88 TO 89%

CLIENTS RETAINED BY ADVISORS WITH NON-RECURRING REVENUE AFTER A BOOK SALE, ON AVERAGE

CHOOSE WISELY

SELLING YOUR BOOK? AT LEAST 88% OF CLIENTS WILL STAY IF THEY LIKE YOUR SUCCESSOR. YOU ONLY GET PAID FOR RETAINED CLIENTS, SO HERE'S HOW TO SELECT THE RIGHT ONE

BY MELISSA SHIN, *Advisor Group managing editor*

93 TO 95%

CLIENTS RETAINED BY FEE-BASED ADVISORS AFTER A BOOK SALE, ON AVERAGE

Source: Valuation department, FP Transitions, n=198 North American book sales in 2010. All figures apply to a well-planned transition.

95 TO 97%

CLIENTS RETAINED BY FEE-ONLY ADVISORS AFTER A BOOK SALE, ON AVERAGE

IF you're buying or selling a book, Todd Fulks knows you're obsessed with multiples. He's heard them all: 1.5 times revenue; 2.5 times gross trailers; 1% of assets under management. But he can't stress enough, "You should not use a multiple to do valuation."

Fulks is general counsel and senior vice-president of the transaction division at FP Transitions, an Oregon-based firm that's valued more than 2,000 financial services businesses.

Each analysis comprises over 100 data points, so it's not surprising Fulks is frustrated by the fixation on standardized multiples to value companies. "They are averages of hundreds of actual sales," he says. "And the average doesn't represent any particular transaction."

Farley Cohen, chair of the Canadian Institute of Chartered Business Valuators and a principal at Cohen Hamilton Steger in Toronto, has also encountered sellers who just want a valuation that states a multiple. But "that doesn't get you far, because the purchaser is going to do due diligence," he says.

And that due diligence entails more than just numbers.

Strategic fit

"There's a lot of homework that has to be done," says Sandra Foster, author of *Buying and Selling a Book of Business: What every advisor and planner should know*. She uses the example of buying a house. "Price is just one consideration. You wouldn't buy it without walking through the door."

While Cohen can rhyme off a list of considerations (see "Value is also...," this page), the ability to retain clients after the sale is key. Many deals involve a price that's payable over time, and is largely contingent on how many clients stick around. "If the vendor does a good job transitioning those clients to the new purchaser, the likelihood is much higher they'll stay," says Cohen.

In fact, FP Transitions' valuation department finds advisors who transition with the proper planning and structure retain at least 88% of clients. For fee-only advisors, this rate averages up to 97% (see statistics, pages 20 and 21).

"There has to be a strategic fit between the buyer and seller," says Bob Labrecque, director of succession planning at Manulife Financial. "If the buyer has a different business philosophy, the transition shock is greater."

For Noreen Mejias-Bennett, business philosophy was top of mind when choosing a buyer. With multiple designations and a holistic approach, the former Ottawa-based advisor wanted a similar successor. She interviewed three prospective buyers about their training philosophies, practice characteristics, approaches to client **continued on page 22**

VALUE IS ALSO...

NUMBER OF CLIENTS. Also, are there some big clients who would take most of the money with them if they walked?

GROWTH RATE OF CLIENTS. Are clients referring clients? "That would give you additional future profits and cash flows," says Farley Cohen, chair of the Canadian Institute of Chartered Business Valuators (CICBV).

LENGTH OF RELATIONSHIPS. A 35-year client is worth more than a one-year client.

AGE OF CLIENTS. "Are they in their 70s? Is the end in sight with respect to the profits to be earned from those clients?" asks Cohen. Examine whether children of aging clients, who will receive inheritances, are clients or potential clients.

PORTFOLIO MIX. "If the vast majority has mostly term deposits, you don't

continued from page 21 care and current clients. She ended up choosing the candidate committed to lifelong learning.

"Although it was tempting to sell to the highest bidder, I was driven by who would be the best fit," says Mejias-Bennett. "I could not have egg on my face. How could I look at my clients a year later in the grocery store?"

