THE DOMINO EFFECT: How to Find, Price and Buy a Financial Business

by Jerry Butler MBA CFP CIM FCSI President Queenston

The Cover – illustrates a visual of the “Domino Effect”.

A domino can knock over another domino about 1.5x larger than itself. A chain of dominos of increasing size makes a kind of mechanical chain reaction that starts with a tiny push and knocks down an impressively large domino.
See http://arxiv.org/abs/physics/0401018 for a sophisticated discussion of the physics.”
First presented by Lorne Whitehead, *American Journal of Physics*, Vol. 51, page 182

Based on the above description; if one were to start with a regular size domino and line up a progressively larger domino 1.5 x the size of the previous domino; the 28th domino would be the size of the Empire State Building.

This progression is used in this context to illustrate growth by acquisition.

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1. INTRODUCTION

In just over 3 years Queenston has valued and facilitated the transition of $25,000,000 in value and in excess of $1.1 billion in assets under management. We started as almost a favour for some friends to find a business to buy and we have expanded into valuing businesses and representing clients in lawsuits and divorces and have recently launched a virtual assistant business to our clients. We are at a minimum one of the major companies in the financial advisor space.

Queenston has 10,000 names in our data base. We have not talked to all of them but I think it is safe to say that if asked “are you a buyer or a seller” the vast majority will say buyer. I get calls from 70+ year olds telling me they want to buy another business. I have individuals with $2 million AUM asking about buying $50 million AUM. The question to ask is “why would a vendor sell to you?” There could be a very good and relevant answer but be prepared to deal with that question.

Growth by acquisition, consolidation and mergers are all methods to leverage your business and grow the enterprise value. The changing landscape of regulations and compliance has and will continue to result in advisors spending a larger percentage on infrastructure. Advisors will have to justify their business model and the value added features and benefits to their clients.

Every deal should be win-win-win. The buyer, the seller and the clients should all be winners. This publication’s objective is to help buyers prepare to find, price and buy a financial planning business.

The buyer has to create a business plan to acquire suitable businesses for their personal strengths. The suitable business to buy should be defined by your goals, resources and risk tolerance.

2. THE FUTURE OF THE FINANCIAL ADVICE INDUSTRY

a) Industry

The financial product distribution industry is a unique and amazing place to be. Everyone is a prospective client. Recurring revenue is available to the sales person on almost all sales. Great profit margins and above average incomes are achieved at every level of the distribution model. To paraphrase Milton Friedman "above average profits creates above average competition".

There have been many structural changes in the last 25 years. The four financial pillars have become one. The distribution model has changed dramatically. Few companies train new advisors and most new advisors enter the industry on an "eat what you kill" commission platform. These advisors are running around with little or no direction trying to sell product. This current model is not unlike the door to door vacuum cleaner sales model from the 60's!

The barriers to entry at the retail level are close to zero. The "perceived" income is very high. The industry is too easy to get into and too difficult to leave when one wants to retire. An interesting paradox that attracts the ambitious and the lazy!

The current threat to the industry is the legislated CRM2. This will make full disclosure of fees and commissions to the client front and centre. The combination of the difficulty in starting out as an advisor and full commission disclosure will make the start-up even more difficult.

The opportunity in the industry is firmly in the hands of the established advisors. The key for the established advisors will be to get bigger. One of the ways to get bigger is to leverage your time. This is a great opportunity to put qualified people on a salary + commission structure. It is an introduction to the business. The professional assistant will service existing clients and identify selling opportunities as well as prospect their own specific demographic. Sounds win- win doesn't it.

b) Technology

Technology is directly attributable to much of the gains in the markets in the last 25 years. The increasing stock prices of the great technology companies have driven the overall returns of the stock market. In fact, all companies leveraging off

the efficiencies and productivity gains from technological advances have fueled tremendous growth. These productivity gains are very evident in our industry. Managing clients and their financial situation is faster and more effective than ever. Assistants are able to put together information in minutes that would have taken an advisor many hours to complete even 10 years ago.

These advances in technology are also the reason the industry has become so saturated with choices for the consumer. A very real threat to the traditional advisor is the advances of the Roboadvisor (see Appendix). Though they are not a threat to the advisor whose clients are in their 50's; prosperous 20 and 30 year olds have been and will continue to flock to that option. The enlightened advisor will recognize this as an opportunity especially in the coming low cost environment. The senior advisor who is "training" younger educated professional assistants will be in a position to work in that environment.

Advisors will continue to leverage their operation from these advances. The effective use of technology will result in productivity and profitability increases for their business not progressing will result in the opposite. Advisors will be positioned to effectively manage more clients and increase revenues proportionately.

One of the main differences between where Canada is in the evolution of the financial industry compared to the US is in the category of Dealer or back office. Most large non-wire house (large national firms) advisors are their own dealer. The biggest issue with a Dealer is compliance but if you are the only advisor (or partners) then that should not be a problem. In addition, depending on where the investment assets are going and the structure of your dealer; the manufacturer may take care of the compliance issues. The data processing and storage is so inexpensive that if you are an established advisor it is probably cost effective. The second thing is your business is now worth more because you are more profitable and you have reduced transition risk when it comes time to plan your exit strategy.

c) Business Models

The systemic changes in the Industry are going to result in changes to most business models. Currently the vast majority of advisors try to be all things to all people. This is the past's Sales Business Model. "Here are a couple of products –

go sell them!" If you are not bringing recognizable value added to your clients you will lose them in the new world. Advisors are going to be squeezed by the middle man (Dealers and MGAs) and the downward pressure on commissions and fees.

