



Reaping Rewards:

assessing, optimising and releasing the value of a financial advisory business

For professional advisers only | not for onward distribution

Better insight + Better process = Better results

J.P.Morgan
Asset Management

Foreword

Financial advisory firms face massive challenges. But the need among UK consumers for expert, impartial financial advice is greater than ever. Advisers who develop well-managed businesses with a clear proposition and stable revenue streams are potentially building a highly valuable asset for themselves.

In this report, we have looked to determine how advisers can optimise that asset value.

Drawing from exclusive analysis into recent Mergers and Acquisitions activity by Ernst & Young, we assess how advisory firms are being valued. We also outline the attributes that have characterised those advisory businesses that have achieved a premium valuation in the market. Finally, we consider how an exit from an advisory business needs to be handled to ensure the projected value is realised successfully.

The credit crunch of 2008 and the global economic slowdown has had a significant effect on transaction activities and valuations in the sector during the first half of 2009. This may not be the best time to sell a business unless you have to, but it is certainly as good a time as any to start modifying a business to improve its value. After all, the attributes that make businesses more attractive to acquirers are also those that make it more able to withstand tough market conditions.

So whether you are an IFA looking to exit the advisory sector or you simply want to manage your business better, we hope you find this report of interest and practical value.

A handwritten signature in black ink, appearing to read 'Jasper Berens', with a long horizontal stroke extending to the right.

Jasper Berens
Head of UK Retail
J.P. Morgan Asset Management

Introduction

Many IFAs also hope their business is an asset with an intrinsic value

The drive to build value

Realising the value of an IFA business will require careful planning as competition for acquirers intensifies

Turning a business into an asset

Running a financial advisory firm can be a source of employment and regular income. But many IFAs also hope their business is an asset with an intrinsic value that can be realised when they choose to retire or otherwise divest themselves of the operation.

Our research suggests there are many factors that will drive high-quality advisory businesses to command attractive valuations - see panel on page 3.

A buyer's market

However, with more than 10,000 IFA firms in the UK, opportunities for acquirers are extensive. At the same time, limited availability of debt finance and the current challenging market environment are making purchasers more circumspect.

For all these reasons, owners looking to maximise value must be mindful of the competition they face. They must do all they can to make their business stand out in the market, and ensure it possesses the attributes that acquirers are seeking.

Planning for an exit

This process cannot be a quick win. Planning for an exit should be a fundamental activity throughout the period of ownership of an advisory business. Preparing for the final sale should be treated as a three to five-year process - including at least one year post-sale to manage the transition.

There are many factors shaping the value of an IFA business. Some of these, such as market sentiment, are outside of an owner's control. However, there are many factors that sellers can influence.

In this report we will assess the bases for valuing IFA firms, the attributes of those firms commanding the highest valuations and what IFAs need to do to secure the best price for their business.

What's driving IFA valuations?



Positives

Retail Distribution Review pressures: Proposals laid down in RDR are set to raise capital adequacy and qualification requirements for IFAs from 2012. Advisers unable to meet these requirements will exit the independent market, raising the value of IFA firms that remain.

The hunt for scale: Medium and large IFA firms are looking to grow through acquisition to retain profitability.

Distribution capture: Product providers are looking to acquire outright, or take stakes in, advisory firms as a clear strategy to increase ownership of distribution channels.

Wealth management focus: International financial services groups are looking to expand into the lucrative UK wealth management market. US wealth management firms are showing particular interest in UK advisory firms as new qualification requirements and higher professional standards make IFAs more comparable to US financial planners.



Negatives

Macro-economic conditions: The economic downturn of 2008/9 has caused a substantial decrease in sales volumes and asset values, resulting in lower profits, and has led to a sharp decline in valuations. This combined with a squeeze on debt finance and potential buyers occupied by their own liquidity issues has led to them being even more demanding on price.

RDR compliance pressure: The average age of advisers in the UK is relatively high and over the next decade (and especially the next three years) there may be a flood of businesses entering the market as owners look to retire as they are unable or unwilling to meet the 2012 RDR requirements.

Poor post-acquisition performance: The lack of synergy in some high-profile IFA transactions and the impact of mis-selling claims is making buyers more cautious, restraining price offers and protracting the due diligence process.

1. Riding the wave:

Trends in IFA acquisition

While the credit crunch may have stalled activity temporarily, historic transactions suggest a robust market for M&A in the IFA sector

Recent transaction activity

The majority of IFAs running smaller firms tend to exit via internal succession plans which may go unreported. However, the last few years have been characterised by a significant increase in the volume of M&A activity in the IFA sector, with 2007 and 2008 seeing 18 and 29 reported transactions respectively. In 2009, though, there has been a slow down in activity.

This activity falls into five areas:

IFA consolidation

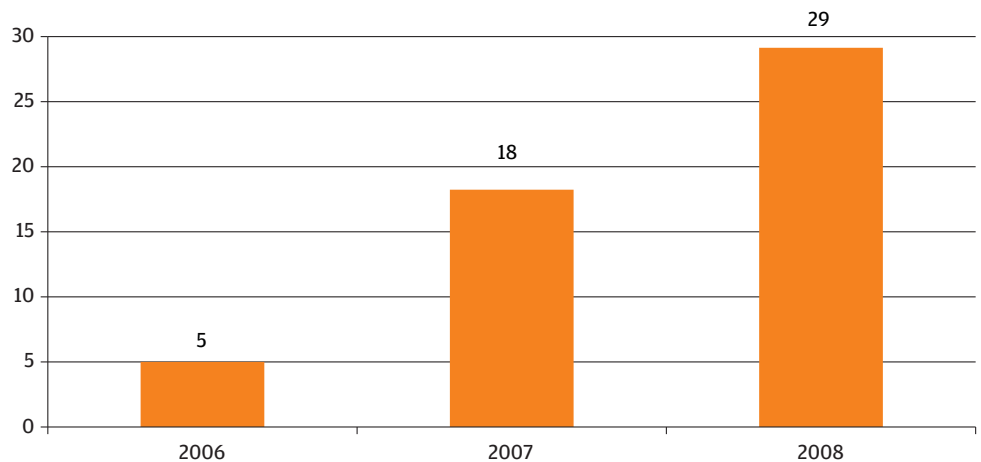
The majority of transactions are industry consolidation, with 16 trade acquisitions reported in 2008 alone. A lot of this activity has been driven as IFAs firms and networks look to build scale and acquire new areas of expertise in a highly fragmented market.

