Independent Practice Acquisition

Moderator:

Scott Stathis – Managing Partner, Stathis Partners

Panelists:

Kevin Beard - Chief Growth Officer and Founding Partner, Atria Wealth Solutions

Frank Drago - President, Citizens Securities Inc.

Arthur Osman - EVP Institution Services, LPL

Jeffrey Thatcher - Managing Director, Visions Investment Services

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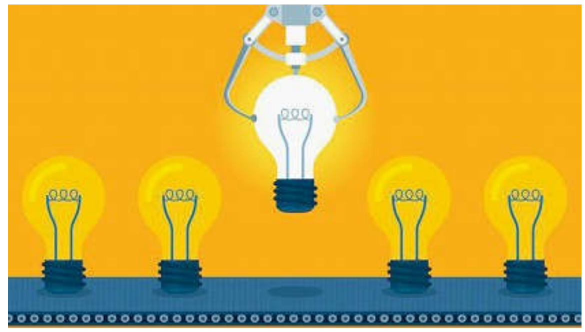

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Discussion Track

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1. Introductions & overview of acquisition experience
2. Acquisition activity in our channel
3. Questions for panelists
4. Lessons learned from IBD channel

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Practice Acquisition Survey

Summary Report - January 2018

49 Participating Institutions

Conducted by Janet Cappelletti

Managing Director, Research

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Participating Institutions

Arvest Bank	First Premier Investment Services	MidFirst Bank	Synovus Securities
Atlantic Capital Advisors	First Tennessee Bank	New York Community Bank	Technology Credit Union
BancorpSouth Wealth Management	Fulton Financial Advisors	Northwest Financial Advisors	Trustmark
BBVA Securities Inc.	Hancock Investment Services	Popular Investments	UnionBanc Inv Services
BMO Harris Financial Advisors	Heartland Financial	Premier America Credit Union	United Nations FCU
Bremer Investment Services	HomeStreet Bank	Progressive Savings Bank	S Bancorp Investments
Canandaigua National Bank & Trust	HSBC	Regions Investment Services	UW Credit Union
Cetera	Huntington Investment Company	Santander Securities	Visions
Citizens Securities	Infinex Group	SPIRE Credit Union	Washington State Emp CU
Commerce Brokerage Services	Key Investment Services	Sterling National Bank	Washington Trust
First Brokerage America	Kinecta Credit Union	SunTrust	Webster Investments Services
First Citizens Investor Services	Some participating institutions elected not to be identified.		

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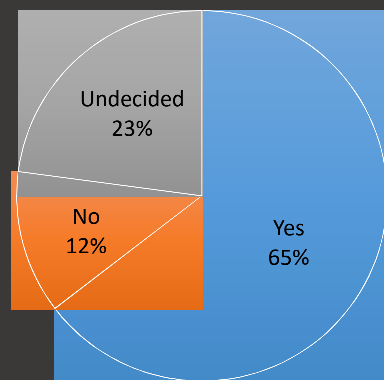
Does your firm have an interest in acquisition of independent practices as a growth strategy?



In the realm of consideration for 88% of respondents.

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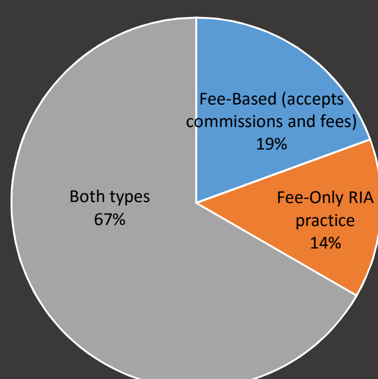
If "Yes", then what type of independent practice is your firm interested in?



