



HOULIHAN LOKEY

# REGISTERED INVESTMENT ADVISORY

INDUSTRY UPDATE | WINTER 2019



Global	Emerging	Sectors	Assets	Strategies
\$ 31,555.00	\$ 52,710.00	\$ 36,338.00	\$ 4,132.00	\$ 3,450.00
\$ 46,032.00	\$ 43,685.00	\$ 37,120.00	\$ 11,020.00	\$ 6,965.00
\$ 88,728.00	\$ 34,648.00	\$ 52,701.00	\$ 10,236.00	\$ 22,758.00
\$ 27,862.00	\$ 15,001.00	\$ 7,337.00	\$ 28,764.00	\$ 80,780.00
\$ 21,764.00	\$ 9,822.00	\$ 60,496.00	\$ 36,825.00	\$ 56,666.00
\$ 53,225.00	\$ 30,369.00	\$ 26,965.00	\$ 12,230.00	\$ 68,415.00
\$ 18,477.00	\$ 27,176.00	\$ 93,248.00	\$ 88,929.00	\$ 49,105.00
\$ 47,572.00	\$ 15,918.00	\$ 42,784.00	\$ 73,164.00	\$ 78,949.00
\$ 41,374.00	\$ 38,366.00	\$ 11,920.00	\$ 82,923.00	\$ 79,386.00

# Registered Investment Advisory Industry Update

---

Dear Clients and Friends,

Houlihan Lokey is pleased to present its Registered Investment Advisory Industry Update for Winter 2019.

Recent transactions in the registered investment advisory (RIA) sector have emphasized that larger, more sophisticated buyers are purchasing and consolidating established, well-run firms.

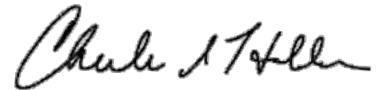
A once highly fragmented and personalized business model is trending towards a more concentrated set of larger companies in response to market forces. As buyers become more aggressive and advanced, sellers must carefully consider their own interests, valuation, and representation, such that any deal meets their long-term objectives and positions them for growth and continued success.

Should you be interested in learning more about the RIA market or discussing strategic opportunities for your firm, we strongly encourage you to reach out to our experienced sector coverage experts below.

Regards,



**Reinhard Koester**  
Managing Director  
Co-Head, Financial Institutions Group  
RKoester@HL.com  
646.259.7476



**Charles Hibbs**  
Vice President  
Financial Institutions Group  
CHibbs@HL.com  
310.712.6592

Our dedicated team has an extensive level of experience in the asset and wealth management sectors. In the past five years, we have transacted or transferred more than \$80 billion in assets under management for a variety of investment and advisory platforms. Our expertise includes identifying potential transactions, structuring deals, negotiating terms, and seeing transactions through successful execution.

# #1 M&A Advisor for All U.S. Transactions in 2018

by Thomson Reuters

## 2018 M&A Advisory Rankings All U.S. Transactions

Advisor	Deals
<b>Houlihan Lokey</b>	<b>207</b>
Goldman Sachs & Co	197
JP Morgan	154
Morgan Stanley	135
Jefferies LLC	117

Source: Thomson Reuters

## 2016-2018 M&A Advisory Rankings All U.S. Specialty Finance Transactions

Advisor	Deals
<b>Houlihan Lokey</b>	<b>38</b>
Credit Suisse (USA), Inc.	18
J.P. Morgan Securities LLC*	15
Stifel/Keefe, Bruyette & Woods*	15
Morgan Stanley	13

Source: SNL Financial

\*Denotes Tie.

## Mergers and Acquisitions

We have extensive expertise in mergers, acquisitions, divestitures, activist shareholder and takeover defense, and other related advisory services for a broad range of U.S. and international clients. Our experience in M&A has earned us consistent recognition throughout the industry. In 2018, we were ranked the No. 1 M&A advisor for all U.S. transactions, and we've been ranked No. 1 for U.S. transactions under \$1 billion for the past 13 years, according to Thomson Reuters.