The basic business models going forward will be:

- The **Generalist** will have smaller average clients, more overhead (on a percentage basis) and will have to leverage their time with qualified dedicated employees and the latest in technology. The independent advisor that is a Generalist will also compete with the financial institutions on every corner. The value added the independent brings to the table will have to be articulated consistently (and constantly) to their clients as the clients will be approached every time they walk into their bank branch. The Generalist will have to try and take ALL of the bank's business away including mortgages and savings accounts and in the future probably chequing and on-line banking. They will have more clients and may have to work harder but the Generalist will also be the best businessperson and create a very valuable business.

- The **Specialist** will be the go-to person for a specific concept or a specific part of the financial planning process. The specialist will strive to be the best in that particular endeavour. They will be the most informed and the best prepared in their speciality. Other advisors (smart ones) will refer their clients to you because you are very good. You will leverage your time with technology and support staff. That speciality could be very narrow eg. Structuring buy sell agreements or more broad such as managing investment portfolios either themselves or other Portfolio Managers. They will be paid either directly by the client or receive a referral fee from their strategic partners.

- **Relationship managers** will be the go to person in their client's life for all things financial. They will have referral relationships with mortgage brokers, investment managers, lawyers, tax accountants, business valuators, etc. They may have a speciality in one area but will refer everything else to specialists.

> The relationship manager will be the rain maker. Many current relationship managers have on-line access to everything including bank accounts, property insurance, etc. The information is up dated daily. The relationship manager will move comfortably in the same circles as their target market. This business model is the generalist of the future in the high net worth market. There are currently University programs that teach advisors how to succeed in the ultra-high net worth family market.

The Sales Model will continue to exist, especially for new advisors, but it will not thrive. It will not create transferable value.

3. REASONS TO ACQUIRE A BUSINESS

Contrary to the common perception in the financial services industry acquiring another business is not a panacea. But in the right situation – buyer and seller – it can be a very effective method to grow your business, create economies of scale, migrate into a better business model or **diversify** (horizontally and vertically) your current operation.

The financial product distribution industry has become very competitive. Every bank, every insurance company, every credit union, many associations and numerous independent advisors are in a very crowded marketplace. They advertise that they have all things for all people. It has become more and more difficult to grow a business from the grass roots up.

In addition, there are **threats to the industry** in the form of regulations and legislative changes resulting in increasing costs and squeezed revenues. The result is the average advisor must increase revenues to find that critical mass in order to maintain personal income and lifestyle. Another threat to the advisor is the full disclosure of costs to clients. The push back from the client in the current distribution model will be placed firmly at the feet of the front line advisor even though the majority of the client's costs are in someone else's pocket.

Growth by acquisition is the fastest way to attain growth.

Consider the following formula:

Quantum of Economic Benefit = Economies of Scale + Strategic Advantage + Financial Synergy

There is a reason growth by acquisition is a very popular and important strategy in almost every industry. Consolidation is very relevant when there is a very competitive and over populated sector. This strategy is especially true when there are good profits and great margins. Big is better and it will be more relevant as we go forward into the future.

When considering a purchase there will be some **economies of scale** between buyer and seller. Can you reduce overhead? Are you expanding your product offerings? If you acquire a business generating $200,000 in revenue and $100,000 in overhead you can afford to pay more if you can reduce or eliminate the overhead and continue to generate the same top line revenue.

Strategic Advantage is the ability to differentiate your business from the competition. This can take many forms including product offerings, office location, qualified long term employees and especially a strong brand. Acquistion is an excellent strategy to put in place the structure to change your business model to a more value oriented business model.

Growing larger creates a **financial synergy** that makes your business more valuable by increasing the market multiples. The profit margins will improve and especially the owner's discretionary earnings. Combining two businesses valued at $500,000 each will result in increasing value not to a million but probably 25 – 30% more than a million.

Most businesses in our industry die with the advisor. This happens for many reasons most wrong. But some businesses go on for the foreseeable future. Long after the advisor is gone. This is called **creating a legacy**. A legacy is a business that will be talked about by your children, your grandchildren and your friends and neighbours long after you are gone. I had lunch recently with a friend who sold his business several years ago. I googled his name for some reason and what came up was "founder of the financial planning firm _____". I said it was very cool that that is what his grandchildren will see when they google his name.

4. YOU MAY HAVE TO CHANGE YOUR APPROACH

I talk to many advisors interested in buying businesses/client lists. Many have the attitude that they have the best business model and everyone wants to be their client and every advisor should want to bring their $20 – 30 million to them and learn from them. Sellers and/or merger candidates have many choices and chances are they are being courted by other advisors.

The single best thing about buying a business, any business in our industry, is the opportunity for clients/prospects to have a reason to see you. What is your closing ratio with cold prospects?

The days where the buyer dictated the terms to the seller are almost gone. Does that mean it doesn't happen – No! But most potential sellers are aware they are in the driver seat.

The other issue used to be "will the cheque clear"? I have not heard of that being a problem in Canada. The key is for the seller is to perform their own due diligence on the buyer and their business. The properly prepared buyer will have the information in their package to present to potential sellers.

If your business is generating $100,000 in revenue than the probability of buying a business with $500,000 in revenue is slim but not impossible. Don't pretend you are bigger than you are. Be honest and up front.

Sellers used to come to the buyer. The buyer was usually the guy down the hall or their buddy. I think the key now is to present yourself as professional and prepared when you approach a potential seller. Know your business model and why it is perfect for the seller's clients.