Vertical acquisition

We have also seen a number of landmark 'vertical' acquisitions with major UK and international financial services groups looking to gain a greater foothold in the UK advisory market.

Many groups are looking to capture greater distribution for their own products. But equally, firms are looking to capture share in the UK discretionary wealth management market with its strong potential for high-quality fee-based revenue.

Number of IFA and network reported transactions



Source: Ernst & Young, Mergermarket, Factiva, December 2008

Financial buyers

There has been some interest among private equity groups in IFA acquisition in the UK. Many financial buyers recognise industry consolidation as a potential opportunity to release value and know that extreme market and regulatory pressures may put pressure on firms to sell at extremely depressed valuations.

However, the number of completed transactions remains low, primarily as financial buyers struggle to gain comfort over the business model of most IFAs, which often relies on transactional initial fees with little recurring income.

Public market activity

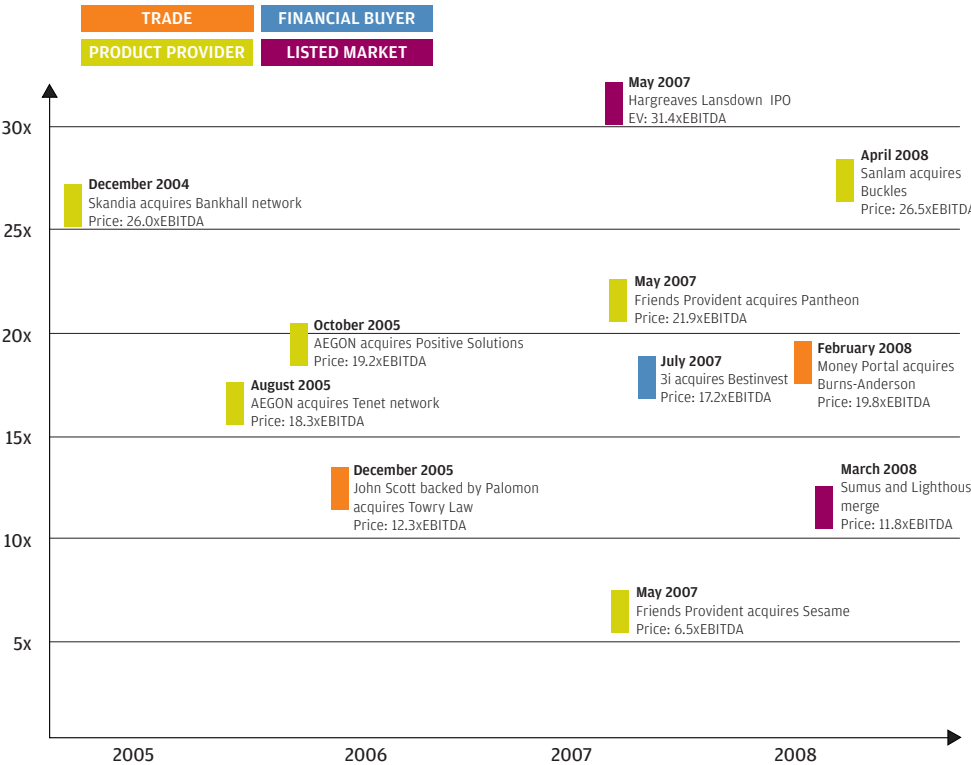
At the time of writing, only four IFA firms and networks were publicly-listed. By far the best-performing of these has been Hargreaves Lansdown, which has consistently seen the highest trading multiples of the sector. The biggest M&A transaction in the public market has been the 2008 merger of Sumus and Lighthouse to create one of the largest networks in the UK.

Networks

The last few years have also seen significant M&A activity among IFA networks such as the £14 million acquisition of Burns Anderson by The Money Portal in February 2008. IFAs and networks acquisition has been seen as a key means of securing distribution among product providers, with Friends Provident acquiring Sesame in 2007, AXA buying the Thinc Group in 2006 (subsequently reorganised) and Aegon acquiring Positive Solutions and a stake in Tenet in 2005.

(In this report we will focus primarily on valuation management for individual unlisted IFAs)

Recent IFAs and Networks reported M&A transactions



Source: Ernst & Young, Mergermarket, Factiva, December 2008

2. What's it worth:

There are a number of quantitative metrics that can be used in the valuation for an unlisted IFA firm.

Determining a firm's market value

The wide range of multiples being placed on IFA transactions indicates the complexity involved in assessing the value of an advisory business

Valuation metrics

There are a number of quantitative metrics that can be used in the valuation for an unlisted IFA firm. The key valuation multiples are:

i. Price per adviser

This is calculated as the price paid divided by the number of advisers and is a specific multiple used for companies in this sector.

ii. Percentage of assets under advice/influence

This can be hard to calculate unless client assets are demonstrable, for example, consolidated on a technology platform.

iii. Multiple of company turnover

Turnover multiples are used universally to value companies across all industries.

iv. Multiple of EBITDA

EBITDA (earnings before interest, tax, depreciation and amortisation) is widely used across industry sectors.

v. Multiple of recurring income

This has become one of the most valuable metrics specifically for valuing smaller IFA firms in recent years as it represents the most secure future income stream the firm can offer.

Other metrics often considered by acquirers include:

- Proportion of initial commissions versus recurring revenue
- Productivity per advisor (revenue generation)
- Sales per customer (number of products and case sizes)
- Level of cross-sales per customer.

Recent multiples achieved

Diagram 1 below shows the range of multiples that were achieved on completed sales of IFA firms between 2004 and 2008. (See the Appendix for individual deals, page 20)

We can see that the average multiples for transactions over 2007 and 2008 have been fairly consistent, with firms on average achieving 1.2-1.5 times turnover, which may be a useful starting benchmark for firms currently looking to determine market value.

