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MARK C. TIBERGIEN  
AND  
OWEN DAHL



HOW TO  
VALUE, BUY, OR SELL  
A FINANCIAL  
ADVISORY PRACTICE

A MANUAL ON MERGERS, ACQUISITIONS,  
AND TRANSITION PLANNING



PRAISE FOR

*How to Value, Buy, or Sell a Financial-Advisory Practice*  
**A Manual on Mergers, Acquisitions, and Transition Planning**

by Mark C. Tibergien and Owen Dahl

“Anyone looking to value, buy, or sell a practice will find it an invaluable resource.”

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“This manual is one of the best of its kind that I have ever read. No stone is left unturned in describing all aspects of concluding a successful deal—from the financial to the psychological—for both buyers and sellers.”

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“Over the last two decades, Mark Tibergien has transformed the way advisers manage their businesses. This new book extends that work into the most important business decision of a principal’s career: buying or selling a business. Mark Tibergien and Owen Dahl have methodically dissected the complex M&A process to produce an invaluable guide that covers all aspects of transition planning.”

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Director of Mergers and Acquisitions, Schwab Institutional

“Don’t make the mistake of trying to buy or sell a financial-advisory practice without having first read this book. Not only does it tell you everything you ever wanted to know about the subject, but you’ll have a clear advantage in negotiating with the other party to your transaction if he or she has failed to read it.”

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“This is a most comprehensive guide that accurately defines how to value, buy, or sell a financial-services firm. Tibergien goes over the top in providing the adviser an understanding of how to maximize business worth. Regardless of what stage of your financial-services career you’re in, this is a must-read!”

DAVID K. GOAD, CHFC

President, Succession Planning Consultants

Author of *Succession Planning Strategies for the Financial Planner*

“This book is a must-read for all investment advisers who someday hope to sell their practices or combine them with other firms. It provides industry professionals with invaluable insight into the various aspects of a successful practice transition.”

THOMAS D. GIACHETTI, ESQ.

Chairman, Securities Practice Group

Stark & Stark, Attorneys at Law

“Mark Tibergien is the Peter F. Drucker of the financial-advisory industry. Principals of advisory firms ignore his counsel at their peril. ‘Value’ is a word of many meanings. Whether you’re a buyer or a seller of an advisory practice, Mark and Owen’s book takes the mystery out of the transactions, giving the reader a complete road map through the process.

“Principals of financial-advisory firms often procrastinate on one of the most important decisions of their business life. Building value in your business and executing a transition are not easy. You have three options: a transition to a strategic party, to a financial buyer, or to the next generation. The fourth possibility—to do nothing and let your heirs worry about it—is not really an option. The transition can be made a lot less painful by following the advice in this book.”

SCOTT D. ROULSTON

Chief Executive Officer, Fairport Asset Management, LLC

“Mark and Owen have done a wonderful job bringing together all aspects of valuing, buying, and selling a financial-advisory practice into one, comprehensive, easy-to-follow book. I wish I’d had this book when we made our first acquisition.”

MARK C. SOEHN

Principal, Managing Director

Financial Solutions Advisory Group

“Tibergien and Dahl have delivered an excellent road map for financial-advisory firms seeking to avoid the critical mistakes that often result when deriving and realizing firm value. This comprehensive guide identifies the steps in the process and provides key insights on how to correctly identify and realize the value of your financial-advisory practice. Whether your focus is on buying and selling financial-advisory firms or on maximizing the value in your practice, this book will become an invaluable resource.”

M. BRETT SUCHOR, CFA, ASA

President, Quist Valuation



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# How to Value, Buy, or Sell a Financial-Advisory Practice



*A Manual on Mergers, Acquisitions,  
and Transition Planning*

MARK C. TIBERGIEN

*and*

OWEN DAHL

BLOOMBERG PRESS  
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*To my parents, Co and Marian Tiberkien,  
for indulging me just enough to pursue my dreams.*

—MT

*To Mom and Dad, for teaching me that  
client service is not a concept, but a calling.*

—OD

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A REFERENCE BOOK that tackles a complex topic requires the help of many people, and *How to Value, Buy, or Sell a Financial-Advisory Practice* was no different. We would like to acknowledge the valuable guidance on legal issues we received from Tom Giachetti, who heads the securities practice for the law firm of Stark & Stark in Princeton, New Jersey; Dick Fohn, a partner at Moss Adams, for his guidance on the tax issues; and Jet Wales, a principal at Moss Adams Capital, for his insight and wisdom on the elements of negotiating and structuring a transaction.

