THE EXIT PARTNERSHIP
WEALTH MANAGEMENT M&A

AJBell Investcentre

The Exit Partnership

What does a typical sales process look like?

The process of selling a business, from the conception of the idea through to completion, generally involves several distinct stages:

1. **Preparation:** This is the stage where you make the initial decision to sell your business. You'll need to assemble your team of professionals, including a business broker, a tax adviser, and a corporate lawyer. You'll also need to prepare your business for sale, which will involve ensuring your business data is accurate and accessible, as well as understanding the acquisition landscape, the different types of acquirers, their expectations and valuation parameters. Now is the time to make any necessary improvements to enhance the appeal to potential buyers.
2. **Marketing:** Once your business is prepared, the next step is to market it to potential buyers. This is typically done by your business broker, who will use their network and marketing skills to reach out to potential buyers, introduce them to your business and gauge their interest.
3. **Negotiation:** As interested buyers come forward, you'll meet with them and uncover what the union could look like for you, your staff and clients before entering the negotiation phase. This involves discussing the terms and conditions of the sale, including the price, payment plan, and any other stipulations. This stage typically involves a lot of back-and-forth communication and will require the skills of both your experienced broker and corporate lawyer to reach mutually agreeable Heads of Terms (HoTs). HoTs are provided by the buyer and outline the key terms of their offer. They are non-legally binding, except for an exclusivity period you enter with the buyer. This reflects the fact that the buyer is about to incur significant costs, as they carry out due diligence on the purchase and instruct their lawyer to produce the purchase agreement. Advice is to seek legal counsel before signing the HoTs to ensure they both reflect your understanding and are balanced.
4. **Due diligence:** Once a preliminary agreement, or HoTs, is reached with a buyer, the due diligence phase begins. The buyer will investigate your business thoroughly, examining its financials, operations, legal status, and more. They will want to confirm that everything you've claimed about the business is true and that there are no hidden liabilities or issues.
5. **Change in Control:** Where the buyer is purchasing some or all of the shares of a business, they need to submit a Change in Control application to the FCA. This must be approved before any deal completes. The process involves the prospective acquirer submitting a series of forms to the FCA, detailing information about the proposed acquisition, the acquirer's financial position, its fitness and propriety, and its plans for the business post-acquisition. The FCA then assesses this information in light of the regulatory objectives, reviewing the potential impact of the acquisition on the firm's customers.
6. **Exchange and completion:** If the due diligence phase goes smoothly and the buyer is satisfied with what they've discovered, you'll move on to finalising the sale. This involves drafting and signing a definitive purchase agreement. Your corporate lawyer will play a crucial role here, ensuring the agreement protects your interests and reflects the agreed-upon terms. If Change in Control has been granted, you may exchange and complete simultaneously. If the purchase agreement is satisfactory but Change of Control is still outstanding, you may exchange first, completing after regulatory approval is granted.
7. **Post-sale transition:** Finally, after the sale is completed, there's usually a transition period where you transition and integrate with the new owner. An integration plan should be agreed prior to completion to help the process. The length and nature of this transition period will vary, but it's typically part of the agreement you negotiate with the buyer.

Remember, each of these steps requires careful consideration and planning. Selling a business is a complex process, and having a team of competent professionals to support you can be invaluable in achieving a successful transaction.

Who might buy my business?

Different types of acquirers

There is healthy appetite for M&A in financial planning and wealth management, across firms of all size and scale, so let's take a look at some of the different types of acquirers and their ambitions:

Private-equity-backed consolidators

Private equity is very interested in the financial planning and wealth management space. With clients paying ongoing fees, high persistency rates, and so many advice firm owners set to exit in the coming years, it isn't hard to see why!

Whist each has its own nuances, they share one thing in common – a desire to grow quickly and at scale.

Some may be open to buying businesses or client banks of any size where they have the structure and resources to integrate these. In other circumstances or in certain locations, they tend to be appropriate for larger businesses with operational capacity from which they can grow.

