CENTURION™
MARKET MAKERS

FINANCIAL PLANNING PRACTICE VALUATION GUIDE

2018 EDITION

INTRODUCTION

When benchmarked against the average family home, a financial planning business is a very valuable asset, for most practice owners their biggest investment. Yet most practice owners do not know the true value of their business or prepare well when it is time to sell this valuable asset. Poor preparation, lack of knowledge and lack of experience in selling a business most often equates to poor results at the time of sale relative to other business owners who prepare well.

Centurion has put together this guide on business valuations to help business owners maximise sale value and minimise transaction risk at the time of sale. This guide, and the webinars we run, will provide any business owner with better insight into the market value of financial planning businesses and the nuances of how buyers will approach valuing your business.

This document was prepared and updated in January 2018 and all commentary and data relating to practice sales and valuations are based on information obtained in the 2017 calendar year.

Your Million Dollar Sale: Maximize your sale price by avoiding the 3 common errors

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Are businesses selling on Profit or Recurring Revenue Multiples?

One of the top 3 questions we get asked every week is whether practices are selling on multiples of profit or recurring revenue.

The answer is both – but how does that work?

When you purchase a business you are fundamentally hoping to make a profit from the business. Every buyer I speak to or client I have worked for on an acquisition, wants to know what they will "make" as a result of the acquisition. Some like to measure profit different ways: many are only interested in free cash flow if they are using debt to fund the purchase; for some it's return on investment; for many it's what they take home that matters!

The vast majority of transactions that are completed in the marketplace are the sale of a practice or book of clients by the owner to an acquirer who has an existing practice. Most often the acquirer already has premises, staff, business systems and infrastructure, so consequently when purchasing another business or client book, most often the acquired business is relocated to the acquirer's office. For the vast majority of transactions, only a part of the purchase price is paid upfront with the balance paid a year or two later and subject to performance clauses.

This is where the complexity begins. When you buy someone else's business and relocate it with yours and the performance clauses for the balance of purchase price are based on profit targets, it can be difficult to reach an agreement on how the expenses are allocated to the purchased asset during the 'earn out' clauses. The vendor also takes a risk on how the purchaser manages costs within the business during the earn out period, and in many instances where the vendor has exited the business, that is simply not an acceptable risk.

SOLUTION

The solution for the purchaser and the vendor is for the performance clauses in the earn out to measure revenue, recurring revenue and or client retention and leave all the expense decisions in the hands of the purchaser. The purchaser and vendor are closely aligned on retaining revenue and clients and thus agreeing to this is easy and arguably not complex to implement, albeit that there are at least 6 different ways to structure a performance clause focusing on revenue and clients – each can deliver very different outcomes for the same given multiple.

In summary, the purchasers want to make a return / profit / free cash flow from their acquisition. However, the least complex transaction structure is one where only revenue needs to be agreed. Thus, the purchaser decides how much profit and free cash flow they will make from the acquisition and then makes an offer as a multiple of recurring revenue as most transaction contracts are documented using recurring revenue for the earn out.

So, the more profitable your business, the more a purchaser is likely to offer for it even though the offer might be positioned as a multiple of recurring revenue!

Practice Valuation and Sale Prices in 2017

Calendar 2017 was a year of increased transaction activity compared with calendar 2016 and 2015. With FoFA reforms in place, MySuper well understood and expected changes completed the marketplace for buying and selling of businesses and client books increased in activity as buyers and sellers both showed interest in achieving their outcomes.

The key questions being asked in the market now around business valuations are about the impact of education standards based on an expectation that advisers will exit increasing supply of businesses for sale and the changes to Life Insurance industry and remuneration. In our view, it is too early to tell if either of these issues will impact the market value of businesses in the next 12 to 24 months.

In 2017, many small practices and client books were sold for between two and three times annual recurring revenue, which was similar to 2016. However, there were exceptions: purchases made by large institutions under BOLR arrangements (or similiar); sales of clients from corporate super plans resulting in accrued default account clients (ADA's); and sales of quality client books of between $100,000 and $750,000 of recurring revenue, approximately.

From discussions with practice owners, other market participants and transactions Centurion has advised on, we observed the following offered or transacted ranges of multiples for trade sales for the 2017 calednar year (RR is annual recurring revenue):

BUSINESS, CLIENT OR REVENUE TYPE:	Multiple Range
C and D clients	2.0 to 2.7 RR
FB Business co-located with buyers business	2.6 to 3.2 RR
Risk and super only business / client book	2.5 to 3.2 RR
Corporate Super	1.0 to 2.0 RR
Large FP Practice - no co-location with buyer business	5 to 7 EBITDA

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PARTIAL EQUITY POSITIONS

Minority Equity position in large practice	4 to 7 EBITDA
Majority Equity position in a large practice	5 to 7 EBITDA

Notes: For the purpose of understanding the above, an FP Business co-located with a buyers business is one of the most common transactions within the industry and the co-location of the acquired business with the purchasers business makes the measurement of profits of the acquired business complex given the co-location and sharing of infrastructure and resources. Thus, the offer and transaction is most often structured using recurring revenue.

There has been a trend for assets in regional areas to attract lower valuations than like businesses in major cities. Often this is a function of supply and demand with fewer buyers in regional areas, however this is not always the case.

Valuation for partial equity positions in large practices can reflect internal succession planning where a small amount of equity may be discounted for long-term or key employees.

How will buyers determine the multiple to offer for a business?

The answer should not be a surprise really: it's partly their awareness of the current marketplace for values generally, part maths and part circumstance. The latter is a key factor and missed by many practice owners.