Diagram 1: Multiples paid for IFA firms and networks on reported transactions

	Price as cost paid per adviser	Price as multiple of turnover	Price as a multiple of EBITDA
Average - 2007 transactions	£100,000-£200,000	1.2x	10.0x-16.0x
Average - 2008 transactions	£180,000	1.5x	12.0x-18.0x

Source: Ernst & Young, Mergermarket, Factiva, December 2008

However, underlying these figures is the extreme diversity in valuations achieved, with price/EBITDA ratios ranging from 2.2x to 27.8x.

This is partly the result of some exceptional deals during this period - such as the £165 million purchase of BestInvest by venture capitalists 3i in July 2007. But we would attribute the wide disparity in valuations to two main factors:

i. Lack of comparable precedent financial information

Valuing small advisory firms - say those with a turnover below £2 million - can prove difficult as data on precedent transactions can be hard to obtain and not necessarily comparable.

Deal values are often not disclosed and only abbreviated accounts are prepared. Plus the expense base of a small IFA may vary enormously, depending on whether an owner draws a large salary, takes out dividends or reinvests into the business.

Valuation therefore can only be calculated on a case-by-case basis and may vary substantially from one company to another.

ii High influence of qualitative factors

As financial advice is a highly regulated and relationship driven activity, 'qualitative' aspects such as proposition and quality of earnings can have a major bearing on the valuation, especially among smaller firms. In transactions where key multiples have been far higher than average, we conclude that high value has been placed on these less measurable factors.

It is, therefore, essential that IFA firms looking to achieve the highest valuation place sufficient importance on achieving the right qualitative attributes, as well as delivering strong financials.

We will outline the attributes most sought after by acquirers in the next section.

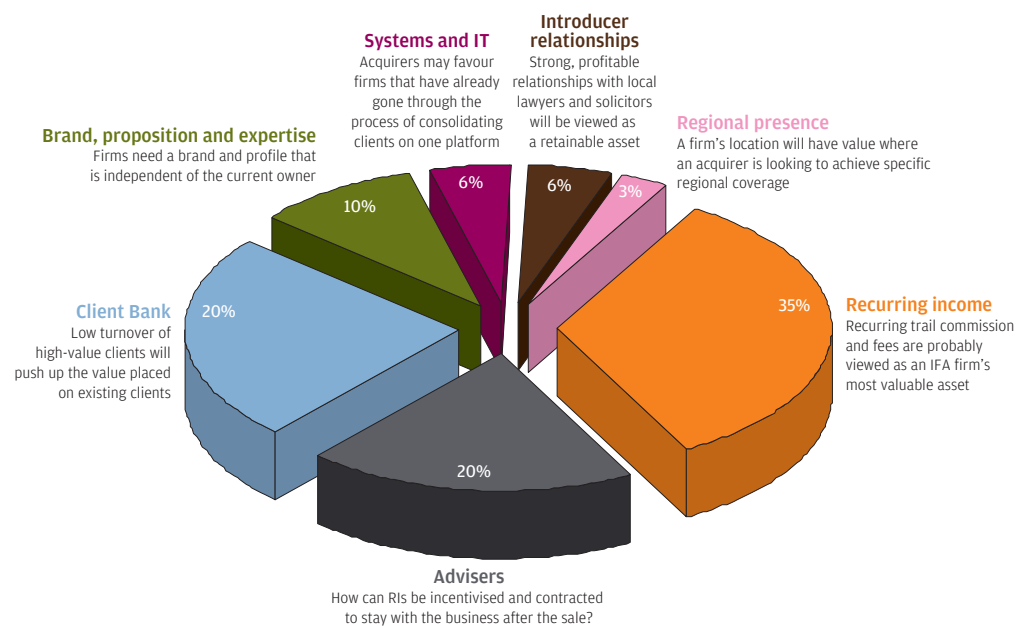
‘What exactly am I selling?’

So what’s for sale?

Assessing the intrinsic value of a small IFA can be challenging. A small IFA firm’s biggest asset is often its owner (who may be leaving) plus its clients and any other RIs, all of whom can walk out the door. Tangible and fixed assets are often negligible and the ‘brand’ is often simply the exiting Managing Director’s name. So, when putting a business up for sale, an owner has to ask: ‘What exactly am I selling?’

The diagram below shows how the ‘asset value’ of an IFA business might be allocated. Owners need to assess what proportion of overall value might be allocated to each of these aspects - and how that value can be properly embedded on behalf of acquirers.

Sample allocation of value embedded in an IFA firm



Source: J.P. Morgan Asset Management

3. Attributes of success

Optimising the value of an advisory business

Certain internal factors can significantly enhance or reduce the valuation placed on small advisory firms by potential acquirers

As we have demonstrated, there are a number of quantitative metrics that can be used in the valuation for an unlisted IFA firm. The value of a small IFA, at any given time, will be governed by a combination of internal and external drivers. Internal drivers can be further broken down into quantitative and qualitative factors.

