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Mid-Year Update
June 2023

Financial Advisor Practice Valuations

Market Update 2023

Despite Market Volatility, Practice Values Remain High, Leading to High Monetization of Equity

It certainly looks like another interesting and unpredictable year for practice valuation and sales. Our data shows that practice sales are down as much as 30%, while price (monetization of equity) has increased by 13%. The decrease in supply, and buyer fears around negative revenue growth due to the stock market, appear to be driving an increase in demand and aggressive pricing. This is in spite of the recent increase in interest rates.

On the other side of the table, sellers are missing this opportunity, largely due to emotional concerns over their client's well-being during the market downturn. Many potential sellers have put their transition plans on hold as they wait for an elusive "perfect time to sell". Selling is often an emotional decision, which is why so many advisors delay selling longer than they should.

Average practice value increased by a rate of 3% over the same time last year. This trend is expected to continue as advisors become more sophisticated business owners and actively manage the key factors that drive practice value. We will dive deeper into those factors and their correlating KPIs later in this white paper.

The Marketplace for Practice Sales

For the past 5-7 years, we have waited for the Baby Boomer generation to retire in mass (known as the predicted "Age Wave"). Instead of retiring, many Baby Boomers have held on to their practice long past the normal retirement age. This created a scenario of low supply of practices for sale in relation to an increasing level of demand for acquisitions, which was largely fuelled by greater access to capital.

This all started to change in 2020, at the start of the pandemic. From 2020 to 2022, we experienced a sharp increase in practice transition related activity, which we assumed was the front of the age wave. A corresponding assumption had been that

the increase in supply of sellers would change the supply and demand dynamic and start to drive prices down. Instead, the supply increase in that time period was met with a greater increase in demand. Demand continues to remain high, but market fears have many retirement aged advisors putting off retirement for fear of selling in a "down market," both due to the perceived impact a down market has on practice value and because of concerns of their client's well being. This mentality is largely based on false assumptions and a lack of understanding of how practice value is grown, maintained, and monetized. This is negatively impacting the ability of many advisors to cash in on the equity they have built over their career.

The Age Wave

The concept of an "Age Wave" was first coined by psychologist and gerontologist Dr. Ken Dychtwald. As the former co-founder and co-director of the Sage Project, Dr. Dychtwald saw first hand the "transformative power of demographic forces" on social dynamics, economics, and politics. He has since founded the Age Wave organization to help educate the public on the impact of an aging population. According to research done by Dychtwald, the number of Americans over the age of 65 will nearly double over the next ten years.