5. WHO HAS BEEN SUCCESSFUL IN FINDING SELLERS

a) The Unaware Seller

In the past those buyers that have been successful are, for the most part, those businesses which are perceived to be successful by the seller and are a friend or at

least an acquaintance. Sellers have looked for the path of least resistance. The seller has entered into a negotiation with no power or leverage. Most sellers have not prepared their business and have not gotten a fair price and certainly not fair terms. Those opportunities are becoming rare.

b) Institutions

There is another buyer in the market place that is aggressively approaching sellers and that is institutions. I frequently get calls from Exempt Market Dealers, Investment Councils and even MFDA Dealers to buy investment assets. They all think they have the perfect solution for advisors and clients in the changing marketplace. The institutions are successful especially with the "unaware seller". These institutions are gathering assets. Most of these deals are structured around a working relationship and referral fees. This can be win-win-win depending on the advisor's business model.

c) The Buyers Who Get It

Currently successful buyers get the new world. They understand they are buying a business with recurring revenues and the potential for new business. They don't fret over the fact they may lose some clients. They concentrate on getting to know those new clients and doing more business. They pay fair prices and fair multiples. They believe in the win-win-win philosophy.

I have talked to and done business with several advisors who have built $100 million+ AUM using an acquisition strategy. They become known in their market for doing good business, being fair to clients and paying fair prices with fair terms for a good business. Sellers approach them now.

d) Going Forward For Buyers

There is a lot of competition to buy and the successful buyer has to impress the potential seller. It is unlikely in the short term of three to five years, even with CRM2, that sellers will be lining up to sell you their business.

Successful buyers will have a business plan to approach, impress and successfully negotiate the purchases of a business.

6. PREPARING TO ACQUIRE A BUSINESS

a) Are you prepared?

One area that is woefully overlooked is the preparation needed to be in a position to acquire another business. What do you want to buy? Be prepared to answer the following:

- Why should I sell?
- Why should I sell to you?
- How much?
- What is your business model?
- What is your service proposition?
- How will you pay?
- What is your business worth?
- Can I see your financial statements?
- Who is your accountant?
- Is this a share sale or an asset sale or an income stream?
- What are the tax consequences for the buyer and the seller?
- Etc? Etc? Etc?

b) Communication

As in any sales contact listening will be your greatest asset. There are many reasons an advisor does not want to sell. The key is to identify the important issues to the prospective seller. Most advisors know they should be preparing but are not.

The other issue that occurs during the negotiations of a potential deal is what is important to the seller. The terms of the deal can often make a crazy request doable.

c) What and who is your target market?

What business model and size of business are you looking for? Are you just looking for a client list or a turnkey operation? The more sophisticated the seller than the more sophisticated the buyer has to be.

The buyer should have a good idea of the prospective seller's business model and does that model fit with their business and personal strengths. If your average client is in the blue collar mid-market area than are you prepared to deal with a client list of high net worth lawyers?

The days of $1 down and a $1 a week are gone. Most advisors are not desperate to sell and most advisors know there is no shortage of buyers.

If you are serious about buying than you need to prepare. You should have a list of businesses that you think may be available and fit your target market. This is no different than prospecting for clients. Your objective is to get to yes, no or maybe. You don't want to waste your time chasing a "business" for months/years to find out it is not for you and vice versa.

d) Valuations

The buyer should have a valuation of their business. In the US the vendor does not even think about selling without a valuation of the buyer's business. It should include an overview of the business and the strengths and weaknesses. A proper valuation should be included in both the financing proposal for the bank and the business proposal for the potential vendor. Most deals do have a vendor financing part of the deal and they need to know the buyer is qualified to run their business and pay them back.

e) Price and Financing

The buyer should know the size of the deal they can afford. The buyer should have a broad definition of the business model that they are interested and the business model that fits with their business and personal strengths. If your average client is in the blue collar mid-market area than are you prepared to deal with a client list of lawyers as an example.

Sellers expect a large percentage of a selling price up front. You should budget 60 – 70% of purchase price to be paid on closing date. Hopefully you will not make any offer to purchase subject to financing. The financing part should be done in advance. If you know that the maximum you can pay up front is 50% than

negotiate from there. Don’t offer 60% and have to go back and say sorry but I can only raise 50%.

The biggest mistake most advisors make when they go to the bank is they go in as a consumer not as a business person. This is a business deal therefore go in as a business person and only deal with a lender capable of lending to a business. Most banks have a department that will specifically finance cash flow businesses or intangibles. That is where you have to go. This is a speciality. You should have a “Financing Package”. It should include financial statements, a marketing plan and a business plan. Projections should be done for your current business and include the numbers of the business to be acquired (even if it is just an estimate).. If your business is worth $100,000 it is unlikely the bank will lend you $500,000 without a lot of other collateral. Knowing what is available will help you determine the top end of your price range.

If you want to piss a seller off than go through the process only to have to say “sorry can’t get financing”. That will spread like wild fire and your name will be mud. No one will sell to you.

f) What are the terms?

The terms make the deal. Different terms usually mean different price. For example – if you are paying 100% up front on closing that amount will be less than 20% upfront and the vendor financing the balance over ten years.

The buyer should know the pros and cons of share sales vs asset sale vs an income stream. How long should the amortization of debt be to have a positive cash flow? What are your expectations of the vendor post sale? What should the vendor do to help in the transition? Will the vendor want an employment contract? What about the non-compete and the non-solicitation?

It is very important to understand all of the different alternatives and how they affect the deal you are attempting to negotiate.

g) Your Presentation Book

If you want to impress a potential seller than you show them you have done your homework. You should have a resume on steroids!

