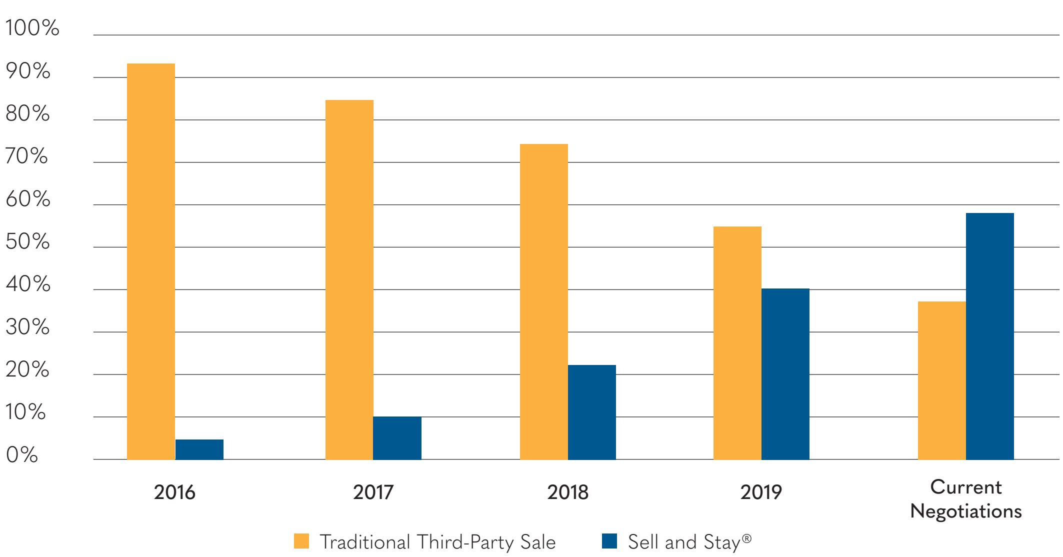
The Sell and Stay® Approach: A Diverse Deal Structure

Introduction

Just over two decades ago, FP Transitions launched the open-market concept for matching the best of many interested buyers with one particular seller and everything changed. Exit planning became a viable, valuable, end of career strategy. But many advisors near retirement age aren't ready for an "end of career" event. For the love of the work, these advisors have evaded the marketplace, yet even the most stalwart entrepreneur can be tempted by the allure of retirement: more time, fewer burdens, and for many, the reward of liquidating your largest personal asset. In spite of the benefits, the idea of retirement—full stop—is too much of a good thing. Faced with these challenges, the marketplace has continued to evolve as buyers have become more resourceful, creative, and aggressive.

Over the past several years, we've seen transactions move into a new area in terms of exit planning—a direction that bears further study and consideration, especially by every practice owner thinking about their own exit plan in the next five or so years.

SELL AND STAY® FREQUENCY



The Sell and Stay® Approach

Simply stated, the Sell and Stay® approach melds the best attributes of a succession plan, a merger, a liquidity event, and ongoing employment income, with a competitive third-party sale and value. In this regard, it has no equal. FP Transitions created this unique approach, figuring out everything from the cash flow models to tax structures to legal documents. It hasn't been an easy or clear path. Recently the process has been bolstered by larger, stronger, more flexible buyers reacting to the increased demand for selling advisors who are willing and capable of working for a few more years.

The Sell and Stay® strategy initially referred to a very limited number of transactions in which a seller executed a Purchase and Sale Agreement with a buyer, acquiring his or her assets, cash flow, and practice relationships inexchange for a down payment and a seller-financed promissory note. Then, following the sale, the seller and key staff members remained, often under formal agreements, and worked for the larger buyer's business for a period of three to five years—sometimes more, sometimes less. Once the seller fully and formally retired and the compensation arrangement came to an end, the note payments began and were paid out over time at long-term capital gains tax rates, with interest.

