For adviser use only

A GUIDE TO MATCHMAKING

FROM KINGMAKERS' ROB STEVENSON

As presented to Transact advisers

Contents

Introduction

I have woven together this story to illustrate some of the key events that frequently happen through the process of buying and selling a firm and to highlight some key insights into how a deal can be concluded, where the focus on price and fit are balanced throughout. Transact has also commented based on its experience of similar, real-life situations.

Let me begin.

Eddie Smith is the owner of a financial advice firm. His team of ten dedicated employees look after the financial affairs of several hundred clients and generate around one million pounds of revenue per annum. Eddie owns eighty percent of the business with his wife and the remainder is owned by his protégée William.

His business, Eddie & Associates Ltd has just turned twenty-five years old and while this should be cause for celebration, Eddie is frustrated. A year ago, a deal to sell the firm fell through. Eddie had spent eighteen months working on the deal, but it fell through after many twists and turns.

He had decided to get on with the business, working with William to transfer client relationships, so the firm could be sold in a few years' time, but this is proving harder than expected and external factors are not helping.

So Eddie, with William, responded to an event invitation to attend a succession planning workshop presented by Kingmakers and organised by Transact – this is Eddie's story.

Chapter 1 – How did we end up here?

It’s now a year since my failed attempt at selling Eddie & Associates ended. There’s a lot that went wrong in the eighteen-month period it dragged on for, and I’ve come to a couple of important conclusions.

Firstly, I wish I’d understood more about the process and what was involved. I didn’t feel like I was in control at any time and I now see that I was reacting to the buyer’s process. They contacted me and from that moment on, I was reacting. I also got far too bogged down with the valuation and the terms of the deal and didn’t spend enough time asking sensible questions about how my firm would be merged into theirs. I kept telling myself that nothing would change, but in hindsight, that was just naive.

Over the course of eighteen months, the price the buyer offered went from almost three million pounds, to half that. Nothing in my business really changed in that time and I think I just wasn’t very strong in negotiations. I completely took my eye off the ball workwise, became isolated from the team and lost one of my favourite clients too. My personal life suffered a great deal and I was totally miserable throughout that period and for a while afterwards too.

So, we resolved to work on for another three years. The plan was to transition my clients to William and then look at our options again once that’s done. Deep down, I’d love William to take over, but I also appreciate that it might be a few years too soon for him. I’m turning fifty-eight this year and William will be thirty-two. I’ve seen him progress rapidly in the last five years since he joined and he has huge potential. However, he needs to pay for a wedding, put down a deposit for a new house and save some money for the family he and his fiancée want to start. In other words, he has a lot he needs to do before he goes into debt to buy me out.

Transitioning my clients to William has not been without its difficulties either. It’s just so hard to follow through, when I don’t absolutely have to. Some of my clients ask me about succession and what my plans are, and I keep telling them that I’m working on it. They all know William and he’s well-liked, but I’m not sure my clients are ready to deal with him alone. I’ve spent years encouraging my clients to rely on me and those habits are hard to break.

Events in the last few weeks have served as a timely reminder of just how tricky the situation really is. First, we got our renewal terms through from our professional indemnity broker, and they were horrible. Then one of our paraplanners handed her notice in. That’s fine when there’s no deadline, but William is taking the three-year timeline very seriously and so these difficult situations have consequences. William and I will be attending a Transact event on succession planning in London to see what ideas they may have.

Transact perspective

Eddie’s experience is all too familiar. Time and again, we hear of advisers entering into negotiations to sell their business without any real forward planning. The promise of a big number and the reassurance that the buyer is experienced, often combine to draw people into negotiations which, once started, have a way of drawing out for extended periods of time.

We also speak to many business owners who have been in Eddie’s situation and like him, have resolved to carry on for a few more years. Transitioning client relationships can also be challenging and time-consuming.

Supporting Content:

- Guide 1: Post-merger Integration
- Guide 2: The M&A Process for the Seller

Chapter 2 – Finding a match

Since attending the Transact Succession workshop, William and I have been ploughing through all their online content, plugging the gaps in our knowledge. The event was focused on education and it was useful to learn about the basic succession options and how the various alternatives play out in real life.

