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Financing An Acquisition

How To Leverage Loans To Gain A Competitive Advantage

The New Finance Landscape

NEW OPPORTUNITY

Financial Advisors and their practices have evolved tremendously over the last ten years.

Many tandem services have evolved with them, creating more opportunities and options for Financial Advisors to grow and manage their practices. Among the most notable changes to come around in the last decade is the access to financing.

For a very long-time, traditional lenders shied away from the Financial Advisor market. This was largely due to the fact that unlike traditional businesses, which have tangible assets like inventory and equipment, the value of a financial advisor practice is based on the goodwill of its clients. Essentially a financial advisor owns a relationship, and up until recently, most lenders didn't know how to reliably value that asset.

As valuation methodologies emerged to create sound and dependable economic data on the viability of a practice, lenders have been able to move into the market. The result is not only more options for financial advisors interested in growing through acquisitions, but also a significant competitive advantage in the acquisitions market.

Benefits

Loans provide many benefits to prospective buyers, especially compared to other financing options.

Retain Control Over Your Business

Loans do not require you to hand over interest in your business. Unlike investors or seller financing, a lender is not assuming any level of operational ownership. As a result, "the lender has no say in how you manage your company beyond meeting the terms of the loan documents. You make all the decisions," says Kirsten Petras, Executive Director of Sales at Oak Street Funding.

Petras adds that, with the lender, not only does the owner retain full control over the business, "the business relationship ends once you have repaid the loan in full." There are no lingering interests or obligations that the buyer must fulfil. This allows the practice owner to run the business as they see fit.

Attractive to Seller

A loan eliminates the need for seller financing. "The Seller appreciates the security of the bank loan and the up-front financing," Says Aaron Hasler, Managing Partner at SkyView Partners. He goes on to explain that because the seller does not have to serve as financier, "They are more likely to sell the business rather than continue working."

If a buyer is competing for the opportunity to purchase a particular book of business, having financing in place before approaching a buyer creates a significant competitive advantage, as the seller is more likely to choose the buyer with a lender at the ready.

Financing also improves the buyers purchasing power overall, especially for firms who wish to grow aggressively through acquisitions. Says Hasler, loans give the buyer "greater leverage to purchase additional businesses." He adds that loans also open up opportunities for buyers to leverage other "banking services and products like Lines of Credit."

Cash Flow

A loan from a financial institution also to helps preserve cash flow. According to Don Hauk, Senior Loan Advisor at Salt Creek, "A bank loan typically provides a longer term and amortization period than other lending options such as Broker/Dealer financing or seller financing."

Generally, a bank loan provides a 10-year term on an acquisition, versus a five-year term, which is common among Seller and B/D financing. Dustin Mangone, Managing Partner at PPC LOAN stresses that the "loan fully amortizes in 10 years and there are no balloon payments."

"Having the flexibility of a 10-year term (with no prepayment penalty), the buyer can be cash flow positive from Day 1," says James Hughes, VP of Investment Advisory Lending at Live Oak Bank. He continues to say that as a result, "Term plays a large part in the success of an acquisition in today's market."

The resulting success of an acquisition that utilizes a loan is largely due to the improved cash flow position. As Hauk explains, "The longer term and amortization can greatly reduce the cash flow needed to make loan payments and preserves the borrower's cash to help further grow the business." Better loan terms generally mean lower loan payments, so fewer obligations on a monthly basis. Hauk goes on to add that the better terms and lower payments, "also allows buyers a bit of a cash flow cushion in the event of client attrition or a market reduction."

Benefits

Continued

Tax Advantage

Oftentimes the interest paid on a bank loan is tax deductible. According to Petras, the deduction “effectively reduces your net obligation.” This tax advantage can further strengthen the cash position of the business and provide a benefit that other forms of financing cannot.

Flexibility

The lenders who are serving the financial market are also offering a wide range of options for financing. According to Dustin Mangone, Managing Partner at PPC LOAN, “the flexibility we offer is advantageous as each and every deal is different.” Mangone adds, “we have designed a program for independent advisors specific to their various needs.”

Thus, advisors aren’t trying to fit the deal to match the available loan product. Instead, they are able to find a loan product that meets their unique needs. Mangone closes by stating this advisor-centric approach allows “the advisor to secure a long-term capital partner” in their lender.

Of course, no option is perfect and there are a few notable drawbacks to financing to consider. Namely, the assignment of collateral and the long-term payment obligation. Still, compared to self-financing, seller financing, and Broker/Dealer financing, the control and cash flow benefits of a loan are significant.

CHOICES

Loan Options

As more lenders have entered into the financial advisor acquisition market, they have introduced a number of loan products and services to help buyers finance a purchase. Most loans fall into two major categories: Conventional and Government Guaranty.

C Conventional

Conventional loans are those provided directly by the financial institution. The financial institution assumes all risk and facilitates the entire transaction. Banks and credit unions each set their own terms including loan maximums, repayment time lines, interest rates, down payments, and other fees. Because the market for acquisition loans is competitive, most financial institutions offer a number of attractive loan products to financial advisors and are willing to work with many situations.