# Financial Markets Have Changed Significantly Since the Financial Crisis

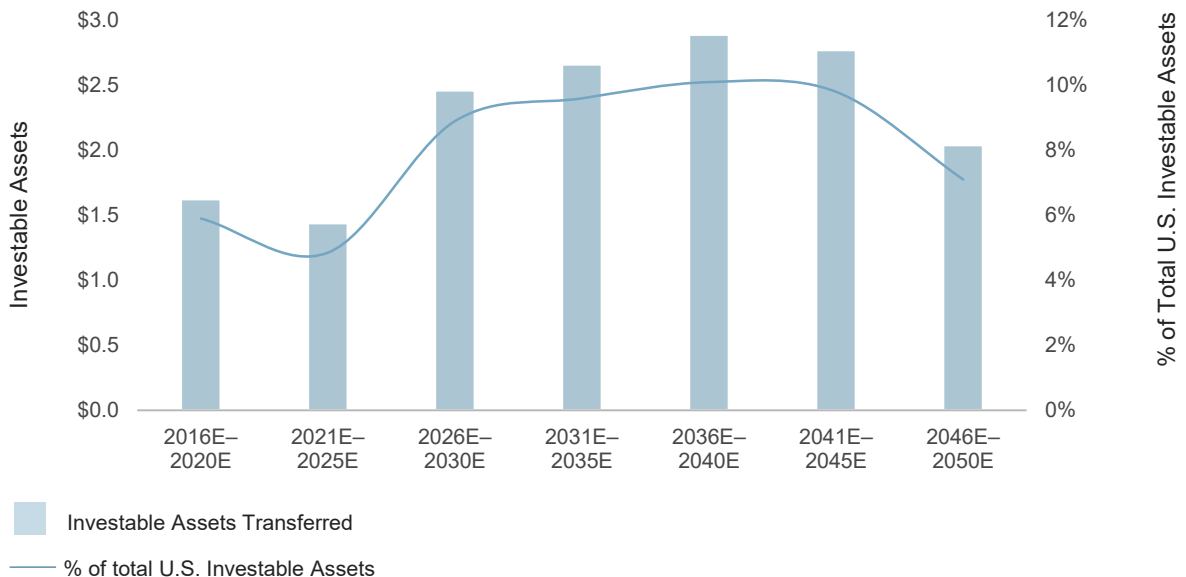
Demand for low-cost index products, the rise of alternative asset classes, technological disruption, and unprecedented demographic changes have all impacted the traditional RIA service model, necessitating advisory firms to evolve and adapt.

Demographic trends, driven largely by baby boomers in the United States, have resulted in a need for more tailored financial advice. As this generation enters their asset-decumulation phase of life, they will initiate a significant wealth transfer over the coming decades, resulting in an estimated \$12 trillion of investable assets changing hands. At its peak, it is estimated that 10% of the total wealth in the United States will be changing hands every five years. This will make the need for personalized financial advice greater than ever before.



## U.S. Investable Assets Transferred by Year

(\$ in trillions)