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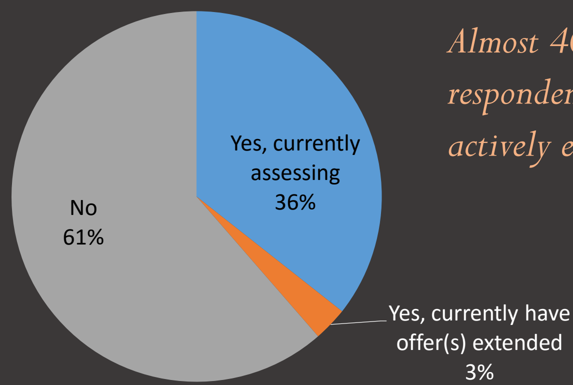
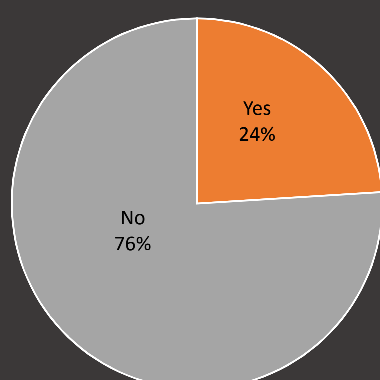
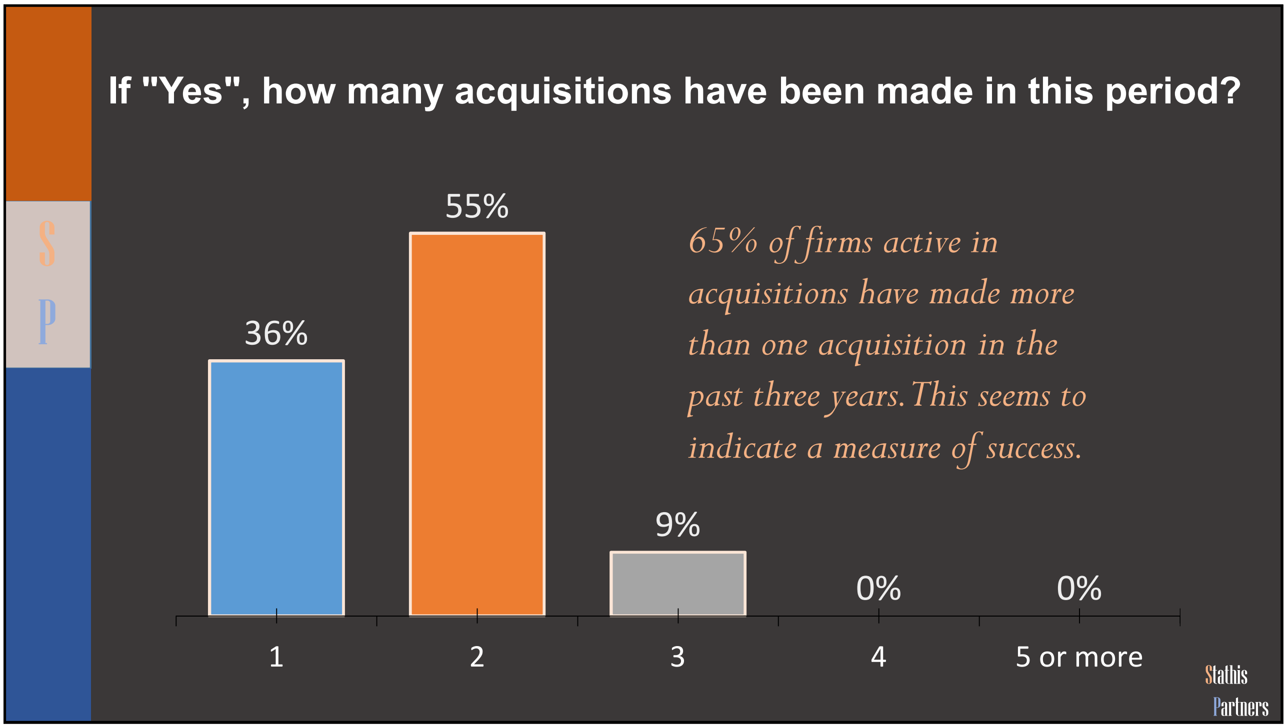
Is your firm currently engaged in assessing potential independent practice acquisition targets?