G Guaranty

In a government guaranty, a portion of the loan is backed by the SBA Loan Guaranty program. The SBA does not directly lend money to the borrower. Instead they work with the lender and other intermediaries to provide funds. Their role is to assume a portion of the risk, thereby incentivizing lenders to provide loans to small businesses who have not yet established a track record of healthy borrowing. However, there are more requirements that a borrower must meet to qualify for a SBA loan, so its always important to verify eligibility first.

Choosing A Lender

As we mentioned in the introduction to this guide, lenders struggled for a long time to value the assets of a financial advisor practice. Though many lenders have entered the field and are actively providing advisors with attractive options, not all lenders have the knowledge or capability to finance the acquisition of a financial advisor practice.

Its best to select a lender who is familiar with the industry, knows how to structure a loan for this type of acquisition, and is experienced in lending to financial advisors.

Process

Preparing Yourself For The Loan Process

Regardless of which type of loan or lending institution you work with, you will need to go through the loan process, which includes providing key documentation to demonstrate credit worthiness, business expertise, and proper use of funds.

Demonstrating Credit Worthiness

All borrowers must provide historical financial information for their personal and business finances. This includes completed tax returns, bank statements, Profit and Loss statements, Balance sheets, and existing debt obligations. Lenders generally pull a credit report on the borrower and the business and may ask for explanations for any items of concern. Negative items on a credit report do not necessarily impact access to loans, especially if supported by documentation.

The purpose of acquiring this information is to help predict the likelihood that you will repay the loan and to verify that you do not have a history of financial misconduct.

Demonstrating Business Expertise

Borrowers are also expected to provide a current business plan, resumes for owners and key staff, and projections showing how an acquisition will impact the current business. A business plan should highlight the purpose of the business, how the business operates, how the business makes money, plans for future growth, and a transition plan for integrating the acquired practice. Resumes should exhibit the key skills and experience each individual brings to their specific role in the company. Projections should include 2-3 years of projected revenue and expenses of the new business post merger/acquisition.

The propose here is to highlight the competence of the team and of the business.

Demonstrating Use of Funds

Lastly, lenders need to know exactly how borrowed funds will be utilized. Often, they require a valuation by a qualified third party on the practice you wish to purchase. Some may also require an up-to-date valuation on your practice. They will also want to see any lease agreements, expenses, or other items that will be paid for by the borrowed funds.

The purpose here is to prove fiduciary judgement and eliminate the improper use of funds.

It’s important to think ahead and engage a lender early so you can have as much completed and ready to go as possible when a deal comes your way.

Competitive Advantage

Loans Give You an Edge in an Acquisition

Bottom line, loans are a significant competitive advantage in an acquisition. Not only do they help you stand out in the marketplace, they also provide you with the means to grow your practice while preserving cash flow. In any acquisition, it is important to move into the transaction fully educated and prepared.

The more you know, the better decisions you can make. And the more experienced professionals you have working in your corner, the more you can expand your capabilities and jump on opportunities as they become available.

Meet the Lenders

Meet the lenders cited in this white paper and learn more about what financing options they provide to financial advisors.

We provide investment advisory financing solutions to help you position your firm for success now and into the future. With a laser focus on innovation in finance and technology, we bring efficiency and excellence to the lending process. We believe deeply in personal service and focus on taking care of our customers throughout the life of the relationship.
https://www.liveoakbank.com/investment-advisor-loans/

Since 2003, we have been successful nationwide in fulfilling the unique capital needs for these cash flow-based industries while providing extraordinary service to our borrowers. We utilize our superior service capabilities, deep industry expertise, and proprietary technology to deliver next generation, relevant niche products and services to financial services industries nationwide.
https://www.oakstreetfunding.com/ria-firm/

PPC LOAN has earned its reputation by consistently providing the highest level of personalized service and the most attractive loan terms available to financial advisors. We offer a variety of conventional loans with terms up to 10 years and fixed interest rates; and will finance up to 100% of a purchase price with no down payment required from the buyer.
https://ppcloan.com

SkyView Partners is focused exclusively on the financing needs of independent and registered investment advisors. We focus on providing financial advisors with guidance and capital with 100% financed loans for acquisitions, internal successions, refinancing, and lines of credit and offer both conventional and SBA loans.
https://www.skyview.com

We are dedicated to helping financial advisors and RIAs expand their firms with efficient access to capital. Salt Creek exclusively serves financial advisors, both independent and registered, with a streamlined lending process and a range of conventional and SBA loans available to help you grow your practice.
https://saltcreek.1fsb.com

ADVISOR LEGACY
It's time to plan for *you*.℠

Advisor Legacy can help you through every stage of an acquisition, from the first step to a successful outcome.

BUSINESS VALUATIONS

CONTINUITY PLANNING

LENDING & LEGAL SUPPORT

DEAL SUPPORT

PRACTICE SALES

SUCCESSION PLANNING

Your future is our only priority.

You wouldn't leave your client's legacy to chance. Why leave yours?

It's time to plan for *you.*

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