Impact of qualitative factors on valuations

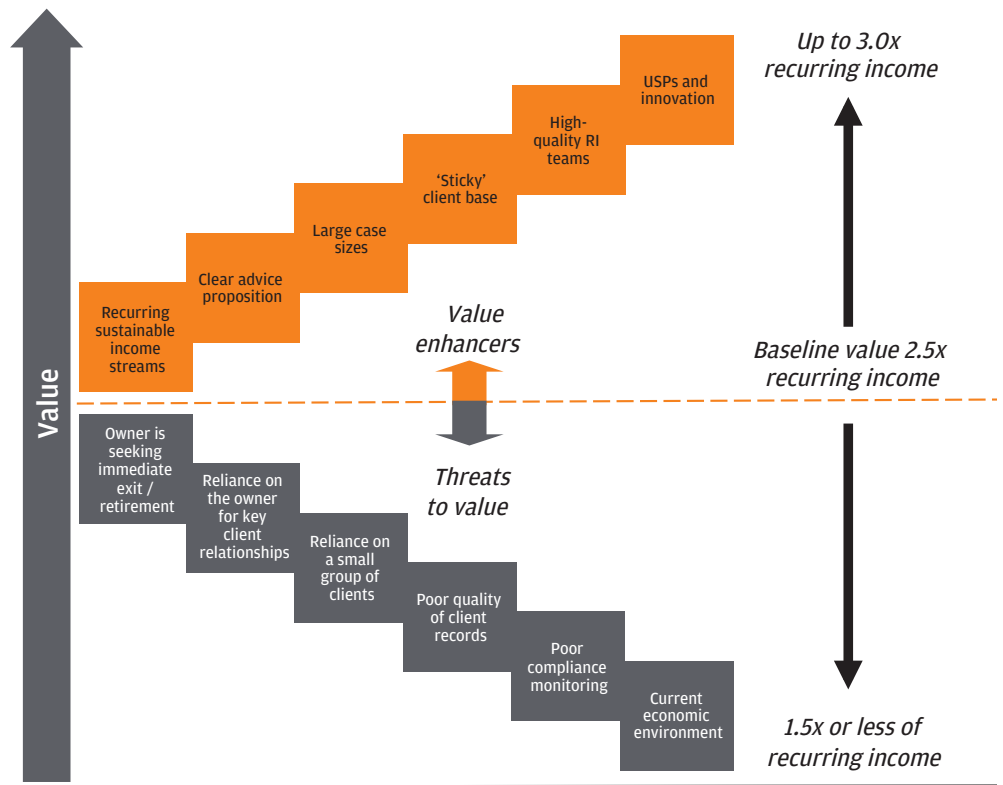
A business owner may be tempted to focus on the quantitative financial aspects of the business in order to optimise market valuation. However, our research has shown there are also specific qualitative aspects that can significantly enhance or threaten the value of, in particular, small IFAs – see Diagram 2 below. If we take the level of recurring income as the key value driver, an approximate base line value is 2.5 x recurring income. This can rise to 3.0x for a business that has all the value enhancers shown below in place. Conversely, it can fall to 1.5x or less if threats to value are present.

Baseline multiples

It should be noted that the baseline value of 2.5x has decreased since a high of 4.0x in mid-2007 when economic conditions were more favourable. This is consistent with trading multiples for listed IFAs, which have also seen a reduction ranging from 25 to 65%.

Diagram 2: Value enhancers and threats for small IFAs

The factors that can increase and reduce IFA valuations. The precise impact of each factor will vary for each firm.



Source: Ernst & Young

Value enhancers for IFAs

There are many attributes that can enhance the value of an IFA business. Below we assess the core value enhancers that Ernst & Young suggests acquirers are actively seeking out

Recurring and sustainable income

Acquirers are placing a high value on firms with a high proportion of recurring revenues such as trail commission and fees that are contractually payable, rather than initial commission that has to be 'resold' each year. Fees agreed with the client, not determined by product providers, are becoming especially valued in preparation for implementation of the Retail Distribution Review. As a very broad rule, acquirers favour firms where at least 30% of revenue is recurring.

Clear advice proposition

A firm that clearly sets out its area of focus will attract a higher rating than a firm with an unclear, poorly executed, whole-of-market offering. A clear proposition can mean:

- A firm's area of expertise (e.g. portfolio management, protection);
- The type of client it services (e.g. high net worth, young professionals);
- A compelling philosophy (e.g. life planning) and company culture.

It is worth noting that a number of firms have been acquired recently expressly for their expertise in a specialist area, e.g. employee benefits, as national and regional firms look to form themselves into a one-stop financial planning service.

'Sticky' client base

An acquirer's major concern is that clients will leave during or after sale - especially if their assigned adviser also chooses to leave the firm. Purchasers will therefore be looking for:

- Low historic client attrition rates;
- High levels of client activity and new inflows;
- Remuneration based on long-term client relationships - e.g. annual fees;
- Client servicing that involves many touch points across a firm, not just one adviser.

Large case sizes

The efficiency of the operation is likely to be greater, the quality of the customer base better and compliance easier to monitor if a firm exhibits a small number of clients with high assets under advice rather than a large number of small clients. That said, there will be concern if only a few clients account for a very high proportion of assets under advice/influence.

High-quality adviser teams

Given the increased professional standards demanded by the Retail Distribution Review, acquirers will favour firms where RIs have, or are in the process of attaining, 'level 4' qualifications such as the CII Diploma - this attribute will become increasingly valuable as the 2012 RDR deadline approaches. To mitigate the risks of losing RIs, purchasers will look favourably on a business model where a team of RIs has a relationship with each client, and where there is a clear strategy to replenish RI numbers (e.g. career progression for paraplanners).

Acquirers may also interview individual RIs within a firm to gauge their commitment and assess terms on which they are happy to be tied into the business.

Unique selling propositions and innovation

Finally, some firms will command a high valuation because they are doing something innovative and forward-thinking that holds a particular attraction for certain acquirers.

For example, one IFA firm commanded a high valuation partly due to its graduate training programme, which the acquirer recognised as a scaleable industry leadership initiative that could easily be rolled out nationwide.

Value threats for IFAs

Below are listed the internal factors that have most commonly led to a downgrade in valuation by potential acquirers

Owner is seeking immediate exit

A lower valuation will be placed on a firm where the owner and/or key client relationship holders want to leave the business before appropriate succession has been put in place and transfer of clients has occurred.

Owner holds key client relationships

The acquirer will be concerned about any concentration of relationships with a single individual – especially if there is any indication the owner is looking to retain those relationships on exit. This may lead to a lower price offer and a greater proportion of the consideration being deferred to ensure interests are aligned.

Over-reliance on few clients

While acquirers look favourably at larger average clients, too high a proportion of overall revenue coming from a few individual clients will cause concern. This may lead to a lower multiple being applied to these revenue streams, or a discount being applied to future revenues to allow for the possible loss of those clients.

Low-quality client records

An inability to demonstrate the quality of the client base and produce various data analyses will affect valuations in two ways. First, a general discount will be applied to reflect poor operational management. Second, a lack of data means acquirers may not be able to value aspects such as recurring revenue, high-value clients or growth in assets under advice.

