FPA 2009 Business Solutions

The Advanced Business Management Conference

TRACK:	**FOUNDATION SESSION - SUCCESSION PLANNING**
SESSION #: 949026	**REAL DEALS 2008: DEFINITIVE INFORMATION ON MERGERS AND ACQUISITIONS FOR ADVISORS**
	TUESDAY, MARCH 10, 2009 4:30 PM - 5:35 PM
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Dan Inveen has assisted businesses with research and strategy development for more than two decades. To help executives gain a better understanding of how to achieve success in the financial advisory marketplace, Mr. Inveen leads a variety of high-profile research initiatives identifying new trends in the distribution and demand for financial advice as well as best practices in firm management.

Mr. Inveen is often a featured presenter at industry events and conferences. He has authored articles or been quoted in leading trade publications such as Investment Advisor, Investment News, Financial Planning, Private Wealth Management and Registered Rep. His research and consulting focus includes strategic planning, financial management, compensation, organizational design, operations, client servicing, and mergers and acquisitions. Prior to founding FA Insight, Mr. Inveen's previous positions included Senior Research Manager for Moss Adams LLP, Marketing Research Manager at Russell Investment Group and Director of the U.S. Virgin Islands Bureau of Economic Research.

Mr. Inveen left Moss Adams in December of 2008 to found FA Insight. FA Insight specializes in providing research and consulting services to financial advisory firms and those that service or work with these firms. The firm provides clients with actionable insight that is based on a powerful combination of unique marketplace data, consulting and analytical expertise, and deep knowledge of financial advisors and their business environment. In addition to independent advisory practices, its clients include trade and professional associations, fund companies, custodians, broker-dealers, banks and accounting firms.

SUMMARY: REAL DEALS 2008: DEFINITIVE INFORMATION ON MERGERS AND ACQUISITIONS FOR ADVISORS

Real Deals 2008 will update the market trends reviewed in the original report, published in 2006, and provide advisers with guidance on how to take best advantage of the new M&A environment. The presentation will highlight growth in transaction activity, noteworthy deals and new developments in deal structures. Special focus will be given to consolidators who are accounting for much of the recent acquisition activity. Finally, in recognition of the need to put a transaction in context with firm strategy, attendees will be provided criteria to evaluate in order to make the right decision to go forward with a sale or purchase for their own firm.

Real Deals: Definitive Information on Mergers and Acquisitions for Advisors

Sponsored by **Pershing Advisor Solutions**

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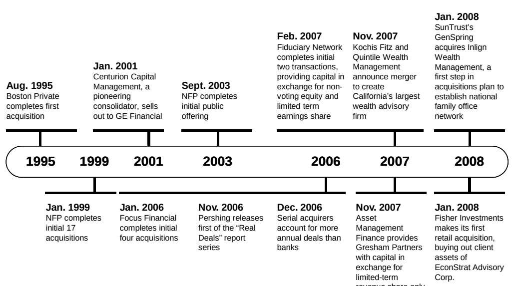
March 10, 2009

Session Objectives

- Provide advisory firm owners with a framework for planning a transaction
- Help firms define the most appropriate path based on:
  - Owner and firm goals
  - Owner values
  - Firm characteristics
- Review the advantages and disadvantages of various merger and acquisition (M&A) options and deal structures
- Profile prominent buyer types and approaches
- Provide owners with an overview of the expected outcome from each transaction type

A Rapidly Evolving Landscape



Sources: Trade press and company Web sites

Defining Terms

- Buyers may be grouped according to primary objectives, as well as the frequency with which they conduct transactions
- By frequency:
  - **Serial buyer:** Strategy based on making multiple transactions
  - **Situational buyer:** Strategy based on exploiting a unique opportunity
- By primary objective:
  - **Purely financial:** Strictly interested in "getting a piece of the action"
  - **Financially motivated:** Desires financial gain but also aims to add value to the firms they invest in
  - **Synergistic:** Invests for strategic reasons, combining entities that create greater value together than if kept independent