The resounding message from Transact seems to be about getting the right fit between the buying and selling firms. I've obviously heard how important this is and it's pretty obvious, but if you delve into the subject a bit deeper, there are some very clear reasons why fit is the place to start the search for the right firm.

The other key thing that Transact has done is work with Vertus who can help source capital. I'd spoken to a few people I knew over the years and the message was always that they would like to buy my business, but would have to pay me with my own money. I guess that's no longer the case and the existence of Vertus Capital is a good sign, that I could find a buyer that's not entirely dissimilar to me.

William and I worked through the various scenarios and agreed that of the four options;

- selling to a large firm,
- selling to a like-minded and similar shape firm,
- William buying my family's shares, or
- a sale to an Employee Trust.

We prefer the external sale to a similar type of firm. We've tried the big firm route; William doesn't want to be responsible for the entire firm and we aren't the right size for a trust.

Fast-forward a few weeks and we've undertaken most of the preparation work we needed to do. That work has included pulling together our management information (we had a lot of this from the aborted deal, so it was just a question of bringing it all up to date), completing our own rudimental valuation and working with Transact to develop a clear understanding of what we want from a buyer and what a good fit might look like.

Skip forward another few weeks and I think we have a possible buyer. It seems the fact that we have the majority of our clients' assets on the Transact platform makes us attractive for other firms in the same situation. There doesn't appear to be a shortage of potential buyers now either. All the same, it was refreshing to talk to people whose day job was also to advise clients. With the aborted deal, all our interactions were with dedicated managers whose job was to steer us through their bit of the process, before passing us on to the next link in the chain. They all talked about financial planning and the importance of prioritising client interests, but I'm not sure many of them had ever been in the same room as a client.

Transact perspective

Many of the firms we work with are owned by individuals who still advise clients and while they are highly skilled at providing financial advice, most have not sold a business before. So, it's good to start with education and that is why we organised Transact workshops using external experts.

The next steps are also frequently overlooked by owners who respond to proactive contact from professional business acquirers. Once you are inside someone else's process, it's hard to stay in control. Of course, this is fine for some firms.

The process of matchmaking is quite different when the focus is on fit. We focus on both buyer and seller shape and consider a number of factors including client service proposition, charging structure, investment philosophy, the key roles and types of people in the firm, operational structure and financial management. All of this helps to identify two firms that will integrate to become a single firm in the future, and crucially, one where clients' interests are prioritised.

Supporting content:

- Guide 3: The 4 succession options
- Guide 4: Assessing fit
- Guide 5: Confidentiality

Chapter 3 – The deal

We now have an appealing offer on the table from a firm we really like. We just need to agree the finer points of the deal and make a final decision to proceed. The process has been so different to last time and it's perhaps worth expanding on some of the key differentials.

For a start, the firms Transact introduced us to were slightly larger than us, about double the size but no more, which is important. They are not huge corporations and so they have behaved in a similar way to us. They feel like similar firms. The people we've been dealing with behave the same way we do, which is refreshing.

It's not all been about the price. We put forward our ideas on the value of the firm and the process we used to arrive at a valuation range. Once the principles of valuation were agreed, it was easy to discuss terms and agree a sensible number. It didn't feel like a battle and we weren't presented with a fait accompli.

We've kept it simple. Because we are not negotiating with experienced acquisition specialists, we seem to have avoided a lot of complexity. We talked in depth to the firms and each was offering half the money upfront and the balance over two years in one case and three in the other. The deferred payments would be fixed and would only be adjusted if certain specific events occurred. I'm staying on for eighteen months to help with the goodwill handover and everyone else is staying long term.

One of the other reasons the deal structure is simple, may be down to the fit between the firms. The firm we've finally chosen, was the closest fit to us in terms of the types of clients they work with and their approach to financial planning. They have the same investment management philosophy and strategy as us and we both use Transact, which means the clients won't see a material difference and will even keep their portfolio number and log in details. But perhaps most importantly, the culture feels similar. The way decisions are reached, how the firm is managed and the acceptable standards of behaviour. Many of these factors are intangible, but having worked through a defined process to assess fit, reviewing each other's client files, processes, talking to staff in the buyers firm, getting the right people talking to each other; all of this has made the assessment of fit possible and hugely valuable. We know what our clients want, they've been expecting a change at some stage and we know they trust us to do the right thing.

