What’s It Worth?
Buying a Financial Advisory Practice in a Seller’s Market

By Donald W. Patrick, CFP®

If you’re in the market to buy a financial planning practice, one overriding fact should inform your search: There are 30 to 50 interested buyers for every practice currently on the block. And with baby boomers starting to retire and the average age of advisors creeping up, growing by acquisition will be an increasingly popular strategy. Accordingly, in such a seller’s market, you must move quickly to determine the value of the practice you’re interested in. What’s more, should your bid be successful, you need a plan in place to integrate your two firms to maintain and enhance that value (see figure 1).

In today’s fragmented small business market, it can be difficult to know where to cast your net. Just more than four years ago when I bought a practice, I directed my search through FP Transitions, the nation’s largest and oldest succession, valuation, and acquisition consulting firm for the financial services industry. There, in clearinghouse fashion, sellers list practices and subscribing buyers can browse according to geographic areas—much like a dating service. Big picture, FP Transitions’ published record of transactions also provides potential buyers a reasonable idea of current market valuations.

Although valuation models for privately held independent financial services practices continue to evolve, two major valuation methodologies are most useful—and it’s the size of the firm that generally dictates which one to use. Today, the bulk of smaller practices sell on a multiple of recurring income. Qualitative judgment comes only in determining what multiple to apply (1–2 times revenue, etc.). Obviously, this valuation method is most useful for small firms where you intend to merge the seller’s client base directly into your cost structure. For larger practices with greater revenues, larger staff, and higher expenses, the more traditional...
Evaluating More than Numbers

Several firms provide valuation services, including FP Transitions and Moss Adams. FP Transitions’ Comprehensive Valuation System considers more than simple revenue multiples. It analyzes a broad range of parameters across three major indexes: transition risk, cash flow quality, and marketplace demand. The result is a clear picture of the value of the financial services practice, with supplemental information on how that value was derived, that illuminates the strengths and weaknesses of the practice.

**Transition risk.** FP Transitions’ post-closing data indicate that transition rates range from 85 percent of clients transferred to the high 90-percent range for well-structured transactions with low transition risk.

**Cash flow quality.** Cash flow quality depends on demographics, asset concentrations, the wealth index of the client base, as well as the expenses required to serve them. Growth components include strength of the referral base, past client acquisition rates, and whether the practice has a niche.

**Marketplace demand.** Marketplace demand is influenced by the type, size, and geographic location of the practice. Deal terms and financing duration also are considered to produce a final, realistic, market-generated value.

For instance, you might be evaluating a firm with an average price multiplier for nonrecurring revenue of one. However, digging deeper, you might note that the nonrecurring revenue comes from an insurance product or variable annuity where a commission is paid. While I question the wisdom of paying for revenue that doesn’t exist, there are exceptions. For example, we have some advisors who have developed valuable niche markets working with the local power company. Over 10–15 years, they’ve developed a very satisfied client base and know when these clients are retiring. I would pay for that. But it’s crucial not to accept this supplemental information at face value. Rather, relate the information to the valuation itself. For example, if the average age of clients is 67, that’s a depleting asset that would decrease the value of the practice.

Because the list of factors to consider is long, and the timeline likely will be tight, a written due diligence process for vetting potential acquisi-

### TABLE 1: CONSIDERATIONS THAT AFFECT VALUATION MULTIPLES

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### Client Analysis

- Determine net income after all expenses and then apply a multiple makes the most sense (see table 1).
- Gross revenue multiples—the industry’s rules of thumb—have oversimplified the complexity and diversity of practice models, thus overvaluing some practices while grossly undervaluing others. Traditional valuation methods, such as income and asset approaches, ignore many subtleties involved in evaluating a practice, such as the transition risk or demographics of the client base.

### Practice Analysis

- Technology capabilities
- Established referral channels
- Revenue mix and growth rate
- Projected growth of fee-based income
- Expense structure
- Client delivery
- Client retention

Managing the Integration

It was no surprise that determining the value and settling on a price didn’t get us even halfway to fully integrating our two firms. Indeed, the task was complicated by the fact that one-third of the new firm’s clients were in a city several hundred miles away. In prepar-

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Clients universally perceived that our firm provided them with an upgrade in image, services, and product offerings. The key to that success was the seller, who was willing to work hard and make the integration happen.

I’d note, too, that the energy and support of my staff was critical as we worked on work flows. Many advisors are terrible business people and view managing staff as secondary to integrating clients. Working with staff, however, will help achieve integration.

Finally, I had some valuable outside support. FP Transitions provided some negotiation help. My broker–dealer, Securities America, provided practice succession and transition support. Securities America initially simply partnered with FP Transitions but now has a dedicated continuity acquisitions program; they provide coaching programs for buyers and sellers as well as transition support.

Looking Ahead

Interestingly, looking for a practice to buy illuminated an unmet need in my own practice—a response to that question all clients have but few ask: What’s going to happen to me if something happens to you? The solution is a continuity agreement, and it varies with the size and type of practice and may include provisions for one advisor to purchase the practice if the owner becomes unable to run the firm or decides to retire. Advisors tend to put these things off, just as clients do, but it’s so critical to have a continuity plan in place in the event of death or disability. In fact, the Financial Industry Regulatory Authority allows a surviving spouse to receive revenues from a practice that is sold if there is a written agreement. Therefore, I made a concerted effort in our consortium to ensure that all the advisors had continuity agreements in place. It took two years to complete, but now their valuable businesses and strong client bases are protected.

Looking ahead, I expect the sellers’ market to continue. And that makes it all the more essential to conduct thorough due diligence, employ an appropriate valuation measure, and establish a framework for practice integration.

With one successful acquisition under my belt, I’m always looking for new acquisition opportunities. Buying a practice is a great investment because it offers a good return and you have control over it—something that’s especially attractive in this market.

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