As buyers began to acquire larger and more valuable fee-based practices, the deal structures needed a more sophisticated approach and the Sell and Stay® model found its place in the M&A arena; today it is commonplace for transactions valued at around $2.0 million or more. Each Sell and Stay® transaction is unique in that there is no standard set of deal terms—every transaction is customized to fit the situation at hand, making them both lucrative and challenging.

This approach is ideal for owners who are looking to retire in the next five years but do not have an internal successor or succession team in place ready to take over the practice within that time frame. The Sell and Stay® approach allows a business owner to hand over the reins to a suitable third-party buyer, but to elongate their retirement horizon through a continued engagement with the acquiring firm. A commonly structured third-party asset sale happens in short-order with the sale completed in approximately 90 days and the seller fully retired six to twelve months later. Conversely, a statutory merger blends the two parties together but almost requires them to work side-by-side for seven or more years to justify their respective investments and equity interests and to take advantage of the synergistic effects. The Sell and Stay® approach falls somewhere in between and can be easily adjusted to fit the circumstances of the transaction and the participants' needs.

SELLER'S POST-CLOSING INVOLVEMENT IN YEARS

In many situations where the Sell and Stay® strategy is used, the acquiring firm immediately takes over compliance, back-office, HR and IT functions, and the overall day-to-day operational and payroll aspects of the business. The selling practice owner is freed up to focus on servicing his or her clients and gradually transitioning those clients over to another advisor or advisory team. The seller can also spend time marketing to new clients and building up AUM. This approach offers selling owners a glide path to retirement, allowing them to de-risk their equity position and to decrease their workload at their own pace over time instead of quitting abruptly and prematurely.

For buyers, the benefits of a Sell and Stay® transaction often include economies of scale and a turn-key operation. This approach can support a buyer's growth strategy by acquiring talented staff in addition to reducing training costs and preserving institutional knowledge. The benefits of this structure extend beyond the buyer to the acquired client base as well, as the gradual transition provides greater continuity of service.

The Challenges

The goal of finding the best match between the buyer and seller may seem obvious, but if the seller is going to stay and work for the buyer for years afterwards, best match is really just the starting point. This is why it is vital to have a competitive buying process that requires buyers to audition for the right to become your successor. That letter you received in the mail might have been sent by the one best buyer you could hope for, but being able to select the best out of 85 or more auditioning buyers replaces hope with clarity.

Second, a business valuation doesn't cover all the ground necessary in a Sell and Stay® transaction. This is why having a team of analysts whose work supports the buyer *and* seller is so critical. An analytics team experienced with these types of transactions can do the math—starting with the valuation results—then help both sides figure out what is feasible, on an after-tax basis, with an ongoing employment arrangement. The analysis maps out the financial future of the transaction, considering client retention and anticipated growth, with the seller's value reflected in cash flow over time. Sometimes the answer lies between the lines of a spreadsheet.

Third, the Sell and Stay® strategy creates some additional challenges in valuing and negotiating the ongoing employment relationship, apart from the value of the practice being acquired. Utilizing experienced, non-advocacy mediation to help address such issues is key. The Sell and Stay® process has to work for everyone, as the parties that walk away from the closing table are going to be working with each other the next morning as colleagues. The fight-to-the-finish approach just doesn't work in these situations.

Finally, not all of these deals make it to the finish line. FP Transitions has a unique system in which it earns a success fee only if the transaction closes. In addition, by splitting the success fee between the buyer and seller, the seller essentially pays the lowest fee of any matchmaker in this industry. Built into this success fee is the cost of a complete and coordinated team.

The Sell and Stay® model is a more sophisticated transaction structure; it is not as easy as selling and walking away. But the challenges, once overcome, inevitably lead to the most lucrative selling opportunity we've seen in over two decades of deal making.

Considering the Economic Picture of a Sell and Stay®

There is no selling scenario that can compete, financially, with your coming to work every day and putting in the time and effort to grow your own business. Even though financial advisors have one of the most valuable professional services models in America, an exit plan is not a windfall. If you love what you do, if you have the energy and the ambition to go to work every day, and you'd like to keep earning a good living from a recurring, fee-based model—keep doing it.

