Transcript

Better conversations. Better outcomes.

Episode 34 – Buying and selling a practice

David Grau – If you go find the very best match out of a competitive dynamic group of qualified buyers, and presented the winner of the audition - not the bidding contest - the talent audition, to your clients. They're the third party. What will work for 100% of them, that's the goal.

Ben Jones - Welcome to Better conversations. Better outcomes. presented by BMO Global Asset Management. I'm Ben Jones.

Emily Larsen - And I'm Emily Larson. In each episode, we'll explore topics relevant to today's trusted financial advisors, interviewing experts and investigating the world of wealth advising from every angle. We'll also provide you with actionable ideas designed to improve outcomes for advisors and their clients.

Ben Jones - To access the resources we discuss in today's show or just to learn more about our guests, visit bmogam.com/betterconversations. Again, that's bmogam.com/betterconversations. Thanks for joining us.

Emily Larsen - Before we get started, one quick request. If you have enjoyed the show and found them of value, please take a moment to leave us a rating or a review on iTunes. It would really mean a lot to us.

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Emily Larsen - Have you ever thought about selling your practice? If you've built a practice you love but are ready for a new project or maybe you're thinking you're nearing retirement selling might be a way to make sure your clients are in good hands, well into the future.

Ben Jones - Or maybe you're looking for that exponential growth strategy to rapidly expand your practice and your firm, in which case buying a practice might just be right for you. Today we're talking about what it takes to buy and sell practices with David Grau, Senior, the president and founder of FP Transitions. David built an entire firm around helping advisors think through the ins and outs of selling financial practices. In fact he even wrote the book on the subject. Literally.

Emily Larsen - Ben sat down with David in Lake Oswego, a suburb of Portland, Oregon, and home to FP Transitions headquarters. First, let's hear from David about why people might be interested in selling even if they aren't ready to retire, and what the marketplace for acquisition is like.

Ben Jones - You wrote the books on succession planning, but what are some of the other reasons that advisors decide to buy or sell.

David Grau - So we're talking about entrepreneurs, and while people say, well it's an aging industry, I mean yes but most entrepreneurs who sell tend to be in their mid- like 50s. They're not done. They're high-energy people, who have had three prior careers and are going onto a fourth or fifth career. The opportunity to go do something else but with really in most cases substantial value derived from this career power your next stage in life, that's fun and that's a really important part of the work we do. So you built something worth $1M or $2M or $3M how do you actually get it out. How do you replace yourself with somebody or a firm or a business of equal or better quality? How do you make sure that 100% of your clients, many of whom are your friend, are happy with your decision to sell and monetize that value and move on? That's the work that we do.

Ben Jones - Now for as long as I can recall, you would know better you have the database-- but for as long as I can remember, there were more advisors interested in buying a practice than selling a practice. Is that still the case today?

David Grau - I think that'll always be the case. It takes very little effort to be interested in something. It takes a lot of effort to overcome the hurdle of saying, I built this thing. It's my baby and after 15 or 25 years I'm going to let it go.

Ben Jones - Now let's talk a little bit about this idea of market demand. We've talked about the fact that there's an oversupply of buyers, so does this kind of create market augmentation in valuations? I mean, I think back to my economist class in college and there's an oversupply of demand, you'd think it would raise prices, so how does that work? Does it work the way you'd think, as an economist?

David Grau - A little. A quick story, when we first opened FP Transitions, we had our first listing. We didn't know how to value it. We took our best guess and we called other people in the industry and they said you know the multiple of revenue for something like this is about 1.5. So this was a practice with Securities America, we listed it for sale for about $675,000, about 80% recurring revenue, and we put a multiple on it of 1.5. That's fine but we were pretty new in our careers and didn't have accredited valuation folks. He got overrun with buyers, higher offering price than asking. Great terms. And we're looking at this going “okay wait.” If the multiples should have been 1.5, why did he get such a better price? Why did he get such better terms? So we looked at that and said “uh oh, I think we're too low on the valuation.” And so literally we listened to the dynamic marketplace and with each subsequent listing we watched buyers and sellers interact. That's the beauty of the M&A work that we have learned to do. By working with buyer and sellers as non-advocates we get to listen in to the conversations on both sides. We get to help both sides do the job right. Fast forward here we are 20 years later. The average gross revenue multiple on recurring revenue is about 2.44. A 50 to 1 buyer to seller ratio. I think having a -- I don't think it's an oversupply of buyers. I'll put it this way. If I'm a seller and I am looking for the perfect match I want somebody who will impress my client so much that a year after the closing they will call me up and thank me for the choice that I made for them. I need a big talent pool. I don't need a friend or a colleague; I need the best person who's auditioned out of a group of qualified buyers, and I think 50 to 1 is better than 5 to 1 and is absolutely better than 1 to 1.

