Advisory Firms Aren't Worth As Much As Owners Think

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It's a seller's market, and many advisers looking to unload their firms think they'll get top dollar. But in fact, many have unrealistic expectations of what their practices are worth.

Over the past year, buyers paid about 2.2 times annual revenue for advisory firms, according to a new Cerulli Associates Inc. report. At the same time, advisers estimate their firms are worth about 2.8 times total revenue, research from the Boston-based firm showed.

Kenton Shirk, a Cerulli associate director, said adviser expectations are high because they know the number of firms looking to buy is much greater than the number of sellers.

"For every adviser who actually acquired a practice, there are nine who wanted to buy one," Mr. Shirk said.

Essentially it boils down to supply and demand — and that's not likely to change much over the next few years.

About 28% of advisers said they have sought to buy a firm in the past two years, compared with 4% who have tried to sell, according to the **2014*InvestmentNews* Financial Performance Study of Advisory Firms**. Looking forward, the market may be even more lopsided. About 33% of firms said they anticipate buying a firm in the next two years, while 5% said they planned to sell, the study of about 300 advisers found.

Similarly, only about 5% of advisers said they plan to leave the business in the next four years, the Cerulli report said. The report finds demand even higher than the *InvestmentNews* numbers over a slightly longer span — about 65% of advisers said they are interested in buying a practice in the next four years.

About a quarter of advisers said they expect to retire in five to 10 years, the report said.

Even in such a strong seller's market, advisory firms haven't experienced the giant run-up in price valuations they did back in the 2006-08 time frame, said **Dan Seivert**, chief executive of **ECHELON Partners**.

"Buyers complain that they are overpaying, but the empirics we see is that they are getting incredible prices," he said.

For firms that plan ahead, certain features can boost valuations.

Advisers seeking to maximize the value of their business should focus on growth and take a close look at their clients, **Mr. Seivert** said. Advisory firm growth becomes more difficult as firms get larger, so sellers should think carefully about the timing of a transaction and make sure growth is still headed upward, he said.

Buyers value a firm with a book of clients who vary in age, hold large asset amounts with the firm and provide referrals to new clients, **Mr. Seivert** said.

The Cerulli report said sellers looking to maximize value also should have multigenerational relationships with clients' families.

Cerulli also examined the most difficult factors involved in making an acquisition.

Advisers said transitioning clients to the new owner was the top acquisition challenge. The report found that deals from the past year had an average client retention rate of about 88%.

Advanced preparation can help improve that, especially if the selling adviser sticks around for a little while.

"It is critical to enlist post-sale support from the seller for approximately six months after the closing," the report said.

In addition, buyers should avoid changing fees or switching broker-dealers or investment philosophy — all things that "can cause client resistance to the new owner," the report said.

Two other top challenges of acquisitions identified in the report were a mismatch with the seller's fee structure and operational issues.

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