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The FP Transitions M&A Guide

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DAVID GRAU SR., JD

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To Oscar

Foreword

About 20 years ago, FP Transitions launched the open market concept for finding and matching the best of many interested and qualified buyers with one particular seller, confidentially, and everything changed.

Back then, we often introduced ourselves at speaking events around the country as "eHarmony for financial advisors," smiling as we said it. But today there is a 50-to-1 buyer-to-seller ratio. The high level of demand has resulted in not only a better value proposition for sellers, but also their ability to select the best of a large auditioning group of interested buyers to step in and take care of a loyal and trusting client base. That's turned out to be a great benefit for the entire industry—it has even increased the value of the buyers' practices as a result. Effectively, we empowered sellers to transfer their duties and responsibilities to someone else at the end of their career, and then created the systems and processes to help them do exactly that.

Fifteen years ago, we completed one of the first acquisitions in this industry that was funded entirely with an SBA-guaranteed bank loan, and today, we're working to help modernize and institutionalize the bank financing process that may yet again change the value proposition, and the payment structures, for an entire industry of independent owners. This could be a significant improvement in the mergers and acquisitions (M&A) space if together with our buyers and sellers we can make it work well from the clients' perspective.

Payment terms and tax structures in this industry have continued to improve as we honed our craft. We introduced the concept of a "shared-risk/shared-reward" payment structure to protect buyers and sellers, and to ensure that the post-closing "economic marriage" adequately supported cooperative and motivated parties to look after the clients who have always been the real focus of this M&A process. Ninety-five percent–plus long-term client retention rates and 2% default rates tell the rest of the story.

As we grew, our service offerings became broader because the business model we envisioned was expanding past what a small three- or four-person consulting practice could ever hope to offer. Like you, we wanted to make a difference. I was brought in about 10 years ago based on my experience as the COO of an international business brokerage firm that had valued and sold more than 2,000 practices and businesses every year of all types, all over the world. Together, we put the wrenches and hammers to a stagnant M&A market and a valuation system that wasn't adapting or evolving very effectively, even as the independent industry changed all around it, and continues to do so.

Ten years ago, it was obvious that buyers and sellers were struggling with a valuation problem as they sought to measure what they'd built, or sought to acquire at market value, and to precisely determine their next steps. There was simply no affordable, accurate, and practical method by which to make a value calculation for M&A purposes. At one end of the valuation spectrum was a multiple of gross revenue (GRM), which worked just fine for very small books with transactional revenue sold through an earn-out arrangement, but not much else. At the other end of the valuation spectrum was a full appraisal, such as the discounted cash flow (DCF) method, which was perfect for a courtroom setting or large, multiowner firms. But at $5,000 to $50,000 per valuation, only the largest and most motivated sellers could afford, were interested in, or had need of, this respected academic approach.

The independent industry needed another choice, a better choice, so our first order of business was to create the Comprehensive Valuation Report, an accurate and affordable value calculation that relied on FP Transitions' large and growing private database of comparable, closed transactions—without which this approach would have no credibility. It's all about the data! After eight years of closings (at the time), we had the "comps" to do the job right. Eight thousand valuations later, the handwriting is on the wall, so to speak, and along the way, the industry vernacular began to regularly borrow our valuation terms like "cash flow quality" and "transition risk." Answering one simple question—What would a competitive, strategic buyer pay for a specific revenue stream given standard and reasonable payment terms?—made all the sense in the world to most of the entrepreneurs in this industry.

But as it turned out, not everyone wanted to sell. Many advisors enjoyed what they did and wanted to sustain their lifestyle practices for as long as possible. Some advisors even had the temerity to want to create a legacy model, to build an enduring and transferable business that could outlive them and serve their clients and their clients' children and grandchildren. So we launched the concept of "equity management" in a white paper published in 2008 by Pershing, LLC, and championed the term "continuity planning" as separate and distinct from "exit planning." The related terms "revenue-strength" and "enterprise-strength" that we first shared in our work with Fidelity in 2009 have become common parlance in describing how practices or businesses are built and structured.