A Sell and Stay® approach should be considered by those practice owners who want to slow down, or by those who have already started to slow down and are within five to seven years of calling it a day. It is an option for those owners who no longer enjoy running a business, hiring and training staff members, or dealing with regulators and regulations. It is an option for those owners who want to keep working, albeit a bit less, and de-risk their equity value by taking it off the table—or at least substantially so.
In terms of the numbers, let's compare the Sell and Stay® approach with the typical traditional sale, beginning with the latter. Selling what you've built to a

third party can and should be conducted with the open-market dynamics on full display. This is a seller's market; buyers should be forced to compete, and paying market value on excellent terms should be the standard every transaction is held to. If so, using a gross revenue multiple as a method of expression results in a valuation of approximately 2.3 to 2.7 times trailing 12 months revenue for most fee-only practices led by one primary advisor with $100M–$1B in AUM. Multiples are often around six to eight times adjusted annual earnings in an EBIT/EBITDA calculation. Down payments should be in the range of 30–50% with seller financing from two to ten years, depending on various factors. But there is a reason why 50 to 100 buyers still vie for the opportunity to acquire what you've built. And the reason is that buying a practice still pencils out—even at the above multiples.

Most market-based valuations look at the post-acquisition cash flow from the buyer's perspective and assume that the seller's salary and benefits package will come to an end when the deal is closed. This additional cash flow is absorbed into the buyer's ongoing operational structure along with the seller's clients and managed assets. The seller's expenses and liabilities are not usually acquired, and this positively affects the overall economics from the buyer's perspective. It is important to note that in a Sell and Stay® scenario, the seller and his or her staff's desired compensation and benefits post-acquisition may impact the acquisition price, but not always. Factors impacting the final purchase price and compensation package include the practice's cash flow and growth outlook, the pay-out period, the strength of the buyer in terms of cash flow, AUM, and value, among other things.

The seller's economic picture is enhanced by the Sell and Stay® process in that it provides liquidity, the receipt of market value at current long-term capital gains tax rates, and an ongoing compensation package. The deal may also have a meaningful upside, structured through an earn-out arrangement, adjustment mechanism, or other incentive compensation. Every transaction is customized to fit the needs and goals of the parties.

Conclusion

There comes a time in every advisor's career where thoughts of retiring begin to creep into the picture. It is hard for an entrepreneur to pick out a certain date, age, or level of achievement or practice value, and use that as the marker for calling it a day and handing off the responsibilities to someone else. The Sell and Stay® approach provides another option and the opportunity to reshape the final retirement picture. It also provides an important opportunity to lock in the value you've built over decades of work at a time when the M&A market is strong and robust.

If you're within five to seven years of a potential retirement decision, consider the options and take the opportunity to learn more. The Sell and Stay® strategy might well be the path your future takes.

A Complete Team to Support Success

Selling your practice can be a short-term plan or it can be the final step of a ten- to twenty-year plan. FP Transitions' role is often much greater than merely brokering and documenting the sales transaction. Our non-advocacy guidance champions the success of your deal for the good of all parties—owners, businesses, and clients alike.

Our business has been built to provide you with a coordinated team under one roof, all focused on this profession and its unique value proposition. At your disposal are experienced consultants to help you explore and assess the possibilities, including:

- The largest and most experienced valuation/appraisal team in the industry;
- Analysts and compensation specialists to help you map out the future in detail; and
- A legal team that knows the unique rules and regulations that you face every day.

Our entire team is focused on helping you implement your plan exactly as it was envisioned. That's a lot of talent on your side, and it is necessary in a highly regulated industry with valuable practice models dependent on the underlying client base and their needs. As a seller, you only get one chance to do this right. That's why we have 40 people on staff ready and waiting to help you get the job done right, on the first try.

Visit fptransitions.com or call 800.934.3303 for more information.