Ben Jones - People who are looking to sell often have an attachment to the practice and their clients so the decision to sell is not taken lightly. Luckily for them, as David mentioned, there's usually more advisors interested in buying than there are in selling a practice, and this gives the seller options so that they can find the absolute best fit for their practice and their clients. So let's say you're thinking about selling your business, and you've decided okay, let's go for it, what's the most important piece of the process? Whether you're buying or selling a practice I imagine that whether it's someone you know or someone you don't know you need a team of advisors to help advise you, no matter what side of the transaction you're on. So what are the team members you need, and what does that typically look like?

David Grau - Let's just tick off a short list here. There are the lawyers, there are the tax professionals. You need people who are familiar, and can navigate through the landmines of a very highly regulated industry, and many of our clients have more than one regulator in the wings, state, federal, insurance, securities, advisory work, sometimes estate planners, sometimes tax work. So you need the lawyers, the tax professionals, the qualified intermediary. You need an appraiser or a valuation specialist who can objectively, but in a qualified sense, put a number on things, and of course everyone thinks, well, you're talking about the seller. In many cases the buyer will use what they built as collateral. So the value of the buyer's business matters too and the buyer has to understand the valuations and the sellers have to understand it. So having a group of qualified professionals is absolutely key, and there are many varied specialties out there that are important. Let's sum it up by saying this; the way we constructed at FP Transitions was to put basically all of those talent sets under one roof, so we do all that for buyers and for sellers. We've got a team of lawyers. We've got the analyst and the cash flow quotes and the compensation specialists. We've got the valuation folks, so we do all of that under one roof, but -- and this might sound quaint, we have kind of an unusual approach to these transactions. We call it non-advocacy. We don't believe in fighting. We believe -- and people laughed at us 20 years ago-- but they don't laugh anymore, because we were right. And here we are 20 years later with 40 people and we're the leader in the industry in this country, in the M&A sector. These deals have to work for both sides. In fact, they not only have to work for the buyer, and for the seller, they have to work for 300 clients who are ultimately our judge and our jury. So our non-advocacy fashion says okay, we're going to help you with the legal stuff, we're going to help you with the regulatory aspects, we're going to help you think through the cash flow and the taxes. We'll interface with your local folks and make sure that every stone is looked under, but let's not fight our way to the finish line here. This isn't about who can punch the hardest or who's got the best attorney; this has to work for everybody post-closing. That's how our company is organized. That's how I think you should assemble your team.

Emily Larsen - Let's say you've got a trusted team to help you through the process. Now it's time to start the valuation process, and work on finding the right buyer for you, and your clients.

David Grau - For most sellers the starting point is a formal valuation; not a $10,000 appraisal. What you need is an accurate market based assessment of what books of practices or businesses like yours are selling for in an open, active competitive dynamic marketplace, so our company is built to do that. I mean there might be others, but I'm not aware of them. So start with a valuation. This is a twofold process, though. Valuation for many sellers, this is the first time most people have done this. So for the seller a lot of times it's the output, what's the number you think I can sell for, but we also find that going through the valuation process is just a remarkably eye-opening process, and that's the input data, so sellers for the first time, often in their career after 20 years or so, sit down over the course of a long weekend, let's call it, entrepreneurs will know what I'm talking about, and they gather all the valuation data. Client demographics, cash flow, growth rates, profitability, what have I built and how have I built it? And let's put it all on paper. We have about a 12 page questionnaire; we ask for about five years worth of P&Ls, and balance sheets and cash flow statements, and we look at what you built and how you built it, and then we tell you what the marketplace's response will likely be. Valuation is the starting place, it's an eye-opening event, and the only thing I'd add to that is sellers should do that earlier than the eve of closing, but at any point start with a valuation, and the second part, a plan. You need an informed plan; that comes by surrounding yourself with a good team who can sit down and show you and explain to you what's going to happen, how to handle it, what will go well, what you might have to struggle through, what we can fix, what we can't fix. In the end, what you can expect and when you can expect it.

Ben Jones - So I love that. So you get to a number and then you have this conversation with the seller about what they can expect and I think a lot of people, like you said it's their baby and assuming they still want to sell, what do you do from there?

