market – what is the implication of the left valuations IF they were the same company…

Ultimately, valuation, especially in private deals, comes down to cash flow. Let's discuss.

#2: Timing of Payments

A simple example

Valuation	At Close	End of Year 1	End of Year 2	End of Year 3
$1,000,000	$400,000	$200,000	$200,000	$200,000

Discussion Points

- What is the typical percentage upfront vs in an earnout?
- What are metrics used to calculate?
- Things to be aware of (e.g., clawbacks etc).

#3: Other Consideration

Valuation	At Close	End of Year 1	End of Year 2	End of Year 3
$1,000,000	$400,000	$200,000	$200,000	$200,000
Consulting or Compensation	???	???	???	???

Discussion Points

- What should I expect?
- Tax implications?
- How should I analyze?

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- Analyze Motivations for M&A Activity
- Deal Structure and Valuations
- Explore Effective Practices for Buyers & Sellers
- The Need for Succession Planning

Question 3:

What’s the biggest mistakes both buyers and sellers make?

Select Best Practices for Sellers

1. **Define Goals:** Define what you are trying to accomplish, the economic and non-economic goals

2. **Learn:** Talk to people who have done deals – large firms, small firms, consultants etc

3. **Package:** Focus on the entire package – deal + compensation/consulting

4. **Terms:** Understand exactly what has to happen for you to see that cash flow

5. **Remember:** Headlines can be misleading and if something is too good to be true, it probably is (buyers are not dumb)

And…don't hire your friend that is a lawyer who has no experience in M&A or financial services! Hire a lawyer with M&A experience who knows what they are doing in this space – not any lawyer will do.

Select Best Practices for Buyers

Same

1. **Define Goals**: Define what you are trying to accomplish, the economic and non-economic goals

Same

2. **Learn**: Talk to people who have done deals – large firms, small firms, consultants etc

3. **Economics**: Understand and model your economic goals (growth, margins, IRRs, paybacks etc)

4. **Risk - Too Profitable**: Excessively profitable firms might mean they under-invested (a key risk)

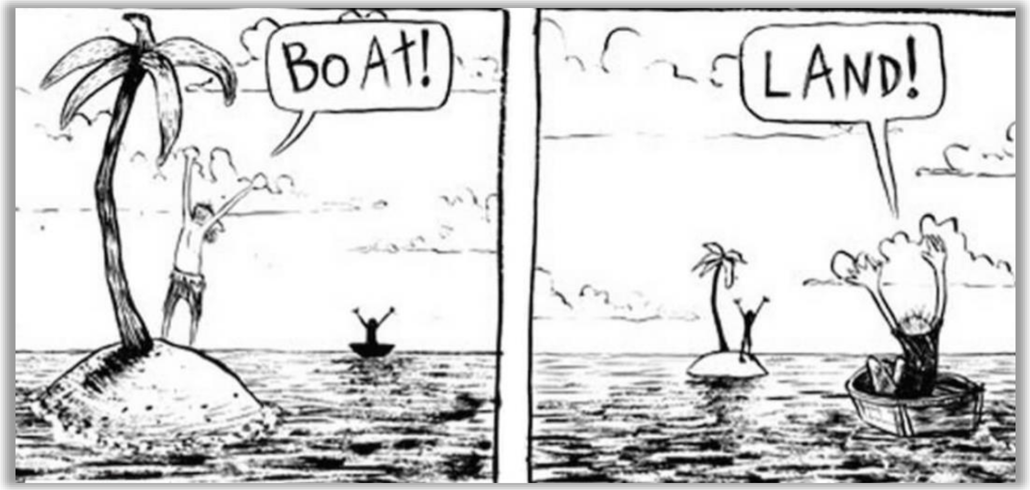
5. **Risk - Culture Killers**: M&A can change your core firm; Beware the culture killers

Same

And…don't hire your friend that is a lawyer who has no experience in M&A or financial services! Hire a lawyer with M&A experience who knows what they are doing in this space – not any lawyer will do.

So, what is the biggest mistake both buyers and sellers make?

Or, put another way, what do successful M&A firms do better than others?



They can see the situation from the other person's perspective, which allows them to create a deal that can work for everyone.

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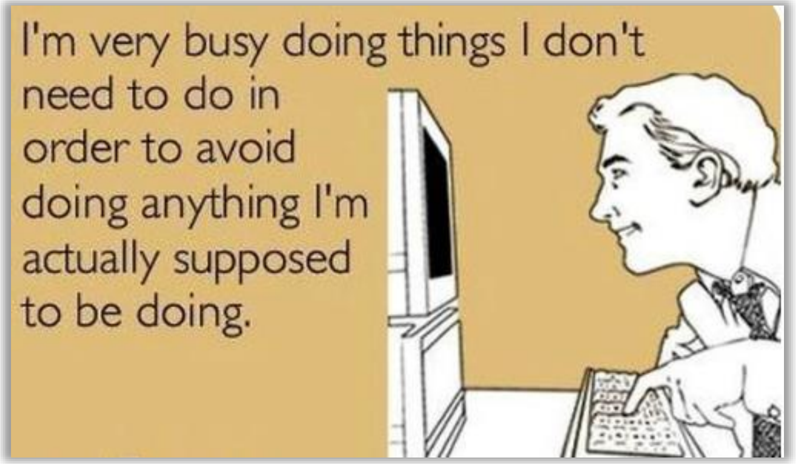
“The Cobbler’s Children Have No Shoes”

Some Data

- In the next 10 years, >100,000 advisors plan to retire
- >26% of them are unsure of their succession plan

Source: Cerulli



Many advisors and financial planners have no plan.

Great Wisdom From One of Your Peers

- **How to Motivate Yourself:** "What motivated me was really thinking about clients, spouses, employees. What really happens if I die now? That motivated me more than the value of the practice."
- **How To Get the Guts of it Right:** "My successor and I sat down and said to each other, 'What do we each need for this to work?' and the we said, 'OK, great. How do we embody that in a deal structure?'"
- **Remember that It's Not About the Paper:** "The succession plan is not the piece of paper. Too many times people think you just fill out this paper and you are done. It is much more than that. It is the person, the process, and yes, the paper documenting it. The first two are the most important."
- **Why Most Can't Find a "Worthy" Successor:** "If you are looking for yourself, you will never find a partner. You have to find someone competent, who shares a similar philosophy and values on clients and investments, and shares passion for client service - whatever that means to you and your practice..."
- **Avoid Undermining Your Successor:** "After transitioning to my successor, I do not check in with clients directly. If I keep checking in, it sows doubt. You can't do that. I will talk to my successor on things, but not to a client directly without him."
- **Frame it As Final Advice to Clients:** "I tell my clients this is my last recommendation to you. I ask you trust my successor as you have trusted me. And I really view this as the final, perhaps most important, thing I need to get right for them."

These are direct quotes from someone who has designed and implemented a thoughtful and successful succession plan.

In Closing…

Thinking about buying or selling is a huge event you want to get done right.

I'd be happy to discuss any of these topics with you in more detail.

Thank you!

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