Ameriprise Financial

Deal structuring and succession trends for advisors

Succession planning and growth through acquisition have become increasingly popular topics for financial advisors over the last decade. With the average advisor age hovering around 55 years old, it should come as no surprise that independent advisors, acting as the CEOs of their companies, are interested in learning more about the opportunities associated with exit and acquisition planning.

Succession/Exit planning for advisors is about more than just selling a business and extracting value at the end of a career. It is about building a plan to ensure the continuation of your business, ensuring clients are taken care of, and that you are able to begin working less when you want/need to while maintaining an income stream. Value and deal structuring are always considerations in a well thought out succession plan, but the real focus for most advisors is creating a plan that ensures their clients are well taken care of as they retire. Whether that plan is with an internal succession (i.e. an employee, junior associate, etc.) or with a peer, the motivation for creating a plan is generally the same.

What has changed dramatically over the years is how advisor businesses are bought and sold (for practices with less than $5 million in annual sales). Ten years ago, your options were to list and sell your book, or hold on to it and retire through gradual attrition. Today, you have a number of alternatives depending on your time line, business, and goals. This stems from advisors planning farther in advance for a transition, as well as a generally more informed group of buyers that understand the value of these businesses. An advisors retirement may occur on a specified date that is months or years in the future, or for many it may occur gradually over a span of years. Advisors looking to sell their business in today's market have a host of great options for realizing their value and ensuring clients end up with the right successor/buyer.

Deal Structures

There are a number of ways to put a deal together between a "retiring" advisor and their buyer. The appropriate successor/buyer, final deal structure and value is largely a function of the seller's needs and wants given the current market conditions. The traditional sale, where a seller transitions their business to a buyer over the course of 6 to 12 months is still common, but the new trend in the industry is longer term transitions where both the buyer and seller work collaboratively for 3 to 5 years after the sale has occurred. There is also a rising trend towards internal succession planning, though the limited financing options and lack of capital from an internal buyer have mitigated much of the interest in this option. Given this variability, it is important to understand both the quantitative elements of structuring a deal (price, terms, taxes, time line) as well as the qualitative elements

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(relationship management, seller emotions, role transition, etc.). The following is a short list of common strategies frequently used by advisors:

Traditional Sale

The "traditional sale" involves a seller that wants to sell their entire book of business immediately, then transition the relationships to a buyer over the course of the next 6 to 18 months after the deal has been closed and down payment made. Common deal terms involve approximately 15% to 40% cash down payment depending on the quality or riskiness of the business. The term "Low Risk" practice is generally used to refer to businesses with a long client tenure, mostly recurring revenue sources, annual growth of 5%+, and a well diversified range of client ages. The balance of the sale price after the down payment is financed by the seller either on a promissory note, flexible note, or earn-out/work-out arrangement with payments typically over 3 to 5 years depending on the role of the seller in the purchaser's practice. Average values range from 1.0 to 3.5 times the seller's trailing 12 months revenue depending on the revenue sources, client age, location, and a variety of other factors.

Partial Book Sale

These deals are typically less complicated for all parties when completed within the same broker dealer and involve a longer post-closing relationship between the parties given the seller's intent to remain active in the industry.

Like the Traditional Sale but this model involves a seller transitioning only a portion of their business while the seller remains active and services the balance of the accounts not sold. These deals typically involve a longer post-closing relationship between the parties given the seller's intent to remain active in the industry. It is common that a seller would sell their "B" and "C" level clients as a way to monetize their business and allows them to judge the success/failure of the deal before transitioning their "A" clients to the buyer. These deals tend to be smaller in size and often must be sold with the same broker-dealer network if the seller has such an affiliation. Partial books sales are a popular, and simple, way to transition a business to a junior associate.

Sell and Stay

An increasingly popular exit strategy for many sellers, the Sell and Stay strategy involves the advisor selling their entire business with an ongoing contract with the buyer for client servicing. This model provides the seller with a down payment at closing, typically in the range of 20% to 30%, an employment contract for part-time client servicing for 1 to 3 years (or longer in some cases), and the balance on a promissory (typically accruing interest during the employment period with payments due upon the expiration/termination of the employment arrangement).