Your Presentation Book may be the most important part of this process. It should have:

i.) **Who You Are** – family, education, experience, sports, hobbies, etc.

ii.) **Your Business** – who are your clients, your growth, etc. Explain your business model. What are your strengths? Location, technology, employees, etc.?

iii.) **Business Valuation** – What is your business worth? The seller is probably going to finance part of the purchase. He wants to know he will be paid.

iv.) **Business Plan** – where you see your business going and how you're going to get there.

v.) **Financing and Financial Projections** – show how you will pay for a business and the effect the "right" business will have going forward. If possible get a Letter of Credit from your bank. It should say you are qualified to buy a business worth x.

The business proposal should look professional and be realistic. Your objective is to ask for 20 minutes to present your case. Be prepared. This could be the biggest "sale" of your life.

7. RISKS OF BUYING

There are four main risks when buying a financial advice business (over and above the obvious such as no due diligence):

a. Transition Risk
b. Cash Flow Quality
c. Growth Potential
d. Financial Timing and Risk

a) Transition Risk

Transition risk is the risk of losing clients. Many times buyers want to have the seller adjust the purchase price to reflect any lost clients. A smart seller does not accept that premise. If the transition is properly implemented any lost clients will be more the buyer's fault than the seller's. There are several factors to consider

when “calculating” transition risk. They include: how long the vendor is available to work with you; number of long term employees; location of office and percentage of in office appointments; the strength of the vendor’s brand; the quality of CRM; client demographics; etc.

The second part of the transition risk is that the buyer should adjust their offer to reflect the risk of losing clients. If the seller has passed away or is selling today and gone tomorrow than the purchase price should be adjusted to reflect the risk of losing clients. All the factors should be considered and the purchase price adjusted accordingly.

b) Cash Flow Quality

Cash flow quality relates to how dependable the revenue from past years will be going forward. If the vendor sells DSC mutual funds and you want to sell FEL or fee based than you have to adjust your value calculation. Or if there is one large commission sale in a particular year than that has to be subtracted out when normalizing the financial statements.

Consistent and dependable cash flow is worth more than bumpy commissions that are not repeatable. That is why recurring revenues are worth much more than non-recurring.

There are other issues that address cash flow quality such as average age, demographics of clients, location, etc. These have to be evaluated and considered in the value calculation.

Remember not all commissions are created equal! Monthly pac plans are recurring revenue. A business with 400 t-10 policies with the vendor consistently rolling over 25 – 30 policies should be priced similar to recurring revenue.

Look under the hood you may be pleasantly surprised what you find.

c) Growth Potential

Growth potential is directly correlated to demographics. If the average client is 50 and earns $500,000 per year than the growth potential is huge. Your goal is to service the clients and grow with them. If the clients are in the withdrawal stage

than growth is probably negative. This does not mean you should not buy this business but it does mean the price should reflect the lack of growth potential.

Client demographics may be the most important part of the analysis to determine the value of a business.

d) Financial Timing and Risk

Paying too much is more a factor of the terms than of the actual selling price. Paying 5x recurring may seem like too much at first glance but if the clients are exactly what you are looking for and the business is a perfect complement to your business and the vendor takes back 80% of the deal and finances over 10 years so that even with no growth it is hugely cash flow positive. So if there is very little transition risk, cash flow quality is top drawer and the growth potential is huge; it is still a good deal at 5x.

The only time paying too much is a factor is if the business does not have positive cash flow. Based on the structure of compensation in our industry it is easy to forecast what revenues will be going forward.

The other caveat to over-paying is a huge market correction. Though usually short term in nature; a major sell off usually results in many sleepless nights for those buyers who financed a large portion of the purchase. An investment business that is subject to a market correction means less recurring revenue and could mean clients leaving.

NOTE: I was hired by a buyer to value a business my client was trying to buy. The vendor had given my client financial statements but would not give a breakdown of revenues – recurring vs commissions or proper expense reporting. The vendor would not give source documents showing assets under management. I told my client that I could not do a proper valuation or negotiate a deal. Consequently, I terminated our agreement. I heard later that my ex-client gave the vendor a large deposit and the vendor cancelled the deal and kept the deposit. Any offer to purchase is conditional on your due diligence and always have a lawyer hold the deposit.

8. STRATEGIES TO FIND OPPORTUNITIES

a) Plan the Work

Finding sellers takes work, planning, research and a lot of phone calls. Sellers do not like anyone knowing their plans let alone their business. They are consumed by secrecy. How would you like advisors phoning your clients saying you are "selling them"? Your presentation MUST be one of professionalism and anonymity or your name will be all over town in the negative sense.

You need to build a list of prospective sellers. You should have their name, phone numbers and email addresses. Even if you are calling or emailing does not mean you can get to first base. Your objective, as in prospecting, is to get to know your prospective seller.

b) Build Your Prospect List

Referrals are a great way to build your data base of prospective sellers. Casually ask other advisors whom you know. If you know someone else who is trying to find sellers talk to them. If they are looking for something different you may be able to pass referrals back and forth.

Your **Broker – Dealer** should be aware you are looking and they may give you names of individuals that they think or know may be considering selling. This could be because of age, business style that does not fit the Dealer's or just the fact that the advisor may be failing. The other reason for the conversation is to find out if your Dealer will help with financing the purchase. I will pre-warn you that if you fit any of the above criteria (age, business style or low commissions) they will probably not assist you in any purchase at the same Dealer but if you can lure someone from a different Dealer you may get some assistance.

