



Executive White Paper

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## **Mergers & Acquisitions for Financial Advisory Practices “Navigating the Age Wave”**



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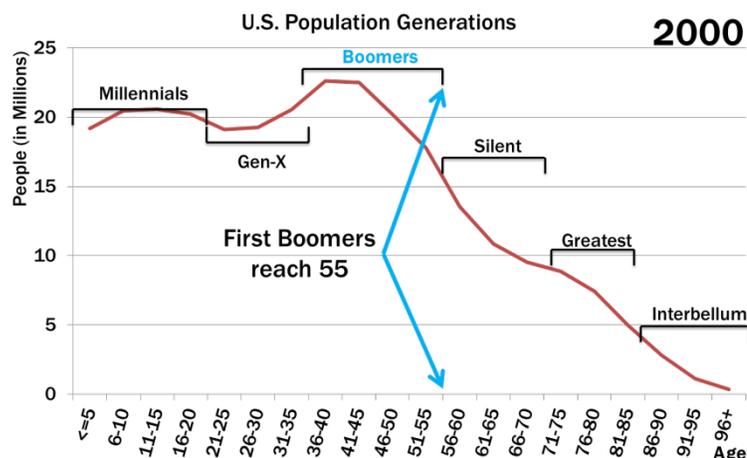
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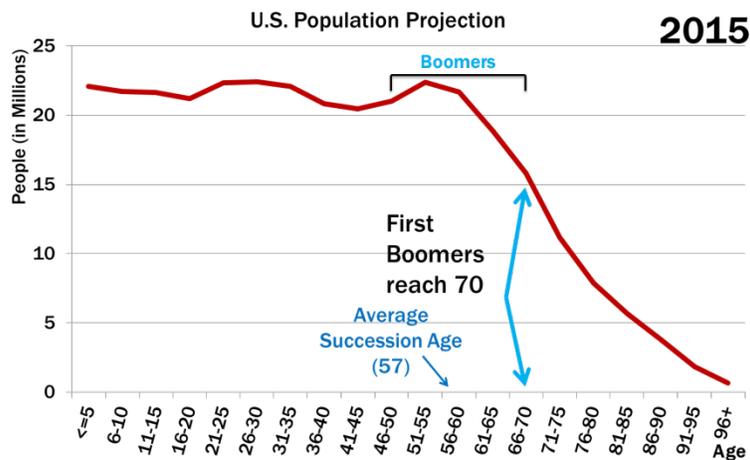
The Mergers and Acquisitions market is entering a 15-year period that is unprecedented in our lifetime. The “Age Wave”, a term coined by Ken Dychtwald, Ph.D and his book of the same title, refers to the aging of the Baby Boomer generation and how it is the most important trend of our time. Without doubt, it will influence succession planning for financial advisors looking to retire in the next 15 years and for advisors looking to acquire practices as a growth strategy during this time. It is estimated that as many as 40% of practices will change hands over the next 10 years. We are currently on the leading edge of this wave of business transfers with both opportunity and risk ahead of us. In this paper, we will examine the M&A market from the point of view of supply and demand (“Age Wave”) as well as current and future trends in practice value (equity); then we will look at the opportunity and risk in the M&A market for succession (sellers) and acquisition (buyers).

### The M&A Market: the “Age Wave”

Baby Boomers represent the generation born between 1946 and 1964. They were the largest generation in U.S. history, peaking at approximately 78 million in population. The majority of business owners are Baby Boomers and, by extension, the majority of owners of financial advisory practices. In fact, the average age of all financial advisors is approximately 56 years old. The following graph shows the relative population size of generations in the year 2000, when the first Baby Boomers reached the age of 55. You should also note the decline in population in Generation X following the Baby Boomers; keeping in mind the simple equation of supply and demand.