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Early in my career, I was recruited to Seattle by Shannon Pratt of Willamette Management Associates, Inc. As an early leader in the valuation profession and a current icon, he has led the way for many. I had the special benefit of having Shannon as a tutor on valuation principles and owe him a big thanks for being my teacher and for being an early influence in my pursuit of a profession.

— MT

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— OD

# Introduction

MUCH HAS BEEN WRITTEN in the trade press about the value of financial-planning, wealth-management, and investment-management firms. This coverage—as well as the interest in it—has expanded as many prominent professionals in the business negotiate purchases and sales of such practices. Although the details of each deal are kept close to the vest, the rumored price and terms create a buzz that advisers can't ignore.

Owners of financial practices view these transactions with both excitement and trepidation. The excitement comes from knowing that there are buyers willing to pay rich prices for such businesses; the trepidation comes from thinking that this may be a window of opportunity they have little choice but to capitalize on soon. But we believe that well-managed firms will always be appealing to willing buyers.

This book lays out a number of issues that should help both buyers and sellers make judgments about the value of businesses. We also identify valuation considerations in the event of internal transition, partner admission, gift and estate tax, divorce, and even shareholder litigation. Value—like beauty—is in the eye of the beholder, but the principles of valuation have been constant for many years. Our goal with this book is to explain how to examine each of the variables and each of the assumptions that can shape conclusions on valuation. We also identify areas that owners can work on to enhance the value of an advisory business, provided they have enough time to plan for an orderly transition.

Not all practices are equal. And although it may be tempting to rely on rules of thumb and industry benchmarks to define value, we've seen so many deals in which the multiple and the terms have

been different that we tend to be fairly cynical about whether such models deserve much weight. The Financial Services consulting team at Moss Adams has consulted with more than 1,000 financial-services organizations on issues related to valuation, succession planning, practice management, and mergers and acquisitions, and we rarely encounter exactly the same assumptions and conclusions being used among these firms.

So even if you're inclined to rely on what other firms are bought and sold for as the basis for valuing your business (or one that you're buying), we believe you'll find *How to Value, Buy, or Sell a Financial-Advisory Practice* helpful in setting values regardless of the purpose of the valuation.

In the first six chapters, we offer a complete analysis of valuation theory and practice and present two case studies to help illustrate the key considerations. Our purpose here is not to give you an exact answer as to the multiple you should use but to demonstrate how to think critically about the differences in practices and therefore the differences in valuations. In chapters 7 through 11, we identify key considerations in negotiating an agreement and setting the terms of a deal. We follow these chapters with a discussion of integration after the sale and key issues to be considered in planning an internal transition.

You'll also find ideas on how to select intermediaries to help you through the sale process and our opinions regarding the state of the market. We close the book with a critical look at how to build value for your firm. The sample documents and checklists offered in the appendix will be useful to anyone contemplating a purchase or sale, although we emphasize that these samples should not be copied but used only as a reference. Only a qualified attorney familiar with both the law and the nuances of your firm's circumstances can assist you in drafting documents.

As you prepare for the process of selling a practice, several key matters require your attention:

1. Be clear on what your goals are.
2. Begin building a history of the business by gathering relevant documents for the last three to five years.
3. Begin benchmarking your business against relevant industry standards to see how yours stacks up.

4. When negative variances show up in your benchmarks, think about the steps you need to take to close these gaps so that you can enhance value.
5. Remember, valuation is more art than science—the firm's numbers tell a story but so does its potential. Position your business so that you can improve your cash flow, minimize your risk, and manage your growth.

As you prepare to buy a practice, there are critical issues you must consider:

1. Value is a function of future potential, not the past results.
2. All firms are not created equal; therefore, rules of thumb are insufficient gauges.
3. Do your own due diligence; the seller's facts are not always as they seem.
4. The devil is in the details; focus on all the terms, not just the price.

And as you progress toward a final agreement, remember that whether you're buying or selling, the trouble you take to confirm the value of the practice while the deal is negotiated can only ensure greater rewards once it's sealed.



