RIA Owners Should Know What Their Firm is Worth, but Many Don't Get Valuations

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Nothing perks up the owner of a financial advisory firm quite like a conversation about valuations, but for some reason most firm owners never make the effort to determine exactly what their business is worth until they're being acquired.

"I think it's a very good idea to have your firm valued, especially if you are in any kind of partnership or are doing succession planning," said Kristi Sullivan, owner of Sullivan Financial Planning.

"I wouldn't take an adviser's word on how much their firm was worth; I'd want to see the value from an objective third party," she said, adding, "Of course, I've never done it myself."

For a lot of financial advisers, especially at sole proprietorships, the valuation question just hangs in the air and keeps getting moved to the next to-do list.

"I haven't done a valuation yet because I've been so busy, but it's on my to-do list for this year," said Rose Swanger, president of Advise Finance.

Despite a normal and natural curiosity about the market value of one's business, financial advisers could be excused for putting off the valuation process because it can be complex and costly to get a valuation from a third-party firm, and the number that results might not be that exact.

David DeVoe, managing director of the investment bank DeVoe & Co., said his firm charges between $6,000 and $21,000 for a comprehensive valuation that is pegged largely to the business's discounted cash flow.

Mr. DeVoe downplays a more generic method of valuing advisory firms based on multiples of items such as cash flow or earnings before owner compensation. "The multiples include such rough metrics, especially for a privately held firm," he said.

Scott Slater, vice president of practice management and consulting at Fidelity Clearing & Custody Solutions, agreed that valuations based on various multiples are an "inexact approach," but said they still offer some value for firm owners.

"I think it's a valuable exercise, because it's a way to form a benchmark for what your firm is worth," he said. "That, in turn, leads to the factors that drive value, and what are the opportunities to become a better business."

Mr. Slater added that "in my experience, most firms don't do valuations unless they have a more immediate purpose," such as being the target of an acquisition.

But waiting until a potential buyer comes knocking to get a sense of what your firm is worth is a mistake, according the experts.

"We recommend that, even if you're not looking to buy or sell, why not just get a checkup on what your firm is worth," said Jason Carroll, managing director of investment adviser lending at Live Oak Bank, which does not perform valuations, but made nearly $200 million worth of loans for advisory firm transactions last year.

Mr. Carroll believes advisers should get regular valuations to help them design and measure ongoing business plans. A "ballpark valuation" could be done for around $1,000, he said.

One thing advisers won't find in their quest for a valuation is a standard multiple based on any of the various metrics. That can be the most frustrating part for advisers just looking for a rough estimate of what their firm is worth.

"I don't like using it even as an example, but if you considered a valuation of two times trailing revenues, that's going to change dramatically based on the age of the owner and the client base," Mr. Carroll said. "A book of business made up of 90-year-olds, when we know 90% of heirs switch advisers, is going to be worth less than a book of younger clients from Silicon Valley."

Considering the inexact nature of valuations, it's not surprising that some advisers settle for self-assessments.

"We have not used a third-party firm because we do not plan any sale in the near future," said Carolyn McClanahan, founder and director of financial planning at Life Planning Partners.

"A valuation is necessary and valuable if you are planning a sale either within the firm or to others," she added. "We have a succession plan; if I die, my coworkers buy the firm from my husband for one-time revenue. They get a deal and he gets something out of it. No need for a valuation at that point, but that option is not what most advisers would want."

Tim Holsworth, president of AHP Financial Services, uses an internal formula to value the private business.

"We update that value annually after calendar-year numbers are determined," he said. "It's valuable, and we think it's important."

General valuation estimates are better than nothing, but until it comes time to cash in, whether through a sale or a succession plan, nothing should be considered set in stone, according to Daniel Seivert, founder and chief executive of Echelon Partners.

Last summer Mr. Seivert spun out a separate valuation business, RIA Valuations, from the investment bank.

He cites multiple subtle distinctions that can impact a firm's valuation, such as a minority ownership position.

"If a firm is worth $10 million, a 40% owner's share probably isn't worth $4 million," he said. "The minority-stake discount could be as much as 25%."

The bottom line, said Matt Lynch, managing partner at the consulting firm Strategy & Resources, is to keep an open mind and never bank on a valuation until it has been converted into cash.

"Unlike the well-defined rules around real estate valuations, the RIA space is still evolving," he said. "There is a disconnect between typically what sellers think the business is worth and what the buyer wants to pay because there is a lot of misinformation out there. In the RIA space, we could look at two firms with similar data and one firm could be worth $5 million and the other firm could be worth zero."