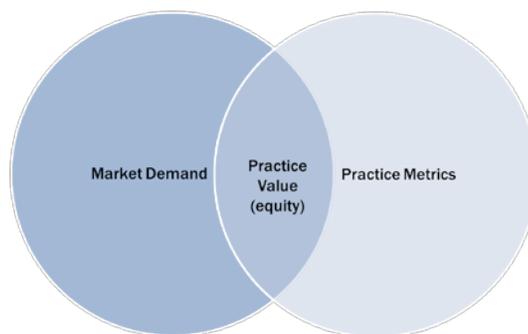


We fast forward 15 years in the following graph to 2015, less than a year from today, and the first Baby Boomers are reaching the age of 70. Note that the average age of a financial advisor’s succession is currently 57 years old. The front of the “Age Wave” is here, with the peak and an all-time record for business transfers expected to happen 6 years from now in the year 2020; with the “Age Wave” trend ending in 2030. This trend and timeframe effectively covers the succession window for the majority of financial advisors – “this is your market”.



### The M&A Market: current and future trends in practice value (equity)

As illustrated below, there are two elements that contribute to practice value (equity); market demand and the specific metrics of the practice.





For the majority of financial advisors, the equity in their practice is their largest personal asset. Moreover, financial advisors recently selling their practice have enjoyed a steady gain in practice value over the past 5 years. Multiple factors can influence valuation, from the stock market to interest rates; with simple supply and demand being the primary, external, market value driver. To date, buyers have kept pace with the recent increase in supply but it is only a matter of time (maybe 2 years) before supply and other factors slow or reverse the current increase in valuation. Overlay this trend onto the complicated dynamics of practice structure, resulting from future consolidation, and you have a scenario with both opportunity and risk.

In our attempts to predict the future, or at least the next 6 to 10 years, we can start by looking at a few of the key indicators in practice valuation. Below are the 2013 average metrics based upon Key Management Group's valuation benchmarks for all broker dealers:

- Multiple paid for **recurring revenue**: 2.475
- Multiple paid for **transactional revenue**: .90
- Ratio of **recurring revenue**: 80%
- **Down payment**: 25%
- **Length of financing**: 5 years
  - This metric has become complicated as a result of recent bank financing options and a shift away from seller financing
- Year over year **revenue (GDC) growth**: 12.71%
- **Asset velocity** (return on assets): .74
- **Net asset flows**: \$1,625,733
- **Advisor payout**: 85%
- **High value client age**: 66

As you consider both the market trends and practice metrics which drive the value of a financial advisory practice, keep in mind that it is a combination of the two (external and internal) and not necessarily weighted toward one or the other (i.e. revenue growth in a specific practice can outweigh declining market demand).

We are entering a time that is unprecedented and certainly requires a higher level of strategic planning and due diligence for success. The "good old days" of a handshake deal based on 2x recurring revenue and 1x transactional revenue are behind us if we are being good stewards of our respective practices. As with the financial planning you do for clients in your practice, your options and ability to achieve your goals will be limited to the extent that you plan.

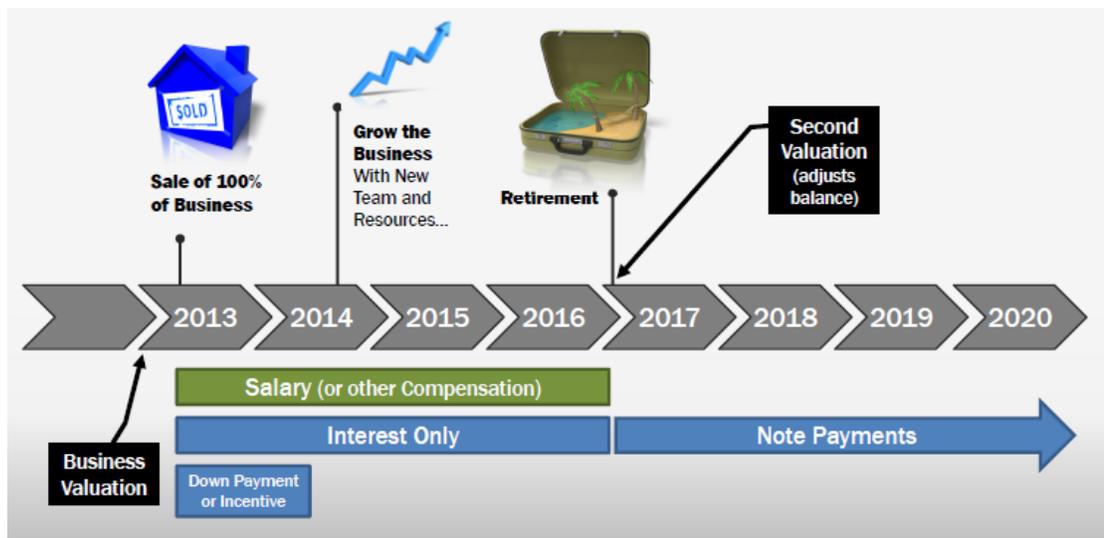
## Succession Opportunities and Risk (sellers)