Almost 40% of respondents are very actively engaged.

Has your firm acquired an independent practice within the past three years?




If "Yes", how many acquisitions have been made in this period?
36%
55%
9%
0%
0%
1
2
3
4
5 or more
65% of firms active in acquisitions have made more than one acquisition in the past three years. This seems to indicate a measure of success.
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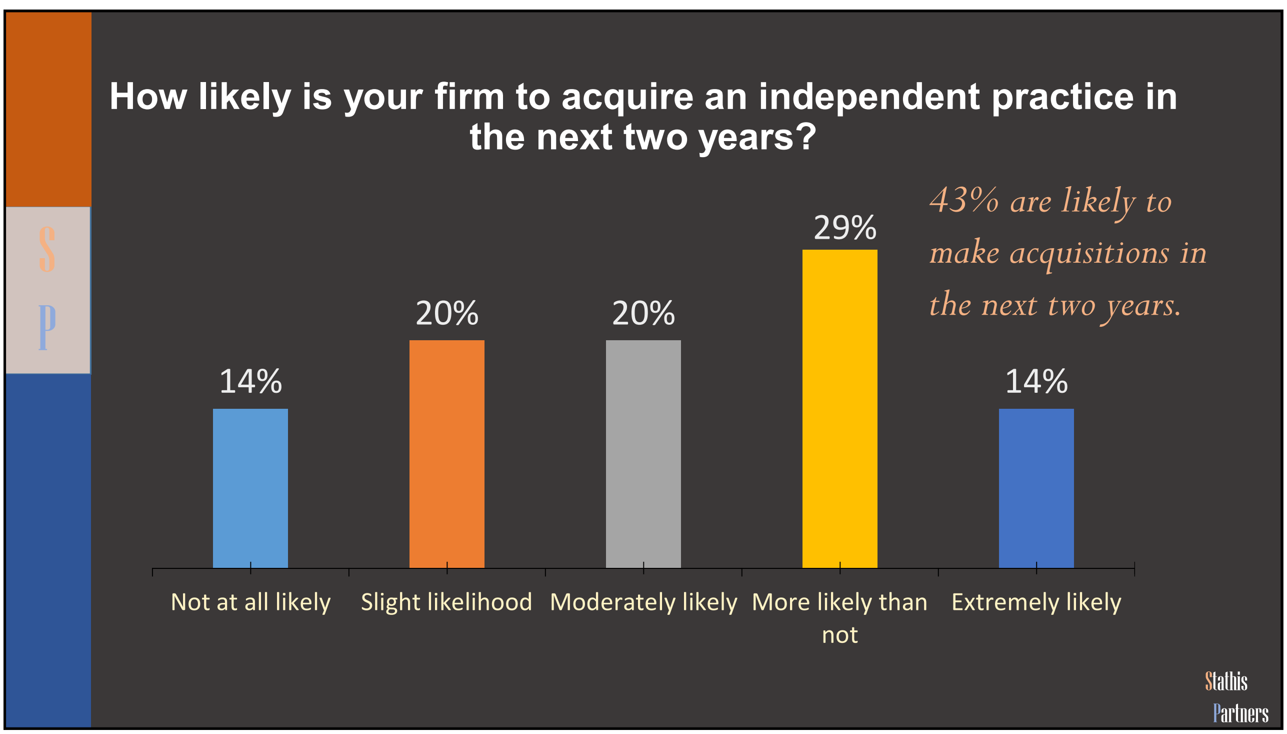
How likely is your firm to acquire an independent practice in the next two years?
14%
20%
20%
29%
14%
Not at all likely
Slight likelihood
Moderately likely
More likely than not
Extremely likely
43% are likely to make acquisitions in the next two years.
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Questions for Panel