A simple scenario: Buyers who, having a strategy to grow by acquisition, have made offers on 2 or 3 businesses and not been successful are:

A. Likely to be super motivated given they have missed out previously and likely to have been working on this strategy for 12 months or more.
B. Having made offers and not been successful, they are far more likely to be aware of the market price assets have been selling for.

Their circumstances are very different to a buyer who is working on their first acquisition offer or who is not really in acquisition mode, if not for an opportunistic asset that has become available via a known colleague.

Buyers also make their valuation decision based on the information and data they are presented. This is an issue itself. Different buyers will focus on different data and want information prepared different ways – a cross section of issues and key data that many buyers use are:

Business type/types of revenue streams
Supply and demand by geography
Supply and demand by business size
Client service offer and pricing
Number of FDS clients
Number of opt-in clients
Number of non FDS clients
Client demographics (Age, RR, FUA)
Investment platforms
Client data storage (ease of transition)
Financial statements
Profitability
Risk assessment
Matrixing of the above data points

Practice Valuation Summary

The above trade sale ranges reflect, most often, a transaction where the purchaser acquires the business from the vendor and collocates this acquired business with the existing business. Thus the payment terms, including any performance measures for the earn-out payments, are most often contracted as recurring revenue measures. EBITDA (or equivalent) profit based multiples are typically used in transactions where the acquired asset will be run on a standalone basis and profit for the business can be measured and the vendor has some control over the expense lines.

There has been a trend for buyers to assess the value of a practice or client book using the age profile of the client base as the key valuation metric. There are many factors that influence the market value of an asset and while the age of a client may have some correlation with the future income streams and propensity to purchase other services, as a standalone valuation tool many buyers have been unsuccessful with offers using this framework as their only valuation metric.

The multiple for a transaction will also vary based on the payment terms and risks attached to the performance measures for any deferred payments as buyers and sellers seek to mitigate risk.

Valuations in the Future

Business valuations have fallen as a result of FoFA and the more recent Life Insurance Commission Reforms and the question many are asking is: are further falls likely over the next three to five years? In general, financial planning businesses tend to sell for more than equivalent-sized businesses in most other industries or professions when measured by revenue or profit multiples. Consequently, the question is why are they worth more and will this continue into the future?

Unlike many other small businesses, including other professional services firms, financial planning practices tend to exhibit some key differences in regards to financial performance:

- Monthly recurring revenue with little seasonality
- Very little aged receivables / invoices
- Extremely low bad debts
- Low levels of working capital
- Low plant and equipment costs
- Zero inventory or stock

Based on the above it could be expected that financial planning businesses will continue to trade at a premium to many other small businesses and other professional service firms. That said, if the generous bank funding terms of 10 years principal and interest (currently available) were to be replaced with shorter repayment period terms, then this would likely impact current valuations.

Do you need a valuation?

Many business owners call us about valuations of Financial Planning businesses and after we answer their questions we ask them a few questions and the most common reason for the call is they are currently involved in a transaction and they have received an offer and are suprised/disappointed by the offer and not sure what to do next. Financial Planning businesses are worth hundreds of thousands of dollars, sometimes millions, a valuation is a very small investment to create certainty around the true value of a business.

By way of example, if you consider your business recurring revenue and then take one tenth of that number, that is the value of 0.1 times your recurring revenue. Every additional 0.1 times recurring revenue you receive as an offer or pay for a business is worth that amount of money. So what is 0.1 times recurring revenue for your business - $30,000 $40,000 $50,000 $100,000... what if the difference was 0.2 or 0.3 times the recurring revenue? A valuation may be a very small investment to ensure that your transaction is at the right multiple for your business and it could make a significant difference to your price.

At Centurion, we provide valuations for businesses across Australia and for different purposes, most commonly:

- Client book valuations for sale or purchase transactions
- Business Valuations for Sale or Purchase transactions
- Shareholder Valuations for sale/purchase of shares and shareholder planning
- Legal matters including matrimonial, disputes and partnership restructure

What to do next?

If you need assistance with valution of your business, then go to our website www.centurionmarketmakers.com.au and hit the "Services" button on the site menu across the top of the page and select "Business Valuation" from the drop down menu. Use the button on that page and fill in your details and we will contact you to further discuss the next steps. Alternatively, use this link click here and it will take you straight to the form to complete and we will be in contact.

About Centurion

Centurion Market Makers are wealth management industry experts providing a suite of advisory services to owners of Financial Planning businesses, and large Practices and Licensees. We can assist you with any of the following.

Practice Sale

Maximise your valuation and minimise your risk with our proven 6 step methodology. We advise you through a business sales process that maximises sale value, negotiates with buyers and conducts the transaction to meet the diverse needs of shareholders, the people in your Practice, and importantly, your clients.

Succession Planning

Thinking about succession? Make sure everyone is on the same page. We facilitate a process that assists all owners to define their specific succession objectives and timeframes, reconcile these with the needs of existing shareholders and provides structural options that can underpin an actionable succession plan.

Practice Valuation

Know where you stand and what to expect. We perform market value appraisals incorporating a review of the business and examination of the 8 key items that buyers assess when reviewing an acquisition opportunity and which significantly influence perceptions of value and risk.

Practice Finance

Save time, money and get the loan and lender that's right for you. With our in-depth understanding of the Financial Planning finance market and experience with transactions and business lending, we can assist practices and business owners with their financing needs.

Where to next?

Ready to take the next step?

Understand the true value of your practice with a market appraisal or formal valuation.

Arrange a valuation

Thinking about selling your practice?

Download our eBook on the 6 steps to maximising your practice sale value.

Download eBook

Are you considering selling equity rather than an outright sale?

Attend our next webinar on succession planning.

Register for webinar

Has someone made an offer for your practice?

Attend our next webinar and learn the 3 mistakes to avoid when selling your practice.

Register for webinar

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