David Grau - For most sellers I think the next part of the process is how do you find the best-qualified match, and of course this is judged not just from the seller's point of view but from all of the seller's trusted clients, how do you find the best match that can keep everybody on board? I think there are really two pathways; think about it like this. If you were going to sell your house, you could put it on the marketplace, in an active dynamic marketplace, you call a real estate agent, the real estate agent provides you with comps, they provide you with expectations. They do the marketing for you. They provide you a group of qualified buyers, hopefully. They'll take it through escrow; they'll help you with the mortgage and the banking process, closing process, and they'll walk you through the whole thing and hopefully you get many offers and you pick the best one. That of course is one way to do it and that's how FP Transitions is organized. Another way to do it, is you could sell your house to a friend, a colleague, someone you know, a son or a daughter. That sounds fine, and it sounds like I'm selling to people I know. Right? What could go wrong? I hope that every entrepreneur and every homeowner out there right now is smiling to themselves, saying “yeah, what could go wrong?” So you start with a one-on-one relationship, which is how some of our sellers prefer to do it, especially when you're selling personal client relationships, so they want to pick out a friend. The challenges there of course are you know the person and you trust them; that part's easier than finding a complete stranger. Is that the best qualified person from your client's point of view? I mean, you know them and trust them from the client's point of view is it just a change of personalities? Are they getting somebody better? Is this the last financial advisor they'll ever have to work with? In terms of value and valuation many times entitlements and expectations creep into the relationship, the close relationship between friends and family and peers and colleagues, and we see that play out, when buyer, seller relationships start out one-to-one there will be a loss in value. It's easier, probably, but not necessarily. So from a seller's point of view do the valuation and sit and think after your team has explored the options with you - do I really want to sell to somebody I know? Is that the best thing for my clients and for me, or should I cast my lot out into the open marketplace and find the best qualified competitive buyer, who might be bigger, better, faster than I am?

Ben Jones - That's a great thing to think on. That sounds like a very long weekend. So talk me through the process that some will go through. They've got the number and now they want to sell, walk me through just the process of how that works.

David Grau - Okay. So armed with the valuation input and output data our transaction team, which is -- our closers, we'll call them. We've got lawyers and analysts around them. So we'll sit down and we'll crunch the numbers. We will pick out the listing value. We will interview the seller, and find out what exactly they're looking for, what they need in terms of the best qualified buyer. When we're sure of that we will put a listing up on our website, FP Transitions.com, the listing process is confidential, we'll send that out to a buyer base of about 25,000 interested and mostly qualified buyers, and we will wait and in most cases, depending on type and size of practice, circumstances of sales, city and community, the typical buyer to seller ratio is about 50 to 1, 50 to 1. Our job then is understanding what the seller wants and we will sort through that list of buyers. Who is prepared? Who has done their homework in terms of value, location, qualifications, credentials? Who's the best fit for the client base that we need to transition in full? We'll help the seller narrow that down to the best two or three or four or five exchange non-disclosure agreements from both sides in both directions and then we'll set up a series of phone calls first, light due diligence. In our system, we extract a formal letter of intent or term sheet fairly early in the process. Of course it's contingent on completion of full due diligence, but in most cases remember, buyers are two to three times the size of a seller and most buyers buy what they know, which means due diligence is not a long arduous affair; it's a couple of weeks in most cases. Buyers buy what they know; they buy within the same regulatory structure. More than half the buyers are within a 50 mile radius, so as a part of due diligence certainly the buyer will visit the seller's office and the seller will visit the buyer's office. Courtship will continue but typically it's not very long, 40, 50, 60 days at most. Along the way we will do all the paperwork for them, purchase agreement. Usually it's an asset purchase agreement. Sometimes there's bank financing, sometimes it's seller financing, sometimes it's both. We do all the paperwork, we take it through escrow, we do a very formal closing with each party, sitting in their offices guided by our team of intermediaries. And when it's all said and done, certainly there's a closing ceremony but in many cases FP Transitions' work starts there, because you close the deal and you've done the paperwork, now you've got to address the client's needs, and the post-closing work I think is what really separates us as a company. We have a plan. We help the seller deliver relationships to the buyer. We help the buyer, who's qualified and the best match, hold onto them. So we work with both sides, to ensure a complete and thorough transaction before and after closing.