Poor compliance and/or regulatory concerns

Poor compliance monitoring (or any regulatory issue/failing) is likely to mean a number of buyers will not consider the acquisition at all. Those that still remain interested would apply an appropriate discount to reflect the risk and the fact that other issues may emerge, as well as making an allowance for the costs likely to be incurred in correcting the problems identified.

Platforms and wraps: asset or liability?

Increasingly, IFA firms are looking to use investment platforms and wrap technology to consolidate client assets, such as funds, ISAs, pensions and bonds. In the sales process, this can work to a firm's advantage:

- If all assets are on one platform, the seller can easily show sales MI data such as assets/revenues per client, activity per RI and distributions of assets under advice by product, fund and provider;
- Acquirers may look favourably on firms that have already enhanced profitability through efficient use of technology;
- It is easier for an acquirer to manage the new assets if they are already registered on one venue.

However, sellers need to be mindful that acquirers may have their own views on which platform technology is best (and the potential operational risks of consolidating client assets in this way). While it is possible to move client assets between platforms, the highest valuations will come from those acquirers who agree with a seller's choice of platform provider. Considerations may include:

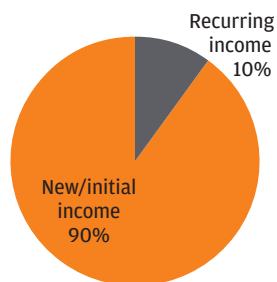
- Independence;
- Types of client catered for;
- Costs;
- Product wrappers offered;
- Ability to transfer to/off platform, etc.

Valuation comparisons

Valuations are driven heavily by quality of income and profitability. The examples below show how three companies with the same level of turnover and adjusted profitability might achieve very different valuations given their respective levels of recurring revenue.

IFA Firm A

Turnover:	£2,000,000
Revenue breakdown:	
New/initial	£1,800,000
Recurring	£200,000

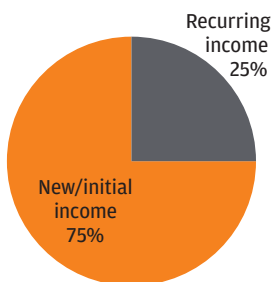


Direct costs:	(£1,000,000)
Overheads:	(£750,000)
Net profit:	£250,000
Adjusted profit*:	£750,000

Likely valuation range:
£1,000,000-£1,500,000

IFA Firm B

Turnover:	£2,000,000
Revenue breakdown:	
New/initial	£1,500,000
Recurring	£500,000

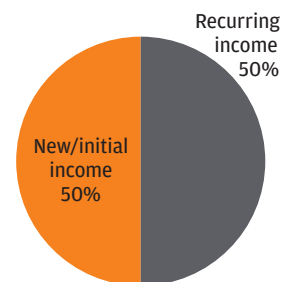


Direct costs:	(£800,000)
Overheads:	(£700,000)
Net profit:	£500,000
Adjusted profit*:	£750,000

Likely valuation range:
£1,500,000-£2,000,000

IFA Firm C

Turnover:	£2,000,000
Revenue breakdown:	
New/initial	£1,000,000
Recurring	£1,000,000



Direct costs:	(£800,000)
Overheads:	(£700,000)
Net profit:	£500,000
Adjusted profit*:	£750,000

Likely valuation range:
£2,000,000-£2,500,000

*Based on identified cost savings

Valuations based on following modelling ranges:

- Turnover - multiple of 0.75 to 1.5
- Recurring revenues - multiple of 2 to 4
- Profitability - multiple of 2 to 4

Reproduced courtesy of threesixty services LLP

Defining the IFA: three advisory propositions

As pressures grow on advisory firms to consolidate and achieve economies of scale, it is likely that the highly fragmented IFA market will stratify into more clearly defined propositions. In 2007, J.P. Morgan Asset Management identified three highly distinct IFA models that might evolve successfully under prevailing regulatory and commercial pressures, such as RDR, MiFID, and the move to wrap technology¹.

We still believe these models remain valid and may be of interest both to IFAs looking to build a compelling business for sale – and those firms wishing to acquire and expand themselves in order to build up a resilient, long-term enterprise.

1. The Investment Drive-In – ‘technology with a human face’

Designed for the growing number of investors who want swift advice on best-of-breed investment opportunities. This model will appeal to young, tech-savvy clients who want to make informed investment decisions but who haven’t got the time or inclination to gather the information themselves.

Giving clients access to their portfolio via the latest technology, it will offer all the convenience of an online fund supermarket with the added value of personalised investment advice from highly-qualified RIs.

2. The Bespoke Boutique – ‘unrivalled expertise’

This is a high-touch business model driven by close personal relationships with advisers and clients. The Bespoke Boutique will not be all things to all people – it may focus on a very specific demographic or offer a very high level of specialism in a certain area such as alternative investment. It may often be used by the other two IFA models to outsource highly specialised investment or financial-planning activities.

3. The Total Wealth Megastore – ‘dynamic wealth management’

This is a total one-stop shop for financial and wealth management – but one that manages to retain a sense of prestige and strong personal relationships. Targeting the high to ultra-high net worth market, it will compete with private banks and other discretionary managers.

Its competitive edge against these established players will be its dynamism: it is not tied to a parent bank’s products and will aggressively seek out best-in-class opportunities. It must offer a level of client choice and service that few banks could afford to maintain.

	1. The Investment Drive-In	2. The Bespoke of turnover	The Total Wealth Megastore
Target client	Mass affluent	Mass affluent/ high net worth	High/ultra high net worth
Coverage	National	Local/regional	National/international
USP	Technology led portfolio management	Personalised financial planning with focused specialism	Complete and exclusive wealth management
Typical client:RI ratio	>250:1	<250:1	<100:1
Scope of advice	Investments only	Highly specialised - e.g. investment or tax or estate planning	Investments, tax, debt and succession planning
Asset allocation	Model portfolio	Bespoke	Bespoke
Use of platforms	Very high	High	High
Client interaction	Low touch	Very high touch	High touch
Branding	Accessible	Discreet	Exclusive
Remuneration	Per transaction	AUM or time-based fee	AUM or time-based fee

¹Surviving the Storm: Opportunities for investment advisory firms in a changing market (August 2007)

4. Making your exit

Realising the value of your business

Careful management of the exit process is required to avoid 11th-hour erosion in value

Options for exit

There are five main ways in which a business may be sold or value can be realised. Each of these options offers various advantages and potential disadvantages as the table shows below.

