

WHAT DRIVES FIRM VALUE? 5 CRITICAL FACTORS

5.2.14 Originally Published by Charles Paikert, Financial Planning

Optimizing an advisory firm's value is the goal for many owners – but the rapidly changing marketplace is making it increasingly difficult to determine a firm's value.

While there may be no one-size-fits-all answer, there are five key factors currently driving value, according to Dan Seivert, chief executive and managing partner of Echelon Partners, the Manhattan Beach, Calif., investment banking and consulting firm.

Speaking at the opening session of the Deals & Deal Makers Summit in New York, Seivert urged advisors to incorporate valuation into their strategic thinking as soon as possible, and to keep an eye on the following areas of their business:

1. FINANCIAL MANAGEMENT

Advisory firms are now being valued on multiples of EBITDA, or cash flow resulting from total revenues minus total operating expenses, Seivert said. A key question for would-be buyers, he told conference attendees, is: "How much of your fee-based revenue is recurring?"

Key drivers of EBITDA include assets, fees, revenue, compensation expenses and non-compensation expenses, Seivert said.

2. GROWTH

"The single most important driver of value by far is growth," Seivert said.

The number of net new clients each year and the assets from each new client are considered "hallmark" metrics, he added. "Lower quality" growth makers include asset growth in a bull market and growth by acquisitions, he added.

In fact, advisory firms that substantially outperform the market are often viewed unfavorably when it comes to valuation, Seivert warned. "It may seem counterintuitive," he said, "but buyers are wondering how much risk they took to achieve those results."

3. SCALE

There are a few ways of gauging scale, Seivert said: by assets, revenues and profits. For assets, quantitative thresholds tend to be at \$100 million, \$500 million, \$1 billion and then \$5 billion, he said. Revenue benchmarks

are typically \$1 million, \$5 million and \$20 million, he added; profit benchmarks are \$1 million, \$3 million and \$10 million.

There are qualitative factors that help achieve scale as well. Seivert highlighted size of management, specialization of the management team, levels of management redundancy and a reduced dependency on any one executive.

4. BUSINESS MODEL

Because recurring revenues are so important, Seivert noted, a holistic wealth management practice must be able to attract and retain clients.

A firm's business model must also create a unique offering, promote agility among its teams and be able to adapt to changing market conditions, he said.

5. CLIENT VALUE

Would-be buyers will seek to quantify several aspects of a firm's client base, Seivert said. Among them: client age distribution, the size of an average client's assets, the number of new clients per advisor each year and the amount of new client assets per advisor.

Qualitative factors driving valuations include the types of service and solutions that firms offer clients, how many referrals clients give and the quality of a firm's communication with and education of clients.

"The relationship a firm has with a client's spouse and beneficiaries is also critical," Seivert said. "That can give an indication of whether or not assets will stay with the firm."

ABOUT ECHELON PARTNERS

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

Daniel Seivert

Managing Director

dseivert@echelon-group.com