1. What is your motivation for acquisitions?
2. Were your acquisitions buyouts, or succession plans (or both)?
   a) What was the basic structure of a succession plan
   b) How long do you keep the owner(s) around in a buyout?
3. Have all your acquisitions been successful, and if so, what are the business results?
   a) If any have been unsuccessful, what have you learned?
4. How did you define suitable targets?
   a) Is there a preference for an RIA firm or not?
5. What valuation methods have you used, and what is your opinion of rule-of-thumb valuations?
6. What do you feel are the most important valuation factors?
7. What do you think are the most critical factors that make an acquisition successful?
   a) What was done to insure client retention?

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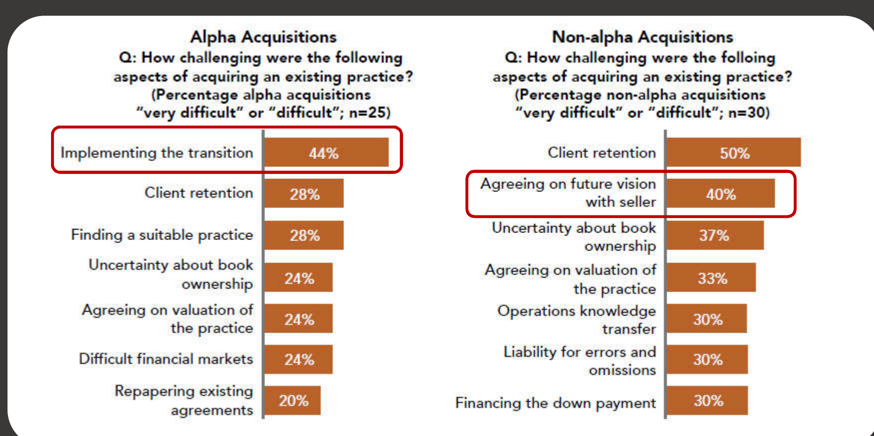
Independent Channel Reference Points



Source: Q1 2014 Aite Group survey of 401 financial advisors

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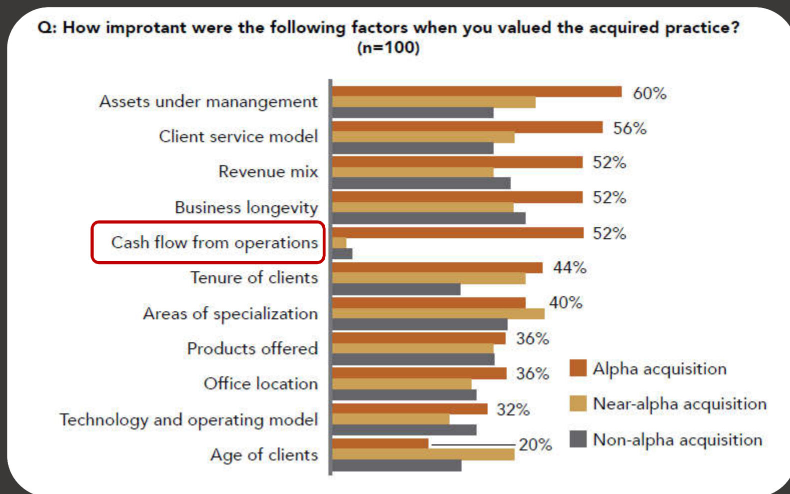
Independent Channel Reference Point



Source: Q1 2014 Aite Group survey of 401 financial advisors

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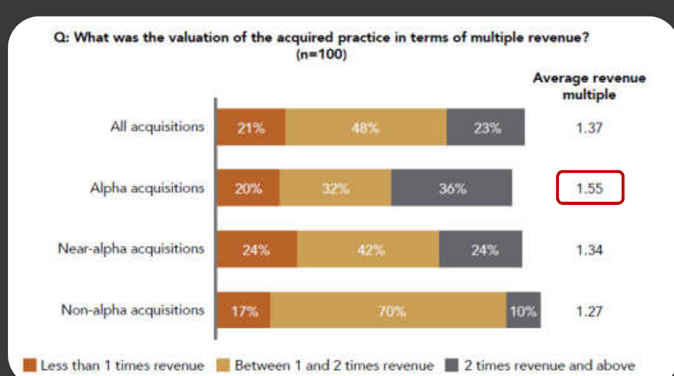
Independent Channel Reference Point

You get what you pay for - The makers of successful acquisitions paid higher multiples of revenues, on average, than their less satisfied peers.