Selling to a private-equity-backed buyer can also be an attractive route for business owners who want to take some risk and capital off the table, and have ambitions to grow and either retain equity or 'roll' into the acquiring firm. This can allow firms to grow further, have access to capital or be part of a new journey, leading to a second capital event in the future.

Private-equity-backed buyers are likely to have their own investment proposition and there will be a requirement to align your firm's brand and client experience.

They can put forward favourable deal terms due to their access to capital, ambitions for growth and arbitrage potential.

Vertically-integrated consolidators

Vertically-integrated firms may also have their own platform or investment management services, as well as providing financial advice. This allows them to control and profit from multiple income streams.

'Vertical integration' can have negative connotations attached to it, with the perception that clients are moved into a different proposition at any cost. But not all vertically-integrated businesses are the same, so it's advisable to look beyond the term itself and under the bonnet to understand the likely outcome for both your clients and staff.

A vertically-integrated buyer could offer the best exit where either there is an alignment in investment philosophy, charges can be reduced for clients, or if you are already outsourcing your investment management to them.

Vertically-integrated buyers tend to have significant experience in acquiring businesses. If they can benefit from multiple income streams, they may put forward attractive financial offers. And if your investment proposition is already aligned, there is potentially little disruption for your clients.

National or regional firms

There are an increasing number of national and regional firms growing both organically and through acquisition. Typically, these businesses are smaller than the large consolidators, something which can be an advantage if you're looking for a more culturally-aligned buyer. They may also have client-facing operations and a brand in your location that is well-respected and of comfort to your clients.

Whilst many of those regional players are not vertically integrated, most will have a well-researched and documented Centralised Investment Proposition (CIP). Over time, there will be a harmonisation of propositions for compliance and operational purposes.

Furthermore, as national and regional firms grow, more are applying for their own discretionary investment permissions. As a result, they're harnessing the benefits of vertical integration, particularly in relation to compliance and reductions in administration.

Typically, national and regional firms have deeper pockets than your local peers. They may be more experienced too, having bought businesses like yours in the past.

Local peer

It isn't just consolidators or larger national and regional firms who are looking to grow through acquisition. There is an increasing number of local firms that have the appetite too.

This could be the perfect option if your preference is to sell to a firm that's aligned with your values whilst giving your clients continuity of a local service.

After your sale completes, you will likely be working with the acquiring firm in some capacity. When you've been used to running your own small business, working with a similarly-sized organisation can be more attractive than working for a larger entity with a corporate feel you're just not used to.

A local firm is unlikely to be able to compete financially with larger firms due to restrictions on their own business value and their ability to raise capital. But it's possible that the transaction can be tailored to your specific needs, including a longer-term deal structure. You may feel comfortable with this offset, especially if it means reducing the potential upheaval for clients.

How would my business be valued and how would I be paid?

How will my business be valued?

Here we will discuss the two most common methods of valuing an Independent Financial Adviser (IFA) business.

Recurring income multiple

Valuing smaller IFA businesses, client banks or businesses to be fully integrated as a multiple of recurring income is a common approach used in the industry. Under this method, the valuation is typically determined by multiplying the annual recurring income of the business by a factor. Typically this ranges from 2.5 to 4.5, although there are outliers. Where your firm sits on the valuation range will depend on the profitability and age profile of your clients, the longevity of relationships and growth potential, and also whether the acquirer has scope to increase charges and/or benefit from additional revenue from their own investment management or platform offering. Recurring income refers to the predictable and stable revenue that a business expects to receive regularly. This could include fees for ongoing advice, portfolio management, or insurance premiums.

This method is particularly beneficial for small IFA businesses, as it reflects the value of their consistent income stream. However, it's important to note that while this approach provides a useful benchmark, it is often complemented with other valuation methods to provide a comprehensive view of a business's worth.