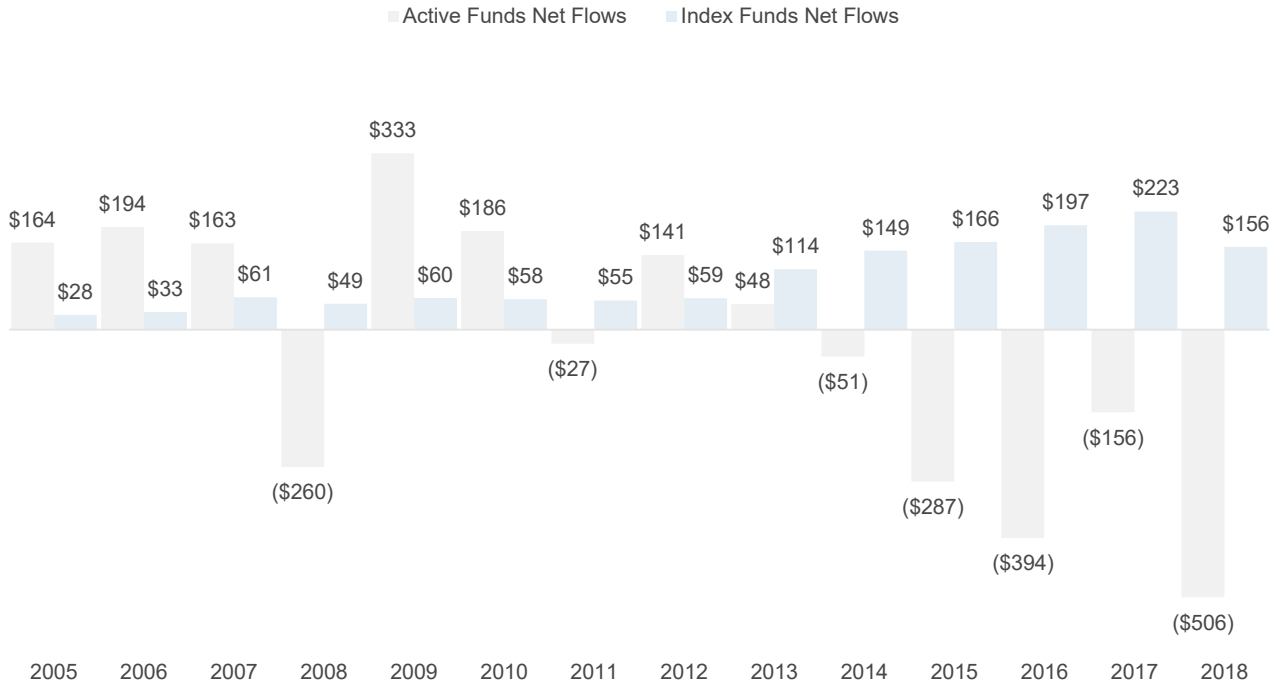


# Strategic Trends

Passive and index investment products have become favored for their ultra-low fees and easy access to market beta relative to actively managed traditional mutual funds. In August 2019, assets in United States index-based equity mutual funds and exchange-traded funds topped those in active stock funds for the first time.<sup>(1)</sup>

## Active and Index Mutual Funds: Net New Cash Flow (Year-End)

(\$ in billions)



Source: 2018 Investment Company Fact Book

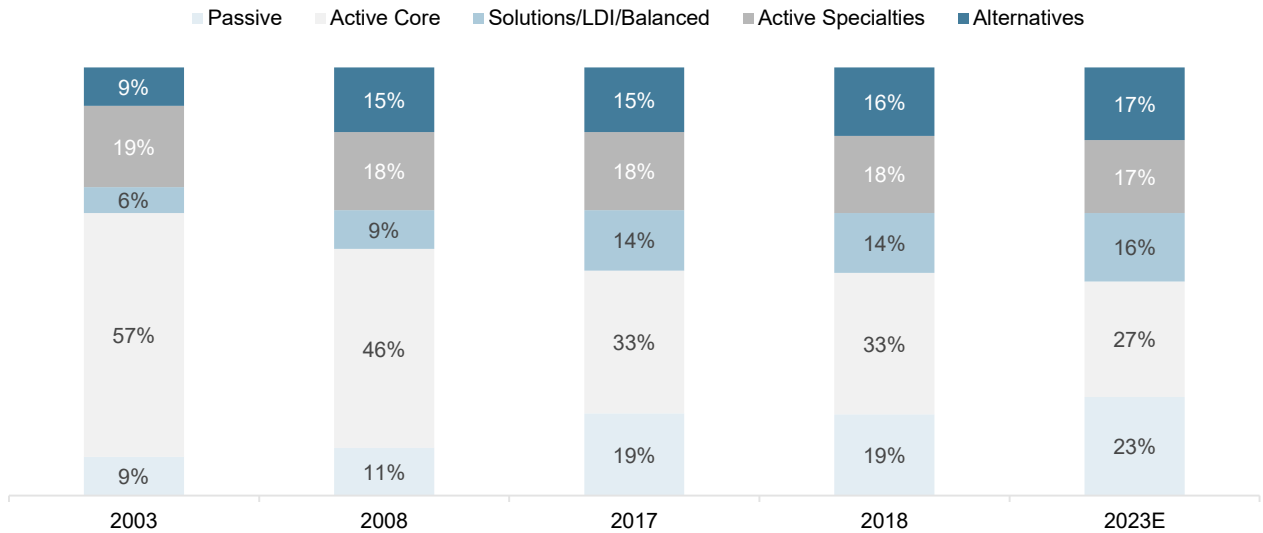


(1) Bloomberg News, "End of Era: Passive Equity Funds Surpass Active in Epic Shift," September 11, 2019

