

embedding value in your business



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Every financial adviser who builds up their own business wants to know they are creating a prized asset. **Jasper Berens** assesses the attributes that matter to embed long-term value into your business.
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Your business is an asset, something that you will want to build in value. For some this will be because you see it as a saleable asset in the period of consolidation we expect to see in the run-up to the Retail Distribution Review (RDR). For some it will be a method of developing a structured business which can attract and acquire other firms. Others may have long-term aspirations for their business, but want it to be saleable when the time comes.

Whatever your mindset I believe you will find insight in the report** we recently published exploring creating value in adviser businesses. Working with Ernst & Young to assess recent sales and acquisitions of adviser businesses, we discovered there were certain attributes that repeatedly occurred among those firms that had commanded the highest valuations. At the same time there are certain attributes that almost always eroded value.

We've described these attributes as either valuation threats or enhancers – and the impact on valuation can be significant – see **figure 1**. So let's look at a few of these attributes in detail:

Recurring, sustainable income

This was an extremely strong theme in our research. Repeatedly, valuations for adviser businesses were higher in firms with a high proportion of earnings based on annual fees and trail commission – to the extent that initial commission business had an almost negligible value because it has to be 'resold' each year. Given RDR proposals to outlaw commission among independent advisers, a fee-based business model will potentially command a premium.

Clear proposition

If you are looking to realise value and appeal to an acquirer, these acquirers may be attracted to a firm for a variety of reasons, for example, because it has strong coverage in a particular region, a strong area of



embedding value in an adviser business – top tips

- **Recurring income** – recurring trail commission and fees are probably viewed as a firm's most valuable asset.
- **Advisers** – incentivised and loyal registered individuals.
- **Client bank** – low turnover of high value clients will push up the value placed on existing clients.
- **Brand, proposition and expertise** – an independent brand and profile.
- **Systems and IT** – consolidating clients on one platform.
- **Introducer relationships** – strong profitable relationships with local lawyers and solicitors.
- **Regional presence** – location can add value where a regional presence is established.

Source: J.P. Morgan Asset Management.

expertise, great technology, a compelling culture or client servicing approach or because it has cornered the market in a certain type of client. Firms that are able to show buyers that they can offer something that other firms cannot have repeatedly achieved stronger valuations than their peers.

'Sticky' client base

If a principal leaves an adviser firm, chances are the business's most prized asset – its clients – may leave with him. Value therefore comes from signs that clients are embedded in the business, for example: team-based client management; a high level of assets entrusted to the firm; strong net new inflows; and longevity of client relationships. Extra value in case of a sale can come through incentives paid for successfully moving clients over to the new firm.

High-quality registered individuals (RIs)

If you are hoping to place a value on advisers within a business, they will need to be of a calibre of interest to acquirers post-RDR. This means RIs who have, or are in the process of attaining 'level 4' qualifications such as the CII Diploma.

Our research suggests that these four attributes, when held in combination, will immediately attract higher valuations.

So what is the value of your business? Our research suggests there's no easy answer. During the most recent period of high transaction activity in 2007/08 (ie prior to the most serious leg of the credit crisis), adviser firms sold for an average of around 14x EBITDA (earnings before interest, tax, depreciation and amortisation) but prices for reported transactions ranged from 2.2x to 27.8x EBITDA. This is partly because there is no uniformly agreed means of valuing an adviser business (although multiples based on recurring income are

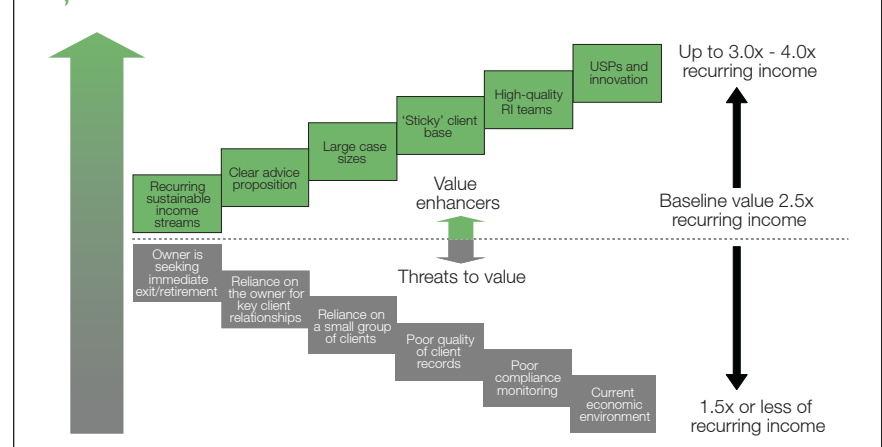
increasingly prevalent). Plus, as we have detailed already, valuations can be based on a broad range of qualitative factors – not just bald financials – as well as external factors such as the market environment and the availability of financing and leverage to acquirers.

Principals should also be aware that the ultimate terms of value in case of a sale may involve significant incentives during the transitional period. The acquiring firm, for example, may pay the outgoing principal(s) an 'earn-out' based on how many clients they successfully transition to the acquirer's own model.

What is also clear from our findings is that building value takes time. Positioning a firm to maximise value, researching potential interest and executing a successful transition can all take three years or more, according to consultants and financial advisers who have been through the process of a sale. But, say the experts, don't rush for the exit. This is your one chance to reap the rewards of having built up your own business. Take your time, take expert advice, but start making value creation a key business objective. ●

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figure 1 – valuation enhancers and threats



You can download J.P. Morgan Asset Management's report 'Reaping Rewards – assessing, optimising and releasing the value of a financial advisory business' at www.jpmorganassetmanagement.co.uk/Adviser/AdviserInsights, or order a free copy by calling J.P. Morgan Asset Management's Brokerline on 0800 727 770.

J.P. Morgan Asset Management presented on embedding value into the adviser business at this year's Skandia Trailblazer Roadshow. To view a recording of their presentation visit www.skandiatrailblazer.co.uk/postevent.asp



*2012 Going for Gold? Preparing for Leadership in the UK life, pensions and savings market, Ernst & Young, Summer 2009.
 **Reaping Rewards: assessing, optimising and releasing the value of a financial advisory business, June 2009.

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