The opportunities for achieving your succession goals have never been stronger than they are today. Increased options for managing succession should continue to outweigh coming decreases in market demand for those who plan early and plan well. With outstanding projections for revenue (GDC) growth over the next 10 years, you have the ability to leverage the “Age Wave” to weight internal valuation metrics over market demand impacted by the same trend. The primary risks present will be a lack of planning and/or planning without the proper experience and knowledge. As a result of the added complexity of the current and future M&A market, working with experts to define and achieve your goals will be central to your success.

There are 4 key elements to achieving your succession goals – listed below in order of importance:

1. The successful transition of clients to an advisor(s) who can continue your legacy of service is “the” most important consideration
2. The terms that define the deal will ensure that the “good intentions” of both parties are executed in good times and in bad
3. The price paid and your monetization of equity is the final compensation received for your many years of effort
4. Planning for the next phase of your life after retirement (this step is often not given its due weight, resulting in a lack of clarity in steps 1-3).

As one example of the varied options open to you in support of your succession, the following visual defines a path for a financial advisor who will maximize equity by selling today but still has a desire to service clients.





## **Acquisition Opportunities and Risk (buyers)**

Buyers of financial advisory practices are enjoying a time of unprecedented and increasing opportunity, while also becoming more mindful of the challenges and risks involved in acquiring and integrating a practice. Not unlike sellers, buyers who are strategic in pursuing “the right” practice, as opposed to any practice willing to sell, will find continued success. In times of increasing abundance of supply, it is more important than ever to execute with a clear vision – based on the ultimate succession and monetization of equity for the practice you are building.

Experienced buyers are aware of the challenges of consolidating “books of business” into larger practice structures where the daily operations are increasing in complexity. The same trend that will decrease market demand for practice sales (smaller Generation X population relative to Baby Boomers), will make it difficult to staff these growing structures with qualified people. The enthusiasm associated with sourcing and closing deals is generally justified in the ROI when prudence and meaningful due diligence are present; even in the current seller’s market.

While we look ahead to the “wave” of opportunity rising in front of us, achieving long-term success with an acquisition strategy will rely on the following 5 elements, in order of importance:

1. Start with an end vision in mind and resist “opportunity for the sake of opportunity” when it doesn’t fit your vision
2. Maintain a primary focus on the transition and service of clients and you will have covered 80% of what is important in a successful deal
3. Make prudent acquisition decisions based on thorough due diligence, starting with a professional valuation, and a robust cash flow model (stress test it for revenue volatility)
4. Focus on the goals of seller first when engaging prospects. They have less interest in how successful you are than in your understanding of their goals and how you might help achieve them
5. The use of force to achieve your goals over that of the seller will result in decreased future opportunities. Look to “expanding the pie” as a vehicle for getting more

## **Conclusion**

We are in exciting times with unprecedented opportunity accompanied by increased complexity (risk). Navigating the waters of the “Age Wave”, as it relates to mergers and acquisitions of financial advisory practices, will require your best efforts and the support of experts. Meaningful planning will be central to avoiding risk and achieving your goals.

