InvestmentNews

STUDY OF PRICING & PROFITABILITY

2018

BENCHMARKING THE FINANCIAL PERFORMANCE OF ADVISORY FIRMS

IN PARTNERSHIP WITH

THE ENSEMBLE PRACTICE

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InvestmentNews is the premier provider of news, data, research and events to the financial advisory industry. Through our weekly newspaper, website, data centers, benchmarking reports and conferences, we provide industry-leading tools and resources that allow financial advisers to learn more about their businesses, clients and competition.

About this study

The survey was conducted between March 27, 2018 and June 25, 2018. The data collected was analyzed and assessed by the teams at *InvestmentNews* Research and The Ensemble Practice. In total, qualified data was used from 385 firms who supplied detailed financial information for their organizations, including data on clients, assets under management, revenue, profit & loss statement, growth strategy, marketing, fees, staffing, and recruiting, as well as compensation information for newly hired or promoted staff members.

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The data reported in this study was provided directly by participants to *InvestmentNews* Research. *InvestmentNews* Research was not engaged to and did not audit or review this information and, accordingly, does not express an opinion or any other form of assurance on it. The data contained in this report may not be a statistically valid representation of the entire market of financial advisory firms; rather, it is representative of the firms that elected to participate in this survey.

IN RESEARCH

InvestmentNews Research

The mission of *InvestmentNews* Research is to provide financial advisers with the industry's most informative practice management studies and benchmarking reports.

Our benchmarking studies are a leading source of market intelligence for advisory firms and industry partners, such as custodians, broker-dealers, service providers and professional organizations.

In 2009, *InvestmentNews* acquired two bellwether benchmarking studies from Moss Adams LLP — the Adviser Compensation & Staffing Study and the Financial Performance Study of Advisory Firms. We continue to improve and expand these two critical industry studies, while we have also introduced new studies on technology and succession planning that support the growth and development of financial advisory firms.

Led by VP and InvestmentNews Publisher Suzanne Siracuse, Associate Publisher Mark Bruno, Senior Manager of Research & Data, Matt Sirinides, and Research Associate James Gallardo, our studies are supported and driven by a team with over 40 years of combined experience and exposure to the ever-evolving financial advisory business.

In addition to our research studies, *InvestmentNews* Research also produces regular webcasts and regional workshops that arm advisers with actionable insights. Our events allow advisers to hear directly from some of the industry's leading experts - and also network with other advisers who are looking to improve their practices and grow their businesses.

Custom research: One of the core capabilities of *InvestmentNews* Research is providing custodians, broker-dealers and RIAs with custom benchmarking reports and white papers that leverage our deep data and analytical expertise. For more information about custom research requests and *InvestmentNews* Research, please contact Mark Bruno at 212-210-0116 and mbruno@investmentnews.com, or visit research.investmentnews.com/dashboard.

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The Ensemble Practice

The Ensemble Practice LLC is the premier business consulting firm for the financial advisory industry. It is committed to helping independent financial advisers create multi-professional ensemble firms with strong organic growth and sustainable profitability. The Ensemble Practice works with the top wealth management firms in the country. The firm also hosts the "G2 Leadership Institute"—a training program for the future leaders of advisory firms. The firm is founded and led by Philip Palaveev, a highly regarded industry expert, thought leader and author of the book "The Ensemble Practice."

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2018 *INVESTMENTNEWS* STUDY OF PRICING & PROFITABILITY

Foreword by Gabriel Garcia,
Managing Director, BNY Mellon's Pershing Advisor Solutions

We are pleased to present the *InvestmentNews* 2018 Pricing & Profitability Study, our annual advisor benchmarking study. For more than two decades, this survey has engaged independent advisory firms, who have generously shared detailed information about their business practices and financial results. The roots of this survey go back to the 1991 International Association of Financial Planners when our CEO Mark Tibergien conducted a survey while at Management Advisory Services and later Moss Adams. This long-running effort to formulate clear industry performance benchmarks has shaped many of the practice management approaches that are still relevant to advisory firms today.

This year, you'll notice a small but important change. The study – formerly titled "*Financial Performance*" – has been updated to more precisely describe its new research focus. The breadth and depth of the research has remained intact, but delves deeper into the data that matters most to your advisory firm. At a high level, this year's findings paint a positive picture for the advisory industry – revenue growth is on the rise, large firms are continuing to grow, and strategic M&A activity and a bit of healthy competition amongst firms is driving industry evolution.