PART

I

Defining  
Value



# I. UNCOVERING TRUE WORTH Defining Value

INVESTMENT OR FINANCIAL-PLANNING professionals—like many small-business owners—often have an inflated perception of the value of their practice. That’s because they typically have 15, 20, or 30 years of blood, sweat, and tears invested in the enterprise, and it has been a fountain of economic rewards during their working years. And they have heard many people quote market multiples that they are certain apply to their practices. But when you assess the value of a practice, shortcuts don’t tell the whole story. You must look more closely to understand nuances like the quality of the client base and the future potential of the practice. It’s also important to understand whether the firm is profitable in its current form and whether that profitability is sustainable.

For a buyer, a realistic understanding of the worth of the practice is essential to paying a fair price. And clarity on these principles will make sellers more effective negotiators. This chapter outlines the valuation process and highlights the factors that drive practice value. Subsequent chapters will address the mechanics of valuation, deal structure, internal versus external transactions, and other factors that should help you prepare for this process regardless of which side of the deal you’re on.

## **The Unruly Rule of Thumb**

For a business as straightforward as financial planning, many ideas that circulate about how to value a financial-advisory practice are surprisingly convoluted. Each month, Moss Adams LLP receives

scores of calls from advisers who want us to tell them the rule of thumb for valuing a practice. “Is it the multiple of gross?” they ask. “The multiple of assets under management? The multiple of EBITDA [earnings before interest, taxes, depreciation, and amortization]?”

Especially maddening is that some practices actually do sell for a rule-of-thumb price. That doesn’t mean it’s an appropriate price, but it happens nevertheless. The good news for sellers is that these rising multiples are enhancing the value of their practices every day, and consequently these advisers are in a unique position to capitalize in a big way on the businesses they’ve built. But some important issues are essential for both buyers and sellers to consider in determining value.

The rule-of-thumb methodology presumes that all advisory practices are equal. Such assumptions are just as faulty in comparing advisory firms as they are in comparing stocks. If the price of Starbucks falls below the price that Microsoft is selling for, does that make it a better buy? The question is obviously not relevant because their economics are different. What’s more, each investor’s perception of risk and growth is different.

The inclination to rely on a rule of thumb makes it clear that buyers and sellers of advisory practices view these transactions as they do the purchase and sale of a house. In real estate, one can look at a neighborhood, measure the square footage, see if it has a view and come up with a price. Buyers of homes don’t usually calculate with accuracy what kind of return on investment they’ll get with this purchase, because the whole point is to acquire an asset that they can live in and possibly sell for a gain down the road. Perhaps it’s because buyers of advisory practices look at these firms as a means to an end, a necessary component for their lifestyle, a job, that they fall into this home buyer’s approach to pricing them.

But advisory firms are not tangible assets like houses or cars; they’re living, breathing entities with multiple nuances that could affect their value. What’s the potential in the client base? How old are the clients? How profitable is the service model? Will clients accept the new adviser? What’s the expense structure? What’s the motivation of the buyer? of the seller?

### *Distorting Value*

Rules of thumb tend to distort value. Even market comparables tend to distort value because of the unique characteristics of each business being sold, as well as the particular motivations of the buyers and sellers. We encountered an example of this when we were asked to evaluate a practice on behalf of a buyer—in fact, the buyer was in a bidding war to acquire the business. The owner of the practice had died suddenly, and his widow engaged a broker to find a buyer. The broker set the price at 2.5 times trailing 12 months' gross revenues. He advised our client not to bother offering anything less. In probing for the opportunity in this practice, we found that 40 percent of the clients were past the age of 70 and many were already withdrawing principal. None were contributing more cash to invest. Looking at the mortality rate of this client base gave the buyer enough pause not to step up to this multiple.

Oddly enough though, sometimes sellers don't realize what their firms have to offer. Again, relying on stated market rules of thumb, one adviser actually undervalued his practice. His average client was a business owner or executive, age 45, whose income was increasing each year and who was contributing substantial new assets yearly. The growth rate for the foreseeable future was exponential, and the practice was extraordinarily profitable, but by relying on the rule of thumb, the owner appraised his practice as "average." He now knows that the only time you should aspire to be average is when you are below it.

## **The Need for Valuation**

Drawbacks aside, rules of thumb and market comparables come in handy as a starting point for a discussion of value. For the buyer, however, that figure should rarely be the end point. So many factors related to structure, financing, terms, and taxes go into a deal that there should be give-and-take in every situation. The key question the buyer of a practice should be asking is, "What is a reasonable rate of return on cash flow when I make this acquisition?" By beginning there, the buyer can move toward an understanding of the principles of business valuation.

