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Buying, Selling & Valuing Financial Practices

The FP Transitions M&A Guide

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Foreword

About 20 years ago, FP Transitions launched the open market concept for finding and matching the best of many interested and qualified buyers with one particular seller, confidentially, and everything changed.

Back then, we often introduced ourselves at speaking events around the country as "eHarmony for financial advisors," smiling as we said it. But today there is a 50-to-1 buyer-to-seller ratio. The high level of demand has resulted in not only a better value proposition for sellers, but also their ability to select the best of a large auditioning group of interested buyers to step in and take care of a loyal and trusting client base. That's turned out to be a great benefit for the entire industry—it has even increased the value of the buyers' practices as a result. Effectively, we empowered sellers to transfer their duties and responsibilities to someone else at the end of their career, and then created the systems and processes to help them do exactly that.

Fifteen years ago, we completed one of the first acquisitions in this industry that was funded entirely with an SBA-guaranteed bank loan, and today, we're working to help modernize and institutionalize the bank financing process that may yet again change the value proposition, and the payment structures, for an entire industry of independent owners. This could be a significant improvement in the mergers and acquisitions (M&A) space if together with our buyers and sellers we can make it work well from the clients' perspective.

Payment terms and tax structures in this industry have continued to improve as we honed our craft. We introduced the concept of a "shared-risk/shared-reward" payment structure to protect buyers and sellers, and to ensure that the post-closing "economic marriage" adequately supported cooperative and motivated parties to look after the clients who have always been the real focus of this M&A process. Ninety-five percent–plus long-term client retention rates and 2% default rates tell the rest of the story.

As we grew, our service offerings became broader because the business model we envisioned was expanding past what a small three- or four-person consulting practice could ever hope to offer. Like you, we wanted to make a difference. I was brought in about 10 years ago based on my experience as the COO of an international business brokerage firm that had valued and sold more than 2,000 practices and businesses every year of all types, all

over the world. Together, we put the wrenches and hammers to a stagnant M&A market and a valuation system that wasn't adapting or evolving very effectively, even as the independent industry changed all around it, and continues to do so.

Ten years ago, it was obvious that buyers and sellers were struggling with a valuation problem as they sought to measure what they'd built, or sought to acquire at market value, and to precisely determine their next steps. There was simply no affordable, accurate, and practical method by which to make a value calculation for M&A purposes. At one end of the valuation spectrum was a multiple of gross revenue (GRM), which worked just fine for very small books with transactional revenue sold through an earn-out arrangement, but not much else. At the other end of the valuation spectrum was a full appraisal, such as the discounted cash flow (DCF) method, which was perfect for a courtroom setting or large, multiowner firms. But at $5,000 to $50,000 per valuation, only the largest and most motivated sellers could afford, were interested in, or had need of, this respected academic approach.

The independent industry needed another choice, a better choice, so our first order of business was to create the Comprehensive Valuation Report, an accurate and affordable value calculation that relied on FP Transitions' large and growing private database of comparable, closed transactions—without which this approach would have no credibility. It's all about the data! After eight years of closings (at the time), we had the "comps" to do the job right. Eight thousand valuations later, the handwriting is on the wall, so to speak, and along the way, the industry vernacular began to regularly borrow our valuation terms like "cash flow quality" and "transition risk." Answering one simple question—What would a competitive, strategic buyer pay for a specific revenue stream given standard and reasonable payment terms?—made all the sense in the world to most of the entrepreneurs in this industry.

But as it turned out, not everyone wanted to sell. Many advisors enjoyed what they did and wanted to sustain their lifestyle practices for as long as possible. Some advisors even had the temerity to want to create a legacy model, to build an enduring and transferable business that could outlive them and serve their clients and their clients' children and grandchildren. So we launched the concept of "equity management" in a white paper published in 2008 by Pershing, LLC, and championed the term "continuity planning" as separate and distinct from "exit planning." The related terms "revenue-strength" and "enterprise-strength" that we first shared in our work with Fidelity in 2009 have become common parlance in describing how practices or businesses are built and structured.

