PRIVATE EQUITY OWNERSHIP

HOW FINANCIAL ADVISORS CAN BE IMPACTED BY

EVALUATE YOUR OPTIONS AND MAKE THE BEST LONG-TERM DECISION FOR YOU AND YOUR CLIENTS

Exit
A strategic partnership with the right private equity (PE) firm can yield significant benefits for a company seeking an injection of cash to accelerate growth, prepare for a public offering, or pursue other business goals. Under the right circumstances, PE firms can create value and take businesses to their next level of growth.

However, if a PE firm’s main strategy is to pursue short-term profit to the exclusion of long-term interests, this can pose potentially significant challenges and disruptions to the underlying business.
In recent years, PE firms have flocked to the wealth management space, thanks in large part to its fast-paced growth relative to other investment management channels. The attraction to the prospect of maximizing the profit potential from that growth is due, in part, to an increasing number of affluent and high-net-worth consumers seeking professional advice.¹

Private equity investment in individual wealth management firms or their broker/dealers can be beneficial if the PE firm:

- Has deep knowledge and experience in the wealth management and broker/dealer space.
- Is focused on long-term growth.
- Is committed to ongoing investment in critical areas such as technology, service, and advisor support.

But herein lies the rub. While advisors rely on their broker/dealers to make significant and continuous investments in back-office, marketing, compliance, and technology support so they can attract and grow profitable client relationships, these may be the first crucial components to be cut when a PE firm enters the picture. Why? Because the two firms—the broker/dealer and the PE—may be working at cross purposes, especially if the PE firm has a singular goal in mind: to realize a profit in a short period, which is often accomplished either through selling shares in an initial public offering (IPO) or by selling the company outright, sometimes to another PE firm.

Locating the nearest exit can be a good thing when you board a plane. Planning an exit strategy from the moment you buy a business may be advantageous to the PE firm, but may have negative ramifications for the acquired business—especially when that business is a broker/dealer serving many hundreds or thousands of financial advisors and their clients. It then becomes critical for advisors to understand the long- and short-term goals, strategy, and proposed time frame for any private equity arrangement made by their firm or broker/dealer in order to fully understand the potential advantages and disadvantages for their practice.

**WHEN IT’S ALL ABOUT THE EXIT**

Before you can understand how PE ownership may impact your growth goals for your business, it’s important to understand how PE firms make money.

The institutions and wealthy individuals who invest in PE firms often expect a significant return on their investment in a relatively short period of time.²

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How they achieve their goals, however, can differ greatly from one firm to the next and one deal to the next.

One strategy is for PE firms to inject capital into either ailing companies or those lacking the necessary cash flow to achieve short-term growth goals and create scale. Those looking to maximize their return in a short period of time may set very aggressive goals and cost-cutting measures. This may impact the broker/dealer’s long-term investments in key areas like technology and service. This strategy can put the PE investor at odds with broker/dealer managers—particularly those with longer-term goals for their companies—introducing uncertainty and anxiety that can make it difficult to retain advisors and their clients.

So what does an approach focused on the PE company’s exit mean for financial advisors and their practices?

It can pose significant risk to a broker/dealer charged with supporting the key growth functions of hundreds or thousands of financial advisors who rely on back-office resources and depth of support to meet their clients’ demands.

IMPACT ON ADVISOR SUPPORT

Diminishing back-office support is one possible result of PE transactions involving independent RIAs, broker/dealers, or custodian firms. That’s because the ways PE firms cut costs to meet their profitability goals in a relatively short time period can include cutting back-office support or acquiring more advisors without expanding back-office support. As a result, advisors may be left struggling to provide the same high-caliber service their clients expect without the support they’re accustomed to from their broker/dealer partner.

This can be compounded by the fact that PE firms may acquire multiple companies in a relatively short time frame. As they buy more firms, there is an increased risk of inattention to your business as their focus may be diverted to the newer acquisition and its needs. Sometimes, in seeking to rapidly grow the combined business, the result can be constant change and reduced support for current advisors. This could include more advisors being assigned to a dwindling number of service personnel as the PE firm consolidates acquired businesses and trims support resources.
HIGH AMOUNT OF DEBT
Managing debt is a significant risk PE owners face. PE transactions are often highly leveraged, meaning they are purchased with a high amount of debt. While this can increase the potential future return, it creates a higher interest burden that may limit cash flow and significantly affect the firm’s ability to make long-term investments.³

If a PE firm finances a significant amount of an acquisition—which, if successful, can amplify the return—it creates a higher debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortization) burden on operational efficiency. That means that those PE firms may have to allocate a significant amount of cash flow to service debt, risking limitations on funds available for investment in long-term growth. As a result, the investments they make may be focused on generating a measurable return in the relative short term, with less focus on or ability to make investments in the future.