It is unnecessary for buyers or sellers to obtain a formal valuation before entering into a merger or sale discussion. Sellers often have an idea of the price they want for the business regardless of economic reality. Buyers, however, will benefit from some form of valuation process. It provides a foundation for early negotiations and will help them put their thoughts through an economic filter. Since most people in the financial-advisory business are financially astute, the valuation process should be easy to relate to.

If a buyer or seller does go through a formal valuation process, the evaluator should consider key standards, such as:

1. Market prices of comparable publicly traded companies
2. Transaction values of similar entities
3. A discounted cash flow analysis of the business being valued
4. A detailed and specific analysis of the entity and the market conditions in which it operates

Typically, the first three benchmarks are given less weight than the specific analysis, but they're considered nonetheless. In using a rule of thumb—or market comparables—only one perspective is considered. Such a single-lens view is a little like making investment recommendations for your clients based on the last conference speaker you heard: compelling but incomplete.

## Standards of Value

There are numerous ways to measure the value of a business. Two key questions are essential to beginning the valuation process:

1. What is the purpose?
2. What is being valued?

The answers to these questions determine the purpose of the valuation and dictate which standard of value applies and whether it's appropriate to consider discounts or premiums in deriving the value.

### *What Is the Purpose?*

**Fair market value and fair value.** The standards of value relied on for tax, litigation, or contractual purposes are referred to as fair market

value and fair value. Fair market value is the standard used in the context of gift and estate tax and sometimes applies in the division of assets in divorce. As promulgated by Revenue Ruling 59-60, fair market value defines a value at which an asset or business would change hands between a typical *willing buyer* and *willing seller*, neither party being under any obligation and both parties being fully informed of all the facts. Fair value is a standard usually defined by state law and is typically used in divorce, partnership, and shareholder disputes and sometimes in buy-sell agreements.

It's quite possible that valuing an asset for tax, divorce, or litigation purposes will result in a conclusion different from that which results in the process used to determine value for purchase or sale. In the case of litigation or divorce or estate tax, however, the emphasis is not on a real-life transaction. When a sale or purchase is contemplated, fair market value may be a starting point, but other factors, including the motivations of the buyers and sellers, could change the result. Another standard—investment value—may also come into play, however, because this standard considers the potential synergy of the two businesses, a measure that's quite useful for some owners and sellers.

**Investment value.** The term *investment value* as used here is defined in the American Society of Appraisers' *Business Valuation Glossary* as the value to a particular investor based on individual investment requirements and expectations. Investment value is different from fair market value, which is value to a typical buyer and seller, for various reasons, including:

- ◆ Economies of scale available with the buyer's operations
- ◆ Synergies available with the buyer's operations
- ◆ Differences in future earnings estimates
- ◆ Differences in perceived risk
- ◆ Differences in tax status

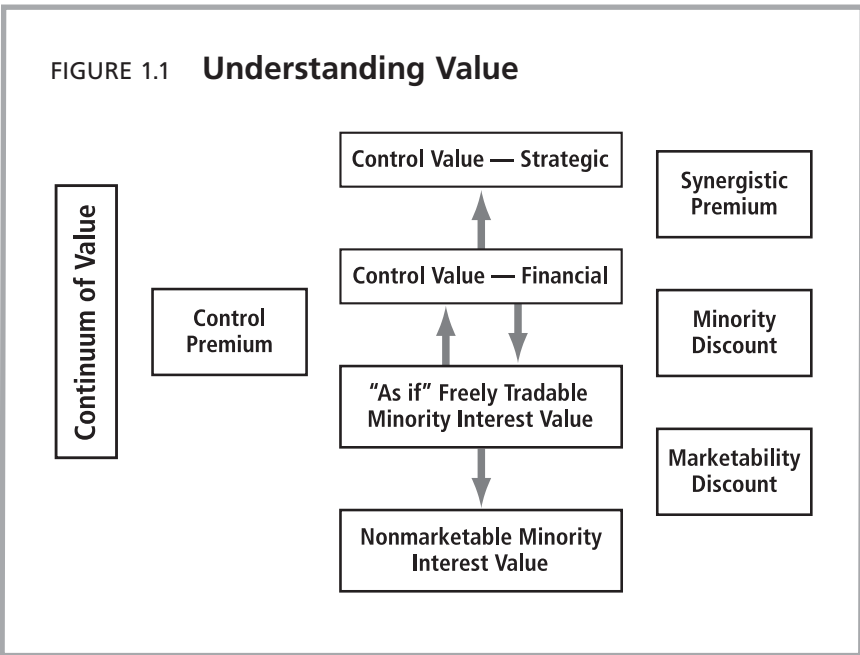
Using investment value as the primary premise of value is inappropriate in the sale of an advisory practice because the seller should not receive all of the synergistic value; nor should the seller expect to receive the full premium. That premium should be considered as part of the negotiation process.