Along the way, FP Transitions led the shift from using basic revenue-sharing agreements, to earn-out arrangements, to today's use of a more sophisticated performance-based promissory note structure. We shared our

concepts and thinking with hundreds, maybe thousands of practice management personnel at the various independent broker-dealer (IBDs) and custodians, sometimes gratefully, sometimes not. It turns out that independence is often more important during the recruitment process than upon an advisor's retirement, but we're going to champion the cause of the independent selling owner because in the long run, that's what is best for the clients who support this industry.

A few years back, FP Transitions literally wrote the book on building an enduring business and formally defined "succession planning" for this unique group of professionals for the very first time. Every year, we now help to create hundreds of new, first-time, "30-year-old" owners who are investing their money and their careers to build on top of an existing practice—to form a "successor team." We coined the terms "G-1, G-2, and G-3" to set up a succession strategy for next-generation advisors. Our original work with many of the large IBDs and custodians led to terms and concepts that are now commonly used throughout the industry. To do all this, we led the use of entity structures to create a chassis that is designed to last, and to serve well beyond the founder's career—a cutting-edge strategy in this industry. That's exciting and important work. And we continue to push the boundaries every day in order to keep advisory practices thriving and serving their client base for generations to come.

As this book is sent to the publisher, we have 40 staff members whose skill-sets include five JDs (lawyers), two CVAs (Certified Valuation Analyst), one of whom has also earned the designations of an ASA (Accredited Senior Appraiser) and MCBA (Master Certified Business Appraiser), ABAR (Accredited in Business Appraisal Review by the Institute of Business Appraisers), and MAFF (Master Analyst in Financial Forensics), and a CFA (Certified Financial Analyst) with several more CFA candidates in the wings. We also have compliance and regulatory skills to augment these credentials, important in this highly regulated industry. And along the way, we're building our own enduring, multigenerational ownership structure.

Today, there is no question that an advisory practice has value, but it doesn't seem that long ago that they didn't. Yesterday, we argued with industry "experts" and "pundits" fighting to establish that an advisory practice had any value at all.

The M&A space for the independent financial services and advisory industry has come a long, long way in a very short time because of great ideas like these and because of a really smart group of financial advisors/entrepreneurs who seem determined and destined to lead the professional services ranks in terms of value, transaction terms, and satisfied clients. And together, we're only just getting started!

Brad Bueermann, CEO, FP Transitions

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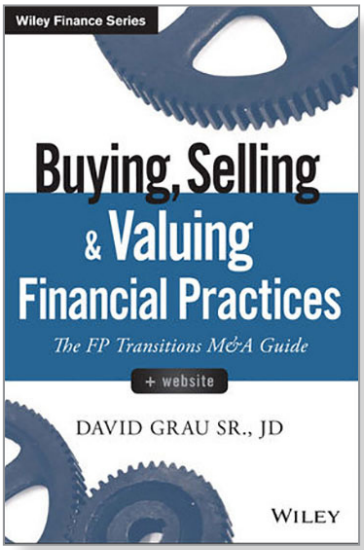

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Buying, Selling, & Valuing Financial Practices shows you how to complete a sale or acquisition of a financial advisory practice and have both the buyer and seller walk away with the best possible terms. From the first pages of this unique book, buyers and sellers and merger partners will find detailed information that separately addresses each of their needs, issues and concerns.

From bestselling author and industry influencer David Grau Sr. JD, this masterful guide takes you from the important basics of valuation to the finer points of deal structuring, due diligence, and legal matters, with a depth of coverage and strategic guidance that puts you in another league when you enter the M&A space. Complete with valuable tools, worksheets, and checklists on a companion website, no other resource enables you to master the concepts of value and valuation.

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