In the end, the final offer was confirmation of the strength of the fit. Briefly, it's £1.8m in total, with half upfront and two further payments of £450,000 at the end of years one and two.

Transact perspective

Buying a business is a commercial activity and paying the right price is obviously a critical element of a successful acquisition. It's understandable that so much attention is focused on the price. It's an emotional element for the seller and the headline price is often the trigger that encourages someone to get involved in a process in the first place.

Fit on the other hand, is a little more nuanced, but of equal importance in terms of success over the long term. A seller shouldn't put themselves in a situation where they must advise their clients to change their arrangements, (e.g. to use a different platform) just because the firm has been sold.

In conversations with owners of adviser firms that use Transact, the thread is almost always the same; there's a desire to get a fair price for the business, while maintaining their duty of care to clients and staff. While it can be difficult to decide how much to share with clients during a succession planning process, those that have kept their clients informed throughout, report client's being appreciative of this.

Now that capital is available for transactions to be undertaken between firms of a similar shape and even for an MBO, fit can finally be balanced with price.

Supporting content:

- Guide 6: Typical Deal Structures
- Guide 7: Offer Documents

Chapter 4 – Time to prove it

The last time we went through a due diligence process, I told the team it was a compliance audit. This time, once we signed heads of terms, I told the team and that's made preparations much easier. The last deal was so completely different to this one. This deal follows a much more open process.

The first day of due diligence is here and we have all the high-level governance, financials and risk management framework to get through. Still, I was provided with details of what they want to look at well in advance and we sent them a lot of the documentation in advance of today. We are meeting key operational people for the first time today too, so it will be good to get a deeper insight into the people that work there. One thing I learned from the aborted deal is that due diligence should be a two-way process.

The end of a long day and although some aspects of it were challenging, I think everyone was happy with what they were looking at. It's tricky because we regard ourselves as a small firm and don't have some of the systems and processes used by much larger firms. The buyers are like us, but they are a fair bit bigger and some of their terminology reflects this. Overall though, I think they have just done some of the projects we have known we need to do for years. I guess that's how you break out as a firm and find some exponential growth, which I admire them for.

Two weeks have passed, and I get an email from the buyer. In a complete departure from last time, the buyer has actually sent us a copy of the due diligence report. Now this really is a refreshing approach to take. The report lists areas that require clarification, rather than listing concerns. We will have a chance to respond and then we will all get in a room to work through any outstanding issues. I like the approach, but there are still one or two pieces of advice that they have flagged that we are very comfortable with, but they seem less so.

Another few weeks of conversations and we've just finished a long day with the buyer and their team. It's natural to go into these situations prepared for the worst, but we had ironed out a few areas of confusion before today's meeting, so it was not as stressful as I had feared. We've ended up agreeing to some specific indemnities (a promise to compensate if a specific situation arises), in order to help the buyer get comfortable with a few pieces of advice. Outside of that, they had some concerns about personnel files, but we agreed this would be picked up and covered by warranties anyway. There were a few financial queries and a robust discussion about the cash on our balance sheet and who gets it, but other than that, we are all happy.

Transact perspective

The process of due diligence is often onerous and complex. The better prepared both firms are, the smoother the process is. Advanced work in this area helps reduce stress for all involved.

Our experience of deals we have been involved in has been refreshing as we have not seen any aggressive due diligence activity looking for issues, as a lever to lower the price paid. This may well be because the firms looking to buy using the Transact Matchmaking process, are Transact users who have been known to us for a long time, not professional acquisition experts.

Supporting content

- Guide 8: The Due Diligence Process
- Guide 9: The Benefits of a Good Fit for the Seller

Chapter 5 – It's the law

When I first tried to sell the business, we didn't engage lawyers until we'd finished the due diligence process. Our thought was that until we got that far, we didn't know if it would go ahead, so what was the point in going through the hassle (and cost), of engaging a lawyer any earlier. Another interesting aspect of the previous deal was that the buyer kept offering to help us with any legal questions, on the basis that it would save us money. In the short term that was true, but in the long term I really wished we had engaged a lawyer earlier on.

