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Welcome to the Q2_2011 edition of 'Market Matters'. Despite predictions to the contrary Practice prices continue to hold and since late last year, buyers and sellers have returned to the transaction market, in numbers.

FoFA dominates most of our conversations with Advisers and owners of Financial planning Practices. Inevitably the discussions turns to future prices for Practices and how other Practices are responding to the proposed FoFA reforms - we touch on both of these questions in this newsletter.

In Summary

The proposed FoFA reforms have prompted a lot of discussion and calls to Centurion from owners of Financial Planning Practices querying the future value of their Practices, and the likely depth of the market should they decide to sell.
Since November last year we have experienced a significant rise in initial inquiry from prospective vendors, a significant increase in the number of buyers submitting offers for businesses and general increased demand from prospective acquirers.
As a general comment, the market continues to provide opportunities to sell at excellent valuations for businesses that offer the right terms.
Prices are holding well for quality businesses. There is increased opportunities for shareholder succession and sale in multi owner businesses. We have assisted a number of businesses with these shareholder succession transactions by sourcing funding and/or funded buyers, and merger partners.

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Watch out for the Exocet on Practice prices……….

In our experience, sales inquiry from potential vendors is up 30%, while transactions that were frustrated by the market and the withdrawal of lenders in mid 2010, have returned and completed. Two large and recent transactions we completed in Victoria and NSW, were on very generous price and terms, as were two smaller books.

The firmness of recent prices, leads us to the inevitable discussion on where will Practice prices go. In our view there is a real prospect prices will soften, albeit over the longer term, and most likely as a result of the declining certainty of revenues due to the FoFA opt-in reforms.

In addition, we anticipate, particularly for larger Practices, EBIT based (rather than revenue) valuations will increasingly, become the norm.

If you're worried about an 'exocet' missile - our tip is to keep your eye on the BOLR; these offers if substantially amended from their current valuations, have the potential to re-shape the market for Practice sales. All owners of Practices need to be aware that the buyer of last resort present in the Institutional Licensee networks has historically set a baseline price for the broader market and for many financial planning transactions across the industry.

However –and this is important to note – current BOLR terms in Adviser business agreements are premised on Practices continuing to use retail managed fund product and retail administration platforms. Combined, the administration platforms and managed funds have generated attractive profit margins for Institutional providers, which explains the Institutions ability to offer 3.0 - 3.5x annual recurrent revenue multiples to Practices covered by their Licensee BOLR agreements.

Significantly, the broader industry trend is for Financial Planning Practices to utilise wholesale/white label platforms and to utilise wraps or technology solutions that mitigate the use of a third party platform completely. This is accompanied by a move away from retail managed funds to direct investments. These two trends are eating away at all Institutions margins.

The migration to wholesale Platforms provides more revenue for the Practice, however it is less profitable for the Institution and ultimately will require all BOLR arrangements to be repriced down – that assumes they don't get banned in the final form of FoFA as a perceived soft dollar benefit or unsuited to a fiduciary environment!
A reduction or revision in BOLR calculation would flow on to transaction price and terms, and the appetite of the major banks to provide cash-flow lending, reducing demand from private buyers.

The good news however, is that well run advice businesses with a genuine EBIT will continue to attract premium prices in the market as they will be in short supply in the immediate term.

Longer term if Practices gather sufficient scale to become a sustainable businesses beyond the current owners, they will continue to be highly desirable assets by market participants due to the nature of the client customer relationship and the opportunity to offer clients additional products and services across a range advice, banking and other financial services.

What's been happening at a Practice level pre FoFA?

The most widespread response pre the final form of FoFA has been migration to wholesale platforms with asset based Advice fees, or the alternative - no change .Many Financial Planners have waited for clear direction from their Licensee and from Bill Shorten before

The Bus is leaving......... there is a-lot of fee substitution taking place – the migration from retail platforms with their 50-60bpts trails to wholesale priced institutionally owned platforms, on which Planners add a 1% asset based (very little dollar based)Advice fee. Many Planners have climbed aboard this bus, and redesigned their advice delivery, service offer and business model around a 1% advice fee.

The cost to client is unchanged but the Advisers share of client revenue is significantly increased, (as are institutional liabilities around Practice revenue based BOLRs!). We are not convinced this fee substitution is what the original FoFA agenda intended, but has certainly been a fast growing and very obvious change.

It is self evident under the FoFA proposals that Practices deriving 1% directly as an Advice fee will need a strong client engagement model and value proposition, to sustain the 1% fee.

What else has been happening....?

With the clearest messages being a ban on commissions, and mixed messages around best interests, opt-in, asset based advice fees and Licensee rebates; how are the innovators responding?

Some are moving their business away from financial advice as the lead proposition. Their new positioning and offer is **Private Wealth Management**.In this model fees for strategic financial advice are dollar based and delivered out of a standalone financial advice entity. All investment management and associated asset based fees are performed in-house in a separate corporate entity. An integral part of the client offer is this in-house investment management is a capability in asset allocation and in securities selection, all charged for on an asset basis – much like the fund managers.

As there has been no debate among industry regulators or commentators on the merit of asset based fees in funds management, this Practice based response to FoFA has been seen to be a safe business strategy.

The most innovative Practice owners have been seeking MDA licenses, and renting an internet enabled administration service.

From a financial perspective these new world Practice models have very impressive and genuine EBITs, especially when they exceed $150m in FUA and have clients with investible assets of a $1m+. Those specialising in SMSFs have a relationship with a tax service, which provides an additional source of income.

A snapshot of the market based on recent transactions:

Syd/Melb/Bris/Perth client book transactions	Holding at 3 - 3.5x annual recurrent revenue, several higher
Syd/Melb/Bris/Perth (large Practice transactions)	EBIT based 5 - 7x, good earn out provisions
Adelaide and Regional Australia	Significant variation on price and terms (supply/demand and business model related)
Risk Only Capital City	Mid to Top end of 3 - 4 x revenue
Corporate Super books	Stalled due to FoFA reforms