Ben Jones - And I really like this idea that the buyers are oftentimes larger than the sellers; I think it's a really interesting concept in that it's not so much because they're bigger. They just have more money. They have it seems the infrastructure to take on the clients because this is a capacity-constrained business. You have to have the system infrastructure, the people to be able to execute well for those clients once you get them.

David Grau - Yeah, perfectly said. We often break -- or create sectors in our industry when we talk and we think and we plan. So we look at the independent financial services industry in four distinct sectors. Those who own a book. A book owner is typically a small proprietor. Those who own a practice. A practice owner has an entity, usually one owner though many producers. Those who own a business, those who own a firm. A business is multi-generational. Books and practices are built for one generation and at the end they will sell. Businesses and firms, those are typically the qualified buyers. Yes, they're bigger, but that's not the point. Structurally -- and this goes to our first book, "Succession Planning for Financial Advisors: Building an Enduring Business." They've got the staff, personnel, multiple owners, multiple generations of owners. And I know that sound like we're talking about a behemoth here. It takes a father and a son, a mother and a daughter to create a business with two owners and two generations. It doesn't have to take 20 or 30 people; it can be done with just a handful. But you put the pieces together right and you put the concrete foundations into place according to a plan, and then you build on top of that. That's a business. And if you're a practice owner who wants to sell what you spent 25 years building, you want to sell it for $1.65M and you want 100% of your clients to be satisfied, sell to a prepared qualified business.

Ben Jones - Now let's look at it from the other side. The point of view of a prospective buyer. Not every buyer is right for every seller and their clients. Most importantly, not every potential buyer is qualified to even run the business. David's firm over the last 20 years has learned what it takes to make a buyer well-suited for a seller. And how buyers should go about finding those sellers.

David Grau - Finding a qualified buyer is ultimately THE GOAL for every serious seller. I would see it this way. I think that a lot of our clients who are serious about selling, they tend to approach this in one of a couple of camps. One camp is they want to find a friend, a colleague, a peer, somebody that they know, somebody that they work with, somebody that they trust because they've been out there in the trenches with them every day. And they bring us their own buyer. We call that a one to one starting relationship. The other group is they absolutely do not want to sell to a friend or a colleague or a peer or a relative, but how do you find the perfectly qualified best match of a complete stranger. So our systems and processes accommodate both of those processes, or both of those thought patterns. There are a lot of buyers out there, but a qualified buyer in our book and literally this is in our second book. We describe a qualified buyer as someone who has prepared for this eventuality. Most buyers are two to three times the size of most sellers. But it's not about just being bigger; it's about structural being sound, perhaps even better. A qualified buyer has gone through a series of valuations, and they understand and can empathize with the seller how to value, what's valuable, what can be transitioned. What are the clients going to think about this? Certainly buyers always are focused on down payments and ROI and cash flow, but a qualified buyer does all of that and more. And as they sit down and they meet with a seller, they understand that this is not an auction, this is not a bidding process. This is more of a suitor. It's more akin to dating than it is to conquering. That's a smart group of buyers. It's kind of ironic that the first book we wrote was succession planning. But again, when you hear succession planning here, building strong sustainable, durable businesses built to last multiple generations. When you build something like that, in many cases you naturally build a great buyer.

Ben Jones - Let's say you are a qualified buyer and you decide part of our growth strategy beyond our organic growth strategy is going to be to grow exponentially through some acquisitions. What's that process like, how do you find these people? Because it's not like there's a *Zillow* of people who are interested in selling. This is a lot of times confidential information, they're very hard to find. If you're a buyer, how do you go about this?

David Grau - Well, I guess there are a couple of different ways you can do it. I think the best way to do it, you don't just throw your -- you know you're fishing lure out into the lake and hope something bites. I mean people do that all of the time. I also would not pay somebody to do a search for me. I think the better way is first get your house in order. Keep the best people you've got, create an internal ownership track. Here's the thing: When you do that, you have to go through the valuation process yourself because you have internal investors. When you go through the valuation process, you're going to learn to take stock of how a business is assembled. Growth, profitability, you'll become a better business owner, a better entrepreneur. You'll become more of an expert at P&Ls and balance sheets, and you need to get the numbers right, what you're going to acquire. Once you've built it inside, take your team, your own team. We call the founder G1, the next generation G2. Have G2, even G3, go out and begin the recruitment process. When we say acquisition, I mean many people tend to think well I'm going to find some 70 year old person who's retiring. Sure. That's one way to do it. But another way to do it is to find a 40 year old or a 37 year old CFP who's a sole proprietor, we often describe it as find somebody who's tired of 18 hour days and being captain of their own canoe, and wants to be first officer on your battleship. So look for acquisitions, look for recruitment. Tell your broker/dealer what you're looking for. Tell your peers what you're looking for. If you go to an FPA chapter or a NAIFA group. Get involved in a study group. Remember, a lot of people in this industry who sell, they're entrepreneurs. It isn't necessarily a formal traditional retirement event, and at 73 they're going to call it a day. A lot of these folks are out of here at 55, or 58, or 61. Sometimes, they don't have a very well thought out plan but they do have 200 or 300 great clients and $100M in assets that need a home and somebody to care about it as much as they did. So be a qualified buyer first. And in my experiences, once you've achieved those goals and we get to know you, we can help you succeed. One acquisition is all it takes. In my experience, I've been doing this for 25 years, you get one acquisition under your belt, and the rest of the time the sellers will find you.