Advocis and other industry organizations (CFP, CLU,CFA,etc.) are a great place to enquire about possible prospects. Most of the regional reps will be familiar with most advisors and especially the senior ones.

Wholesalers are usually at the top of the advisor's list. My personal experience is that wholesalers are familiar with the buyers but don't have a clue who may be a candidate to sell.

Linkedin and other social media is a great place to mine for prospective sellers. You will probably get a picture and a resume giving you an idea of their business models and years in the business. Unfortunately most "older" advisors are not on Linkedin unless they are successful and recognize the importance. You will also get their web site etc.

The above is a ton of work taking lots of time and energy but you will be successful. If you feel your time is better spent doing business rather than building data bases and phoning and meeting with prospective sellers you can hire a consulting company to "hunt" for prospective sellers.

Queenston does contract with buyers. In fact, our first contract was with a buyer which we successfully found and negotiated the purchase of a business. We will prepare you to buy including Financing and Business Proposals (Valuation, Business Projections and Marketing Plan). We will market you to our extensive data base including emailing and phoning anonymously. We will follow the protocol outlined in this document.

Work the Plan

Once you have your target market identified than it is a matter of approaching, getting to know and "selling" them on the idea of working with you. This should be a combination of phoning, meeting and developing a drip campaign designed to meet and keep in touch over time.

9. WHY WOULD ANYONE SELL

Everyone will transition their clients sooner or later! Too many advisors are in the second category.

Here are some things we know for certain:

- Approximately 10% of all transitions happen because they have to – death, disability or loss of licence.
- 75% of all advisors do not have a Succession Plan.
- 90% do not have a formal Succession Plan.

There are many reasons for anyone to exit out of the business. A smart business person should be looking at a Succession Plan or an Exit Strategy as part of long term planning. A proper Succession Plan can actually be a growth strategy. Here are a few reasons for anyone to consider selling all or part of their business:

a) Will Your Business Die With You?

Lack of proper planning means you are messing with you and your estate. If you or your estate "has" to sell you will get half of today's value - if you're lucky.

b) Market Timing

I am not a big believer in market timing but right now is a great time to sell a financial product distribution business. The investment markets are at all-time highs, interest rates are at historical lows and it is relatively easy to borrow. The banks now lend to "cash flow" businesses and intangible assets.

c) Equity and Income

Every advisor has two forms of income. One is employment income and the other is a return on the equity of the business. The current owner can sell part or all of their equity but continue to earn an employment income. All transitions should have the vendor negotiating an employment contract.

d) Clients want to know what happens to them

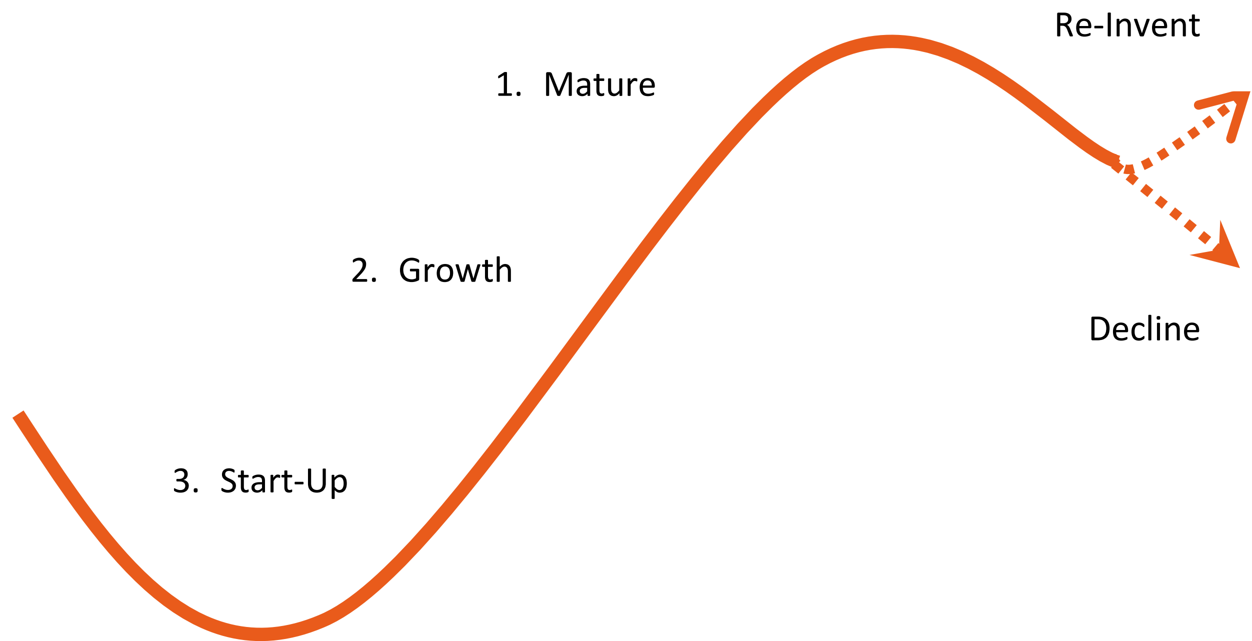
Chances are that clients are already asking the senior advisor "what happens to me if you are not around?" A Plan will be received positively by clients especially if you introduce the plan over time rather than drop it in the lap that you are gone.

e) Business Structure

Many advisors have not properly structured their business to take advantage of the benefits of a share sale. Either they are not incorporated or the corporation is off side. Now may be the time to start getting ready to transition. Selling is a process. Often the initiation of a buyer starts the preparation of getting ready to sell.

f) What stage is their business?