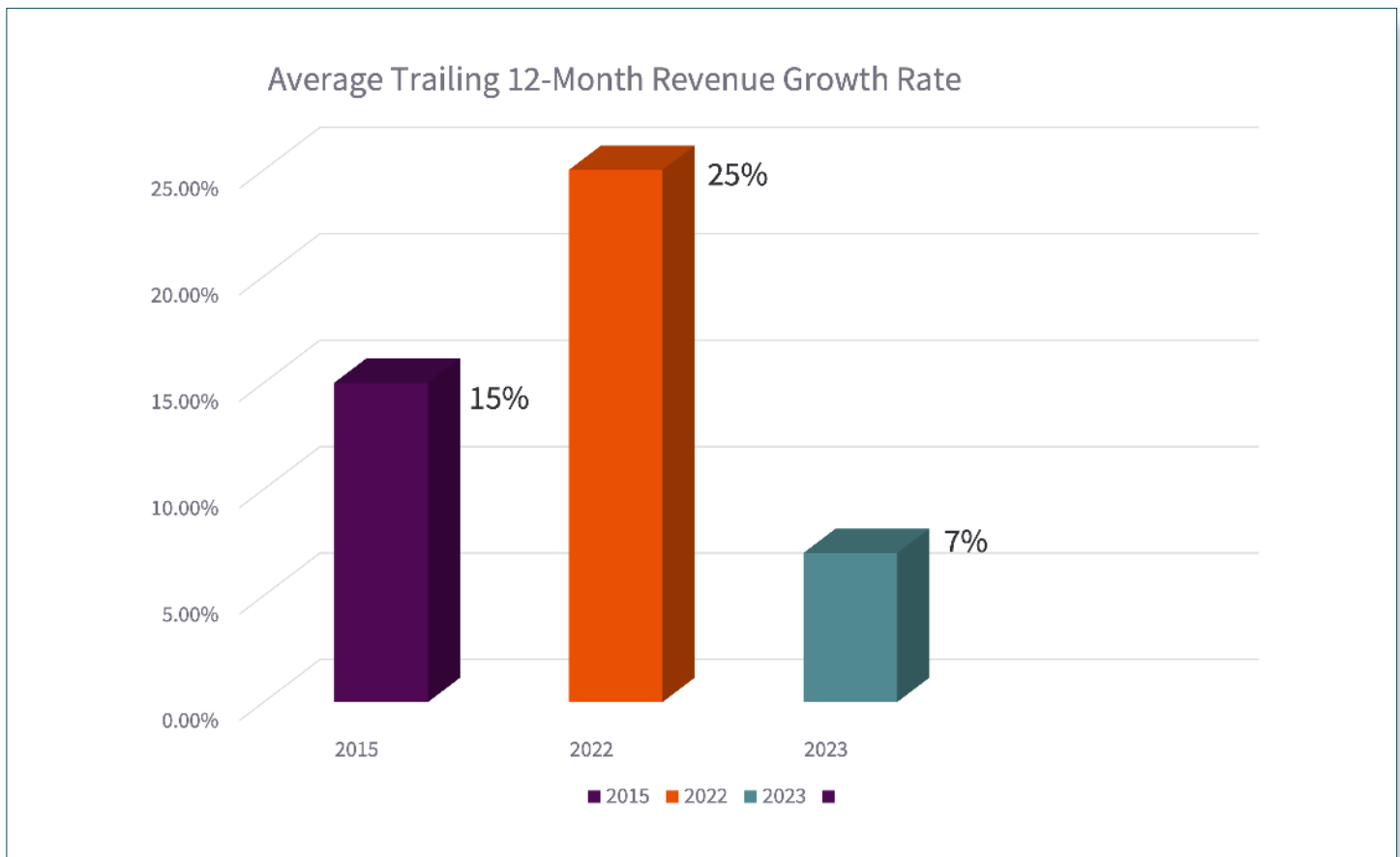
The number of financial advisors over the age of 65 is also expected to double over the next decade. However, less than a third have a known successor for their practice. The disproportionate number of advisors set to retire without a known successor has created sustainability concerns for the industry.

Market Update 2023

Annual Average Revenue Growth Rate For 2023 Is Down, After Reaching a 10-Year High in 2022

Practice AUM and Revenue Growth

Based on our valuations data; the current average trailing 12-month revenue growth rate for 2022 neared 25% this time last year. To put that into perspective, the highest average we had previously tracked was 15% in 2015. The volatile stock market is taking a toll on revenue, with the average trailing growth rate slowed to 7% for 2023. Much of the growth we are seeing is largely from positive net flows (organic growth) and not practice acquisitions (inorganic growth). Advisors who lean more toward formal financial planning often do very well in client acquisition in times of market volatility. The same age wave predicted for the financial advisor industry is expected across all sectors of the economy. We can also assume that the increase in Americans retiring in all industries, where retirees are rolling over workplace retirement accounts and investing funds from business sales outside of the financial advisor industry, will positively impact revenue until such time as they begin drawing down their retirement funds. Advisors who engage in multi-generational planning and organic acquisition strategies are best able to mitigate any negative impact these factors can have on practice value and revenue.



Practice Value

Methods of Calculation And Key Factors That Influence Practice Value

Valuing Goodwill

Unlike traditional businesses with equipment, inventory, and other assets, a financial practice's value is largely based on the goodwill of the firm's clients. Essentially, you own a relationship, which can be tricky to quantify, especially if one is not experienced in valuing relationship-based businesses. Valuation Experts that serve the financial services market have proven methods that they rely on for arriving at a number that represents the true fair market value of a practice. Specifically, there are two approaches an experienced valuation expert will take: the market approach and the income approach.