This time around we had planned to engage a lawyer when we started the negotiations and before heads of terms. We went back to the firm we used before and they had a quick glance at the offer and the heads of terms, but outside of that, we haven't needed them. Still it's been helpful to keep them up to speed and now that they are about to receive first drafts of all the various documents, I'm pleased they are ready for it, know about the shape of the deal and have slotted us into their workflow.

The first review of the legal documents is done and there are a few bits that we'd like amended. We have a share purchase agreement which covers the sale of Eddie & Associates Limited, new employment contracts for all the team and a few other related documents. Some of the main contract wording seems a bit heavy-handed, so my lawyers are asking if we can make some changes to reflect the spirit of the transaction. In addition, my employment contract has been drafted as a fixed term arrangement of one year, which seems a little short.

Turns out the first draft of the share purchase agreement was built out of a template that had been previously used by the buyer's lawyers, for a much larger deal. Once we'd had a chat with the buyers and realised that they had not intended to take such a strict approach, we all quickly realised what had happened and some changes were made, allowing us to make more good progress.

Now we come onto disclosure. The warranties in the legal documentation seem intentionally bland, which encourages greater disclosure, but where do you draw the line? I'm not sure I want to dig up all sorts of events that could potentially be construed as an issue, depending on one's perspective. William thinks we should play it safe and so do the lawyers, but coming up with the disclosure letter is really difficult.

I really hope this deal goes through. The goodwill we have built between the two firms is powerful and I want my clients to be looked after by this business, and my staff to work here, well into the future. I decided to share my reservations around warranty disclosures with the buyer and they arranged for all of us to get into a room and work through it together. I supplied a draft disclosure letter and we all met up, lawyers in tow and worked through the process, finding the right level of detail to satisfy the buyer, which worked well. The disclosure is still a legally binding document and entirely my firm's responsibility, but at least we are all comfortable with its contents.

Transact perspective

We have noticed that those firms that engage a professional team of advisers, early on in the process, often spend less on legal fees than those that handle everything themselves for as long as possible, before referring it to lawyers, who then have to spend time catching up and almost inevitably question some of the decisions that have already been taken. It seems best to think about the entire process, identify the areas where legal advice might be useful and then proceed accordingly.

Intent becomes very apparent throughout the legal process. If the intention is to simply document the transaction as previously agreed and not look for ways to reduce the price paid and/or alter the terms of the deal, re-negotiation can be kept to a minimum and goodwill maintained. If you feel you can approach the other party with concerns, that's often a good sign that goodwill has been established.

Supporting content:

- Guide 10: Legal Documentation

Chapter 6 – A done deal

It’s now been almost two months since the due diligence process was completed and we still haven’t completed due to some complications with the buyer. They’ve been so open with us up to now, but the last few weeks they’ve been unusually quiet. We had a good lunch with the buyer and I think we’ve at least surfaced the problem. Apparently, it’s them and not us. I guess the downside of not being engaged in buying businesses every day is that while they might have the right resources to advise their clients, they don’t necessarily have all the resources they need to do that and buy a business at the same time. Two weeks later and we are ready to complete tomorrow. We’re still not sure exactly what caused the delay, but the date was set shortly after the lunch; regulatory permissions came through for change of control and suddenly it’s all systems go. I’m having supper with William and his partner tonight, just to reassure them that while this should go through, if it doesn’t for whatever reason, we still have a great business and he still has a bright future ahead of him. The last time we tried to sell the company, I did it all in the shadows and the stress was horrible. This time I’ve been far more open, and I feel a lot better about the process. I’m sure the team do too.

And there we have it. I’m sat in a nice restaurant, surrounded by the buyer’s people, William and a few lawyers. The deal is complete. We wound up with pretty much exactly what was in the heads of terms; £1.8m with £900,000 currently sat in mine and William’s bank accounts and another two payments of £450,000 due to us in twelve and twenty-four months. It was still a real mission to get this done, but at this moment, I feel like it was worth it. Right now, I think I can finally relax and let myself think about the future.

My clients have been supportive of the deal. Turns out quite a few of them were becoming really concerned about my plans, whether William would stay with the firm and what might happen to them if I had to sell out to a much larger firm. When the previous deal collapsed, I told a few of my closest clients and they seemed pretty happy it didn’t go through. This time they were happy for me and pleased that I would be around for a while to make sure the transition goes smoothly.