# Strategic Trends

## Global AUM by Product Type

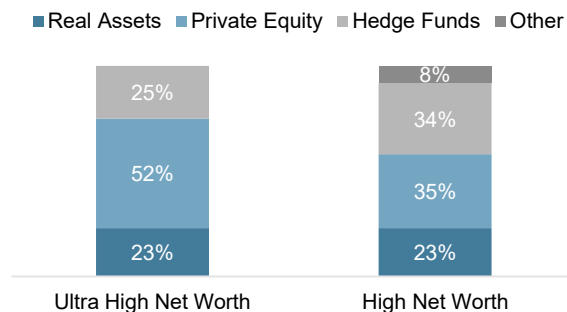
(Relative Distribution)



Source: Boston Consulting Group, "Global Asset Management 2019: Will These '20s Roar?"

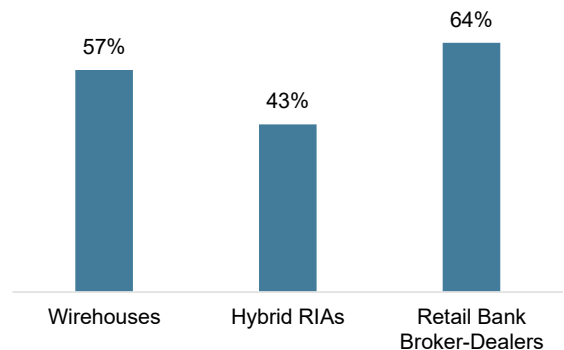
In addition to passive and index investments, retail investors have increasingly been drawn to alternative investments, such as private credit and equity, real estate, and infrastructure due to attractive returns and lower correlation with public equity and traditional fixed income investments.

## Alternative Asset Allocations



Source: KKR, "The Ultra High Net Worth Investor: Coming of Age."

## Percent of Financial Advisors Investing in Alternatives by Channel



Source: Cerulli Associates, "U.S. Alternative Investments 2018: Accessing Evolving Alternative Platforms."

Shifts in product demand have created a need for RIAs to adapt, thus offering additional services, such as comprehensive asset allocation strategies, access to more competitive product sets, and expanding their operating leverage to offset margin compression.

