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Valuing Your Financial Advice Business

"A little planning now will not only raise the value of your advice business in the longer term but also make it easier to run on a weekly basis".

Practice101

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In this edition

1. INTRODUCTION

There may be a few reasons why you are interested in determining a value for your advice business. Whether you feel it is time to explore new horizons, move on, retire or slow down there is a time in life when every financial adviser begins to think about the value of their business.

There is no hard rule of thumb or magic formula that can be used to value an advice business and typical valuation guidelines can be simplistic and fail to produce a realistic market value for the average business. It is important for you understand valuation basics and why you need to examine your businesses strengths and weaknesses and its appeal as a saleable enterprise sooner rather than later so that you still have an opportunity to make changes that will ensure you achieve the best possible price for your business.

The first step is to determine a clear understanding of the valuation purpose and its intended use as this will inform many of the steps that follow. Secondly, the level of value needs to be established.

2. PURPOSE

The need for a business valuation may be driven by a few different factors. Common motivators for valuing a financial advice business are:

General Knowledge: strategic planning and performance monitoring.
Reasonability assessments: reasonableness of offer price.
Loans: assess the business value to secure a bank loan.
Disputes: in matters of divorce, contract breach or dissolution of partnerships.

Each of the above purposes has unique factors that must be considered to provide value for that specific circumstance. Once the purpose has been identified the value needs to be determined.

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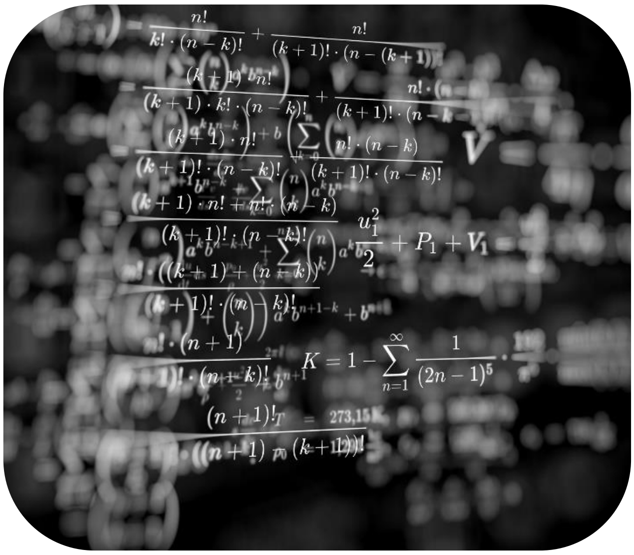
3. VALUING THE BUSINESS

Once of most highly debated topics in advice valuation is: Which method is best to value an advice business? Again, there is no one size fits all approach for all advice businesses. There are essentially three generally accepted approaches to valuing a financial advice business:



1. Asset-based: This approach the assets and liabilities of the advice business are valued at their fair market value. However, advice businesses do not have large tangible asset bases and this approach renders a low value in relation to the actual market valuation.

Because of this the asset-based approach is not used to value privately held advice businesses.

2. Market or comparable (revenue) based: This approach uses valuation multiples derived from current market transactions involving businesses that are similar to the business being valued.

For this method to be effective, most advice businesses must be identical or have comparable revenue, service models, pricing models, product offerings and business models. An appraiser of financial advice businesses will use this method for synergistic and control values.

This approach is also use as a reasonability check when using the income approach.

Commonly used multiples used in the financial services industry are:

- **Multiples of revenue**
- **Multiples of EBIT or EBITDA**
- **Percentage of Assets under Management**

Because these multiples are easy to communicate, they are commonly used by advice businesses to estimate their value. These can be misleading as they do not consider the important aspects relevant to a specific business such as the transferability of clients, management functions and ownership.

3. Income approach: this approach is most used for the valuation of financial advice businesses. This method uses the present value of future cash flows to calculate value. The income-based or discounted cash flow method involves estimating your annual cash flows (net profit) for the next five to seven years, to determine present and terminal value.

The most difficult part is determining the rates for converting income streams into value. The rate is determined by risk and takes into consideration a number of different factors, some of which are outlined below.

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4. DIFFERENT FACTORS

❶ Buyer type

The practice will be worth more to a buyer that has similar values, offerings, services and investments because client transition will be less volatile. This type of partnership is strategic and the commonalities between the buyer and seller help reduce some of the costs associated with a merger of incompatible practices

❷ Seller involvement

When a service business changes hands, a certain amount of client attrition is expected and will occur. To minimize this effect, the seller's continued involvement in the transition phase is a key factor. The timeline is one that must be mutually agreed upon by both parties and can range from one to five years. Regardless, seller involvement after the sale is critical for the business to continue to flourish with minimal disruption.

❸ Deal Structure

Deal structures can have a tremendous impact on the amount of risk both the buyer and seller assume and ultimately affects valuation. Consider a typical deal in which the advice business buyer provides a 20-30% down payment with a five-year earn-out period. In this situation, the advice business seller may receive as much as five times cash flow. However, if the deal structure is altered, for example the buyer offers 100% of the cash up-front, the seller will probably agree to a lower valuation to reduce the risk of not being paid. Furthermore, the ability of potential buyers to obtain financing will impact the advice business value since lenders look at a business's value differently than accountants do.

5. KEY PERFORMANCE INDICATORS

The biggest value drivers for any advice business are size, reliability, scalability, revenue, business growth and transferability of revenues. A comprehensive valuation will consider the strength and durability of the advice business revenues as well as look at critical factors related to business growth such as profitability, fee for services (revenues), client profile, technology, business processes, staff and dependency on the business owner. These KPI’s are important for the determination, monitoring and growth of value in an advice business.

6. SUMMARY

When thinking about valuing your advice business and establishing your approach to facilitate the process these guidelines above, can help you achieve a more realistic view and set of financial expectations. Similarly, a buyer of your business should look at the purchase in the same way you would look at an investment for a client, understand the risks associated with achieving specific income streams and how the risks measure up against risk tolerance and investment objectives.

It is never too early to start maximizing the value of your business and you should constantly be focusing on the aspects of your business that drive value and will make an acquisition or sale more beneficial for you.

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