Source: Q1 2014 Aite Group survey of 401 financial advisors

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Rule of Thumb Valuation

- 2.3X recurring rev + 1.1X transactional

"Professionally, from the vantage point of a certified valuation analyst, a multiple of revenue deserves little or no weight as a reliable and accurate valuation method."

"Rules of Thumb do not factor in risks that can materially impact value such as capital structure, regulatory issues, liabilities, profitability, growth rates, client demographics, infrastructure, etc."

- *David Grau Sr., FP Transitions*

"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."

- *Mark Tibergien & Owen Dahl, Moss Adams LLP*

- Acquisitions based on Rule-of-Thumb valuations seldom yield successful results.

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Insights

- Rule-of-Thumb valuations should be avoided – valuation is complex, there are too many factors that effect real value.
- Culture and cash flow could be two of the most overlooked critical valuation factors
- You get what you pay for – successful acquirers are not afraid to pay a premium for premium firms.
- Firms that want to be bought often don't make the best acquisition targets – create a *perfect acquisition target profile* and proactively look for that type of firm.
- The best "finds" may not currently be for sale, but that doesn't mean you shouldn't initiate an ongoing discussion.
- The most successful acquisition makers obsess over a transition plan.

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Reference

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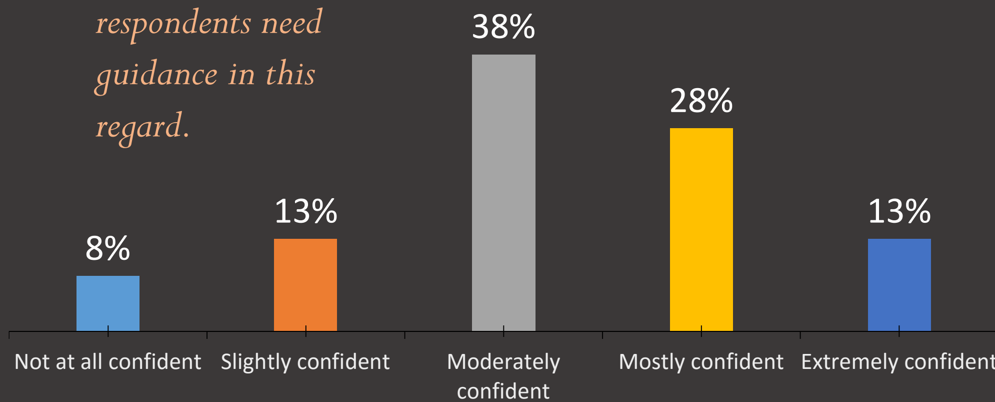
What is the confidence level of your firm's ability to assess the value of an independent practice to use as a basis for an offer? (Assessment elements include business stability, client stability, revenue stream stability, cultural match, etc.)

It seems the majority of respondents need guidance in this regard.



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Critical Valuation Factors

- Cultural match
- Years in business
- # of clients
- AUM
- Annual net revenue
- Profit margins
- YOY revenue and AUM growth trends
- % recurring revenue
- % of Advisory AUM
- Advisory fees
- % of AUM thru top 10 clients
- % of discretionary AUM
- % of AUM thru institutional clients
- Revenue/AUM by product type
- Revenue stream diversity
- Revenue projections
- Avg client age
- Avg client tenure
- Client demographics
- Clients added per year
- Clients lost per year
- % of new clients thru referrals
- Transition risk

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Critical Valuation Factors

- Avg advisor age
- Clients per advisor
- Staff tenure
- % of clients where there is relationship with next generation
- % of client with financial plan
- # of client contacts per year
- Service level policies
- Operating expense breakdown
- Staff type and count
- Software
  - CRM
  - Financial Planning
  - Accounting
  - Portfolio management
  - Client portal
  - Compliance monitoring
  - Archival
  - Website

Successful valuation takes a very deep dive!