Along the way, FP Transitions led the shift from using basic revenue-sharing agreements, to earn-out arrangements, to today's use of a more sophisticated performance-based promissory note structure. We shared our concepts and thinking with hundreds, maybe thousands of practice management personnel at the various independent broker-dealer (IBDs) and custodians, sometimes gratefully, sometimes not. It turns out that independence is often more important during the recruitment process than upon an advisor's retirement, but we're going to champion the cause of the independent selling owner because in the long run, that's what is best for the clients who support this industry.

A few years back, FP Transitions literally wrote the book on building an enduring business and formally defined "succession planning" for this unique group of professionals for the very first time. Every year, we now help to create hundreds of new, first-time, "30-year-old" owners who are investing their money and their careers to build on top of an existing practice—to form a "successor team." We coined the terms "G-1, G-2, and G-3" to set up a succession strategy for next-generation advisors. Our original work with many of the large IBDs and custodians led to terms and concepts that are now commonly used throughout the industry. To do all this, we led the use of entity structures to create a chassis that is designed to last, and to serve well beyond the founder's career—a cutting-edge strategy in this industry. That's exciting and important work. And we continue to push the boundaries every day in order to keep advisory practices thriving and serving their client base for generations to come.

As this book is sent to the publisher, we have 40 staff members whose skill-sets include five JDs (lawyers), two CVAs (Certified Valuation Analyst), one of whom has also earned the designations of an ASA (Accredited Senior Appraiser) and MCBA (Master Certified Business Appraiser), ABAR (Accredited in Business Appraisal Review by the Institute of Business Appraisers), and MAFF (Master Analyst in Financial Forensics), and a CFA (Certified Financial Analyst) with several more CFA candidates in the wings. We also have compliance and regulatory skills to augment these credentials, important in this highly regulated industry. And along the way, we're building our own enduring, multigenerational ownership structure.

Today, there is no question that an advisory practice has value, but it doesn't seem that long ago that they didn't. Yesterday, we argued with industry "experts" and "pundits" fighting to establish that an advisory practice had any value at all.

The M&A space for the independent financial services and advisory industry has come a long, long way in a very short time because of great ideas like these and because of a really smart group of financial advisors/entrepreneurs who seem determined and destined to lead the professional services ranks in terms of value, transaction terms, and satisfied clients. And together, we're only just getting started!

Brad Bueermann, CEO, FP Transitions

Preface

FOR SELLERS

Rule No. 1: You get only one chance to do this right.

In our experience, sellers tend to be at a distinct disadvantage in the M&A process. That might sound strange given that there is, and has been over the past 20 years or so, a strong seller's market in the financial services and advisory industry. With a 50+-to-1 buyer-to-seller ratio, how can sellers not have the upper hand? The fundamental truths are these: (1) buyers tend to be more skilled in the M&A process, and; (2) the deck is usually stacked against a seller.

Advisors can buy many times, but selling tends to happen just once in a career, and unfortunately it often happens without a solid plan and without accurate and reliable information upon which to base any plan. It is hard to master a concept that you get to do only one time, especially if you learn mostly by word of mouth. Sellers have the advantage of scarcity, but buyers have the advantage of being able to repeat the acquisition process over and over again until they get it right. Buyers also have the support of their broker-dealers and custodians, whose goals align much more closely with those who stay than those who leave. Sellers, please read that last sentence over and over again.

For all these reasons, sellers need to pay very careful attention to the strategies in this book. Sellers need to understand that, while in the "driver's seat," they are not in control unless and until they command the entire transition process, from valuation to listing to documentation to taxation to closing, and then being able to deliver the clients—an overall process that often starts at least three to five years before most advisors think it does. Too often, sellers sit in the driver's seat full of confidence, but fail to understand that they're actually sitting atop a car-carrier and being driven along by someone else who knows where they're going and what they're doing. Sellers, be mindful of where you get your information and who appears to be helping you. Free information is usually worth just that, but it can sometimes cost a fortune.