Multiple of adjusted EBITDA

Businesses, particularly in the financial sector, are frequently valued using a method known as a multiple of adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortisation). Adjusted EBITDA is a metric used to analyse and compare profitability among companies, as it eliminates the effects of financing and accounting decisions.

The first step in this method is to calculate the EBITDA, which provides a measure of a company's operational profitability by focusing on earnings derived solely from core business operations. Adjustments are then made to the EBITDA to remove the effects of one-off or non-recurring items that are not expected to continue in the future. The opposite is also true, where costs may need to be added. For example, shareholders taking just a small salary and dividends in lieu of income will need replacing post sale, therefore fair market rate salaries will need to be included in the costs.

The "multiple" in "multiple of adjusted EBITDA" refers to a factor that is used to estimate the value of the business. This multiple can vary widely – typically from as low as 5, up to and over 10, with some outliers.

Where your firm sits on the valuation range will depend on the security of the income, the level of profit (with firms generating higher profits benefitting from higher multiples), and the acquirer themselves. Where buying your firm offers them a strategic advantage, for example a foothold in a key location, you will find higher offers made.

How are deals structured?

When financial advisory client banks or businesses are sold, rarely does the seller receive the full consideration on day one, unless they are willing to take a significant reduction in value.

Typically, the payments are structured over a two- or three-year period, with up to 50% paid on completion. The balance is paid in tranches, dependent on certain qualifying conditions, such as the maintenance of the recurring income, turnover or profitability being purchased.

Deferred consideration, whilst standard, comes with its own set of risks, and both the business broker and legal counsel will pay close attention to the deferred consideration conditions to protect and improve the seller's position.

Whilst there is an acceptance of deferred consideration as a strategy, sellers need to understand the risks and the control they have to protect their value. For example, should a seller face a reduction in their deferred payments if clients leave because the new firm imposes an increase in charges straight away? Or if they are tasked to maintain profit, what control does the seller have over this post sale? There is also the risk of non-payment or delayed payment if the buyer faces financial difficulties in the future.

Therefore, while deferred consideration can be a useful tool in negotiating a sale, it is essential for both parties to critically evaluate these risks and seek proper legal and taxation advice before entering such an arrangement.

It is also important to consider the payment term. Whilst a two-to-three-year term is standard, deals could be structured over a longer payment term, but here we typically see higher valuations to reflect this. The longer the term or the lower the completion payment, the more risk sits with the seller. This could suit a seller's objectives where they require an income-like structure for a longer period, and can also be good for the acquirer as they may need to borrow less and/or can manage their cash flow better.

More considerations …

Secrets of a broker

Unless you personally know the successor of your firm, it is wise to enlist the services of a business broker to market your business, provide reach to a breadth of acquirers, and assist with negotiations to structure the best deal.

But seller beware… here are five secrets of a broker – knowing them will help you to ask the right questions when appointing a firm in this important role:

1. **Most brokers work for the buyer**

   Engaging a business broker who is paid by the buyer can lead to conflicts of interest. When a broker has financial ties with the buyer, their incentive can shift away from maximising the seller's benefits and towards fulfilling the buyer's objectives. This situation can become more complicated if the broker has negotiated different fee structures with different buyers, creating an uneven playing field. They might be tempted to introduce your business to those buyers from whom they stand to garner the highest fees. A key part of a broker's role is to negotiate on your behalf, but ask yourself this question: is your broker able to negotiate the best deal for you, if this means biting the hand that feeds them?

2. **A lot of brokers market their services to sellers as free**

   We all know there is no such thing as a free lunch. A broker's fee is a cost of purchase for the acquirer. When structuring an offer, they will account for any additional costs of purchase – including due diligence costs, legal fees and the broker fee. The best way to understand this is by thinking about pre-RDR commissions, and post-RDR adviser fees. The client was always paying, it was just bundled up in the overall charges. Quality brokers work in a post-RDR world. You pay them, and they sit on your side of the table. Any broker fee typically paid can then be included in the offer.