In 2017, the median revenue growth for all participating advisory firms was 11.7%. This is significantly higher than the growth rates reported for 2016 (5.0%) or 2015 (6.9%). In fact, this result may signal a return to the double-digit annual revenue growth rates reported by firms for 2014 (13.5%) and 2013 (15.5%).

The study results also reinforce what industry insiders intuit: that large firms are not only getting larger, but continue to win the lion's share of high-asset clients. Super Ensembles (those with over $10 million in annual revenue) generated over $18 million in revenue, on average, in 2017 – more than quadruple what the average firm generated. In fact, the study found that Super Ensembles are outpacing other firms in all areas: from growth and profitability, to recruiting and productivity, to client quality.

As advantages continue to accrue to larger firms, their capacity to acquire other firms and practices has expanded. As a result, smaller firms are witnessing the signs of a maturing industry in which merging with other firms may represent the best (perhaps the only) path forward. One indication of the relative disadvantages of smallness is the finding that revenue for Solo practices (those with only one professional) grew revenue by 6.3% in 2017 – barely half of the 11.7% average growth rate for all firms.

The study also reveals that independent firms increasingly are competing against each other for clients. Firms reported that in 2017 about a third of their new clients (34.6%) came from competing Registered Investment Advisors or Broker-Dealers. This is a significant shift from 2015, when only 10% of new clients were won over from other advisors.

You will discover many more high-level insights in this study, along with extensive details and data that reveal the inner workings of firms of all sizes across the country. As with past studies, our goal is to provide you with clear, actionable information that you can use to fine-tune your firm for better results, or explore exciting new business approaches to achieve enduring success in the years ahead.

EXECUTIVE SUMMARY

The independent financial advisory industry continues to grow and achieve new heights of size and profitability. However, the gap in performance between the largest and smallest firms is increasing and competition is intensifying. Growth has created appetite to hire more professionals and employees at every position. Advisory firms were very active recruiters in 2017. Competition did not just focus on clients but also on recruiting and retaining the best professionals; firms devoted a lot of budget and time to increasing their capacity to better service clients.

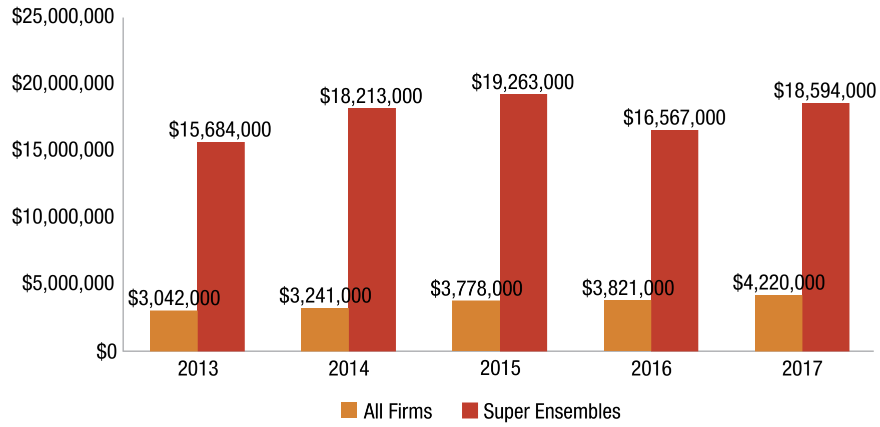
Each year for more than 25 years, this survey has reached out to the industry to collect extensive information about the business practices and financial performance of independent advisory firms. The survey goes out to the entire independent financial advisory industry, and while participation is voluntary and non-random, the results are statistically significant and speak to the trends that shape and impact the industry at large.

For the 2018 edition of the study, 385 firms provided a complete set of income statements, as well as information around staffing, compensation, strategy, marketing, services, fees, and other data, allowing us to examine the shape and direction of the industry. Participation was particularly strong in the categories populated by the largest firms: the Super Ensembles and Enterprise Ensembles. We define Super Ensembles as firms with over $10 million in revenue and Enterprise Ensembles as firms between $5 million and $10 million in revenue.