Being prepared means planning ahead and relying on accurate, occasionally blunt information and data sources; do not make the mistake of relying on stories told by advisors who have gone through the M&A process one time as a seller and came out relatively unscathed, or by a practice management person at your broker-dealer or custodian whose job it is to make sure your clients/assets aren't lost to a competing broker-dealer, no matter what. Learn the basic facts and decide for yourself—but do the math.

Finally, sellers have a duty to place their clients' financial futures in the hands of the best person they can find, not the first person to walk through the door. Selling to a friend or someone who makes the process seem so easy is tempting, but stop and ask yourself this question: Am I doing what is best for my clients? The advantage of a seller's market does not lie simply in higher values; it lies in being able to find the very best match for your trusting clients. The goal is to find the perfect buyer, the perfect advisor to take over, which, in the end, creates and supports a fair value proposition for all. Starting with a one-to-one buyer-to-seller ratio, though, is rarely, if ever, the best way to achieve that goal.

Rest assured that buyers are reading this same material and are studying the very systems and processes that you're now learning. That's okay. You can always choose to keep working, at your pace, and not sell. In fact, trading in your exit plan for a long-term succession plan is a great idea if you start early enough and have the time and energy. This book is designed to put you in control of your future and to level a playing field now dominated by buyers of independent financial advisory practices. A level playing field is good for your buyers, too! But sellers, you need a plan and you need to execute it in a professional and learned manner.

And no matter what you choose to do in the end, don't forget Rule No. 1.

FOR BUYERS

Rule No. 2: Do it right—the value and terms you agree to pay as a part of today's M&A activity will affect the value and terms you'll receive tomorrow.

There is a lot of competition to acquire a financial advisory practice. Recognizing that acquisition allows you to substantially increase the size of your practice or business in about 90 days, paying for at least two-thirds or more of the acquisition out of the acquired cash flow over the next three to five years, there should be no surprise that there is a 50-to-1 buyer-to-seller ratio. But this book isn't just about how to fight your way to the front of that long line of interested buyers—it is also about how to avoid that line altogether by planning ahead and knowing exactly what you're doing and how to get the job done correctly.

In this book, you'll learn the basics of acquisition, including the legal, regulatory, payment structures, and tax aspects of the process. You'll learn how to look at sellers in a different way and how to sculpt your offer to reflect what the seller is selling and how they've assembled the pieces. You'll learn that there is no one single, formulaic method by which to value, construct, and complete every acquisition. You'll learn that in some instances, using a multiple of revenue is a perfectly acceptable method for valuing the book you're buying, and in other cases, that's about the worst thing you could possibly do. It all depends on what you're buying, and how the seller is constructed.

You'll also learn the difference between cash flow and equity value. For those of you reading this book that came from or learned the most important lessons in your professional life from the wirehouse side of the industry, there is a difference. Cash flow is obviously important and, day to day, captures the attention of every practice owner. But if you're going to build a business, or acquire a practice (and there is a difference between a business and a practice), you'll need to master and implement the concept of equity. This book will help you understand what it means to build a practice versus a business versus a firm. As a buyer, you need to know the differences because a successful acquisition strategy will depend on it.

Buyers, this book will also help you *get ready* for the next acquisition opportunity. Being prepared doesn't mean being very excited and willing to jump into the ring on a moment's notice when an M&A bout is about to begin. It means planning and building and valuing your own business ahead of time. Smart sellers can tell the difference between a well-prepared buyer and a mildly interested participant who thinks they can figure it out as they go and prevail through good intentions, enthusiasm, and even force of will.