Market Approach

Client & KPI Focused

The value of the firm is based primarily on the key performance metrics of the practice. Specifically we look at:

- Quality of Revenue
- Client Age
- Asset Velocity
- Compared to Benchmark

Income Approach

Enterprise Value

The value of the firm is based primarily on discounted cash-flow, using assumptions of risk and growth. Specifically we look at:

- Team
- Systems
- P&L
- Discount Rate utilizing various risk factors inherent in your practice

Calculation of Value

To arrive at your calculation of value, we combine the numbers from each approach and average them out to find your firm's valuation number.

Drivers of Value

As part of the valuation you will receive recommendations on how to improve your practice value based on the key drivers that push practice value up or down. Those factors are:



Drive Value Up

The key factors that drive value up:

- Recurring Revenue
- Operating Profit
- Ratio of High Net Worth Clients



Drive Value Down

The key factors that drive value down:

- Ratio of Low Value Clients
- Older Clients
- Number of Professionals

Market Update 2023

Across The Board Increase In The Top 3 Metrics That Influence Practice Value

The Key Practice Metrics That Influence Valuation

The top three practice metrics that have the strongest correlation to a positive valuation result are the recurring revenue ratio, client segmentation and profitability. We have seen an increase among all three of these metrics in recent years. The recurring revenue ratio has improved by approximately 16% in the past 4-5 years, going from an average of 75% to the current average of 91%. In roughly the same time frame, client segmentation (average client size by AUM) has increased from approximately \$350k to the current average of \$561k.

Lastly, while profit margins vary by practice size, we have seen a 5-7% increase in margin across those size ranges. In short, we have seen a meaningful improvement in the three most significant practice metrics that influence valuation. We believe this is due to strong business practices among financial advisors as they shift from serving mainly as practitioners to also serving as business owners and practice leaders.

Another factor that will continue to positively impact practice metrics is a growing emphasis on organic client acquisition and a deepening of the current client relationship. The industry has been hyper-focused on inorganic acquisition strategies over the past several years, with many advisors neglecting organic acquisition strategies. With rising interest rates and decreased supply making opportunities less available, advisors are once again turning their attention to deepening existing client relationships, shifting to up-market opportunities, and driving new client acquisition. These efforts will positively impact such KPIs as average client size and profit margin, so long as advisors keep an eye on practice expenses and make smart staffing decisions when it comes to servicing low value clients.

Organic client acquisition strategies are also a key factor in making a practice an attractive acquisition opportunity to potential buyers. Practices with growth strategies in place provide buyers with greater revenue generating opportunities than those with an aging client base and declining revenue.

Recurring
Revenue
Ratio

91%

Average
Client Size
By AUM

\$561k

Average
Profit
Margin
Increase

5%-7%

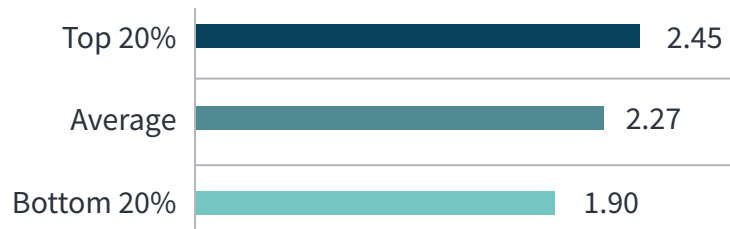
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Comparison of Top 3 KPIs In 2022 and 2023 Shows Positive Improvement Despite Market Pressures and Down Revenue

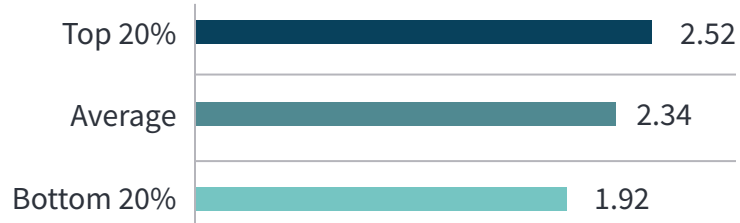
Multiples Year Over Year

Valuation Results Expressed as a Multiple of Total Gross Trailing 12-Month Revenue:

2022
MULTIPLES



2023
MULTIPLES



Key metrics showing improvement year over year, which will continue to positively impact valuations and multiples in the remainder of 2023 and beyond.

