Is M&A appetite for Independent Financial Advisors set to continue in 2024?

Gambit Corporate Finance Director, Oliver Phillips, examines how prevailing economic conditions, regulatory changes and an ageing demographic are driving investor demand for UK financial advisers and wealth managers, whilst at the same time more IFAs consider selling than ever before.

Economic Recovery

- With the **UK economy** now **recovering** from the **effects** of **high inflation, higher costs** of **capital** and **restrictive debt capital markets**, the sector will likely see **continued deal activity throughout 2024** as private equity backed consolidators compete for premium Independent Financial Advisors and Wealth Management businesses.
- PE investors have focused their attention over recent years towards the IFA and Wealth Management sectors, with a **key attraction being** the **recurring revenue streams,** and the **opportunity to build businesses of scale relatively quickly** by combining AUMs and consolidating cash flows.
- In a market **primarily made up of small, independent advisors,** the industry ranks amongst the most recession-proof of occupations, **exhibiting an almost counter-cyclical nature during periods of economic uncertainty.**

Increasing Regulatory Compliance

- Navigating the ever-evolving regulatory environment, whilst simultaneously running a business in a highly competitive market is the tightrope independent financial advisors walk daily. However, **many smaller firms** do **not have the management time** or **resources available** to **comfortably comply** with **FCA's regulations.**
- In a recent survey conducted by Alpha FMC and Adviser Home, issues around compliance are one of the biggest challenges facing IFAs. The survey found that **43% of advisers ranked regulation** and **process inefficiencies** as their **shared primary concerns.**
- With **Consumer Duty** regulations now in force, the FCA are assessing financial advisers more rigorously on providing **value for money**, whilst also creating much more onerous reporting requirements. **Regulation** was one of the **primary reasons** advisers looked to **sell their business in 2023.**

Ageing Demographic

- Another key factor behind the rise in consolidation seen over recent periods is the ageing demographic of IFA practitioners. According to various studies and publications, the **average age** of **IFAs in the UK** is **58,** and with an **increasing number of IFA business owners coming towards the end of their careers**, it is natural for the **focus to shift towards succession planning** and **funding retirement.**
- Given the fragmented nature of the market and the relatively small scale of many of the firms making up the market, **a large proportion** of IFA and Wealth Management businesses are **operated by 1 – 2 individuals.** As such, **succession options** are **limited**.
- The UK's ageing population has **given rise to large market consolidators** seeking **IFA** and **wealth management assets across the UK.**

Valuation

- It is apparent that the current mix of economic conditions, regulatory pressures and ageing demographics mean **the appetite** from **consolidators is unlikely to abate anytime soon,** and there **exists considerable headroom** for **further roll-up to occur.**
- However, aggregators and **consolidators** are **becoming increasingly demanding** as to where and with who they deploy their capital. Typically, established **firms** with **strong recurring revenue streams,** or **younger advisers writing new books of business** remain attractive propositions for acquirors.
- IFA and Wealth Management business owners looking to consider their options in 2024 should continue to **focus on enhancing margins, maximising recurring revenue streams** and **taking a proactive approach to driving growth across all KPIs,** as due diligence processes become increasingly more scrupulous.

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Alternatives to an Exit

- A key alternative to an exit or partial exit is seeking debt finance, particularly for IFA businesses looking to scale. Debt can be deployed alongside private equity, but for shareholders that don't want to dilute their equity, there is the option to seek debt finance, particularly for buy and build strategies.
- Appetite for the sector has been growing as funders recognise the strong quality of earnings, underpinned by predictable revenue streams and high cash conversion levels. IFAs can generate over 80% of income via recurring fees, and with modest working capital and capex requirements, cash conversion tends to be strong. The IFA operating model is further enhanced by the diversified nature of the underlying investment portfolios which helps to spread risk. By combining these features, it creates a robust platform to lend into.
- There is funding appetite across traditional banks, alternative providers including private credit. For buy-and-build strategies, private debt funds continue to be creative around their offerings to market, providing high levels of committed capital for 'war chest' type facilities. Other exit options include debt funded MBOs and Employee Ownership Trust Schemes (EOT), which still appeal to many owners seeking to exit.

Strategic Options

- In summary, it can be a daunting and emotional journey for the IFA business owner who is considering their strategic options; whether this is a full or partial exit, or possibly seeking to raise capital as part of a debt strategy. That's why at Gambit, our many years of experience working with owner-managed, private equity backed and leveraged companies can prove to be invaluable when a sale is under consideration.
- Our team is well connected with the consolidator ecosystem and has an extensive track record demonstrating how to obtain the optimum deal structure and valuation that is compatible with your immediate and long-term priorities. Whether you're considering selling to a strategic, private equity or your existing management team, our expertise will help to identify the best option. Our debt advisory team are well placed to support with debt strategies, and whilst there is market appetite, producing a quality proposal to present to the most relevant funder audience is key to achieving a successful fundraise.
- If pursuing a sale/disposal, then you can rest assured that our Partners will be on hand throughout the disposal process, and we will protect your interests by:
  - ✓ **Establishing realistic price expectations and valuation parameters**
  - ✓ **Identifying and validating prospective purchasers through our in-house global research capability**
  - ✓ **Preparing and assisting in the drafting of an Information Memorandum**
  - ✓ **Leading negotiations, ensuring competitive tension and guiding through to closure**
  - ✓ **Seeking tax efficient structures, maximising vendor exposure and post transaction service obligations including deferred consideration**
  - ✓ **Advising on separation planning**

We will provide the expert help needed to realise the best value for your business.

Gambit is an independent corporate finance advisory firm specialising in advising private and public companies on mid-market transactions in the UK and overseas. With offices in London and Cardiff, Gambit is widely recognised as a market leader in the provision of corporate finance advice to the Financial Services sector, having built up detailed industry knowledge and an enviable track record in deal origination and execution.

Gambit's dedicated Financial Services team has deep relationships with investors, funders, vendors and acquirers and we understand the key issues and trends that drive M&A activity in the sector.

If you would like to arrange a call to discuss the market and current M&A climate relevant to your business, please contact a member of our team.

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