THE ART AND SCIENCE OF A DEAL: YOUR GUIDE TO ACQUIRING A PRACTICE

Standing Out in a Crowd

For any one financial advisor practice listed for sale, there can be 20, 50, or even 100 buyers claiming to be the perfect fit, leaving the acquisition market place exceptionally crowded. To become the buyer every seller wants to meet requires preparation, communication, and dedication. The first and most important step is preparation. It is important to know what your target acquisition looks like, but also to know what type of practice you are not looking to acquire. Knowing the general shape of your target acquisition allows you to better communicate your vision. Start by asking yourself these questions:

- Do I have an AUA minimum/maximum?
- Do I have a maximum number of clients I would acquire?
- Do I have geographic restrictions?
- Is there a particular niche of the industry I want to target?
- Is there a minimum revenue per client metric I am seeking?

The financial services space is a relatively small community and being able to articulate your vision for acquisitions to as many in the community as possible will serve you well. Networking is a great way to let your peers know you are in the market for acquisitions. Attend conferences and connect with friends, colleagues, or older advisors. Another source of knowledge are product wholesalers. They speak with all advisors and typically know which advisors are contemplating retirement and the sale of their practice.

Next, ask yourself if you are willing to pay for an acquisition search. There are reputable firms that will cold call advisors to gauge their interest in selling their practice. Take the time to interview these firms and understand their success rate and pricing structure. Ask questions such as:

- How do they find the firms they are calling?
- What is their definition of a “viable” seller?
- How long does it usually take to find viable sellers?
- How do they get paid?
- Do they work off a monthly retainer or a percent commission of the sale price?
- Are any of these points negotiable?

I Found an Acquisition, Now What?

For some, moving to the next steps of valuation and deal terms negotiation may be a seamless transition, while others may find themselves asking for help. The best course of action is to work with a professional versed in the valuation and negotiation surrounding the sale of financial services firms. Advisors at Cambridge have access to the dedicated staff of the Succession and Acquisition Solutions Team, specializing in the art of deal making and the financing of these transactions. Regardless of your buy side support, two central points of action remain the same: identify the value of the business and negotiate the terms of the sale.

Valuation and Terms of Sale

There are many ways to find the value of a business, such as using multiples of gross revenue, EBOC (Earnings Before Owner's Compensation), or EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization). Regardless of the methodology your buy side expert uses, identifying items like the number of clients, the type of revenue, client age, and profit margin are the top level items a prospective buyer needs to analyze in order to decide if a practice is worth pursuing. Rely on your buy side support to focus on a proper valuation of the business but remember, in the end, a practice is worth what the seller and buyer agree it is worth. Often, this is dictated by three key drivers: price, time, and protection.

If the seller is asking for receipt of proceeds as quickly as possible, as the buyer you may request a lower purchase price or ask for stronger terms of protection. On the other hand, the seller may indicate quick receipt of proceeds or a large down payment are less important and instead may ask for a larger purchase price paid over a longer period of time or for protections that favor the sell side. Overall, a typical deal structure will include a down payment of varying percentages with the balance of the purchase price likely paid via funds held in escrow for future distribution or through a series of installment payments made over a negotiated period of time, commonly referred to as seller financing.

In terms of protection, both sides are working to negotiate terms that provide the greatest likelihood of success for their goals. As the buyer, a few key areas to negotiate that provide the greatest protection to the future cash flow of the business include the seller's involvement post-sale, the tax treatment of the sale price, and the negotiation of a revaluation period – known as the clawback period.

One of the unique things about the advice business is how revenues are ultimately produced – through relationships with clients. Typically, the seller has spent many years cultivating and deepening client relationships which makes it important to ensure the seller is providing their best efforts in transitioning the clients to the buyer. Part of the terms of sale includes a negotiated consulting period in which the seller assists the buyer in transitioning the clients, participates in meetings to facilitate introductions, and re-enforces to the clients that the buyer is the right person or firm to continue guiding them.

Another point of protection for the buyer is to have the flexibility to reduce the overall purchase price if client relationships do not materialize in the transition. In the event that clients do not move their investments to the buyer or leave the buyer's firm within the negotiated time period, the buyer has the right to reduce the purchase price. Additionally, it is common to have the seller commit to a non-solicit or non-service agreement after the expiration of the consulting contract. During this period, the seller agrees to refrain from soliciting the recently transitioned clients and is not allowed to serve the client in any capacity.

