SELLING YOUR PRACTICE

ONE CHANCE TO DO IT RIGHT

The decision to sell a financial services practice is a difficult one for any advisor to make. After a lifetime of work to build your business, and after years of earning your clients' trust, how do you turn the job over to someone else? Will they work as hard as you have? Will they care as much as you do? Will they always put your clients' interests first?

When selling your practice, you get just one chance to do it right. The following case study provides some unique insights into the process and illustrates the opportunities, and the mistakes, that many first time sellers make:

Early in the fall of 2013, an advisor whom we'll call James decided it might be time to sell his independent financial services practice. After many years of living and working in the Chicago area, James and his wife wanted to relocate to be closer to their grown children and their young families, and at age 63, it just seemed like it was time to finally slow down and do something else.

James owned a fee-based practice with more than 75% of his revenue from fees or trails, and the rest in the form of commissions or hourly planning work. His total revenue of about $475,000 per year was stable, but not really growing much from one year to the next. James waded into the selling process on an informal basis, giving himself time to get used to the idea and to see what interest there was in what he'd built. He told a handful of friends and colleagues and even one of his favorite wholesalers, and it wasn't long before he received several calls from advisors who wanted to discuss buying his practice – the word was out!

On the one hand, James was excited to know that someone wanted what he'd spent a life working on; on the other hand, he was feeling a bit disconcerted – he had no real plan for how to go about the process, and he had never had his practice formally valued. There seemed to be plenty of anecdotal information available from his friends and colleagues, though everyone had a different take on how to be successful in the process.

James was surprised when he received a couple of "handshake offers" from the first two advisors he met with. Instead of spending time to see if there was a good match, the advisors were very eager to get the deal done and sort out the client details and concerns later. The offers he received relied on a multiple of 2.0 times trailing twelve months gross revenue for the fees and trails, with the non-recurring income ignored completely. The deals seemed to be structured in a very simple and straightforward manner. In fact, one buyer handed him a standardized, 2 ½ page revenue sharing agreement and offered to sign it on the spot.

Simply put, the buyers proposed paying to James somewhere around 50% of everything they made from the list of acquired clients for up to four years. The more they made, they argued, the more James would make, and if he chose, he could stay licensed and work in the background and provide support and new client referrals for as long as he'd like. A fair transaction to be sure, they argued, and with James always in the background, the clients would likely stay as well. These experienced buyers had bought many practices this way and they assured James that "this is the way it is done in this industry."

But James wasn't so sure and he started to do a lot more thinking. Something just didn't seem right. After talking to his CPA, he found that the revenue sharing format would result in his receiving payments at ordinary income tax rates. He also realized that the buyers had no up-front payment and basically had no real obligation other than to do their best. But those weren't the issues that were nagging at James the most. The buyers didn't seem like a great match, and they didn't really seem to care. This wasn't how James was envisioning the process would work, or should work. It seemed like he was taking all the risk. He felt like he was working to give away his practice.

After a couple of months of worrying and more thinking, James called FP Transitions for help. The first thing FP Transitions did was to perform a formal practice valuation of James' practice. James was pleasantly surprised when his value was determined to be $1,083,000. In addition, James learned that the valuation process took into account the deal terms and the tax structure common and necessary to support that value proposition – something he hadn't really thought about prior to receiving the two quick offers earlier. The deal terms suggested for this transaction based on the determined value were 30% cash down, with most of the money received at long term capital gains tax rates over about 3 to 4 years, and with no earn-out arrangement.

James also learned that the process involved a confidential, but very broad search designed to provide him with an advisor/buyer who was the best possible match for his client base. With an average buyer to seller ratio of 50 to 1, James felt assured that he would find the one perfect match in that group – and worst case scenario if he didn't was that his listing was confidential and he would remain behind the scenes unless and until he decided to work directly with the small group of best qualified candidates. James listed his practice and here is how the transaction unfolded:

WEEK 1

95 buyers inquired through a confidential listing process. The list was narrowed down to the best group of experienced and prepared buyers. Confidentiality Agreements were obtained from this group.

WEEK 3

James called and spoke with each of the qualified buyers. The buyers were provided with a Letter of Intent template to create consistency in the offer process. By the end of week three, James had received 5 full price offers each with different terms (such as the size of the down payment, length of seller financing, interest rate, etc.).

WEEK 4

After additional calls and limited due diligence, James signed one of the offers – interestingly, it was not the highest offer he received. James instead focused on the best match, and was convinced that he had found the right person. He did not counter the offer because it was a full price offer and the terms were as suggested in the listing. Two of the other buyers asked to remain in back up position.