Buyer Overview

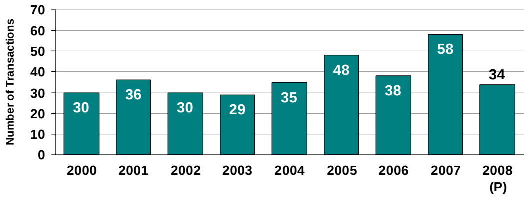
Transaction Frequency

Transaction Objective: Hands-Off ↕ Hands-On

	Serial Buyer	Situational Buyer
Purely Financial	▪ Asset Management Finance ▪ Fiduciary Network	▪ Private equity
Financially Motivated	▪ Boston Private ▪ Focus Financial ▪ Mesa Holdings ▪ National Financial Partners ▪ United Capital ▪ WealthTrust	▪ Private equity
Synergistic	▪ Fisher Investments ▪ GenSpring ▪ Stancorp ▪ SMH Capital ▪ US Fiduciary ▪ Wilmington Trust	▪ Banks ▪ CPAs ▪ RIAs ▪ Trusts ▪ Internal successor

Trends Review

2008 M&A Activity Cools After Record 2007



- RIAs became distracted and buyer's capital contracted
- Slow-down in transactions will be short-lived, however
- Volume will rebound due to a crowded landscape of buyers and continued interest from advisory firms

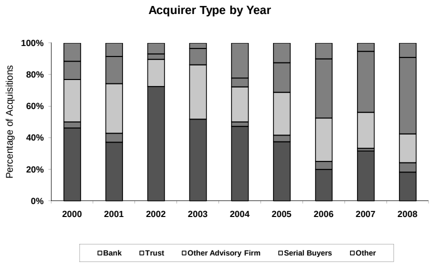
The New Environment

- Valuations appear to be holding steady but risk is increasingly shifting to the seller
- Across the different buyer types, structures and capitalization options, valuations are converging
- Strictly comparable valuations, however, are difficult to ascertain
- Financial buyers are promoting more complex deals
- Serial buyers, and not banks, are driving activity
- Their prime target range is coming down from firm sizes of more than $1 billion in AUM to firms of $500 million

What Motivates Sellers

- *Real Deals 2006* accurately suggested more deals would be driven by the liquidity needs of owners rather than a desire to make an immediate exit
- Today liquidity needs are indeed more prominent because of:
  - Owners' desires to diversify personal wealth out of a rapidly appreciated asset; or to reinvest in their businesses for continued growth
- Meeting human capital often forms the core of reinvestment plans
- Capital is used either to acquire premium talent from outside the firm or to finance the succession of a new generation of firm owners (assuming partial sale)
- Rarely does a deal center on founding owners quickly cashing out and walking away from the firm

Buyers by Deal Share, 2000–2008



- Since *Real Deals 2006*, the share of serial buyer deals nearly tripled—from 17% in 2005 to 48% in 2008

Purely Financial Buyers

- 2007 marked the entry of purely financial serial buyers
  - Asset Management Finance
  - Fiduciary Network
- Largely passive, these investors provide capitalization through equity financing
- Typically the purchase focuses on a share of revenues or cash flows and not equity

Financially Motivated Buyers

- These buyers create additional value in a number of ways
  - Practice management assistance
  - Centralized back-office support
  - Integration of complementary service offerings
  - General scale efficiencies
- Currently, financially motivated buyers represent the largest share of active serial buyers
  - Firms include: Boston Private, Focus Financial, Mesa Holdings, National Financial Partners, United Capital and WealthTrust

Synergistic Buyers

- Synergistic buyers tend to be situational buyers, buying on an ad-hoc or a one-time basis
- Traditionally the majority of transactions were synergistic, but this deal type is accounting for an increasingly smaller share in recent years
- Two prominent serial buyers are synergistic:
  - SunTrust GenSpring
  - Wilmington Trust
- The two have similarities—both are rooted in banking, and both aim to establish national wealth management networks that cater to the affluent
- Acquisitions by banks and registered investment advisors, as well as internal successions, are typical synergistic transactions

Future Directions

- One market at a time, consolidation appears to be taking hold
- New financing options will encourage internal succession and organic growth, weakening the desire for large firms to be acquired
- Greater liquidity options should strengthen the competitiveness of RIAs vis-à-vis other distribution channels
- Demand to buy firms will remain strong, fueled by continued, healthy industry growth
- Strong demand, coupled with growing scarcity of premium independent targets, will drive up prices for well-managed firms beyond $1 billion in AUM
- Nearly every firm will be affected by this new M&A environment, and firms will face growing pressure to consider a transaction due to rising valuations, consolidation and staff development needs