For very small IFAs comprising, say just one or two RIs coming up to retirement age, the sale of the firm or just the client base to another advisory firm can be the most common course of action. Larger firms can consider options such as a succession plan or a management buy-out by younger advisers/directors.

Medium-sized firms with strong regional coverage tend to have the widest array of options, particularly as national IFAs, product providers and financial buyers may have a specific strategy to increase/consolidate coverage in a particular region.

Stock market flotation is only viable for larger national firms.

Exit options

	Small IFAs				Large IFAs
IFA		Succession/ Management Buy Out	Product provider	Private Equity	Initial Public Offering
Why interested?	<ul style="list-style-type: none"> Economies of scale Opportunity to improve business model to extract value AUM aggregation 	Why interested? <ul style="list-style-type: none"> Familiarity with business Opportunity to move from employee to owner/shareholder 	Why interested? <ul style="list-style-type: none"> Defensive move to protect market share against risk of disintermediation Diversification of business exposure 	Why interested? <ul style="list-style-type: none"> 'Buy and grow' consolidation strategy in a fragmented market Opportunity to improve business model and enhance multiple on exit 	Why interested? <ul style="list-style-type: none"> Exit route for shareholders Enables owners to realise value without exiting the business
Opportunities	<ul style="list-style-type: none"> Economies of scale Potential access to new technology or quality staff Access to new client base and AUM Cost synergies 	Opportunities <ul style="list-style-type: none"> Continuity for clients and employees 'New' management will have already identified areas for change Lower due diligence burden unless third-party financier involved 	Opportunities <ul style="list-style-type: none"> Strategic focus Stronger balance sheet Cost synergies Funds to acquire RIs and businesses 	Opportunities <ul style="list-style-type: none"> Injection of fresh ideas Funds to acquire RIs and businesses Equity incentivisation of RIs and directors Synergies with buyer's other investments 	Opportunities <ul style="list-style-type: none"> Higher commercial visibility and profile Funds/shares to acquire RIs and businesses Incentivisation of RIs and management
Challenges	<ul style="list-style-type: none"> Culture clash Loss of management Client attrition Incentivisation of RIs and management 	Challenges <ul style="list-style-type: none"> Tend to attract lowest valuation May be limited by management's access to venture capital Harder for exiting owner to make clean break. No new injection of new ideas unless venture capitalist is hands on 	Challenges <ul style="list-style-type: none"> Loss of management and RIs Institutionalisation Incentivisation of RIs and management 	Challenges <ul style="list-style-type: none"> Very aggressive valuations Lack of leverage in current market Client concerns over a financial buyer's long-term commitment Buyer's IFA sector insight may be limited unless a financial services specialist 	Challenges <ul style="list-style-type: none"> Public scrutiny Costly and time consuming Additional compliance expense Institutionalisation Not appropriate for smaller businesses

Source: Ernst & Young

Many factors that can throw the transaction off course

Avoiding value erosion

Once a sale has been agreed there are many factors that can throw the transaction off course. Some of these, such as market conditions may largely be outside of the seller's control. However, there are many areas where firms can take action both to minimise dispute and delay and to maximise interest among potential buyers.

Realistic performance forecasts - Forecast results need to be attractive but attainable. If actual results post below expectations during the sale period, the impact on valuations and buyer interest can be severe.

Clear positioning and strategy - Management must be able to articulate and support current marketing positioning and strategy both in the Information Memorandum and in subsequent management presentations after initial offers have been accepted. Inconsistencies in messaging will concern potential acquirers.

Due diligence support - All financials and other business information must be clear, up-to-date and readily available to all relevant parties throughout the due diligence process.

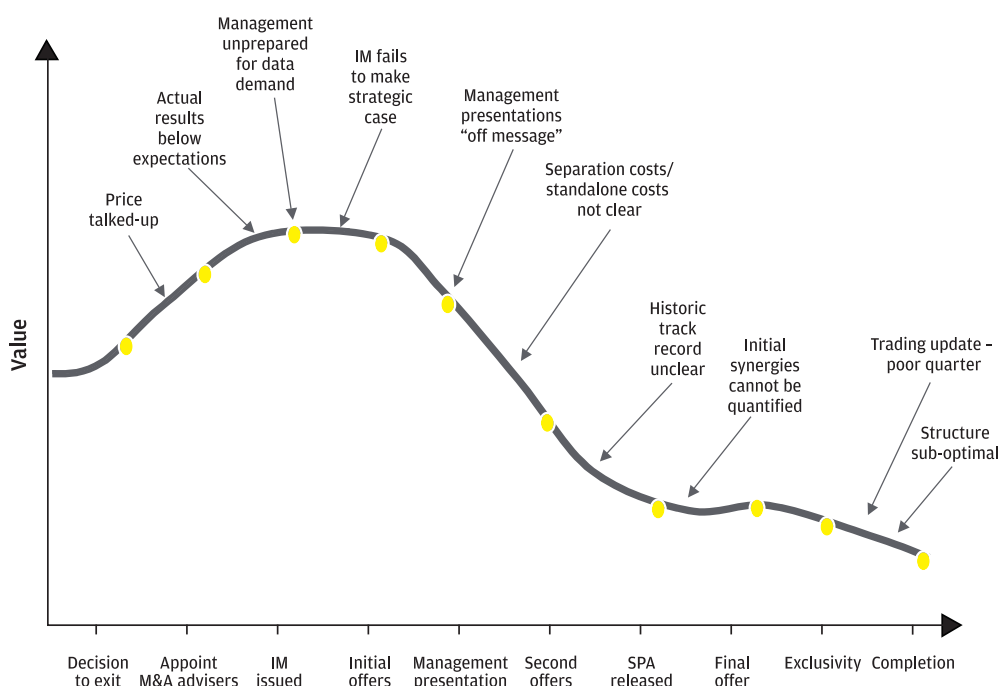
Incentivised and properly resourced team - Employees need to be properly incentivised and supported to enable integration to go ahead smoothly and ensure that clients experience minimal disruption.