So, all’s well that ends well. I’m quite sure I had to go through the first experience, to learn some important lessons, which set me on the right trajectory and helped make this deal possible. This was a well-planned, well executed deal, with a great group of professionals (on both sides), working together toward some clearly defined objectives. While that might sound like a load of corporate waffle, it’s actually true. I guess in my late fifties, I had to go through one final career transition, to make this all possible.

Transact perspective

We help sellers and buyers find each other and we know of other professionals that can provide help and guidance when it’s needed. While we feel like this works well, it’s always good to bear in mind that in most situations, neither seller or buyer are particularly experienced at acquisitions and these transactions often represent significant risk for both sides.

It’s rare that negotiations fail without good reason and we generally witness business owners working together, to build goodwill between them, while bringing the transaction to a close. The same people that work on the transaction, will be the same people that work on the integration of the two firms and so it pays to build a strong relationship, as everyone will be working together for a few years. That’s not the case where a deal team doesn’t get involved in a business once it’s been purchased.

Finally, it’s worth noting that where a good fit has been identified and the integration of the two firms has been the focus throughout the acquisition process, we find that the final deal size and shape is often very close to what was agreed in the heads of terms.

Supporting Content

- Guide 11: The Benefits of a Good Fit for the Buyer

Chapter 7 – Some time later

It’s a year to the day since the deal was concluded. I’ve just received my first deferred consideration payment and it’s slightly less than the full amount. That’s not a surprise though, as a few clients decided to go elsewhere immediately after the sale, so the deferred consideration was adjusted in accordance with the indemnity in the share purchase agreement. It’s entirely fair from my point of view and was discussed and agreed in about five minutes.

You can take every precaution, choose the best possible firm and follow a detailed change management plan, but you just won’t know how clients will react, until you give them the news. The small number of clients that left knew each other and had agreed to change firms when I retired, which I was unaware of. It was all very amicable but there’s an important lesson in there. You can’t control every aspect of a business sale, there will always be variables.

On the brighter side, the plan that everyone followed to integrate my business into theirs, was very effective as a way of keeping us all focused on the various tasks that needed to be undertaken. The buyer now has a solid business that incorporates my old one and they are in the process of acquiring another firm too. The entire team has stayed put and William has purchased some equity in the new firm. I think he will go far, and he seems to have settled in well.

Over the last twelve months I’ve seen every one of my former clients, to introduce them to the new firm and their new adviser. True to their word, the buyer has allowed William to take over in most cases, so there is some great continuity for clients there too. Apart from the few who departed, my clients are very happy with the new firm and the fact that the proposition and service they received from Eddie & Associates has been maintained. It feels good to have found a great home for them and the team and I feel like I can head off to write the next chapter of my life, safe in the knowledge that I’ve taken care of my obligations.

The next thing for me to do is go on a nice extended holiday. It will be the first time we’ve been away in twenty-five years, that I won’t have to worry about my clients, the business, the staff, the bank account or the office. I’m ready to wind down a bit and plan the next chapter of our lives.

Transact perspective

We have heard from a number of advisers who have sold, and the majority seem to feel that the one-year anniversary is the time when they feel like they are safe. By ‘they’ we mean their families, their clients and of course their teams. There is almost always a strong sense of obligation, but after the first year, once clients have been seen face-to-face and once the first payment of deferred consideration has been paid, many find that they can finally relax.

Supporting content:

- Guide 12: Change Management

Conclusion

The story illustrates a few key insights; education is the best place to start, advanced planning is essential and knowing what you're worth helps manage everyone's expectations. Never be afraid to walk away, negotiations don't have to be a battle, good advisers are valuable and engaging them early helps. Building goodwill between the parties pays dividends and a good fit helps reduce excessive deal restructuring.

If you are a Transact user and are considering your succession options, please get in touch. There's plenty of supporting information on the dedicated Matchmaking area of the Transact website, Transact runs regular workshops in locations around the country and provides an active matchmaking service to help sellers find like-minded buyers.

We look forward to assisting.

If you have any further questions on the information you have read here or would like to discuss anything further confidentially, please do not hesitate to contact me Rob Stevenson or Transact's Mark Taylor

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