Super Ensemble	Enterprise Ensemble	Ensemble	Solo
Multi-professional firms with at least $10 million in annual revenue. (n=43)	Multi-professional firms with between $5 million and $10 million in annual revenue. (n=46)	Multi-professional firms with $5 million or less in annual revenue. (n=250)	A firm with a single client-facing professional. (n=46)

The results of the survey leave no doubt that the industry is growing. The typical firm is no longer a small practice. The average participant size in the survey has increased to just over $4 million in revenue (**Figure 1**). The distance between the largest firms in the industry and the average firm is also very significant. Super Ensembles had on average over $18 million in revenue in 2017 — more than four times the size of the average firm.

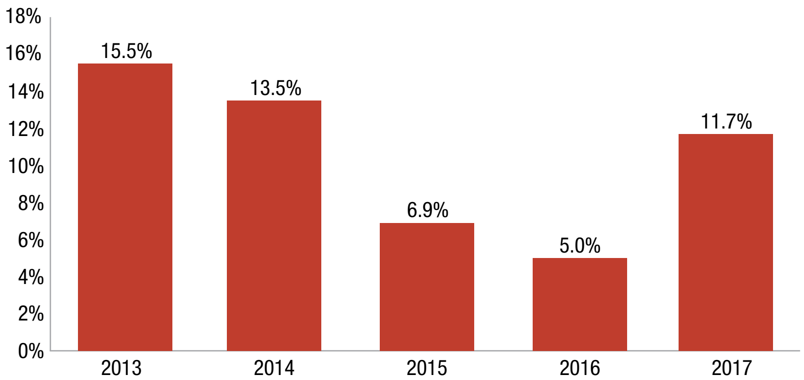
Figure 1: Average Revenue of All Participants vs. Super Ensembles Over the Last Five Years



This performance gap between Super Ensembles and the average firm is a trend that permeates the survey results. Super Ensembles have distinguished themselves as industry leaders and are outpacing their peers in many areas: growth, recruiting, profitability, client quality and productivity. The result is an industry that is becoming more competitive and more consolidated. This process can be described as maturation, and it compels every firm to consider whether it can best achieve its vision by going it alone or joining forces with others.

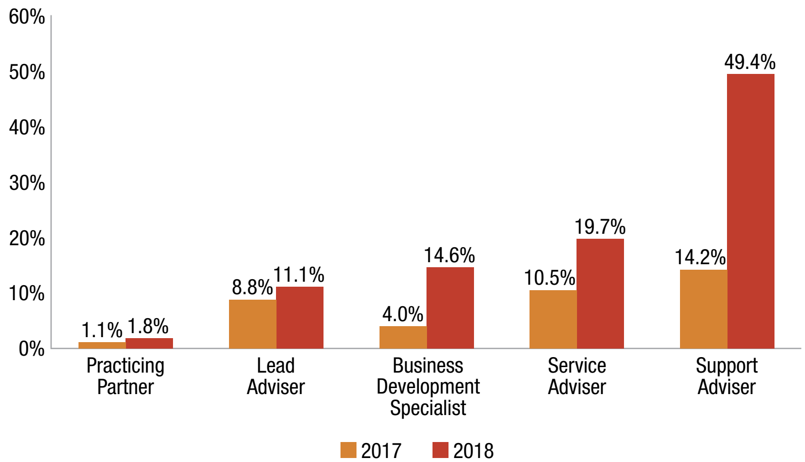
At the same time, the industry has experienced another growth spurt. The revenue of firms participating in the study increased by 11.7% on median in 2017, which is a high rate of growth compared to the relatively low growth rates over the previous two years (**Figure 2**). Asset growth was also very strong in 2017, indicating that high levels of revenue growth will continue in 2018, since assets added in 2017 will have a full year to bill. The result has been optimism throughout the industry and a growing appetite to hire and create capacity.