Gradual owner exit - Owners must generally be willing to exit the business gradually to allow appropriate succession and successful transition of clients - a period of at least 12 months will generally be expected.

Selling pointers

- **Keep an eye on the market** - Try to interest buyers at the right point in their own growth curve;
- **Don't simply accept the first offer** - Talk to a number of potential buyers and explore very different exit routes as valuations can vary massively depending on an acquirer's objectives;
- **Time your exit** - If you have to sell during a market slump, negotiate the valuation to be based on income over the next three to five years to capture any upswing;
- **Use a specialist** - Engaging a corporate finance expert to manage the sale can result in a higher price and lets you focus on running the business.

Diagram 3: Value erosion factors on exit



Source: Ernst & Young

IM = Information Memorandum SPA = Special Purchase Agreement

Case Study

FIRST HAND: Michael McCroddan on Conforto Financial Management's acquisition of The McCroddan Partnership Ltd.

When we started preparing for sale

We always had an eye on our exit strategy. For example, when we formed The McCroddan Partnership in 2000, we deliberately structured it as a limited company as we knew defined shareholdings would be easier to handle as part of a sale.

However the real catalyst came in 2005 when I was introduced to Finbarr O'Connell, head receiver for KPMG Corporate Finance. He pointed out that the whole sales process takes at least two years: one year to sell the business and at least a further year to help the acquirer make a successful transition. His golden advice was: "Sell before you need to sell - don't wait until you are too old or too ill and there is no value left in the business."

Our unique selling point

Every advisory firm needs a clear and compelling proposition. The McCroddan Partnership had started out as a general financial planning firm. However, the acquisition of a number of high net worth clients meant we evolved into a small family wealth office with robust fee-based revenue. This became the main appeal for acquirers.

Finding potential buyers

The process of finding potential acquirers took two years via discreet networking and close professional contacts. We took the time to conduct an extensive beauty parade, and were introduced to many different business models from small IFAs to the wealth management division of a Swiss private bank.

It was vital at this point to retain a completely open mind because you really don't know which firm will offer the best cultural fit and the best terms. The firm that looks great on paper may not feel right when you meet them and vice versa.

What appealed about Conforto

Conforto was a young firm specialising in advising sportspeople and which was looking to expand further into the private client sector. There were a number of aspects we liked immediately about the firm - first its young and vibrant culture, second, its very forward-looking non-indemnity based business model. Most of all, it was the first company we met that genuinely put our needs and objectives first - in terms of valuation, structuring the deal, retaining staff and in giving me a transitional exit role.

How we structured terms

The valuation was based on a multiple of proven recurring income to be paid in three instalments from 2008 to 2010. In addition we agreed an "earn-out" that required me to convert as many existing clients as possible to the Conforto fees model over a three-year period. This allows me to generate additional income from the sale - while enabling Conforto to maximise client retention during the integration process.

How we managed staff

Keeping staff informed is probably the most difficult part of the process because there's no point telling them too early and unsettling them. When we had a shortlist of three buyers, we told them in confidence what was happening. We made it clear we were only considering companies that had agreed to retain all our personnel and that gave them a lot of reassurance. As a result, all staff who elected to move to Conforto have stayed with the firm.

Handling client expectations

Prior to completing the sale, we got Conforto to meet with key clients of ours. This helped involve our most valued clients in the process and gave us an opportunity to ask them what they thought of Conforto. By disclosing my plans at the right time I was able to manage my succession strategy with my clients' full co-operation.

What I've learnt

The process of selling an advisory business is fascinating but highly fraught - and it's invaluable to share your experiences with other IFAs in the same boat. What would my key tips be? First, understand that selling your 'baby' is an emotional process. Make sure you have a close personal mentor who has experience in selling businesses, who knows your strengths and weak spots, and who can help you look at every offer objectively.

Second, don't ever be tempted to economise on your legal team. This is a once-in-a-lifetime transaction so hire the best corporate lawyers you can. They will give you invaluable advice you didn't expect and an acquirer will respect an experienced legal team far more.

Finally, remember that initial indemnity commission counts for almost nothing in the valuation because it has to be built up from scratch every year. By building up trail commission and fees, you will have a business model that can generate income each year and thus a valuable asset to sell on.

Finding a buyer

- Some of the national networks run a business exchange to enable buyers and sellers to get in touch - although they may not offer any particular support to help you get the best price.
- If you are keen to sell to a local or regional firm, networking is your best bet. Let key contacts know you are looking to sell. However this means you must be ready and willing for your plans to be made public.
- Alternatively, approach some of the larger IFA firms in your region on a confidential basis. Study their business and compose an argument as to why your business could be a good fit with their existing activities. If they are at an acquisitive stage, they may have already earmarked your firm.
- Talk to your business bank or accountant to see if they offer, or know of, suitable business introduction services.
- Business brokers that match buyers and vendors can easily be found on line. To get the best valuation for your business, seek out a broker that genuinely specialises in the financial intermediary sector. Speak to a range of brokers on a no-obligation basis to get an idea of valuation, their terms and whether you feel comfortable working with them.
- Consider hiring a corporate finance adviser, or the corporate finance arm of your bank, to identify suitable acquirers and/or handle the sale. Talk to a few firms to get an idea of costs and to ensure they are amenable to handling your size of firm.

Again, it's important to stress that finding the right buyer can take time and you may need to start addressing the process five years prior to your intended sale date.

Final word

As IFA numbers decline, firms with the right attributes to withstand current headwinds may enjoy a heightened value in the long term

A sector under change

The composition of the UK IFA sector is set to transform dramatically if proposals regarding capital adequacy, professional standards and methods of remuneration go ahead.

Together with challenges presented by declines in the economic climate and stock market volatility, many IFAs may find themselves unable to compete. The FSA already estimates that almost one in five advisory firms is loss-making and almost a quarter have reported profits of less than 5% of turnover.

Ernst & Young recently predicted that the number of registered IFAs is likely to drop to 10,000 by 2013² - with the bulk of this reduction happening towards the end of 2012 if the proposals in the Retail Distribution Review become regulatory requirements.

