Have RIA multiples peaked?

A falling market and upcoming IPOs could sap dealmakers' optimism

By Ian Wenik for CityWireUSA

'Crazy.'

In any 2021 discussion of RIA valuations among advisors, that's one pronouncement you would be guaranteed to hear. The prices for $1bn-plus RIAs, these M&A skeptics claimed, had lost connection with reality. Are they now being proven right?

Public market valuations have certainly corrected in a hurry, with the S&P 500 diving more than 20% between the start of the year and mid-June. The move comes alongside rising interest rates and increasing fears of a recession partially stoked by the Fed's attempts to quell surging inflation.

This is clearly bad for the profitability of most RIAs, given that their overwhelming model is to charge clients 1% of AUM. But does it also suggest that valuations have been out of whack – and that they must continue to come down?

'The tide has indeed started to go out on aggregators paying absurd multiples, and we're beginning to see who has been swimming naked,' said Jason Carver, once the top dealmaker at Carson Group and now a managing partner at $4.1bn RIA Pure Financial.

The state of valuations

The average price paid for an RIA rose to 9x adjusted Ebitda in 2021, according to Advisor Growth Strategies. That's up from 8x in 2020, 6.6x in 2019, and 5.1x before that.

Valuations for the biggest RIAs can rise much higher than that, as recent glossy deals attest.

$45bn Cerity Partners achieved what sources told Citywire was a $1.65bn enterprise valuation when it changed hands from Lightyear Capital to fellow private equity firm Genstar Capital in June. That figure represents a multiple of more than 20x Cerity Partners' earnings, sources said.

In July of 2021, Bain Capital took a minority stake in then-$17bn Carson Group at a valuation of roughly $1bn.

'There just are very few truly scaled "enterprises" in the independent RIA space with top notch leadership teams already built out,' said Adam Birenbaum, chief executive of $62bn Focus Financial Partners affiliate Buckingham Wealth Partners. 'Smart dollars should flow to

those. They have the ability to sustain impressive compounded annual growth rates and ultimately become the “winners” of this story.’

But the fact that the largest RIAs can earn larger valuations creates an odd dynamic that some see as unsustainable. ‘When a large RIA receives an investment from a private equity firm implying a mid-teens Ebitda multiple valuation, any firm it buys for less is immediately accretive to value,’ Advisor Growth Strategies’ Brandon Kawal and John Furey pointed out. ‘This spread has created an arbitrage opportunity that has caused a rebalancing of scales.’

The fastest-growing quality firms will always command a premium, but is that 14x earnings like it was four years ago, or 23x as it is today?

-Anonymous dealmaker

Carver goes even further, saying that this ‘multiple arbitrage’ dynamic is responsible for a large portion of the record-setting M&A activity the RIA industry has seen over the past few years. Serial acquirers pay high multiples for RIAs, using cheaply borrowed cash. Their private equity owners then profit when they flip the acquirer to another investor at a higher multiple than what the RIA acquirer has been paying for its own deals. But what happens when the music stops?

PE investors’ valuations of 15x or 20x run-rate Ebitda are based on assumptions that are ‘being severely strained by the broad market pullback this year,’ said Chas Burkhart, who runs ‘permanent capital’ investor Rosemont Investment Group. He noted that private equity investors model their targets’ future growth and returns on assumptions, such as that the company will be able to replicate or improve on its own growth. But much of that growth has been driven by increasing AUM revenue, which in turn has been due to the simple fact that markets have soared; Burkhart said there has been ‘very little in the way of truly organic growth.’

The surge in valuations ‘is setting a very dangerous precedent that has great risk of being unwound,’ he said. ‘You put that in the context of the current market, and it seems like a bloodbath waiting to happen.’

‘The fastest-growing quality firms will always command a premium,’ predicted one serial dealmaker. ‘The big hairy question is whether that’s 14x earnings like it was four years ago, or 23x as it is today.’

That executive, who has been granted anonymity in order to speak freely, added that this question ‘eventually gets answered when a pure-play RIA starts trading as a public company.’

The public weighs in

That may not be far off. Ultra-high net worth RIA Tiedemann Advisors is well on its way to going public via a merger with British money manager Alvarium Investments and special-purpose acquisition company Cartesian Growth Corp. That deal is set to close in the second half of 2022.

The anonymous RIA M&A executive said Tiedemann will likely become the best public comp to the RIA industry at large.

‘I do think where it trades from a multiple on earnings basis will potentially set the tone for how sponsors see potential exit options for the larger platforms,’ the executive said of Tiedemann.

Right now, the best analogue for the industry in public markets is seen to be Focus Financial, which has lost nearly half of its value between the start of the year and the middle of June.

It’s into these choppy waters that CI Financial wants to dip a toe. A Canadian asset manager that has become one of the RIA industry’s most prolific acquirers, CI revealed in April that it plans to spin out its RIA business and sell a 20% stake in the company via an IPO.

The IPO is designed to help CI on two fronts. Chief executive Kurt MacAlpine previously told Citywire that he was dissatisfied with CI’s valuation, which he said reflected a company trading as an asset manager instead of a wealth manager.

The offering is also supposed to help CI raise funds to pay down some of the debt associated with its recent M&A binge. The company’s net leverage ratio rose by a full turn from the end of the first quarter of 2021 to the end of the first quarter of 2022.

But if it follows through with the IPO now, CI runs the risk of its RIA division coming to market with a valuation lower than what it has paid for firms in the past, which would make it harder to use equity in its acquisition structures. After all, what seller would want to take equity worth less than the equity in their own business?

‘I just don’t think it would be a good idea to do the IPO now,’ said Tim Welsh, president of RIA consultancy Nexus Strategy. ‘I’m sure they’re smart enough to know that.’