### What's Being Valued?

Many assume that what's being valued is the entire business. But there are situations in which portions of the business may have to be valued separately. The difference would influence whether one applies a control premium or a minority or nonmarketability discount to the price. It's all a function of rights.

The more rights the owner has—such as the right to liquidate the business, declare dividends, or sell major assets—the greater the premium applied. A discount is applied based on the transferability of the asset, lack of voting rights, or lack of a ready market. These matters become important to define in the context of litigation, shareholder disputes, divorce, or the admission of partners or when using stock as currency in a transaction (see *Figure 1.1*).

The factors related to defining value also play a role in translating market rules of thumb into your planning. We often see buy-sell agreements with multiple shareholders in which the value of each ownership interest is based on an enterprise value, meaning 100 percent control divided by the number of shares. The challenge with this



approach is that most of the shareholders in these companies cannot do the things they could if they had control (usually 51 percent of the equity). Market multiples are generally on a minority, fully marketable basis, whereas transaction multiples are always based on control, so you must be careful to compare apples to apples.

## The Valuation Process

In principle, the value of an investment equals the present value of expected future returns from the investment. Various methods may be used to estimate the value of a business-ownership interest. Broadly categorized, these methods separate into three approaches:

- ◆ **Cost- or asset-based approach.** In this method, the assets and liabilities of the business are restated from historical cost to fair market value.
- ◆ **Market approach.** This technique uses valuation ratios derived from market transactions involving companies that are similar to the business being valued. Past transactions, if any, involving the business are also considered.
- ◆ **Income approach.** In this method, expected future returns from an investment are discounted to present value at an appropriate rate of return for the investment.

### *Cost- or Asset-Based Approach*

The cost or asset approach in this context refers to balance sheet assets, not assets under management (AUM). In the cost- or asset-based approach, net asset value is estimated by restating the value of assets and liabilities from historical cost to fair market value. Assets and liabilities can be valued either individually or collectively. Individual assets and liabilities of a business can be appraised using the cost, market, and income approaches to asset valuation.

Because most investment and financial-advisory practices do not have much in the way of tangible assets, accounts receivables, or work in process (WIP), this approach is not likely to have much weight in valuing such a practice.

### *The Market Approach*

The market approach involves a comparison of the subject company to similar businesses, business ownership interests, securities that have been sold or are actively traded, and previous transactions involving the subject company. The method uses valuation ratios based on current market prices and historical (or projected) financial data for the guideline companies. Selected valuation ratios derived from the analysis—such as price/revenue, price/AUM, and price/EBITDA—are then applied to the subject company's adjusted historical (or projected) financial results to arrive at indications of value.

Most practitioners would like to have an easy formula—a rule of thumb—to determine the value of a practice. Typically the rule of thumb for the financial-advisory profession is a multiple of gross revenue or a percentage of assets under management. People often estimate the value of advisory firms at somewhere between one and two times gross revenue or between 1 percent and 2 percent of assets under management. We use the term *financial-advisory practice* generically here. Our observation is that commission-based practices tend to command multiples in the lower end of these ranges because their revenue is not as consistent and predictable.

As advisory firms become larger—for example, when they're responsible for more than \$1 billion of assets under management—the multiples that buyers are willing to pay increase. That's because they perceive a lower risk and greater growth potential because of how the business has been institutionalized. According to Liz Nesvold, an investment banker with Berkshire Capital who specializes in wealth-management firms, multiples in the range of eight to 12 times EBITDA for larger firms are not uncommon.

### *The Income Approach*

The method most likely to result in sound economic judgments in valuing an advisory practice is the income approach. There are two related income-approach valuation methods: capitalization of cash flow and discounted cash flow. *Capitalization of cash flow analysis* uses forecasted cash flow for the next period, which is converted to present value using an appropriate capitalization rate equal to a discount rate less the expected growth rate in perpetuity. In a *discounted*