Making the Right Decision

Whether a Buy, Sale or Merger— Be Prepared to Deal

- Regardless of the firm, a transaction may help owners who wish to:
  - Access liquidity for growth
  - Diversify assets out of a concentrated position
  - Succeed firm ownership
  - Develop or broaden expertise
- Therefore, every firm should have a clear understanding of its transactions options, including:
  - The menu of available choices
  - The choices best suited to the strategy of the firm owners and culture
  - The most realistic choices based on the desirability and general characteristics of the firm
  - Measures the firm can take to improve its options

Identify the Goal

- An advisory firm owner's decision to sell, merge or buy depends on the ultimate goal
- Determining the right kind of deal hinges on which goal ranks the highest in priority:
  - Growth and the desire for liquidity or resources to support growth
  - Diversification of personal assets
  - Exit strategy

Fundamental Approaches

Available transaction options fall into three broad types of solutions:

- Do-It-Yourself
  - An internal ownership succession is arranged without external financing or sale of shares
- Financial
  - Third-party financing is acquired without relinquishing significant management control of the firm
- Synergistic
  - Transaction is structured with an external party to provide additional growth opportunities; management responsibility is shared

Do-It-Yourself: Evaluating an Internal Transaction

Advantages

- Preserves the culture, management and strategy of the firm
- Provides performance incentive for firm's next generation of leaders
- Allows for controlled pace of exit for the founding owners
- Partial retirement is possible
- Buyer is known and familiar
- Easy to position with clients
- Highly customizable transaction terms
- Employees are protected

Disadvantages

- Qualified buyers are limited or nonexistent
- Buyer's capital is limited, resulting in:
  - High risk to seller
  - Slow pace of exit
  - Significant business risk
- Generally yields lower valuations, especially in terms of net present value

Evaluating a Financial Deal

Advantages

- Preserves the culture, management and strategy of the firm
- Allows for transfer of control to the firm's next generation of leaders
- Creates a clear plan and controlled transition process that is often missing from internal deals
- Yields some of the highest valuations
  - Private to public arbitrage
  - Preferred status of capital allows for taking on more risk
- Provides financing for external acquisitions

Disadvantages

- Requires the participation, collaboration and retention of the next generation
- Next generation becomes the critical party to the deal, but is often not at the negotiating table
- High valuations mean a long buy-in period for the new generation
- No direct strategic effect to improve the positioning of the firm

Evaluating a Synergistic Deal

Advantages

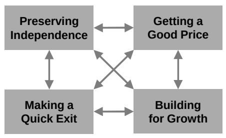
- Enhances the value and competitive positioning of the firm
- Creates new opportunities for staff and management
- Increases structure for:
  - Operations
  - Human resources
  - Strategic discipline
  - Business development
- Frees more time to focus on client service
- Improves capital position
- Yields higher valuation if situational buyer

Disadvantages

- Creates loss of control and often identity
- Being "merged" and integrated may bring cultural clash
- May limit motivation of the firm's next generation
- Negative client impressions may ensue from a perceived weakening of the firm's independence
- Causes challenges in reassuring clients of service continuity

Let Your Conscience Be Your Guide

- The general path toward a transaction will be determined by the firm owner's primary issue or goal
- Specifics of the transaction, however, typically strike a balance across four often competing owner preferences



- Owners may focus on one or two of these items; they cannot achieve all of them
- The specifics of the right deal are determined by the key objectives

What to Expect

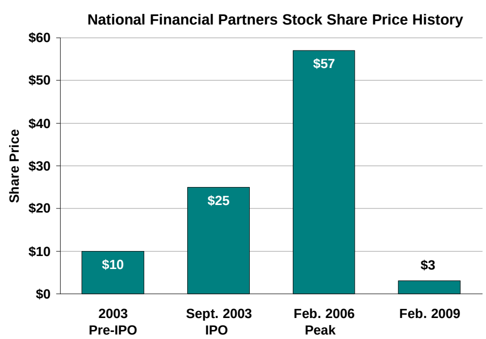
Typical Target

Revenue	$4.0M	100%
• Owners' compensation	$0.9M	23%
• Non-owners' compensation	$0.6M	15%
Less: direct expense	$1.5M	38%
Gross profit	$2.5M	63%
Less: overhead	$1.5M	38%
= Operating profit (EBITA)	$1.0M	25%
Earnings before owner compensation (EBOC)	$1.9M	48%