Emily Larsen - Now that you have an idea of what the process looks like for both the seller and the potential buyer, let's say the deal is made. The transaction doesn't really stop there. In this situation, it's all about continuing great service for the clients.

Ben Jones - What does it feel like when the buyer gets it right?

David Grau - When the buyer gets it right, certainly the buyer would say okay one year later, five years later, they look at that P&L and they go “look at the numbers.” That's certainly one aspect of it. The other aspect is the client sitting in front of them that they acquired who said “you know I used to work with an advisor, what was her name? I can't remember.” When the clients react well and are appreciative, and 100% of them come over and work with the buyer and say “you know what - I think you're going to be my financial advisory firm for the rest of my life. And I notice you have some young folks in the backroom who are principals, could they work with my children so that they have an advisor of their own age?” That feels great. And as an intermediary, that's a good feeling for us, too. That's our goal.

Ben Jones - Absolutely. And when the seller gets it right, what does it feel like for them?

David Grau - Sellers want two things that they will equate to success and leave them feeling great about what has just happened. One of course is putting their value in the bank at optimum tax rates. That goes without saying. Second, is meeting one of those clients on the golf course, 18 months later, and the client walks up to them -- and this is a true story, we hear it many times. And a client walks up to their former advisor and says “Bob, Becky, how are you doing? I hope you're enjoying your retirement. Things have gone so well for me with the firm that you had take over. And I'm so glad you did it and I'm so glad for how you did it.” That's success for a seller. That's what makes you feel good.

Ben Jones - What a powerful experience, yeah.

David Grau - And honestly that's what we aim for in every case.

Ben Jones - Throughout my conversation with David, he offered so many pieces of wisdom from his long career in the merger and acquisition industry. This was his parting advice for potential sellers or buyers.

David Grau - If you're approaching the M&A marketplace as a buyer or a seller, do not do this alone. Get your team together and prepare ahead of time.

Emily Larsen - Entering the marketplace for buying or selling a practice is all about doing your research and being prepared.

Ben Jones - Right. No matter which role you're in, it's important to take all of the pieces into account. If you're thinking about selling, find a team of professionals to help you do a valuation that takes into account the actual numbers, as well as the process and relationships that you've built over time. Then look for a buyer that will successfully meld with your clients and your team. Remember, you want your clients to be just as happy, if not happier than when they were working with you.

Emily Larsen - And if you want to buy, come to the table prepared. Look at your own business and see where the gaps are, and identify the kind of business you might want to add. Be empathetic with the seller about what is valuable and do your homework. Once you've worked with your team to complete one acquisition, you'll be better prepared to grow through the same process in the future.

Ben Jones - Thanks to David and his team for hosting me as well as sharing your knowledge with our audience. Do you have a success story about buying or selling a practice? If so, let us know by e-mailing us at betterconversations@bmo.com. Thanks for listening to Better conversations. Better outcomes. This podcast is presented by BMO Global Asset Management. To learn more about what BMO can do for you, visit us at www.bmogam.com/betterconversations.

Emily Larsen - We value listener feedback and would love to hear about what you have thought about today's episode. Or, if you're willing to share your own experiences or insights related to today's topic, please e-mail us at betterconversations@bmo.com. And of course, the greatest compliment of all is if you tell your friends and co-workers to subscribe to the show. You can subscribe to our show on iTunes, Google Play, the Stitcher app, or your favorite podcast platform. Until next time, I'm Emily Larson.

Ben Jones - And I'm Ben Jones. From all of us at BMO Global Asset Management hoping you have a productive and wonderful week.

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