WEEK 5-6

During this due diligence period, the buyer and seller exchanged financial information, reports, and various materials and information as listed on FP Transitions' Due Diligence Checklist. The parties met at each other's offices, and met with staff members. They had dinner to introduce their families to each other and, in general, became very comfortable with each other.

WEEK 7-8

A complete contract package was delivered to support this specific transaction. Each side spotted a couple of issues in the paperwork process that they had not thought of or discussed. After some light negotiation and discussion, they came to a quick agreement on all major issues and asked their attorneys to review the completed documents. Both sides were satisfied with a fair deal.

WEEK 9

Transaction was closed and the post-closing transition period commenced, according to plan.

WEEK 25

We checked in with the seller and buyer – both responded very positively. The transition was going smoothly and all were happy. All but a few of the clients had transitioned and they were still in the meeting and transition process, but agreed they were on track for a 95-96% client retention rate, and enjoyed the possibility of several new client referrals from the clients they had met with.

This is a true account of one client's experience. And, in our world, it is a weekly event. Since you only get to do this right one time, here are the four things that you need to focus on when selling your financial services practice:

STEP 1: DETERMINE THE VALUE OF YOUR PRACTICE

Independently owned financial service practices are often the single largest, most valuable asset that an advisor has in his or her personal portfolio. Don't make the mistake of guessing at the value you've built by applying a rule of thumb multiple – every practice is unique and demands a professional and experienced assessment. Skipping the formal valuation process nearly cost James $370,000.

Today, there is an extremely accurate and affordable way of valuing your business. Using a method developed specifically for financial service practices, FP Transitions' Comprehensive Valuation is the industry's best selling valuation with over 5,100 satisfied advisors, and counting.

STEP 2: FIND THE BEST MATCH

Currently, the FP Transitions' open-market system yields, on average, a 50-to-1 buyer-to-seller ratio. What does this mean for you? It means choice. It means you can focus on the "best match" for your clients; find the one person or firm, in the right location, that can replace you and earn the level of client trust you've enjoyed. It means that your succession plan will work for you and your family, as well as for your clients and their families, and even your staff.

Finding the best match in an outside third-party buyer is the goal. At FP Transitions, we make that goal a reality. You can rely on a proven system, a track record of excellence, and the best contract support in the industry to help you quickly and efficiently close the deal and transition the clients.

STEP 3: STRUCTURE THE TRANSACTION PROPERLY AND PROFESSIONALLY

Mastering the dynamics of the deal structure is complicated, yet crucial. The first mistake that many sellers make when approaching a transaction is to focus on determining the purchase price without fully considering the underlying deal terms and tax implications. In the acquisition or sale of a professional services practice, value starts and stops with the terms of the deal – the amount of the down payment, the use of contingent financing (such as an earn-out or an adjustable note), the duration of the financing period, the tax allocation strategy, and the interest rate the seller will charge to finance the transaction. FP Transitions builds these factors into the valuation process and ensures fair compensation and consideration in the transaction.

STEP 4: SUCCESSFULLY TRANSITIONING YOUR CLIENTS

Successfully transitioning clients, assets, and staff members from one owner to the next is an essential step in the sales or acquisition process. Transferring the trust and loyalty of clients is best accomplished with a carefully coordinated transition plan. FP Transitions works with buyer, seller, and their respective support staffs to choreograph a thoughtful and professional hand-off of the trusting client relationships.

The methods that you will employ through our Post-Closing Transition Guide have been used by over a thousand advisors who have successfully sold or acquired practices while smoothly transferring clients, assets and staff members.

When you are ready to sell your business (or even a portion of it), FP Transitions' nationwide, confidential listing system can help you find the best successor and make a smooth transition. Your practice will be listed for sale in complete confidence. FP Transitions' consultants will provide non-advocacy support every step of the way helping you get the right deal closed quickly and efficiently.

Your practice is often a reflection of your life's work; make sure you think about the best transition possible for you and your clients. Be sure to assemble an experienced team and the proper tools to help you with the transition you envision for your practice.

FP Transitions is the nation's leading provider of equity management, valuation and succession planning services for the financial services industry. Based in Portland, Oregon, FP Transitions operates the largest open market for buying and selling financial service practices in the U.S.

Since opening its doors in 1999, FP Transitions has completed more financial service transactions than any investment banker or business-broker in the country. FP Transitions' expertise also includes continuity planning, practice benchmarking, compensation studies, entity formation, mergers and acquisitions, and equity compensation strategies.

4900 Meadows, Suite 300
Lake Oswego, OR 97035
p: 800.934.3303
f: 503.452.4205
www.fptransitions.com