It is important to remember all parts of a transaction are negotiable, from the purchase price to the seller's involvement and even how the purchase price is taxed. You will want to consult your buy side expert and your CPA for the final tax allocation and implications as the purchase price is typically allocated between goodwill – preferential treatment for the seller, versus the consulting and non-service agreements – preferential treatment for the buyer. Tax treatment is one more way for you as a buyer to protect your acquisition and drive long term profitability of the transaction.

After identifying a potential acquisition, having a valuation completed, and negotiating the terms of sale, three critical steps remain: secure financing, create the asset purchase agreement, and develop a communication plan.

Secure Financing

A critical step to secure financing is to have your financial house in order. Have a few years of tax returns and financial statements readily available. It is important to show the lender you operate a mature, prudent, and profitable business. Make sure you know your operating expenses and can clearly articulate your revenue centers and projections. The more peace of mind you can provide to the lender regarding repayment, the more secure your chance to borrow.

After financing appears secured, be certain to review the terms they offer and how it might impact the profitability of the acquisition and your overall business. Ask what collateral requirements the lender must have, projected closing costs, or if there is cash that must be placed in escrow. It is also important to know if there is a security position on your residence or the requirement for a personal guarantee. If your financial house is in good order, you will have the ability to negotiate terms with the lender as opposed to simply having to agree to their requirements.

The Asset Purchase Agreement

The asset purchase agreement is a legal agreement that conveys and dictates all terms, requirements, and rights of both parties. Work with a knowledgeable consultant and securities attorney to ensure the details of the transaction and your legal protections are covered. The asset purchase agreement clearly defines what is being sold, the purchase price, tax allocation, size of any down payment, as well as the method for the remaining balance to be paid to the seller. The agreement also outlines the seller's involvement and responsibilities post-closing and any methodology for a clawback adjustment to the purchase price.

Client Communication

Communicating with clients that they have a new financial advisor or firm because of the recent transaction may come as a surprise to them, depending on the level of pre-transaction communication from the seller. Change is hard and for a client that has been working with the same advisor for many years to learn they have a new primary point of contact could prove too big of a change. The development of a communication plan during the negotiation phase with the seller followed by proper execution of the plan post-sale is crucial.

During due diligence, identify the top 10 clients and the clients that comprise the top 20 percent of revenue. Talk with the seller about these clients – what are their likes, how do they prefer to communicate, what are their goals, etc. Craft a plan to secure in-person meetings with top clients as soon after the sale date as possible. For the remaining clients, consider hosting an open house and paperwork party where you and the seller meet clients, discuss the transaction, and complete any necessary paperwork to officially transition the clients to you.

Similarly, prior to the closing date, communicate with your broker-dealer or custodian about paperwork requirements and the timing of client transitions. Keep in mind moving the clients over will require hard work, but cementing these client relationships will allow for the long term success of the acquisition.

Acquisition is a hard game, but careful planning, dedication, high levels of communication, and partnering with the proper buy side consultant can significantly raise your odds for a successful transaction. To further better your odds, commit to these key points:

Stand out from the crowd.

Be able to clearly articulate what your desired acquisition looks like as well as what type of business you are not seeking to buy. Further your chances by working with your product wholesalers, broker-dealer, and other centers of influence.

Understand how the valuation works.

Though it may best serve you to work with a professional versed in the valuation and negotiation, it is important to understand the primary factors in a higher or lower valuation such as client age, asset concentration, and profitability.

Be flexible in negotiations – to a point.

Enter into negotiations knowing the price, time, and protections you are willing to give on and which you are not. Be willing to walk away if the seller's demands significantly impact the long term opportunity for your success. Make certain the seller is as committed to the success of the transaction as you are.

Have your financial house in order.

Have your financing pre-approved or in the works prior to committing to an acquisition. Have your tax returns and financial statements in order. Be able to articulate to the lender your revenue, expense centers, and your plans for future growth.

Capture it in one place.

The asset purchase agreement cements the transaction and makes the acquisition official. Work with an experienced and knowledgeable consultant and securities attorney to ensure the document correctly captures the essence of the transaction and provides all necessary legal protections.

Communication is key.

The clients are the most important aspect of a transaction. Failure to secure their buy-in can quickly lead to a troubled acquisition. Prior to closing day, have a plan in place to meet with top clients as soon as possible. Host events for the remaining clients to meet you and complete paperwork to finalize the transition. Recognize and embrace the work that needs to be done and commit to it.

About Cambridge

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Selective advisors choose Cambridge.
Contact us (TheFeeExperts@cir2.com) at 877-688-2369.

Cambridge Investment Research, Inc.
1776 Pleasant Plain Road | Fairfield, Iowa 52556
877-688-2369 | www.JoinCambridge.com