3. **How are broker's fees triggered?**

   Usually, a broker's fee is triggered when they present you to a buyer. If you then sell to that buyer within a period of time, typically up to three years, they will receive their broker fee. This can encourage brokers to rush your firm out to market, which rarely ends well. This haste might not serve your best interests, as proper preparation, positioning, and strategy are crucial aspects of achieving a successful sale. A rushed introduction to potential buyers might not present your business in its best light, and thus, might result in missed opportunities. If a potential buyer declines the initial offer due to an inadequate introduction, the broker might move on to the next prospect without fully exploring the reasons for the rejection. This could potentially shut doors you were not even aware existed.

4. **They talk the talk, but can they walk the walk?**

   Are you sure your broker really understands you and your business? Have they worked in this regulated space, and do they understand the questions to ask to really get to the nub of your objectives and ensure alignment with the buyers? Choose a broker who has been in your shoes and understands your business and personal objectives, especially as they are likely to be a buyer's first impression of you.

5. **Do they have true market coverage?**

   All too often firms are introduced to the same handful of buyers, and it's no surprise they pay the highest fees. A lot of acquirers won't work with all brokers as they don't like their approach and tactics. Ensure your broker has access to the full market, or you could be missing out on some exciting opportunities. It is also not advisable to have different brokers introducing different businesses. Choose the one you feel can best support your ambitions and run the process with them, so all offers received can be reviewed and negotiated without bias.

Finding the right fit

Culture before cash

Ensuring a strong cultural fit when selling your business is important for several reasons. First, it significantly aids in staff retention. Employees are more likely to continue working under new management if they feel that the company's values, vision, and work environment align with their own. This continuity in staff ensures stability in the business operations, and can have a direct impact on post-sale client retention.

Clients build relationships not only with the business itself but also with its ethos, and a drastic shift in corporate culture can lead to discomfort and potential loss of clients. Cultural alignment can ensure a smoother transition, maintaining strong relationships with clients and preserving the company's revenue streams.

When a deal includes deferred consideration, as they often do, the significance of cultural fit becomes even more crucial. The seller's future payments are often tied to the future performance of the business. If the new management's culture negatively impacts staff morale or client satisfaction, it could impede the business's performance, affecting the seller's financial returns.

Passing the "Tesco test" – the ability to encounter an ex-colleague or client in public without feeling the need to avoid them – is another indicator of a successful sale and transition. If the cultural alignment is right, it paves the way for a smooth exit, preserving your reputation and relationships.

A sale usually involves an after-period during which the seller works with the acquirer to integrate the business. A compatible culture can make this phase more enjoyable and productive, allowing for a successful end to your professional journey.

In summary, getting the cultural fit right when selling your business not only helps to preserve its value and your reputation, but also smooths the transition process, protects your future payments, and enhances your post-sale experience.

Staff engagement

Communicating with staff

Communicating a business sale to your staff is a delicate and strategic process, which should be handled with thoughtfulness and precision. Timing is an essential element to consider in this process. Revealing the sale too early may cause uncertainty and anxiety if the deal doesn't proceed as anticipated. However, sharing the news too late might make employees feel overlooked or unimportant. It's crucial to find a balanced timing, ideally when the deal is close to final, but there is enough time to address employees' questions and concerns.

Understanding the individual ambitions and concerns of your staff is key to this communication. Empathetic dialogue about how the sale applies to each employee's role and career path can alleviate fears and foster a sense of transparency and trust. This involves recognising what is important to them, whether it's job security, growth opportunities, or changes to work culture.

Additionally, arranging meetings for your staff to meet the new team can be a significant step in this transition. These introductions can promote familiarity, create rapport, and provide a platform for open dialogue about the future direction of the company.

