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M&A in the Investment Services Space – Help! My Deal Went Sideways…

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M&A activity in the investment advisory space was occurring at a fevered pitch at the beginning of the year. However, the downturn in the market, along with the uncertainty clouding the next few months, has slowed and even halted many of these transactions. We have seen deals die, transactions pause indefinitely, and executed deals that still have not closed become the subject of disputes and litigation. With many advisory firm owners looking for an exit, the current timing has become an adversary and a major obstacle. Some, however, feel that the current market may actually lead to greater interest from buyers because of the lower valuations caused by existing economic conditions. Below are some of the ways that deals can be structured in order to facilitate a transaction that is workable for both buyers and sellers against the backdrop of these once-in-a-lifetime market events and conditions.

Base M&A Purchase Price Adjustments on Something Other Than Investment Account Values

Purchase and sale agreements typically include purchase price adjustments because a buyer wants to guard against a drop in the value of the entity or assets they are purchasing. This frequently means creating an agreed-upon projected asset under management ("AUM") amount against which actual AUM would be compared and the resulting discrepancy would be the basis for an adjustment to the purchase price. With a drop in the market, so too have AUM amounts, thereby creating a problem for utilizing an AUM-based adjustment because of market volatility. Many believe that ultimately the market will again rise, but the timing is clearly unknown. As such, parties to a transaction could look to shifting the adjustment basis from an AUM adjustment to a client- or account-based adjustment, or some combination of the two different adjustment methodologies. This could have an effect on neutralizing the effect of market-based fluctuations. In addition, as the market rises, so will the AUM in the retained accounts/clients relationships, which could benefit the buyer over the long-term from a revenue standpoint.

Longer-Term Measurement Periods for Adjustments

Extending the time period used to measure whether an adjustment would occur could neutralize the current market volatility. Instead of looking at a twelve-month comparison period for revenue or AUM-based targets, draw it out to a period of time that the parties reasonably believe will not be affected

by the current pandemic. Whether that is 18-24 months or some other time horizon, it could afford the seller a market agnostic adjustment calculation while also providing the buyer with an opportunity to reduce purchase price payments based on more “realistic” business conditions, as opposed to adjustments based on conditions that arise under these “extraordinary” circumstances.

Less Than 100% Equity Purchase With a Later Option to Purchase

Structuring the transaction as a less than 100% equity purchase could more closely align the parties’ interests. This would require greater attention to how the day-to-day and non-day-to-day decisions would be handled among the buyer and seller – in other words, who is expected to control the day-to-day decisions and what types of decisions would require consent of all of the owners? For a profitable business, the buyer may not be interested in imposing much oversight or controls other than material financial decisions (such as taking on large debt, or issuing additional equity), so this could be an alternative of interest to the seller. The parties may also determine to couple this arrangement with either a right by the seller to force the buyer to purchase, a right by the buyer to force the seller to sell the remaining equity of the business upon achieving certain metrics, or at a particular point in time for a purchase price that is based on an agreed-upon formula.

Create an Investment Account Co-Servicing Relationship with M&A-type Equity Option

Instead of working toward a purchase, the parties can agree on a working relationship for the next few months (or longer) where they share expenses and revenues in an agreed-upon manner. One or both parties may have an option to purchase or sell upon a later date or on the attainment of threshold business objectives. The notion here is to traverse the current uncertain markets and work toward setting up a deal during more steady times. This type of relationship may carry a higher level of risk for the seller as sometimes the buyer has a greater level of access to seller clients than would otherwise be the case outside of a traditional sale arrangement, but this risk could be mitigated through mutual non-solicitation or non-service of customer agreements.

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