As a comparison, in each of the past two years, LPL Financial invested more than $100 million in technology and service to continually support growth for thousands of advisors.

HIGHER POTENTIAL RISK OF INSTABILITY
Instability Due to High Debt: With debt comes a potentially higher risk of instability. If a PE firm has a high amount of debt, and a narrow focus on short-term results, they may become limited in their ability to weather market conditions, which in some cases could lead to a delay in selling the business, a fire sale, or possibly even bankruptcy in the event of a significant market decline or extended downturn.

Instability Due to Management Changes:
Management changes can also be a part of a PE firm’s strategy. When a firm is focused on executing a short-term buy-and-sell approach, rather than a longer-term buy-and-hold approach, they may recruit and reward executives who are experienced in implementing short-term exit strategies—whether or not they have experience in the industry.

If they’re operating under a short-term strategy, PE executives may make swift judgements, prioritizing what’s best for the exit strategy versus what’s best for advisors. They may quickly replace key personnel, which could lead to increased management turnover and constant changes for advisors who are trying to maintain stability for their clients.

TRANSPARENCY
Transparency is another important consideration. While regulatory oversight of the PE market has increased since the 2008 financial crisis, that market still faces less-stringent regulation than other businesses. A lack of insight into the company’s financial information can add greater uncertainty for advisors.

PROTECTING YOUR BOTTOM LINE
For your business to grow and thrive, the firm you trust with your practice and your clients should have a long-term vision that includes significant reinvestment in important areas. Key investments in core functions like technology, service, and platform development are required to support the growing complexity of financial services, meet increasing client demands, and continuously deliver value. That’s why financial advisors should ensure that their broker/dealer shares the same vision, values, and long-term goals.

As the financial advisory business becomes increasingly complex, time becomes an important resource to advisors. Access to the technology, tools, and resources you need to scale your business while focusing on client relationships is critical. A broker/dealer that brings short-term instability and has no long-term vision can leave you and your business in a constant state of uncertainty—not a winning strategy.

SHOULD YOU STAY OR SHOULD YOU GO?
Determining whether to remain with a broker/dealer partner when a PE firm

with a short-term exit strategy enters the picture, or whether to transition to a partner with a stable record, begins with asking the right questions:

- What’s the PE firm’s track record for how long they hold on to companies?
- Does the PE firm have experience in the industry? Do they have experience managing and supporting financial advisors and understand their needs?
- What’s the PE firm’s long-term strategy?
- Is the PE firm consistent in the promises they’re making?
- Has the PE firm incentivized you to stay?

**WHAT IT MEANS TO PARTNER WITH THE INDEPENDENT INDUSTRY LEADER**

At LPL Financial, we believe every American deserves objective advice from independent small-business owners, which is why LPL remains committed to being truly advisor-centric by putting advisors first. When we invest in our advisors, we enable them to deliver exceptional service and guidance to their clients. Our success depends upon theirs. The proof is in our advisor-centric initiatives:

**Investment in Technology:** LPL invested $100 million in technology in 2017 and $125 million in 2018. This investment, which has more than doubled in the past two years, ensures we are ready to address the future needs of you and your clients.

**Investment in People:** We invest heavily in talent to support a 4:1 advisor/employee ratio. This allows us to personalize your experience with us, whether it’s a one-on-one conversation with a dedicated service team member or in-depth consultations with specialized groups that help you with complex issue resolution.

**Increasing Economies of Scale:** LPL’s large volume of business creates economies of scale and cost savings that we can pass along to you, through cost reductions and investing in service and support. It’s a shared success model: Our wins can help you compete better, which may lead to even greater wins for all.

**Access to a Full Range of Support, Resources, and Capital:** Whatever the stage of your practice, LPL offers you a full range of services and resources

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As reported by *Financial Planning* magazine, June 1996–2018, based on total revenue.
for starting, growing, or selling your business, with personalized support along the way.

**Our Road Map for Future Thriving Advisors:**
As the leading independent broker/dealer, our goal is for advisors to be successful today, tomorrow, and for years to come. Our corporate road map outlines how we’ll deliver capabilities that help advisors thrive:
- Digitize the advisor practice to drive efficiency and meet the growing demand for personalized advice.
- Create a sustainable value proposition for advisors through new platforms that are cost competitive for investors.
- Help advisors optimize growth by making it easier for advisors to transition appropriate business from brokerage to advisory.

**What Could Life At LPL Look Like For You?**
A confidential discussion with your recruiter can provide you with an understanding of LPL’s investment in you and your success, including:
- Available transition assistance
- Competitive pricing and payout
- The support teams and resources available to you
- Your eligibility for additional offers and incentives

To discuss your options, get in touch with your local recruiter at www.JoinLPL.com or call (866) 518-6109.

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