Bear in mind that your staff are vital stakeholders in the success of the business sale, especially where there's deferred consideration involved. Your employees chose to work for you and your business ethos, not necessarily the acquirer's. Addressing their concerns and ensuring their buy-in during this transition period is critical to maintaining business continuity and success post-sale.

Understanding TUPE

The Transfer of Undertakings (Protection of Employment) regulations, commonly known as TUPE, is a UK law that protects employees' rights when the organisation they work for, or part of it, is transferred to a new employer. This might occur during situations such as business or asset sales.

Under TUPE, employees are automatically transferred from the old employer to the new employer, with their terms and conditions of employment, and continuity of service preserved. The regulations also require both old and new employers to inform and consult with employees, or their representatives, about the transfer and any associated measures.

Crucially, TUPE regulations prohibit the new employer from changing the employees' terms and conditions of employment for reasons connected with the transfer, unless there is an 'economic, technical, or organisational' (ETO) reason. This could include changes to the numbers or functions of employees.

Moreover, any dismissals connected to the transfer are automatically considered unfair, unless there is an ETO reason. Both the outgoing and incoming employers may also have obligations to provide certain information to each other and to the transferring employees – failure to do so can result in legal penalties.

In essence, TUPE regulations are designed to provide robust protections for employees when businesses change hands. It's imperative for both the selling and buying parties in a business transfer to understand and adhere to these regulations to ensure a smooth transition and to mitigate the risk of legal complications.

The impact of the Consumer Duty

The Consumer Duty is a regulatory initiative introduced by the Financial Conduct Authority (FCA) in the UK aimed at enhancing the standard of conduct and care provided by financial planning firms to their consumers. It requires firms to act in the best interests of their clients, prioritising the clients' needs over the firm's profits. The concept of Consumer Duty is underpinned by three key elements: the Consumer Principle, which mandates that firms must act in the best interests of consumers; the cross-cutting rules, which require firms to take all reasonable steps to avoid foreseeable harm to customers and to enable them to pursue their financial objectives; and the four outcomes, which relate to communications, products and services, customer service, and price and value. Failure to comply with the Consumer Duty can lead to serious consequences, including regulatory sanctions, reputational damage, and loss of consumer trust.

To ensure Consumer Duty is met when selling an IFA firm in the UK, it is crucial to emphasise the significance of integration upon acquisition. This entails combining the acquired firm with the existing operations, systems, and processes. By doing so, it not only enhances the overall efficiency and effectiveness, but also ensures a seamless experience for customers, and fairness across all clients – both existing and acquired. Therefore, it is imperative to consider the acquirer's service range, propositions and charges, to make sure your clients can be integrated with the same or improved outcomes.

Keeping it in the family

What is the difference between exit planning and succession planning?

Exit planning and succession planning are two distinct, yet interconnected concepts in the context of ownership transition.

Exit planning is a strategy devised to allow an owner to leave their business, either by selling it, closing it, or transferring it to successors. It typically involves a comprehensive assessment of the business's financial, legal, and operational aspects to establish its value before a planned exit. The goal is to ensure that the owner can leave the business in a manner that meets their personal and financial objectives.

On the other hand, succession planning is a proactive process that focuses on making sure the business and/or your client relationships will continue once you are no longer there. This could mean working with the acquiring firm to identify the best advisers to take the client relationships forward, or developing potential successors within the business to ensure a smooth transition of relationships and leadership when the current leaders or key personnel leave, retire, or pass away. This often involves training and mentoring programmes to equip the successors with necessary skills and knowledge.

While the two might seem similar, the key difference lies in their focus. Exit planning targets the business owner's goals and how to achieve them upon leaving, while succession planning focuses on the continuity of the business and minimising disruption in the business's operations and performance after exit.

As most deals are structured with a significant amount of deferred consideration (part of the enterprise value withheld for a period with conditions attached to receiving it, such as maintenance of client relationships or profitability), adequate succession planning is the key to a successful exit.

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