Understand this simple fact: larger, stronger, durable businesses tend to acquire smaller, one-generational practices, books, or jobs. Where do you fit in this food chain? You need to know how things work in this industry and you need a strategy to succeed if you're serious about building a business designed for the sudden and explosive growth that accompanies an acquisition strategy. Your broker-dealer or custodian will gladly support your efforts to acquire and retain the clients and assets of every seller in their network. But will they help you first build a business model specifically designed for this purpose?

Today, you're the buyer. One day, too soon, you'll be the seller and will be dependent on the marketplace and values you're helping to develop, even the network you're working within. Plan and execute accordingly.

Acknowledgments

Writing a book is hard work. Most people probably intuitively understand that aspect of the process, but few have firsthand knowledge of what it actually takes—and the many people whose inputs and guidance are invaluable.

Of the many contributors, first, thanks must go to the clients who let us assist them, building and reshaping their practices, and sometimes calling it a day and selling or merging what they'd spent a lifetime building. The daily contact and connection with independent advisors, young and old, building and/or selling, is the lifeblood of a book like this. Not a night went by in the year of writing it that something learned by day didn't make its way into the manuscript. This daily connection is what separates a book based on theory and a book based on fact and observation—our goal has clearly been the latter.

The downside of writing through such a connection, on top of a day job, is that the book writing is mostly done at nights and on weekends, and that is why (along with three complete drafts) it took so long to complete. My wife, Penny, gave up all those weekends and gave me the endless quiet time to do what I needed to do. I'd like to say that she knew what she was getting into when she married an English major who became a lawyer who became a businessman who yearned to write, but most of us don't plan that far in advance. We just make the best of the world we find ourselves in the midst of, and she has done that without complaint.

I also had a great business team without whom this book would not exist. My longtime business partner and our company's CEO, Brad Bueermann, guided gently and patiently, telling me the truth whether I wanted to hear it or not. Laura Bueermann served as my personal editor and labored through draft after draft with me. It turns out that Stanford people are really smart. Laura saw things that I didn't and had the ability to add that one perfect word or two to each sentence and paragraph she touched, and the book is the better for it.

FP Transitions' valuation experts, Warren Burkholder, ASA, MCBA, ABAR, MAFF, CVA, and Ryan Grau, CVA, were incredible in helping shape the text and the messages in Chapters 2 and 3 on value and valuation, the most difficult chapters in this book to write. Eric Leeper, CFA, helped me think through the logic of various sections and double-checked the math throughout. As an English major, I have a lot of respect for our team of math majors.

Jeanie O'Reilly Northcutt, our longtime Listings Director, and Aaron Wells, Transactions Coordinator, serve as the anchors of our transactions section and helped maintain a steady flow of information from the daily activity of our buyers and sellers and contributed to the accuracy and strength of Chapters 5 and 6.

FP Transitions has assembled its own law firm over the years, and Rod Boutin, JD, our General Counsel, and Ericka Langone, JD, Assistant General Counsel, both contributed to the final draft, making sure that all the "t's" were crossed and the "i's" dotted. Rod and his entire team, in particular, helped shape Chapters 8, 9, and 10 and the forms in the Appendix.

Christine Sjolin, our Operations Manager, and Marcus Hagood, our head of EMS (our Equity Management System), each applied their special and gentle touches to various sections and helped keep me on track as earlier drafts occasionally wandered a bit . . . or a lot.

And last but not least, our marketing department, comprised of Elise Rogers, Marketing Director, Rachel Beckwith, Senior Marketing Strategist, and Alex Moan, Video Marketing Specialist, gets credit for everything artistic about this book from the cover to the graphs and illustrations.

Building a great business is about surrounding yourself with great people, and in that I have certainly succeeded. I am honored to work with those listed here as well as all of our many loyal and hardworking staff members every day of the week.

Praise for *Buying, Selling, and Valuing Financial Practices*

David Grau Sr. has been listening attentively and working effectively with financial advisors since founding FP Transitions. This book reflects his profound understanding of our profession and what it requires to exit one's business with purpose, clarity, and effectiveness. Just as we don't believe there is a one-size-fits-all approach to financial planning, David does not believe there is only one way to approach your exit plan, and *that* is what sets him apart. The sooner you read the book the better.