Figure 2: Median Revenue Growth Rate Over the Last Five Years



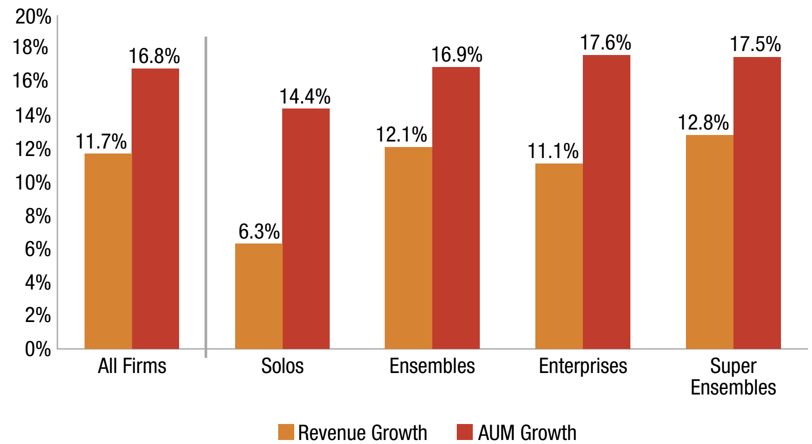
Increases in profitability gave firms a sense of confidence, and many used the opportunity to hire additional professionals and create capacity for even more growth in the future. Nearly half of the firms in the survey hired Support Advisers, and one-fifth hired Service Advisers. Lead Advisers were also in high demand, with 11% of firms hiring for the position in the past year (**Figure 3**).

Figure 3: Percent of Firms Hiring Advisers by Position in 2017 and 2018



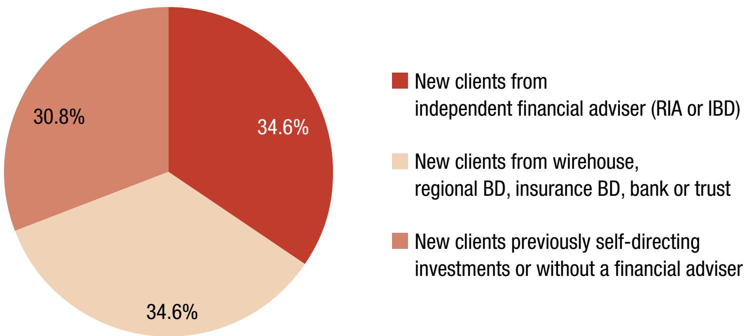
Growth and opportunity were pervasive in the industry in 2017, but smaller firms are in danger of falling behind. Firms with only one professional (or "Solo" practices) grew revenue by 6.3% on median in 2017, which is relatively low compared to the 11.7% for all firms (**Figure 4**). Super Ensembles grew revenue by 12.8%, mid-sized Enterprise Ensembles by 11.1% and smaller Ensembles by 12.1%.

Figure 4: Median Year-Over-Year Revenue and AUM Growth by Firm Category



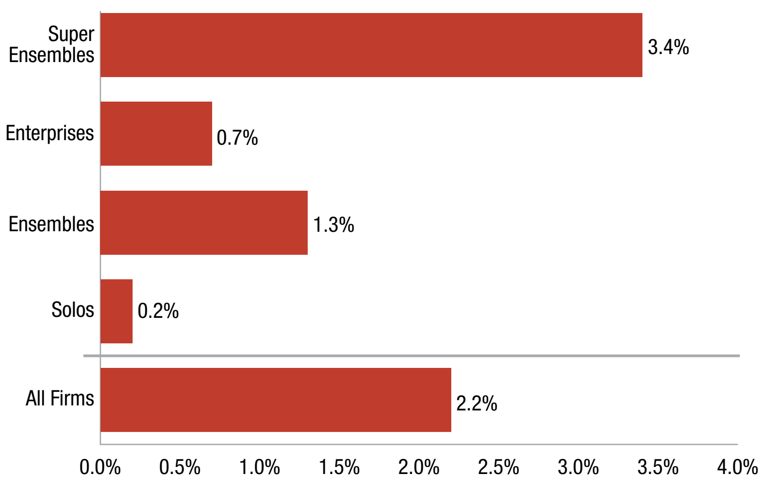
We are also starting to see intensifying competition among independent firms. Firms are reporting that more than a third of their new clients came from another independent firm, with approximately the same proportion coming from wirehouses and other broker-dealers (**Figure 5**). For comparison, in 2015 firms reported that only 9.9% of their new clients came from other independent firms. Historically, self-directed investors have been the primary source of new clients. In 2017, they accounted for less than a third of new clients.