This model is also commonly referred to as a merger by many selling advisors. Values vary widely for these deals but generally involve less contingent financing (which is better for the seller) and higher multiples when the total compensation package is calculated (i.e. the payment for the business plus the value of the consulting/employment agreement).

Internal Succession

Internal succession planning is a transition to someone within the seller's organization, including a team member, junior associate, employee, or family member. These deals usually involve little to no down payment, longer term financing, and extended transition periods where the founder/seller(s) slowly sells interest to the successor(s) often spanning no less than 10 years from the start of the plan to the eventual retirement of the founder(s). Internal transitions are beginning to occur more frequently for small-cap advisory practices (those generating less than $5 million in annual gross revenue) but are typically limited due to a generally lack of preparedness and lack of capital. However, when financed by the exiting owner on a series of successive notes each spanning a period of 5 to 7 years (typically paid by the successor from their salary and distributions/profits they receive as an owner), these deals can provide fixed income to a retiring advisors for a 10 to 20 years.

Values

The value of a financial services practice is typically represented in the form of a gross revenue multiple, based off of market comparable sales. The industry relies on multiples of gross revenue (as opposed to multiples of earnings) because the majority of advisors sell just their book of business with the buyer integrating the clients into their existing infrastructure. Therefore, the seller's overhead and profitability in most deals is not relevant. However, in some cases it may be more appropriate to base the estimate of value on a multiple of earnings or a more traditional discounted cash flows approach. For example, a sale to an internal successor, or buyer who plans to maintain the seller's current infrastructure, can consider a value based on the seller's current earnings. While a multiples or gross

revenue or earnings can provide an important foundation for comparative purposes, they should not be used as a basis for determining value.

The multiples of gross revenue are typically further divided into recurring and non-recurring multiples. Recurring multiples currently range typically from about 2.0 to 3.5 depending on the deal structure and quality of the business being sold. The range for non-recurring revenue is currently approximately 0.50 up to about 1.2. Internal deals tend to produce higher overall multiples, but are paid over an extended period of time, effectively making them comparable to the value from a sale to a peer. However, these internal deals tend to have higher retention rates and elongates the seller's transition. The range of values in the market vary widely based on three key factors:

- **Quality of the Business** — Factors like revenue sources, growth rates, client attrition rates, client demographics, and infrastructure drive value up or down;
- **Location** — The physical location of the business to be sold, as well as the network (broker-dealer, custodian, etc.) that the seller is a part of is very influential in the seller's ability to receive maximum value. Practices in large metropolitan regions have more successor candidates to chose from and therefore command higher values. Likewise, advisors that are affiliated with large broker-dealer or custodian networks often also receive higher values and have lower client attrition rates;
- **Deal Terms** — Whether a seller requires a large cash payment at closing, or is willing to finance a large portion of the balance on a debt instrument (i.e. promissory note) is one of the most influential value drivers.

Overall, the volume of selling advisors has steadily increased over the past decade which would generally cause values to decrease. However, buyer demand has kept pace. The surplus of buyers, combined with a seller population that is generally more prepared than seller's even five years ago, continues to drive values every year with no expectation of a decline in these growth rates.

About Succession Resource Group

Succession Resource Group helps advisors define the value of their business, acquire or merge, develop continuity plans in case of death or disability, as well as plan for and manage the transition of their business. Specialized in helping professional service providers, SRG is uniquely positioned to help advisors manage the value of their business with a clear understanding of the nuances of the financial services industry and intangible books of business. Founded by David Grau Jr., formerly a partner at FP Transitions, David has helped financial advisors, CPAs, insurance professionals, and other professional service providers for the last decade with their acquisition and succession planning needs and started SRG to provide personalized and customizable solutions. David and his team have assisted hundreds of advisors and other professional service providers buy, merge, sell, and craft their transition plan for the sale of their business, helping clients with businesses ranging in size from $100,000 gross receipts to in excess of $10 million.

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