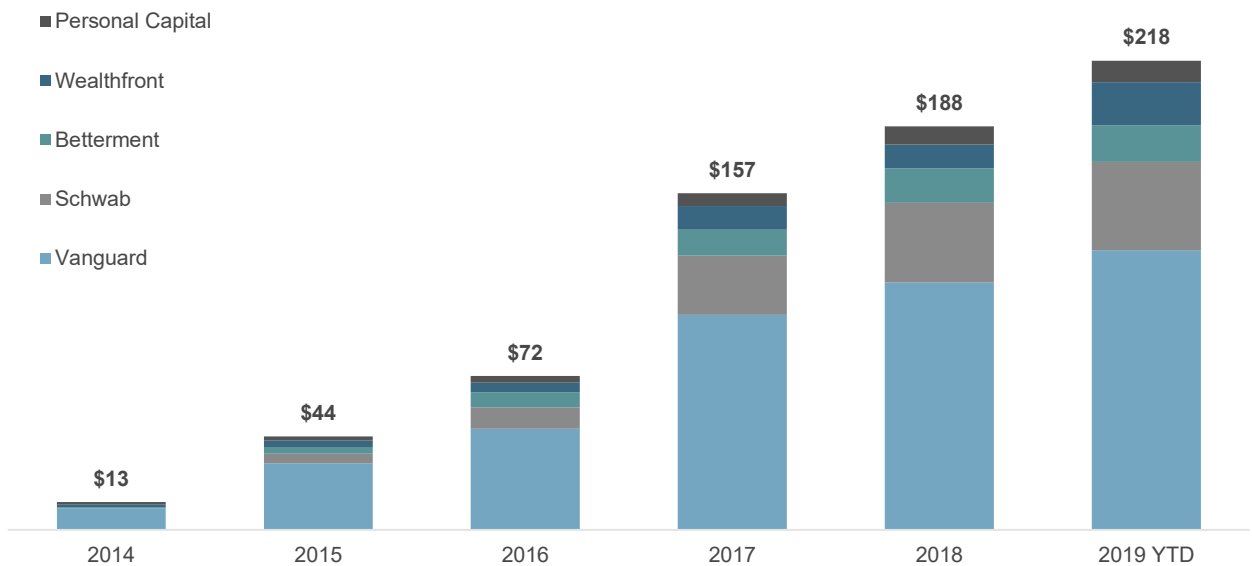
# Strategic Trends

A new breed of disruptive startups were launched nearly a decade ago, on a mission to overturn the wealth management industry by offering passive index products with low management fees and free portfolio services once reserved for high net worth and institutional investors.

After a few years, many of these disruptive platforms were rapidly eclipsed in size by more established firms that marketed directly to their existing client base and quickly gathered assets, subsidizing their competing product offerings with their broader platforms.

## Automated Investing Assets by Select Advisor

(\$ in billions)



Source: Public filings

The survivors of these early disruptors are finally starting to define sustainable business models and paths towards profitability, having expanded their product offerings and blended their core asset allocation services with more traditional advisor support, banking products, and comprehensive financial planning advice. As these disruptors evolve to look more like traditional retail advisory firms, industry fees are likely to further compress facilitating additional consolidation.

**RIAs that fail to address key industry changes are at risk of losing their core businesses, while those that create operating leverage through scale and technology, proactively respond with additional services, and offer access to index and alternative products, will be best positioned to gain market share and grow significantly in the coming years.**

# M&A Activity

## Acquisition Activity Has Increased Significantly in Recent Years

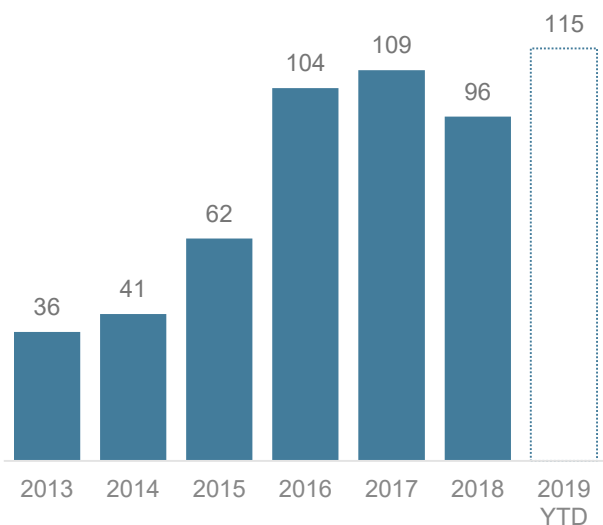
Strategic and financial buyers are seeking to capitalize on the transformational opportunities impacting the industry, targeting the more than 7,500 retail-focused RIAs in the United States.<sup>(1)</sup>

With median profit margins of 20% or more, cheap borrowing costs, and low capital requirements, many financial investors are attracted to the potential of doubling their investments within three to five years. While a handful of specialized private equity firms have traditionally invested in the space, family offices, sovereign funds, insurance companies, pension funds, private investors, and private equity funds—all with record amounts of dry powder—are starting to invest in RIAs.

Most buyers, both strategic and financial, are aiming to mitigate revenue lost to fee compression, broaden products and services, build operating leverage through synergies, and institutionalize platforms to facilitate succession planning.