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Due Diligence Checklist

Is the House in Order?

- Tax returns
- 3-5 years of financial statements
- Audit documentation
- Credit report
- Real Estate leases
- Equipment leases
- Partnership agreements
- Joint venture and marketing agreements
- Vendor agreements
- Insurance policies
- Non-competes and NDAs
- Operating agreement
- Licenses and permits
- FINRA status
- Regulatory filings
- Litigations and investigations
- Asset inventory

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Due Diligence Checklist

Is the House in Order?

- Cyber security audit
- Privacy policies
- Social media policies
- Third-party vendor due diligence records
- Security breach history
- Business continuity plans
- Data retention
- Employment agreements
- Bonus agreements
- Stock ownership
- Business debts
- Employee policy manuals

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Critical Valuation Factors

What are you buying?

- An Independent Advisor *(a rep with a book)*
- A Practice *(primary advisor with support staff)*
- A Business *(equity-centric organizational structure with a compensation system – can currently survive without the owner)*
- A Firm *(established multi-owner, multi-generational business)*

Source: Buying, Selling, and Valuing Financial Practices - David Grau Sr.

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Three Valuation Approaches

- Income Approach – *Future economic benefit projection discounted by risk factors. (Most appropriate for Businesses and Firms.)*
- Market Approach - *Establish business value in comparison to historic sales involving similar businesses. (Most appropriate for Books and Practices.)*
- Asset Approach - *Fair market value of assets less liabilities. (Least appropriate in our industry.)*

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Table F: Five Principles That Increase the Chances of Making and Alpha Acquisition

Principle	Description
1. Don't rush the deal.	Take time selecting a practice to acquire. One-third of alpha acquisitions take three or more years to find. Another third are opportunities that present themselves to buyers. Advisors should carefully analyze a possible acquisition target for compatibility with the practice the advisor already manages. If agreeing on a joint vision is a challenge early on, it might be better to continue looking for a better-fitting practice.
2. Finance the acquisition well.	Putting a deal on solid financial ground and not compromising on the quality of the acquired practice will increase the chances of achieving an alpha acquisition. Leveraging loans for an acquisition can provide the additional financing that enables an advisor to purchase a higher-quality practice. While more than half of all advisors making alpha acquisitions do not leverage any outside financing, about one-third get loans for more than 50 percent of the acquisition amount. Conversely, advisors who make non-alpha acquisitions typically have greater difficulty in this area.
3. Use multiple key aspects to value the practice.	Alpha acquisition advisors generally perform a much more holistic analysis of the acquisition target in order to determine its value than non-alpha acquisition advisors do. The majority of alpha acquisitions in the study were valued using on or more of five key criteria: assets under management, client service model, revenue mix, business longevity and cash flow from operations.
4. Implement, and fast.	Advisors making alpha acquisitions put emphasis on implementing the transition and keeping the transition period relatively short. Though acquisition can take months or years to implement, for the majority of alpha acquisitions covered in the study, the previous owners of the acquired practices were involved for just one year after the acquisition. Only 17 percent of non-alpha acquisitions have such a short transition period.
5. Retain key staff.	Wealth management is a business driven by people and relationships. The majority of alpha acquisitions are characterized by a staff-retention rate of 100 percent, with more than two thirds of alpha acquisitions retaining the majority of employees of the acquired practice. Retaining staff allows for a swift implementation and provides stability for the acquired practice and its clients.

Source: Aite Group analysis

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