

## Be Alert to M&A Nuances

The surge in acquisitions means opportunity for sellers, but they need to know what to expect.

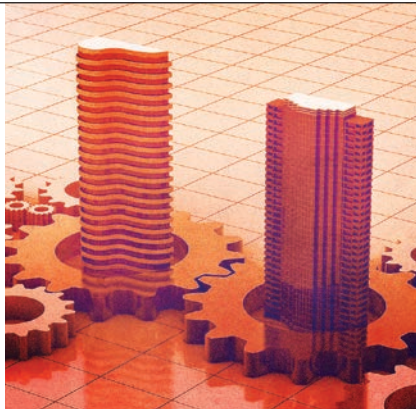
As one of the finest M&A transaction lawyers in the country, my law partner Dan Sheridan provided insights on the recent merger and acquisition explosion in our industry.

DeVoe & Company's *RIA Dealbook* states 2019 is on track to be another record year for M&As involving RIAs. The drive towards consolidation and greater economies of scale, together with an ample supply of cash from private equity sponsors, continues to fuel what was already a very hot market.

In terms of fundamental deal structure, Dan said most transactions continue to fit into a fairly straightforward template. The first element is a split of purchase consideration between cash and buyer equity. The second element is a split between consideration payable at closing and earnouts payable over time, usually based upon some combination of client retention and achievement of growth targets.

There are wide variations in the relative proportions of cash versus equity and closing payment versus earnout, which tend to be dependent upon seller motivation and goals. For example, a selling advisor whose active time horizon is more than seven or 10 years is more likely to accept a greater proportion of buyer equity as well as lower proportion of closing cash. However, an advisor who is nearing retirement may not be interested in a large equity stake (especially one that is illiquid) or in taking substantial risk on client retention or growth.

Buyers also have their preferences. If a buyer wants to simply grow AUM and capitalize on efficiencies, they are less likely to offer equity as part of the



consideration. Instead, they are more likely to emphasize earnout payments over closing cash. In some instances this may be perfectly acceptable, especially for a small RIA looking for some return on the goodwill value of his or her business prior to retirement.

In recent months, though, Dan has noticed a nuanced shift in deal terms, primarily around the issues of market risk and projected returns. Buyers now rarely accept “market risk” (i.e. the risk to deal value based on a decline in acquired revenues arising solely from market performance of AUM), while in the past that was a relatively common (or at least negotiable) deal point.

Additionally, earnout payments now often are tied either to year-over-year revenue growth, or to preservation of targeted earnings. Because earnings can fluctuate greatly based upon the expense profile of each individual business, the negotiation of earnouts measured at the level of earnings (as opposed to revenues) becomes simultaneously more difficult and more complex. When advising a seller, we are careful to point out that, if the business has high fixed expenses, a relatively

modest drop in revenue can result in a catastrophic drop in earnings.

We also have observed an uptick in activity involving firms that have more diverse revenue streams. Some buyers are more interested in firms that offer tax preparation, insurance planning (including group benefits business), estate planning and “family office” type services to capture a greater share of the client spend. The problem with this profile is that diverse business lines do not fit in well with more simplistic market measures (e.g. annual advisory fees multiplied by a fixed multiple) and often have additional regulatory requirements. Both of these factors tend to extend the time and expense associated with negotiating and closing transactions.

While many participants in the M&A market remain cautiously optimistic about the future of the U.S. economy, there is a growing recognition of the risk of greater market volatility, especially as we approach an election year. Those factors no doubt will continue to influence the thinking of all parties, as well as key transaction terms. While some transaction features are likely to remain static, negotiation of these risks are likely to absorb more time and more “deal capital” than in years past. **IA**

*Thomas D. Giachetti is chairman of the Investment Management and Securities Practice Group of Stark & Stark, a law firm with offices in Princeton, New York and Philadelphia that represents investment advisors, financial planners, BDs, CPA firms, registered reps and investment companies, and is a regular contributor to Investment Advisor. He can be reached at [tgiachetti@stark-stark.com](mailto:tgiachetti@stark-stark.com).*