Elizabeth Jetton, CFP®, Former President of the FPA; Cofounder, TurningPoint Vision

As the leader of one of America's largest independent advisor groups, I have known David Grau Sr. and FP Transitions for the better part of 15 years. I have great respect for their vision, knowledge, and insight into the world of practice mergers and acquisitions. Once again, David Sr. and FP Transitions have published a book that every advisor should read.

At some point, every advisor will either be a buyer or a seller. This clear, practical, and expertly written book will help tremendously no matter what side of the table you are on. While reading the book alone will not prepare you for the complexity of constructing a thorough and appropriate deal, it is the best first step.

Bill J. Williams, Executive Vice President, Ameriprise Financial

David Grau Sr. and FP Transitions have written the consummate M&A guide for the financial services profession. Coupled with their first book on succession planning and building a sustainable business, this second book provides advisors with a set of bookends that provide a range of great options as advisors consider their future and plan accordingly. Advisors interested in buying, selling, or merging their practices now have a clear road map for developing and executing their plans. This is a practical, step-by-step guide that provides detailed insights on value and valuation, due diligence and documentation, even the financial tools for executing an M&A strategy such as acquisition loans and acceleration options. A must-read for those committed to mastering the process of buying, selling, or merging an advisory practice!

Chip Mahan, Founder and Chairman, Live Oak Bank

David Grau Sr. has written yet another outstanding book. He has a unique way of taking ideas that typically scare investment professionals away and capture their attention. So many in our industry wait until it is too late to develop succession plans and/or exit strategies. Grau does a great job of being blunt to get a professional's attention and then thoroughly educating them as to what they should consider doing. Succession planning, exit strategies, and M&A work is a detailed, thoughtful exercise. This book gives a professional the tools, language, and knowledge to begin the dive into that process.

Chris McAlpin, Senior Advisor, MBA, CMFC,
Sound Financial Strategies Group Inc.

David Grau Sr. and FP Transitions comprise one of the advisor industry's most skilled and sought-after matchmakers, bringing buyers and sellers together for more than two decades. In his new book, *Buying, Selling, and Valuing Financial Practices*, David manages to take the complex and often intimidating topic of mergers and acquisitions and deliver a powerful, yet simplified guide for advisors at every stage in their businesses. Whether in the market to acquire or sell a practice, advisors will benefit from David's insights on the buying basics, valuation fundamentals, and making the deal.

TD Ameritrade Institutional has worked with David and FP Transitions for more than a decade, and we've seen advisors put these ideas into action with great success. David goes beyond theory and provides advisors with a proven process and methods that have been tested in the trenches. This book is a must-read for any advisor who has ever said to themselves, "I know I need an exit strategy and I want to do what's best for my clients, but I don't know where to start."

Tom Nally, President, TD Ameritrade Institutional

The ability for financial advisors to successfully sell or transition their business (arguably their largest financial asset) is a huge challenge that the industry faces. Rather than just admiring this issue, David Grau Sr. and FP Transitions have evaluated the different causes of this problem and identified how advisors can apply these findings and solutions to their own firms, while recognizing that there's no one-size-fits-all approach to buying, selling, or valuing a financial practice.

Wayne Withrow, Executive Vice President,
Head of SEI Advisor Network

The "go-to playbook" for financial services professionals who are looking to grow through M&A activity.

John W. Smith, ChFC®, CLU®, CASL®, MBA, Managing Partner, Cardinal Pointe Financial Group

This book describes everything you need to know for buying, selling, and valuing an advisory practice. A powerful read with many tools.

Jonathon L. Myers, CFP®, ChFC®, CLTC, MBA, CASL®, Private Wealth Advisor, Jon L. Myers and Associates

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