Valuation pressures

In the long term, this severe attrition may increase the value of those IFAs that remain. In the short term, however, IFAs looking to sell or merge their business in the next three years or so may find valuations under extreme pressure as a growing number of advisers rush for the exit.

Even so, and while transaction activity has paused in the second half of 2008 and the beginning of 2009, there is strong reason to believe that a small proportion of high quality IFAs can continue to stand apart and attract premium valuations.

Sale or survival

In this report, we outlined the primary features that have enabled IFA firms to achieve a premium valuation - such as repeatable income, clear expertise and a loyal, well-served client base.

But these are also the same qualities that will, we believe, enable IFAs to weather the current commercial, economic and regulatory headwinds (which is exactly why they are so prized by acquirers).

The next three to five years are going to be extremely challenging for IFAs. But by 2014, we envisage an advisory sector that is smaller, less fragmented but possibly more highly valued than ever before.

Whether an IFA is looking to sell or survive in the next few years, we believe the attributes outlined in this report will be key to a successful outcome.

²In shifting sands: Life and Pensions Outlook 2009

Appendix

i. Multiples for reported IFA transactions 2004 - 2008

Date	Target	Type	Acquirer	Deal value £m	No. of advisors	P/Advisor £000's	Turnover £m	P/Turnover	EBITDA £m	P/EBITDA
Apr-08	Buckles Holdings	IFA	Sanlam	13	45	285	5.8	2.2x	0.5	26.5x
Mar-08	AWD Holding	IFA	Swiss Life Holding	715	200	3,577	490.2	1.5x	60.3	11.9x
Mar-08	Sumus	Network	Lighthouse Group plc	15	335	45	29.8	0.5x	1.3	11.8x
Feb-08	Burns-Anderson	Network	The Money Portal Plc	14	410	35	42.2	0.3x	0.7	19.8x
Feb-08	Independent Financial Solutions	IFA	Syndicate Asset Management	2	3	633	1.9	1.0x	0.3	6.1x
Jan-08	Independent Investment Associates	IFA	Arc Fund Management	2	n/a	n/a	0.9	2.3x	0.5	4.2x
Nov-07	JRG Financial Consultancy	IFA	Cavanagh Group plc	5	n/a	n/a	4.3	1.0x	0.3	16.3x
Nov-07	Professional Assurance Services	IFA	Tenon Group PLC	5	n/a	n/a	3.4	1.3x	1.0	4.5x
Sep-07	Premier Wealth Solutions	IFA	Rixons Financial Services	1	n/a	n/a	0.6	1.7x	0.4	2.2x
Aug-07	John Miln & Company	IFA	iimia Investment	2	22	100	n/a	n/a	n/a	n/a
Apr-07	LEBC	IFA	BP Marsh	2	56	35	6.7	1.3x	0.6	13.6x
Jul-07	Bestinvest	IFA	3i	165	45	3,667	21.6	7.6x	9.6	17.2x
Jun-07	Deverill Black & co	IFA	Sumus	2	n/a	n/a	0.9	1.7x	0.3	4.4x
May-07	Sesame Group	Network	Friends Provident	75	7,500	10	313.0	0.2x	11.6	6.5x
May-07	Pantheon Financial	IFAs - HNW	Friends Provident	35	31	1,129	8.5	4.1x	1.6	21.9x
Oct-06	Thinc Group	Network	Axa UK	70	650	108	40.0	1.8x	n/a	n/a
Jun-06	Millfield Group	IFA	The Money Portal	11	1,200	9	26.0	0.4x	n/a	n/a
Sep-06	Personal Touch	Network	LDC	9	1,710	29	56.3	0.9x	1.8	27.8x
Dec-05	Towry Law	IFA	John Scott & Partners	37	180	206	29.0	1.3x	3.0	12.3x
Oct-05	Positive Solutions	Network	Aegon	163	1,308	125	72.0	2.3x	8.5	19.2x
Aug-05	Tenet	Network	Aegon	55	5,000	11	65.0	0.8x	3.0	18.3x
Feb-05	Chase de Vere	IFA	AWD	21	160	131	33.0	0.6x	n/a	n/a
Dec-04	Bankhall Investment Mgt	Network	Skandia	130	7,000	19	28.0	4.6x	5.0	26.0x
Aug-04	Inter Alliance Group	IFA	Millfield Group	21	n/a	n/a	n/a	n/a	n/a	n/a

Insight for advisers from J.P. Morgan Asset Management

This report is one of a series of insight pieces from J.P. Morgan Asset Management that aim to assess the forces shaping the UK financial advisory sector and how intermediaries can respond to them.

Recent titles in the series include:

- **Surviving the Storm:** Opportunities for investment advisory firms in a changing market (August 2007)
- **Changing Fortunes:** Setting the foundations for financial well-being in the UK (April 2008)
- **TCF for Advisers:** Ten considerations in treating customers fairly (September 2008)
- **Wealth Management Report:** Meeting the expectations of UK high net worth clients (January 2009)
- **Outsmart the Recession:** Tips to recession-proof an advisory business (March 2009)

To request copies, intermediaries can call our Brokerline on **0800 727 770** or visit www.jpmorganassetmanagement.co.uk

J.P. Morgan Asset Management
Finsbury Dials
20 Finsbury Street
London EC2Y 9AQ
www.jpmorganassetmanagement.co.uk

This document represents the view of JPMorgan Asset Management Marketing Limited on this subject at the date of this document and may be subject to subsequent change. Please be aware that this material is produced for informational purposes only and should not be taken as or construed as investment advice. JPMorgan Asset Management Marketing Limited accepts no legal responsibility or liability for any matter or opinion expressed in this material. Telephone calls are recorded to ensure compliance with our legal and regulatory obligations and internal policies. The information in this document is based on our understanding of law and regulation at the time of print and is subject to change. Issued by JPMorgan Asset Management Marketing limited in the UK which is authorised and regulated by the Financial Services Authority. Registered in England No. 288553, 125 London Wall, London EC2Y 5AJ.

J.P.Morgan Chase & Co.

LV-JPM2838 06/09