Figure 5: Competitive Source of New Clients



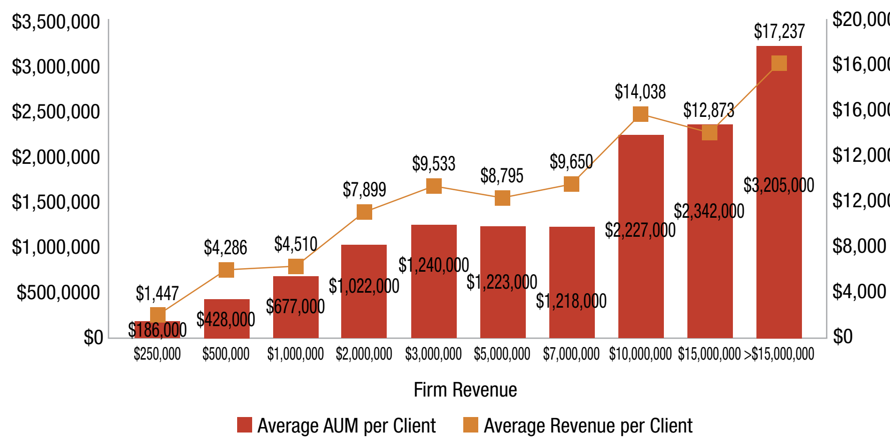
The ability to acquire firms is becoming a critical part of the growth strategy for many firms, and acquisitions were an important contributor to growth in 2017. However, the ability to acquire firms or to recruit advisers with established books of business has been almost exclusively the domain of Super Ensembles. While, on average firms reported adding 2.2% in new assets from acquisitions, most of those assets went to Super Ensembles. Solo practices reported almost no acquisitions, and Enterprise Ensembles and smaller Ensembles reported only 0.7% and 1.3%, respectively (**Figure 6**).

Figure 6: Average AUM Growth From Acquisitions by Firm Category



Perhaps the biggest difference between firms small and large, however, comes from the clients they are able to attract. The data clearly shows that the size of an advisory firm is very closely correlated with the size of its average client relationship (**Figure 7**). Simply put: the largest firms work with the largest clients. This correlation is very strong in terms of both revenue and AUM. It has also been very consistent from year to year in the study. In statistical terms, 95% of the change in average client size across participating firms (R-squared) can be explained by the difference in the annual revenue each firm generates.

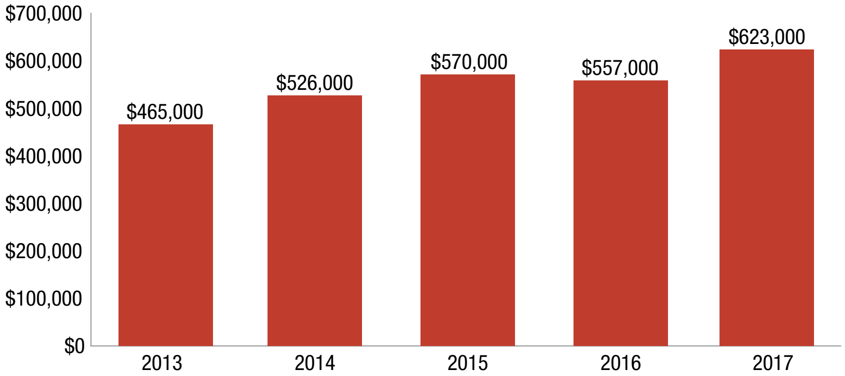
Figure 7: Average AUM per Client and Revenue per Client by Firm Revenue Size



The ability to attract larger clients results in higher productivity, better leverage and higher profitability. In turn, the higher profits and bigger budgets allow larger firms to pay more and attract better talent. The cycle then reinforces itself.

Growing profitability and income in the industry as a whole has benefited all firms. It also appears that much of this growth has translated into owner profits. In 2017, owners earned an average of $623,000 in personal pre-tax income (**Figure 8**). Pre-tax income per owner is a simplistic measure of success that combines both compensation and profits to the owners. Pre-tax income per owner in 2017 was 11.8% higher than the previous year — and the highest in the history of the study — and is a number that closely matches growth in revenues.

Figure 8: Average Pre-Tax Income per Owner Over the Last Five Years



The Ancient Greek philosopher Heraclitus said that "change is the only constant in life." The same is true for the advisory industry — it is always changing and evolving. The changes are not drastic, but consistent. Year after year, we find that the relatively small but incremental advantages accumulated by the top firms in the industry produce a dramatic and lasting effect.

The data in this study is comprehensive and covers many of the decisions that advisers and owners of advisory practices seek to make on an ongoing basis. We hope that the study continues to bring insight to those decision-makers and allows them to build bigger and better firms.

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