One candidate didn't make time to read the 12-page client backgrounder Mejias-Bennett had prepared, so she knew that advisor wouldn't have nurtured her client relationships.

"The years of goodwill and depth of rapport I built have value, not just the amount of annual recurring revenue per client," she says. While her buyer decided to get rid of clients with assets under half a million, the majority of Mejias-Bennett's book has stayed since the sale in 2010.

Retaining clients was one reason advisor Michael Moore, director of Moore Financial in Ottawa, decided to sell his book to son Jeremy Moore, who's now president. Jeremy has been with the practice since 1994 and many clients assumed the father-son handoff would be taking place. In fact, no clients left as a result of the handoff.

Handing over the keys

But that retention didn't just occur because of the fit between buyer and seller.

Over the past five years, Jeremy gradually got to know Michael's clients. After the Moores decided on a sale date, the two met with nearly all Michael's clients to brief them on the transition. This took about one year.

To make this process easier, "We grouped them into people I had a strong relationship with, people I knew well personally but not financially, and people I didn't know," says Jeremy, and adjusted their messages accordingly.

Mejias-Bennett didn't have the luxury of time, but she still took a month to meet with all clients to let them know she was selling. During the meeting, she shared her criteria for choosing the new advisor, and let clients know that she would be entrusting her personal finances to the new advisor. "Their responses were, 'We trusted you. If he's good enough for you, then we have confidence in your decision,' " says Mejias-Bennett.

She also held joint appointments over the next two months with her and the new advisor so clients could ask questions. "I also left the door open: should they wish me to be present for a subsequent meeting, I would be available with the strict understanding I could not offer financial advice."

This type of overlap can smooth the transition.

make as much as you do with people trading equities," says Cohen.

OTHER COSTS. Notes Cohen: "If I have two assistants, I pay them out of my commissions. If you buy my book, and you have assistants you can load work onto, you can make more money with the portfolio than I did."

SCALE. Will merging your book with the buyer's create economies of scale? "[The buyer] doesn't want to run two separate businesses," says author and consultant Sandra Foster.

MISSED OPPORTUNITIES. Have your clients been asking for divorce advice? Access to alternative investments? Let the buyer know so he can capitalize.

WHAT WILL A VALUATION COST?

There are *three levels of valuations* under the CICBV, from least to most thorough (and expensive):

1. **Calculation**
2. **Estimate**
3. **Comprehensive valuation**

Cohen says a valuation will cost at least $5,000, and could be substantially more. "It depends on what legal agreements there are, how big and diversified the portfolio is, how much detailed analysis you can get from your company," and a host of other factors.

The father and son comprising Moore Financial say it's money well spent. Since their sale was a non-arm's-length transaction, a third party had to value it—but they would have done it that way even if it were optional. "Someone who doesn't have a card in the game can give a more believable number," says father Michael Moore.

What's more, says son Jeremy Moore, "Work with people who understand the purchase and sale of a business. I wouldn't rely on your accountant that doesn't practise in this field, or your real estate lawyer."

> *"It was tempting to sell to the highest bidder.* **I was driven by who would be the best fit."**
>
> —NOREEN MEJIAS-BENNETT

"There are certain relationships we've decided Michael shouldn't be completely cut off from," says Jeremy. "It didn't make sense to stop and start from scratch."

This raises another question: how long does the seller stick around?

"It's important for both parties to understand the expectation," says Jeremy—and getting it in writing is crucial. "I've heard stories of a seller who says he's getting out, yet won't let go. Or the guy says he'll stay, and once he realizes he doesn't have to he isn't around."

Compensation complications

While the price of a book comes down to the number of clients who stay, an advisor's compensation also matters. In this case, the trend—and possible regulatory move—toward a fee-based rather than commission-based model will eventually raise book values.

MULTIPLES, REVISITED

FP Transitions has found the following ranges in multiples for all 2010 book sales:

Non-recurring revenue: 0.3x the trailing 12 months to 1.74x the trailing 12 (average: 1.08)

Recurring revenue: 1.16x the trailing 12 to 3.38x the trailing 12 (average: 2.31)

"A transactional book is tougher to price and less valuable," says Hamish Angus, managing director and head of ScotiaMcLeod Full Service Brokerage. "A fee-based book of business will likely retain a higher value because of the consistency of the revenue."