### Established RIA M&A Activity

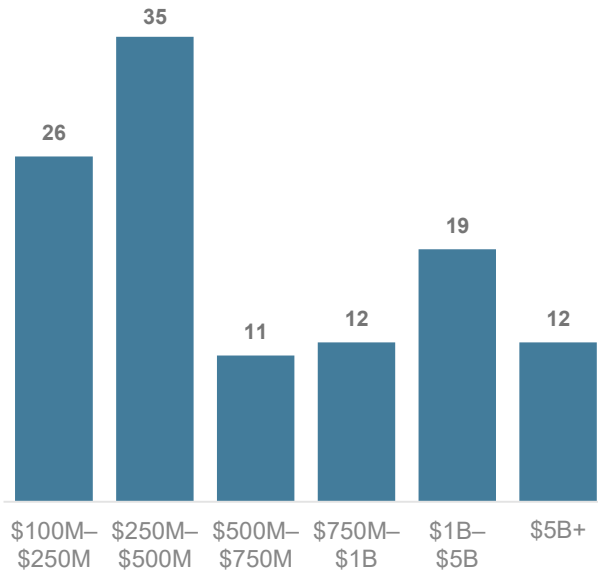
(Number of transactions executed per year; 2019 YTD as of October)



Source: Fidelity RIA M&A Reports, October 2019

### RIA M&A Activity by Seller Size

(Number of RIA transactions by seller size; 2019 YTD as of October)



Source: Fidelity RIA M&A Reports, October 2019

**Consolidation has increased the number of registered investment advisors with \$1 billion or more in client assets by more than 50% in the last five years. The number of firms with \$5 billion or more in assets under management has increased more than 80%—to more than 50 firms—during that same time period.<sup>(2)</sup>**

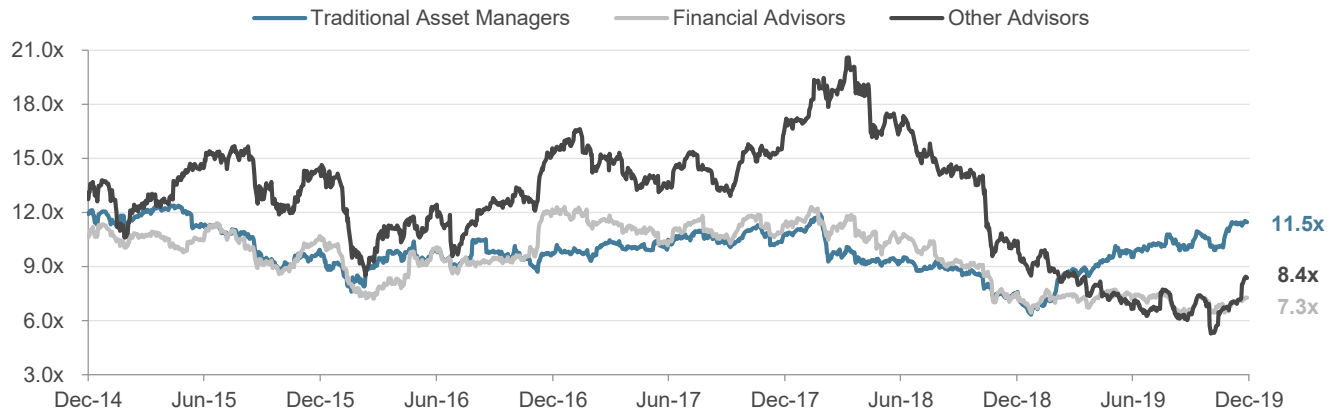
(1) SNL Financial  
(2) InvestmentNews, "RIAs acquiring firms at record pace," September 28, 2019



# Valuation Approaches and Trends

There are a number of approaches used for RIA valuations, many often benchmarked against common business metrics such as percentage of assets under management (AUM), revenues, adjusted EBITDA (including earnings before partner’s compensation), and net earnings. Trading multiples are often a quick, publicly available method for setting initial valuation expectations.