KPI
Changes

	2022	2023
Recurring Revenue	87%	91%
Average Client AUM	\$531k	\$561k
Asset Velocity (ROA)	.69	.76

Market Update 2023

Practice Values To Remain High, And Despite Market Volatility There Are Many Factors Within An Advisor's Control

Again, several factors have been driving practice values up and will continue to do so for the foreseeable future. As practice leaders at all levels become more sophisticated business owners, they will continue to build resilient practices that can weather market volatility and other operational factors that once had tremendous impact on practice value and revenue. Things can always change, but for now, we don't see practice values dropping off any time soon.

What Advisors Can Control

There are many factors advisors can and should control when it comes to their practice value. Securing an annual valuation is a critical starting point as it provides an accurate, objective view of how the practice is performing in key areas. With that information, advisors can address the following items:

- **Industry Benchmarks:** How the practice is performing in key performance metrics compared to peers so the advisor can identify priority areas for improvement, such as average client AUM or client age.
- **Growth Potential and Value Peak:** Leverage a proprietary age-based analysis of the practice's existing client group, to determine the long-term growth potential of the group and estimate the future peak of practice value. This is critical for determining the timing of equity events if the advisor does not wish to invest in growth strategies.
- **Fine Tune Client Segmentation:** A valuation includes a deep dive into the segmentation of the practice's clients (clients analyzed by AUM segments), to understand where revenue is coming from and how to operate at peak efficiency. One of the biggest financial mistakes advisors make is having too much staff or too many high dollar staff servicing low-value clients. Understanding the client mix in relation to client segmentation and ratio to servicing staff is key to driving practice profitability.
- **Address Practice Profitability and Time Use:** A valuation includes a benchmark comparison of your practice structure and P&L, using peer data of similar size practices. This data is valuable for improving practice profitability through better expense management and revenue generating activities. It also serves as a tool to help advisors make better use of their valuable time, allowing them to either focus on serving high value clients or on driving growth in other areas.

No matter what is happening in the market, advisors have many things they can do to strengthen their practice now and drive value over time. Completing an annual valuation and working with a coach to prioritize and improve the metrics that impact practice value, are long term practice management strategies advisors should employ.

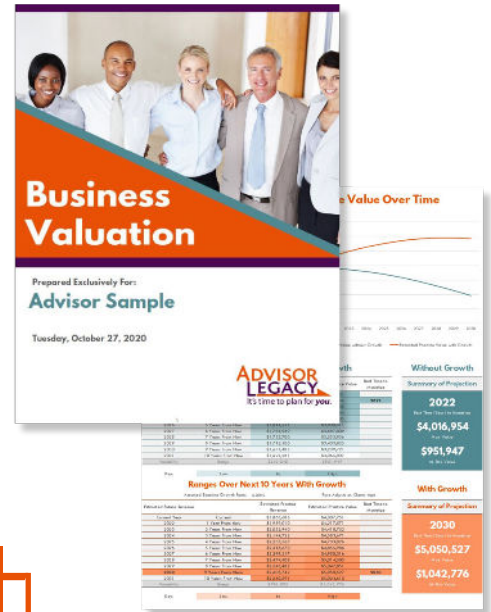
What is your practice worth?

Maximize the value of your practice with our quick valuations and unexpected insight.

While other firm's valuation data may take many hours to complete, our proven process starts with a straight forward questionnaire and just a few reports. Within 15 days you'll have a written valuation with personalized, actionable steps you can take to maximize your practice value. Our M&A experts walk you through the report, answer your questions and arm you with a full understanding of value drivers in the

"An Advisor Legacy valuation gives you a great overall summary of the practice, shows you where you need to focus, and if there is an area you are weak in, they are going to be quick to point it out."

-David McKinley, President, Mckinley Carter



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