Financially Motivated: Case Study

Typical Deal: 100% of Equity Acquired, But Just 50% of Profit Interest	
Earnings capitalized (EBOC)	$1.9M
EBOC multiple	5x
Valuation of the firm	$9.5M
50% earnings capitalized	$4.75M
Cash (50%)	$2.4M
Acquirer stock (50%)	$2.4M
Potential additional payments for growth	$1.1M–$2.7M
Potential range of payments	
Guaranteed (cash)	$2.4M or 1.2x revenue
Best case scenario	$12.2M or 3.1x revenue

Risk and Reward



Synergistic: RIA Case Study

Typical RIA Deal: Terms Vary, But Typically No Cash Is Exchanged	
Acquiring firm revenue	$3.0M
Selling firm revenue	$0.8M
Combined revenue	$3.8M
Resulting ownership distribution:	
Acquiring firm ($3.0M ÷ $3.8M)	79%
Selling firm ($0.8M ÷ $3.8M)	21%
Buy-sell agreement when seller retires:	
Multiple of seller's revenue paid over five years	2.5x
Payment total	$2.0M
Net present value	$1.5M

Do-It-Yourself: Internal Succession Case Study

- Typical terms
  - Sale commonly financed by the firm through direct loan
  - The new owner makes payments for three to seven years on a fixed schedule
  - Compensation is garnished to pay down purchase price
  - After vesting, the new owner gets full share of profit distributions
- Introductory deal
  - New owner offered a 5%–10% ownership share
  - Buyer signs buy-sell and non-compete agreements
  - Financed over five years with balloon payment at end of term
  - Valuation of 2–2½ times revenue
- Complete buy-out of founder
  - Financed over five years
  - Valuation of 2½ times revenue
  - Price may be based on EBITDA

Real Value of Any Deal

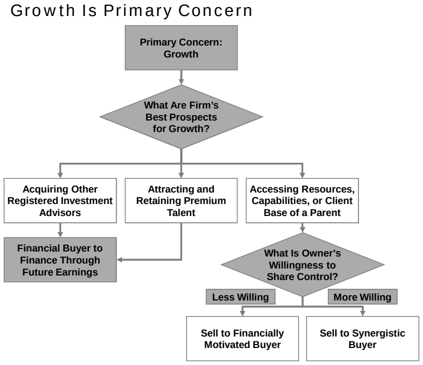
- Deals are increasingly shifting more risk to the seller
- 78% of acquisitions over last three years included an earn-out provision
- 73% of acquisitions paid out in stock
- The ultimate value paid to selling owners relies heavily on post-acquisition performance, including variables such as:
  - Payments contingent on meeting earnings targets
  - Payments varying according to reaching certain growth levels
  - Performance of acquirer stock
  - Shifts in discount rate

Status Quo Is Best Benchmark

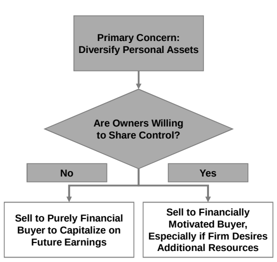
- If firm is not sold at all:
  - $1.9 million per year in annual income to owners (EBOC)
  - $5.7 million equals present value of income over five years
  - Owners retain 100% of firm
- If firm is sold to a financially motivated buyer:
  - $8.1 million in consideration and
  - $2.8 million in present value of income earned through remaining interest
- If firm is sold to a bank:
  - $10.8 million in cash and liquid stock
  - Option of fair market compensation for remaining 10% share
- Present value of five-year income ($5.7 million) represents:
  - 52% of the financially motivated deal
  - 53% of the bank buyer deal

Decision Framework

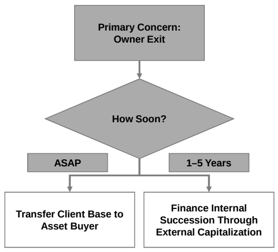
Decision Framework:
Growth Is Primary Concern