## Enterprise Value/Trailing Last 12 Months EBITDA



**Most public company asset manager and advisor valuations have been impacted by industry fee compression, a move to passive and index investments products, low interest rates, and increasing compliance and operational costs.**

## Stock Price/Next 12 Months EPS



Although “multiples” are common valuation bases, free cash flow ultimately drives the intrinsic value of any RIA platform. A number of assumptions and sensitivities must be considered in creating a reliable cash flow forecast, such as assets under management and net flows, investment performance, revenue sources, expenses, and normalized operating margins.

Source: Public filings, SNL Financial, S&P Capital IQ  
 Note: Financial data as of most recent available; market data as of November 29, 2019; indices weighted by market capitalization  
 Traditional Asset Managers: AB, AMG, APAM, BEN, BSIG, EV, FII, IVZ, JHG, LM, MN, TROW, VCTR, VRTS, WDR, WETF  
 Financial Advisors: LPLA, LTS, RJF  
 Other Advisors: AMTD, ETFC, SCHW, SF

# Transaction Considerations

---

## Potential Transaction Drivers, Structures, and Terms

More so than other industries the RIA sector is a people business, and although valuations often draw the most attention there are a number of other important considerations that can impact a transaction and will influence a buyer's ability (and willingness) to pay.

### Select Valuation and Transaction Considerations

---

<b>Client Base and Asset Composition</b>	<ul style="list-style-type: none"><li>▪ Client makeup and diversification/concentration<ul style="list-style-type: none"><li>▪ Retail (mass affluent, high net worth, etc.)</li><li>▪ Institutional (corporates, governments, nonprofits, pension plans, etc.)</li></ul></li><li>▪ Allocations to various asset classes</li><li>▪ Historical asset growth<ul style="list-style-type: none"><li>▪ Organic vs. inorganic sources</li></ul></li></ul>
<b>Revenue Sources</b>	<ul style="list-style-type: none"><li>▪ Diversity of products and services offered (financial and estate planning, tax, retirement, banking, etc.)</li><li>▪ Recurring revenues vs. nonrecurring revenues</li><li>▪ Performance fees and other revenues</li></ul>
<b>Productivity and Profitability</b>	<ul style="list-style-type: none"><li>▪ Operating leverage</li><li>▪ Financial statement adjustments<ul style="list-style-type: none"><li>▪ Normalized owners' compensation</li><li>▪ Nonrecurring, one-time noncash charges</li></ul></li></ul>
<b>Synergies</b>	<ul style="list-style-type: none"><li>▪ Revenue synergies: cross-selling</li><li>▪ Cost synergies: removing duplicative costs, lower capital costs, etc.</li></ul>
<b>Transaction Structure</b>	<ul style="list-style-type: none"><li>▪ Consideration type<ul style="list-style-type: none"><li>▪ Cash and stock<ul style="list-style-type: none"><li>▪ Primary shares vs. secondary shares</li><li>▪ Accretion (dilution)</li></ul></li></ul></li><li>▪ Control, path to control</li><li>▪ Earn-outs<ul style="list-style-type: none"><li>▪ Milestones, measurement thresholds</li></ul></li><li>▪ Employment agreements</li><li>▪ Pro forma<ul style="list-style-type: none"><li>▪ Investment decision-making process</li><li>▪ Corporate governance</li></ul></li></ul>

**While some buyers are interested in control, others prefer passive or minority stakes (with a vast number of alternatives in between). Knowing those parties to target based upon buyer and seller objectives will result in a more efficient, value-maximizing transaction process.**

# About Houlihan Lokey

Houlihan Lokey (NYSE:HLI) is a global investment bank with expertise in [mergers and acquisitions](#), [capital markets](#), [financial restructuring](#), and [valuation](#). The firm serves corporations, institutions, and governments worldwide with offices in the United States, Europe, the Middle East, and the Asia-Pacific region. Independent advice and intellectual rigor are hallmarks of the firm's commitment to client success across its advisory services. Houlihan Lokey is ranked as the No. 1 M&A advisor for all U.S. transactions, the No. 1 global restructuring advisor, and the No. 1 global M&A fairness opinion advisor over the past 20 years, according to Thomson Reuters.

