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MARKET MATTERS April 2010

Practice Sales Mergers and Acquisitions.

Market Summary

The signs in this first quarter are that transaction activity is gathering pace. Practice sales that were deferred through the GFC are being reactivated as buyers and sellers are getting closer to a meeting of minds.

In our view, the momentum indicates that private buyers are rejoining the institutional investors, to capitalise on increasing business confidence and on the investment market turnaround.

In terms of demand, **Risk Practices and books remain the standout** - we have long advocated the strength a quality risk book brings to Practices, for its income reliability and complement to asset based income – the market recognises and is premium pricing these risk books and businesses.

Funding acquisitions remains the greatest variable - while Institutional buyers have been balance sheet funding, debt funding is available for individual Practices although Banks are favouring those Practices with experience in acquisition, integration and a demonstrably robust business model.

An interesting trend we are facilitating, is the **merger of similar size Practices** - generally to gain the benefits of scale, or in the case of larger Practices, to facilitate the retirement of a partowner.

As a rule of thumb, and assuming some new business is written, we believe Practices need annual recurrent revenue (ARR) of $350k as a baseline, to fund the cost of providing advice, running a business and providing Principal remuneration. Combining and aligning Practices of this size does deliver some fixed cost saves – premises and people in particular.

As ARR edges closer to a $1m (and higher), the cost saving in combining with a similar size Practice and business model, is significant. In well managed integrations, this benefit is in the vicinity of **25 - 30% straight to the bottom line.**

At a macro level, **transaction terms still favour sellers**, principally because genuine funded buyers still out-number sellers. In a recently completed Sydney transaction we were able to introduce 10 funded buyers within a 4 week period, and quickly move to terms with the Vendors preferred buyer.

For some time we have had numerous buyers looking to **acquire minority equity positions** in Practices. In these transactions the Vendors realise equity from the business (say 15-25%), and often receive funding assistance from the new shareholder, to grow by acquisition – this is attractive if you want to quickly achieve scale and significantly improve the value of your business.

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Value Realisation

If there is one thing that has remained consistent over a number of years, it is **the pricing of transactions** – annual recurrent revenue (ARR) multiples for most transactions, EBIT based for the larger Practices.

The ARR multiples remain in the range of 3 - 3.5x ARR, while the EBIT multiples reside in the 5 -7x range with some variation around ***key terms, business mix, location, size of Practice, risk Practices versus investment, client profile and business model.***

Risk centric Advice Practices	3.1 - 3.5x revenue
Investment centric Advice models	2.9 - 3.5x revenue
Private Wealth Management models (large Practices, broad based revenue and solutions, average client size>$1m)	5-7x EBIT
Corporate Super Practices	Significant variation depending on cross-sell potential and perceived risk

We hear the 'bar talk' on some 4x ARR in open market transactions; however when you *present value the payment schedules*, the **actual prices generally fall within the above ranges**.

We have previously flagged the future uncertainty of product and platform commissions - any outcome from the Ripoll or Cooper Inquiries limiting or banning product or platform commissions and rebates will likely devalue commission based Practices.

If you have no intention or desire to evolve to a fee- based Advice model, it is most likely that the value of your commission based Practice is near its peak. We encourage you to consider this as an opportunity to sell. The good news is commission based Practices are an attractive acquisition for Practices who have the knowledge to migrate the client offer to their fee based model.

If you are considering a partial or outright sale, or a merger, and want to discuss the market, the price and terms for Practices - don't hesitate to call us on 1300 766 156.

Click here for your Guide to Selling a Financial Planning business(link)

Centurion Market Makers(link) – bringing together buyers and sellers of Financial Planning Practices

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Licencee Consulting Activities

Practice Trends

A natural consequence of the *Ripoll recommendation (link)* and the public discussion emerging from the *Cooper Inquiry (link)* submissions, is significant concern among Practices and Licencees as to how any change to the commercial relationship (commission, profit share/rebates) will impact current operating models, and for the sustainability of perceived conflicts of interest between Practices, Licencees and platform providers (soft and hard dollar).

Fiduciary - There is no industry consensus on the impact of an explicit fiduciary obligation might mean in practice, but it would seem to **imply fees are derived from the client not the product**, which is a significant shift from the current operating models of many Advice Practices.

In the wealth management industry the total revenue derived (cost to client) is a function of advice, investment management, custody and administration charges, circa 2.0% of FUA. In this context, emerging as key challenges for Practice owners and business models over the next 2 years are:

i. **Building an operating model that captures more of the total revenue(the 2.0%) with-out increasing costs,**
ii. **Reducing/eliminating perceived conflicts of interest (hard and soft dollar), and redefining relationships with Product and Platform suppliers,**
iii.
iv. **Evolving the client offer and experience to be of greater value, and not solely reliant on investment performance,**
v. **Migrating to a revenue model based on fee for advice and for service.**

We are encouraging Licences to see the pending changes as an opportunity, not a threat.

On this, we have consulted to numerous major Licencees on their operating model, including the design and implementation of fee for service, ***objectives based Lifestyle financial planning, their investment model and the client conversations that support this approach.***

This fee based approach to personal wealth management has at its heart, an Advice model that recognises the principles of adult behaviour and learning, the consumer research on how clients want to be engaged, and defines the preferred client experience and conversation. In this approach the value is easily recognised by the client, and supports explicit advice and service fees.

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In an environment where delivering value in Advice is paramount, have your Licencee call us to discuss a programme to redefine the current business model and migrate to high value fee based advice and service, with less reliance on commissions and rebates.

Centurion Valued Advice(link) - the industry's leading consultant on Licencee offers, advice delivery, client engagement, & building robust private wealth management business models.