FP Transitions does report a range of multiples (see "Multiples, revisited," this page). The larger North American market concurs recurring revenue is more valuable than non-recurring.

Fulks says if clients come back every year, they're worth more. The catch is, you have to make sure they'll keep coming back after you're gone.

"You want to build a business of enduring and transferrable value, so put systems in place to automate workflow," he says. "For example, a contact management system can help automate communications. And convert from a non-recurring revenue model to recurring revenue model, where appropriate."

The challenge is this can't happen overnight, and the advisor will have to justify charging fees **continued on page 24**

WHO CAN HELP?

- Business brokers
- Your professional team (accountant, lawyer); they may also be able to refer you to potential buyers
- Chartered Business Valuators
- Tax experts (as sale will result in capital gains)
- Lawyers
- Internal firm resources, including an interested junior or associate, and/or other advisors within your larger firm. Some firms have study groups of advisors at a similar career stage that can provide anecdotal advice.

> "A transactional book is *tougher to price* and less valuable."
> —HAMISH ANGUS

DON'T LEAVE US

Former wealth advisor Noreen Mejias-Bennett recommends being fully certain as to why you're leaving. One reason: your colleagues won't always understand why you're selling.

"I felt isolated and ostracized, like I had disappointed them and the firm," she says. Her colleagues questioned why she would leave when she was still young (under 55) and successful—and when female advisors are still only 20% of the force. "My departure, I feel, was seen as an act of betrayal." But she stood her ground, because "life is not a dress rehearsal. You have to do what feels right for you."

continued from page 23 to clients who've been used to embedded commissions, says Dave Velanoff, president and CEO of MGI Financial, in Waterloo, Ont. That's not an easy sell.

"Traditionally, a modest down payment to the seller and a three- to five-year earnout is the method used to pay for a book purchase," he says. "If the trailers dry up during this period, you're not going to have the built-in revenue stream to pay the seller and business expenses. The book [won't] get the advice fee unless you get clients to sign for it."

And it's unlikely clients will sign if they don't understand why they're paying fees.

"Future book values will drop for advisors who aren't good at clarifying the value they bring to the table," says Foster. "People have short memories, so we have to remind clients of our value in a professional manner. Keep a tally of all the benefits they've received from following your advice, and review this list with them every once in awhile."

Right successor, right time

But don't let regulatory and business model uncertainty cause you to wait too long to sell, or hold off entirely. "You can't time the market. We tell our clients that all the time," says Foster. "Your job is to find your clients your best successor. If the range of advice isn't there, don't sell."

Regardless, there are indications it's currently a healthy market for books. "We expected because of the average age of advisors that we'd see more sellers," says Labrecque. "But I'm still seeing a lot more buyers."

Indeed, three candidates approached Mejias-Bennett. "As markets have rebounded, advisors are in a better position to offer top dollar to acquire a book," she says.

As well, "there's currently a fair bit of commodities activity in the Canadian markets," says Cohen. "So you have an active client base now, which would mean more commissions." Cohen also points to the impending transfer of wealth from WWII-generation parents to boomers.

"Buyers want to get those portfolios, so they have the opportunity to service that transfer," he says. "They might be willing to pay more as a result."

All this means sellers can—and must—afford to be more choosy when picking a successor.

Thinking of the demand side, Velanoff is more cautious. "It's a good time for the right buyer," he says. "In my mind, that's a financial institution. The banks and other well-capitalized firms aren't going to hurt if they buy a bunch of books that drop slightly in value because they go to fee-based."

And, he notes, large firms also have strategic advantages: for example, a manufacturer that purchases a book has employees selling its product, which provides additional margin—and cushion—that an individual advisor doesn't have.

As a result, "I'm not sure it's the right time for an advisor to buy a book from another advisor. The risk to the purchaser is higher and that could lower the purchase price. But we can only speculate as to what the future will look like."

And that's the bottom line. You don't have a crystal ball, so you have to put yourself and your clients first. AE

SHIN