As advisors age so do their clients. In addition, most senior advisors are slowing down and their business is probably not growing. If your clients are aging and your business is "mature" it is becoming less valuable every single year.



Where is your prospect's business in the life cycle? Your strategy is different for each stage. Know your prospect and find out their hot buttons.

g) A Succession Plan does not have to be an Exit Strategy

Most advisors think they sell when they are ready to exit the business. This is not the case. Every deal Queenston has done has given the seller an employment contract. Most sellers continue to earn an above average income after the sale plus put a large amount of money in the bank.

h) Monetize their largest asset

The senior advisor should be locking in the value of their business. Selling, financing and protecting the value are all excellent financial planning strategies. The money could be used to eliminate non-deductible debt, buy that

winter/summer 2nd or 3rd home, top up RRSPs or just have more liquidity in your portfolio.

i) Selling as a growth strategy

If an advisor sells half of his business and brings in the right partner the business could double in value. This means in 5 – 7 years when the senior advisor exits, he gets half of twice as much. The result is 50% of current value plus 50% of twice as much. This is a great growth strategy and win-win-win.

j) Diversification

Most advisors largest asset is their business. They would not let their clients have 60 – 70% of their net worth in one asset. Yet their portfolio is heavily weighted in one asset.

k) Continuity Plan

What happens to your business in the case of your disability or death? An agreement for someone to buy or service your clients until your business is sold or thte advisor comes back to work is a Continuity Plan. This contract helps protect the value of your business until you can return to work or if you cannot return to work.

If the senior advisor cannot work or does not want to work than they are protecting the value of their largest asset. Everything is in place. A buyer and a fair price is a win-win-win propostion.

An Exit Strategy is 90% an emotional decision. The industry has a problem in that advisors are not aware of their options. The distribution channel is doing NOTHING to change that. Buyers are doing a better job of educating senior advisors than any other source.

10. IT'S THE TERMS NOT THE MULTIPLE

When discussing sales the first thing out of an advisor's mouth is "what is the multiple". The part that I find amusing is the multiple being referred to can be based on something different to different people, different platforms and even different models.

Multiples are "rules of thumb" and by definition mean average. If you paid a higher multiple than the guy down the hall chances are it is because your purchase was worth more or the terms were better. Would you rather pay 1.5 times recurring revenue when average client is 75 and 2 hours away with small accounts with records in a rollodex or 4.5 times recurring revenue for a turnkey business with the perfect clients for your business model and the vendor will continue working with you for 3+ years?

a) Different Platforms = Different Multiples

Most MFDA advisors use of a multiple refers to net trails and renewals and to IIROC advisors the multiple is referring to Gross Production to the Dealer. When I use a multiple, the only one that is relevant is percentage of assets. Insurance is different as the selling factors become recurring and also term policies.

IIROC advisors are selling a client list and the deal is usually done with the vendor receiving an income stream. The reason for this transaction structure is that most IIROC advisors do not own their clients – the firm does. If the advisor is T4'd than they are an employee and the firm owns the clients therefore when they sell they are selling an income stream.

Most IIROC advisors use a sales model and their business totally relies on their Dealer. The firm also provides, especially in the case of bank owned firms, amazing goodwill in the marketplace. Most IAs especially at bank owned firms manage much more in assets and generate more in gross commissions but also receive a lower payout than an independent.

The flip side is the fact that the Dealer will often buy the assets for the advisor. The problem is most advisors do not want to pay anything over and above the formula of their Dealer.

It is difficult for most IIROC advisors to purchase a business from a MFDA advisor because the seller is selling assets and the buyer is acquiring an income stream. Buyers and sellers should contact an experienced income tax professional before undertaking a deal.

MFDA advisors in a captive sales force (eg. Sunlife and Investors Group) do not own their clients and therefore may be selling an income stream when they want to transition out of that company.

Most independent **MFDA advisors** own their client list and therefore can sell it as an asset. If they have a corporation they may be able to sell shares and be eligible for the capital gains exemption.

The conclusion is that multiples mean different things to different people. Queenston does not do valuations on rules of thumb.

b) Terms

There are many terms of a deal that can affect the negotiated price. I will touch on some of the terms but each situation is different.

Vendor Take Back Loan – this is the single most important term on everyone's list. If you can go to the bank and negotiate a loan the vendor should take considerably less than if the vendor is financing a large portion. Having said that I always want at least 20% in a vendor take back so that the vendor does what they have promised. Introducing to clients, maintaining an office or whatever is negotiated to minimize the transition risk.

Vendor Employment Contract – is one of the best factors in reducing transition risk. Clients like to be able to phone in and find out their "old" advisor is still around even if they don't see them. Clients do not like change! The other thing I like is to heavily incentivize the vendor with commissions for business generated. Let them continue to deal with their best clients because if you pay them 50% of what they generate you are still earning 50% and you still own the client so therefore the value of your business is increasing.

Amortization Period – this can be an excellent negotiating term. The buyer wants positive cash flow. The vendor wants their money today if not yesterday. The

longer the payback period to the vendor than the higher the risk but some vendors do not have a problem with this especially if they getting a much higher selling price and a bit of interest.

Payment as an Income Stream – this is the best deal for the buyer and usually the worst for the seller. Paying for the business with pre-tax dollars is attractive especially if an individual is buying rather than a corporation. This does not mean it never fits. Smaller books can be sold for an income stream frequently. If a business is worth $150,000 and the vendor has little other income it is more tax efficient to sell for an income stream of $40,000 a year for 5 years. The vendor receives more on an after tax basis and the buyer pays less. The buyers ACB will be 0 and they may pay capital gains when they sell. The other structure I like in certain circumstances is a combination. The above example may be done as an asset purchase of $75,000 and $30,000 a year for 3 years. I think you get the point. When the buyer is in a higher marginal tax bracket than the seller will be over the next few years than an income stream is a great option. The other factor in an income stream is if it is a consulting contract the seller will have write-offs against that income.

