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Raymond James willing and able to make other deals

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By inking a deal with Deutsche Bank AG, Raymond James Financial Inc. showed it will deploy capital on an acquisition, and the company is ready to do it again, according to CEO Paul Reilly.

Raymond James announced Dec. 3 that it agreed to acquire Deutsche Asset & Wealth Management's U.S. private client services business in a deal expected to close in the third quarter of 2016. During a conference call to discuss the transaction, Reilly said the company has other possible deals in the pipeline, with asset management a big focus and other areas of interest including M&A advisory and equity capital markets.

"[We] still believe there are a lot of opportunities similar to this to deploy cash and capital to grow the business," he said.

Reilly has made similar comments in the past, and Raymond James acquired Cougar Global Investments Ltd. in April. However, Evercore ISI analyst Chris Allen doubts the company will become a serial acquirer.

"They're not very transaction oriented," he told SNL.

The company has not completed a sizable deal since the purchase of Morgan Keegan & Co. LLC for $930 million in 2012. The Deutsche deal is much smaller in comparison. For instance, when the Morgan Keegan deal was announced, the target had more than 1,000 advisers in its private client group. In the Deutsche deal, roughly 200 financial advisers are part of the transaction.

How much Raymond James pays in the Deutsche deal will depend on the number of advisers it retains from the transaction. If the retention rate reaches 100%, Raymond James will pay about $420 million since the business being sold generates about $300 million in annual revenue and the buyer agreed to pay 1.4x the revenue of the advisers it adds.

Raymond James paid about 1.2x revenue for Morgan Keegan, but Credit Suisse Securities (USA) LLC analyst Christian Bolu believes the Deutsche deal terms are reasonable in part because the near-zero short-term interest rate has depressed adviser revenue. He also noted that the multiple is lower than the industrywide recruiting and retention rate, which is closer to the 2x revenue range.

Raymond James' retention of the advisers will become a focal point. Bolu said significant attrition is possible because the company could face a retention challenge similar to that faced by Stifel Financial Corp. with its deal to purchase Barclays Plc's U.S. wealth and investment management business. The Stifel/Barclays deal is similar to the Raymond James/Deutsche deal in that the buyers are adding high-net-worth advisers and the sellers are large European-based financial institutions.

"Some advisers will prefer staying under the umbrella of a global investment bank," Bolu said in a Dec. 3 research report.

Stifel estimated that it will retain 90 to 105 of the 180 Barclays advisers. At the midpoint of that expected range, it would realize a 54% retention rate in the deal, Bolu noted. However, he expects Raymond James to retain 60% to 80% of the advisers involved in the Deutsche deal.

"We do believe Raymond James' brand value and stronger capabilities in the high net worth space will ultimately drive a higher retention rate than in Stifel/Barclays," he said.

The Deutsche advisers that Raymond James adds will operate under the name Alex. Brown Inc. Bolu said a dilution of Raymond James' brand is a potential risk from the transaction, noting that the company prides itself on a regional and family culture. The Deutsche deal — which Bolu believes will double Raymond James' penetration in such metropolitan cities as New York, Boston, Los Angeles and San Francisco — represents "a move away from its core DNA."

Still, he said, the deal is modest in size and a sensible use of the company's substantial excess capital.

Bolu was not the only analyst to view the transaction that way. JMP Securities LLC analyst Devin Ryan said the deal is relatively small, and he expects Raymond James to continue to have a strong level of excess liquidity after the transactions. He said the deal will utilize a portion of the company's more than $500 million of excess liquidity, and he would not mind seeing the company use more liquidity on acquisitions.

"[We] view other deals from here as positive optionality as we do not believe much credit for this deployment is currently in RJF's valuation," he said in a Dec. 3 report.

Ryan added that Raymond James aims to ensure its acquisitions make sense economically, strategically and culturally. Given that the company has such a high bar for targets, "the ability to get a deal to announcement would most likely represent a positive shareholder event," the analyst believes.

However, Raymond James' deliberate approach with its capital has also led to some criticism. Nomura Securities International equity research analyst

Steven Chubak said in a Nov. 20 research report that Raymond James' conservative approach to capital deployment leaves it exposed to potential activist action. He added that investors are growing more reluctant to ascribe value to excess capital given management's "conservative deployment." In the report, the analyst estimated that Raymond James retains more than $2 billion of excess capital.

The Deutsche deal is not expected to make much of an impact to Raymond James' capital position. During the deal call, Reilly said the transaction will have a nominally negative up-front impact to the company's regulatory ratios, adding, however, that the deal shows his company is willing to pursue inorganic growth initiatives.

"I think this transaction, as hopefully some others in the future, will show that we are deploying capital," he said.

Reilly said deals can take years to come to fruition, and his company aims to make decisions that can generate long-term value rather than short-term gains.

While Raymond James' conservative approach may slow down capital deployment, it does help with recruiting, Chubak said. He said the company has had success with recruiting in part because its conservative style makes it "a nice safe place to land" for financial advisers.

"There's definitely some appeal to that, especially as a financial adviser where your activities are becoming increasingly scrutinized," he told SNL.

Others also noted that Raymond James has been successful in recruiting. Attacca International LLC Managing Partner Mark Yancey, whose firm provides strategic corporate development and advisory services in the global investment management industry, said the company has had substantial success in recruiting advisers from larger competitors.

"They have been in the news more than any other broker/dealer in terms of acquiring [financial advisers]," Yancey told SNL.

In its Form 10-K filing, Raymond James reported a 331 net increase of financial advisers in fiscal 2015, which ended Sept. 30, which the company said ranked as its second-best financial adviser recruiting year. At the fiscal year-end, the company had 6,596 affiliated financial advisers, a 5% year-over-year increase, and the private client group's assets under administration increased to $450.6 billion, a 12% year-over-year increase, according to the filing.

Reilly said recruiting will remain a focus for Raymond James and noted that the company has no plans to rely solely on deals for expansion.

"We are not dependent on just acquisition to grow, but we are not afraid of them either," he said.