Decision Framework:
Diversification Is Primary Concern



Decision Framework:
Exit Is Primary Concern



Deal Deliberately

Continued Industry Prosperity

- The new environment bodes well for continued industry prosperity
- Transaction and liquidity options are increasing
- Market liquidity is enabling firms to grow and develop in ways previously unimaginable
- Firms best positioned to buy or sell possess the same attributes of any successful firm:
  - Solid management
  - Growth orientation
  - Depth of talent
  - Sustained profitability

Stay Focused

- Deal options are numerous, with interest high among both buyers and sellers
- With choice comes complexity, which creates challenges for owners to distinguish appropriate opportunities
- Owners must be guided by a deliberate plan and resist reactive behavior
- Personal goals as well as the goals owners have for staff and clients, should form the basis for a deal
- These goals and the strategic needs of the firm—not cash—should dictate the terms

Questions?

Appendix

Purely Financial: Case Studies

Asset Management Finance (AMF)

- Deal structure provides liquidity to principals while enabling management to remain completely independent
- Provides capital in exchange for a limited-term interest in a firm's future revenues
- Owners never give up control—AMF holds no equity but shares in business risk
- There is no fixed debt obligation for the advisory firm—AMF only acquires right to participate in the firm's revenue
- Term periods range from 7 to 20 years, with the average term lasting 10–12 years

Purely Financial: Case Studies

Fiduciary Network

- Fiduciary Network buys 70% of future cash flow that converts into nonvoting stock
- Firm owners sell their shares over several years (6–20) to Fiduciary Network and the firm's next generation of owners
- Fiduciary Network lends money to the next generation to finance share purchase
- Owners typically paid 8–14 times cash flow with ultimate acquisition price dependent upon the firm's future cash flow
- Firm remains virtually autonomous

Financially Motivated: Case Study

National Financial Partners (NFP)

- NFP paid an average of $9.3 million for 25 firms acquired in 2007
- Valuations are based on EBOC, generally a multiple of five to six times
- 100% of firm equity is acquired in exchange for cash, stock and future cash flow
- Sellers receive immediate combined stock and cash payment, with a minimum of 30% paid in stock
- Share of acquired cash flow is 50%
- A three-year earn-out is variable based on the selling firm's achievement of performance goals
- Sellers must commit to staying for at least five years after acquisition

Financially Motivated: Case Study

United Capital

- United Capital actively seeks to develop and grow acquired firms while performing all back-office and administrative functions
- United Capital expects to be contributive to any firm they partner with
- United Capital acquires 100% of assets in exchange for a combination of cash, stock, and notes
- Valuations typically pay three to five times cash flow, but may vary depending on the firm's share of recurring cash flow and expected growth post-transaction
- Acquired owners receive a set percentage of the practice cash flow, dependent upon revenues hitting certain growth targets
- United Capital takes over all of the compliance, bill paying, reporting, personnel and payroll duties of each new affiliate
- The aim is to reduce overhead costs and operational responsibilities of acquired firms, thereby raising growth rates and profitability levels

Synergistic: RIA Case Study

Kochis Fitz/Quintile

- The January 2008 merger of Kotchis Fitz and Quintile created the largest independent wealth management business in California and third largest in the nation
- Client assets of the combined firm total more than $5 billion
- The merger yields many benefits as a result of size:
  - Advantages for leveraging marketing and business development efforts
  - Enhanced recruiting and career development opportunities
  - Greater accessibility to products
  - Pricing power for service and product purchases
- The deal resulted in a broadly distributed equity plan, creating 32 employee-owners out of 68 total employees
  - Large equity pool allows firm to finance long-term growth indefinitely
  - Equity now can be used widely to retain hardworking employees, as well as recruit new advisors
- The new firm is committed to building a "firm of the future," capable of welcoming new participants onto its platform

Synergistic: Bank Case Study

Typical Bank Deal: High Valuations and Upfront Payments	
Firm revenue	$4.0M
Valuation of the firm	$12.0M
Multiple of revenue	3.0x
Multiple of EBOC	6.3x
Bank buys 90% of equity with option for remaining at fair value	
Total consideration paid	$10.8M
Cash (70%)	$7.6M
Acquirer stock (30%)	$3.2M

> Incentive compensation plan for selling principals based on bank stock

> Bank retains option to purchase remaining interest at fair value

Notes