Asset vs Share Sale – I often hear that buying shares is terrible, wrong, stupid, etc yet the person saying that usually does not know why. To the buyer it is the same from a tax perspective to buy assets or shares – NO DIFFERENCE. So if you are buying a business which would you rather do: 1. Pay $800,000 for assets or 2. Pay $600,000 (approximately) for shares. To the seller, it is basically the same after tax income. To the buyer choice #1 is 33% more expensive than choice #2. There is an issue with future liabilities but that can usually be lawyered out. Often the vendor will maintain their license and their E&O for several years as they continue to work with the buyer.

Miscellaneous – almost every seller has a few "hot spots". It could be a long term employee. A condition may be for you hire the employee which is usually a smart thing to do anyway. It could be a rent lease or an equipment lease. I have even seen where the vendor liked his truck that was in the corporation name which he was able to keep. Sometimes it is the small items that help swing the deal.

11. WHAT IS A GOOD PRICE?

This section should probably be titled "what is a bad price?" If the business you purchase, assuming you already have a business, pays for itself i.e. cash flow positive than it is close to being a good price. There is another factor that will take a deal from good to great and that is the performance of the buyer not the price and not the vendor. If you pay 1x recurring revenue and every client leaves – YOU made a bad deal because you were not prepared.

Growth by acquisition is a very aggressive growth strategy especially in a seller's market. Most people reading this are aware of how frenzied the price of a public company's stock gets especially with multiple buyers in the mix. An attractive business for sale in the financial product distribution sector will do the same. So be careful. Do not get caught up in the frenzy. (If you are a seller – you want two or three qualified buyers if for no other reason to give you the power.)

The following are some factors to consider when determining a price:

Positive Cash Flow is the key. That includes servicing the debt, paying the expenses and maintaining your life style. Note I said maintaining not increasing in the short term. Buying a business in our industry should be two things: 1. An investment; and 2. A forced savings plan. If your income goes up in the short term, that is great and probably because you are doing a good job. Bottom line it is an investment not just a way to increase income.

Economies of Scale and/or Synergy will be achieved if you manage your business and the new business properly. Budget for the changes and set goals and you will be successful especially if cash flow positive. Often, the buyer is obtaining cash flow and their current overhead will be able to absorb the increase in revenue.

Client demographics is one of the most over looked and under analyzed factors. The closer the acquired clients are to your client's demographics the higher price you can pay.

Business Model of the vendor should be the same as yours or a model the buyer can move clients into seamlessly. If you buy a "client list" from a mutual fund

salesman those clients will appreciate moving into an effective financial planning business model – BUT not vice versa. The less work for the buyer to integrate new clients into their system the more the business is worth.

Geography is another factor that comes into play if the new clients are in the same area where your current clients are located. This makes the purchase more valuable to the buyer.

Geography may be important for the firm that wants to expand to another city. In the US almost 30% of transitions are done with an out of state buyer. I get calls every day from buyers who will look at different cities. The key is to buy a turnkey operation. Good staff, good office, great CRM and a similar business model. If a new location is part of your business plan; purchasing a thriving business in that community is a great way to go. Buying an existing business in that community is much easier and less expensive than starting from scratch.

A **Valuation** should be done. There are many firms that do valuations. The Valuator should be at a minimum familiar with the industry of the targeted business. Individuals buy a million dollar business and do not even know if it is close to being worth the price or if the new business will have positive cash flow based on the structure of the negotiated deal.

12. THE BUYING PROCESS

a) Confidentiality Agreement

The buyer will work very hard just to sit down with a potential vendor. All of the preliminary work will now pay off.

The buyer will approach the potential vendor and want financial information in order to make a qualified offer and the vendor will want a qualified offer before they give any proprietary information. This is a classic Catch 22!

There are two issues for the vendor:

1. Is this person qualified to buy my business, and
2. Can I trust them?

The buyer should have a Non-Disclosure Agreement prepared to offer the vendor. This agreement is as much a legal form as a way to instill confidence in the vendor that you are prepared and professional. This is a very serious document.

Remember this important fact – if the vendor runs around telling everyone you approached him about buying his business you get free advertising. If you tell one person and they are the wrong person than other advisors will learn. The next step is advisors phoning the vendor's clients saying "I hear Bill is retiring. You and I should sit down and discuss your options." The vendor has all the risk in this situation. Be very very careful that you tell no one. Assuming the vendor has only talked to you and one client tells them they heard he is selling – he will blame you. That is not the advertising you want in the very tight knit community of financial advisors.

The second step of the buyer is to present the vendor with your "Book". Let them know you are prepared and qualified. If you show them your financial information they should relax and be able to answer your questions about their business.

One of the benefits of hiring a firm similar to Queenston is that both sides are anonymous until both sides are qualified for a fit. Queenston does not reveal names, location or even Dealer when we talk to either side. Queenston knows the parameters of a deal for both sides and we are able to weed out those not fitting this transition. See NDA in Appendix.

b) Questionnaire

The buyer (and the seller) should be prepared with a list of questions. These questions will give a concise easy to answer overview of the prospects business. You want to know what is important to you. The prospect may have his book in a community two hours away – is this a deal breaker? To one advisor this is a negative while for you it could be a positive. Know what your preferences are and know your knock out questions.