## Locations



## Industry Expertise

### Product Expertise

Mergers and Acquisitions  
Capital Markets  
Financial Restructuring  
Financial and Valuation Advisory

### Dedicated Industry Groups

Business Services  
Consumer, Food, and Retail  
Data and Analytics  
Energy  
Financial Institutions  
Healthcare  
Industrials  
Real Estate, Lodging, and Leisure  
Technology, Media, and Telecom

### Financial Sponsors

Active Dialogue  
With a Diverse Group of  
1000+ Sponsors  
Private Equity Firms  
Hedge Funds  
Capital Alliances

# Disclaimer

---

© 2019 Houlihan Lokey. All rights reserved. This material may not be reproduced in any format by any means or redistributed without the prior written consent of Houlihan Lokey.

Houlihan Lokey is a trade name for Houlihan Lokey, Inc., and its subsidiaries and affiliates, which include those in (i) the United States: Houlihan Lokey Capital, Inc., an SEC-registered broker-dealer and member of FINRA ([www.finra.org](http://www.finra.org)) and SIPC ([www.sipc.org](http://www.sipc.org)) (investment banking services); Houlihan Lokey Financial Advisors, Inc. (financial advisory services); HL Finance, LLC (syndicated leveraged finance platform); and Houlihan Lokey Real Estate Group, Inc. (real estate advisory services); (ii) Europe: Houlihan Lokey EMEA, LLP, and Houlihan Lokey (Corporate Finance) Limited, authorized and regulated by the U.K. Financial Conduct Authority; Houlihan Lokey S.p.A.; Houlihan Lokey GmbH; Houlihan Lokey (Netherlands) B.V.; Houlihan Lokey (España), S.A.; and Houlihan Lokey (Corporate Finance), S.A.; (iii) the United Arab Emirates, Dubai International Financial Centre (Dubai): Houlihan Lokey (MEA Financial Advisory) Limited, regulated by the Dubai Financial Services Authority for the provision of advising on financial products, arranging deals in investments, and arranging credit and advising on credit to professional clients only; (iv) Singapore: Houlihan Lokey (Singapore) Private Limited, an “exempt corporate finance adviser” able to provide exempt corporate finance advisory services to accredited investors only; (v) Hong Kong SAR: Houlihan Lokey (China) Limited, licensed in Hong Kong by the Securities and Futures Commission to conduct Type 1, 4, and 6 regulated activities to professional investors only; (vi) China: Houlihan Lokey Howard & Zukin Investment Consulting (Beijing) Co., Limited (financial advisory services); (vii) Japan: Houlihan Lokey K.K. (financial advisory services); and (viii) Australia: Houlihan Lokey (Australia) Pty Limited (ABN 74 601 825 227), a company incorporated in Australia and licensed by the [Australian Securities and Investments Commission](#) (AFSL number 474953) in respect of financial services provided to wholesale clients only. In the European Economic Area (EEA), Dubai, Singapore, Hong Kong, and Australia, this communication is directed to intended recipients, including actual or potential professional clients (EEA and Dubai), accredited investors (Singapore), professional investors (Hong Kong), and wholesale clients (Australia), respectively. Other persons, such as retail clients, are NOT the intended recipients of our communications or services and should not act upon this communication.

Houlihan Lokey gathers its data from sources it considers reliable; however, it does not guarantee the accuracy or completeness of the information provided within this presentation. The material presented reflects information known to the authors at the time this presentation was written, and this information is subject to change. Houlihan Lokey makes no representations or warranties, expressed or implied, regarding the accuracy of this material. The views expressed in this material accurately reflect the personal views of the authors regarding the subject securities and issuers and do not necessarily coincide with those of Houlihan Lokey. Officers, directors, and partners in the Houlihan Lokey group of companies may have positions in the securities of the companies discussed. This presentation does not constitute advice or a recommendation, offer, or solicitation with respect to the securities of any company discussed herein, is not intended to provide information upon which to base an investment decision, and should not be construed as such. Houlihan Lokey or its affiliates may from time to time provide investment banking or related services to these companies. Like all Houlihan Lokey employees, the authors of this presentation receive compensation that is affected by overall firm profitability.