Do not say anything negative. Do not show your hand. If an answer hits a knock out factor keep asking your questions. Go back to your office and review the negative answers as there may be a way to make them positive. Half the book is four hours away and your wife just had a baby? Maybe you know an advisor in

that community that you could partner with on those clients? Explore solutions. There are very few problems that do not have a solution.

See questionnaire in Appendix.

c) Sweeteners

Look for hot buttons as you are talking. Try to find sweeteners that will swing the vendor to your side. It could be on the personal side. Car collector or golfer or hockey fan can conjure up some type of sweetener from your side. Your buddy is selling his 67 Mustang? Throw the Mustang into the offer.

d) Letter of Intent

The LOI will outline the basics of the offer. It is non-binding to the buyer. There is a no-shop provision for the seller. Outline structure of offer; what your expectations are and what the vendor can expect to get from you.

e) Due Diligence

There are two types of due diligence that should be undertaken. They are related to the business operations and to legal due diligence. I strongly recommend that you have professionals review both of these tasks.

Business Due Diligence is the process whereby the buyer has the opportunity to examine the target from a financial and strategic perspective. Check for any business skeletons in the closet. Some of the things you should evaluate:

i) Business structure and business model.
ii) Accountant's statements for the last 3 – 5 years and Income Tax returns.
iii) Normalize the P&L. Take out owners personal expenses. Take out any large extraordinary revenues or expenses.
iv) Business planning documentation. Budget to Actual. Mid – Long Term.
v) Marketing and/or Promotion plans, issues, successes, etc.
vi) Are there assets on the Balance Sheet you want? Don't want? Liabilities?
vii) Credit agreements, loan agreements, lease agreements, rental, etc.
viii) Source documents of the assets under management and the breakdown of positions. Look for risky concentration.

ix) Number of households and average age and demographics.
x) Distribution of assets – look for concentration of a few disproportionately large clients.
xi) Location of office, percentage of in office meetings vs out of office.
xii) Employees – get resumes. Are they licensed? How long have they been there? Do they deal with clients? Do they sell? Employment contracts? Severance liability?
xiii) Technology. What software? How current? Is there a CRM with clients and prospects? Is it up to date and complete?
xiv) Is there a business brand?
xv) Other business issues that you consider important.

The **legal due diligence** should be done by a professional especially if you are making a share purchase. Again one must be sure there aren't any skeletons in the legal closet. Some of the areas to be examined:

i) Corporation papers. Are they current? Minutes? By laws, etc? Shareholders? Buy Sell Agreements?
ii) Registrations, Licences, E&O Insurance . Are they current? In order?
iii) Contracts? Any outstanding contracts that you want or don't want? Don't be surprised.
iv) Any complaints with the Dealer or the MGA?
v) Any issues with the regulators?
vi) Litigation issues – past and present.
vii) Past problems or issues have to be researched. Is there a pattern?
viii) Bankruptcy? Many advisors have been bankrupt 2+ times. Is there business style walking on the edge?
ix) Plus any other issues you deem important to research or qualify.

f) Purchase Agreement

Once the basic tenets of the negotiated deal are complete than it is time to have your lawyer draw up a Asset Purchase Agreement or Share Purchase Agreement depending on what has been negotiated.

This is usually when Queenston's work is done except to answer questions and clarify certain specifics of the deal.

Both sides should hire a lawyer and I can speak from experience that when advisors think they are saving a relatively small percentage of the purchase / sale price it often ends up costing more.

To see the Law Society check list for an Asset Purchase Agreement – go to:

http://www.lawsociety.bc.ca/docs/practice/checklists/B-2.pdf

g) Employment Contract

I strongly recommend every vendor acquire an employment contract. There are several different structures to this contract but the two that Queenston has negotiated are an employment contract outlining commissions and referral fees for the vendor and a consulting agreement.

The buyer should encourage this arrangement because the clients will generally stick around if the advisor is still there even in a limited capacity. In addition, though the vendor will sign a non-compete if they have the opportunity to make money through you and not somewhere else.

The vendor should want an agreement to keep their fingers in the pie. They will make a few extra dollars without a lot of effort.

13. TRANSITIONING THE CLIENTS

Advisors considering moving from one broker dealer to another do little to no planning. Each situation is different and yet if any planning is done it is done using a cookie cutter plan.

Here are some considerations:

i) Time Frame
ii) Your CRM
iii) Your platform. The strategy for moving between IIROC firms is much different compared to MFDA. There are a lot of reasons for this but the main issue is the types of securities held and the way they are held. Nominee accounts can be very expensive to move. Who will pay? Client held mutual fund accounts are simpler. The client knows the investment

and they know the advisor but chances are they do not know who the Broker Dealer is unless it is a major bank or credit union.

iv) Who "owns" the clients?
v) Sales Assistant – yours and the receiving company
vi) Who are your clients dealing with?
vii) Due Diligence
viii) Logistics
ix) Transition Cost

http://www.thinkadvisor.com/2011/04/25/top-10-reasons-brokerdealer-transitions-fail

http://www.hdvest.com/Media/Default/Documents/Brochures/Advisor-Transition-Guide.pdf

http://www.investmentnews.com/article/20131126/FREE/131129931/transition-essentials-for-advisers-changing-broker-dealers

14. CONCLUSION

Queenston is currently working with several clients to find businesses. It is currently a seller's market and will be for a few years. If you have an Exit Strategy of less than 5 years – now is the time to put together a deal. Give us a call!!