Acquisition Loans

A Guide for Financial Advisors

PPCLOAN®

Financing Solutions for Investment Advisors

Introduction

M&A Activity in the advisor industry is expected to continue to grow over the next ten years.

Fueled by a number of aging advisors reaching retirement and a growing and diverse pool of buyers with access to capital.

The financial advisor industry is facing what many are calling a "succession cliff." The majority of advisors are over the age of 65, which will lead to a wave of advisors selling and retiring over the next ten years. This creates an opportunity for financial advisory firms of all sizes to leverage inorganic growth through mergers and acquisitions. In previous years, advisors had to rely on personal capital and seller financing to secure acquisition deals. But a number of specialty lenders have entered the space, giving financial advisors access to capital and loan options they never had before.

The deal landscape has also changed

Now we are seeing advisory practices of all sizes and structures engage in M&A activity. The deals themselves have also changed in order to reflect the needs of the market and the diverse range of personal goals and motivations of each party. From traditional acquisitions to "sell and stay" scenarios, advisors and the consultants and lenders that support them are developing creative, flexible deal terms. These flexible terms allow a practice to satisfy the needs of a seller while ensuring cash flow and opportunity for the practice in the future. As the industry continues to mature, more lenders and other service providers have entered the space, giving advisors greater access to expertise, resources, and capital than ever before. Now small and mid-sized firms can compete with the behemoths of the industry.

Purpose of this guide

This guide serves as an introduction into the world of acquisition financing and lending. Not all lenders are created equal, and each loan option comes with its own benefits and drawbacks. Its important for advisors to thoroughly educate themselves on the types of loans available, the different lenders serving the markets, the rules and regulations governing mergers and acquisitions, as well as any special guidelines administered by their broker dealer or wirehouse.

This guide is a starting point for advisors looking to engage in acquisitions. We recommend securing an experienced M&A team and lawyer to provide expert guidance specific to your situation.

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Options For Funding An Acquisition

Self Financing

One option is to finance the acquisition with either personal capital or business savings. The main benefit of this option is that the practice is not strapped by any liabilities moving forward and you remain in total control of the business. The downside is it limits the size of business you can purchase and ties up much needed capital for other necessary business investments.

Private Equity

Private equity firms have recently entered the financial advisor space, providing financial backing and professional expertise to firms looking to grow. On the plus side, private equity can bring significant capital and business acumen to a deal. On the downside, a practice leader often gives up significant control and ownership in the business, which may impact decision making and the direction of the practice long-term. Also, private equity firms tend to work with larger practices, omitting small to medium sized advisory practices.

Seller Financing

For many years, seller financing was the primary method for doing acquisitions. The benefit of this approach was that a buyer and seller could negotiate any terms they were both comfortable with. Unfortunately, many sellers are reluctant to assume the role of financier. Those who do generally did so with five year terms and interest rates that made cash flow difficult.

Broker Dealer Financing

Many broker dealers have started offering financing to their advisors. This has created an opportunity for advisors with little personal capital or credit to engage in growth activities. However, advisors should know that BD financing comes with certain covenants that can impact an advisors ability to change platforms or make important business decisions. For example, If the advisor does move, the loan procured through their broker dealer or custodian likely has a stipulation that it be paid in full in the event of a migration to another platform. Additionally, some broker dealers build in covenants that tie repayment amounts to the firm's revenue, which can impact cash flow and profitability.

Bank Financing

For many years, lenders shied away from providing loans to independent financial advisors/firms for their acquisition needs. This was largely due to the fact that the businesses lack tangible assets and very few understood the industry or the value of these firms. However, in recent years many specialty lenders have entered the field and are providing a variety of loan options to advisors. More importantly, they are offering loans that have terms up to 10 years with interest rates and fees that allow advisors to preserve cash flow while expanding purchasing power and providing sellers significant up-front liquidity. Because of this, most acquisitions are now financed through loans from specialty lenders.

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Types of Acquisition Loans

As lenders have become more aware of the market, they have developed loan solutions to match the needs of financial advisors. Those loan products typically fall into one of two buckets: conventional loans or SBA guaranty loans. Each loan type has different terms and conditions that advisors will want to consider before committing.

	Conventional Loan	SBA Loan
Term	Up to 10 years	10 years
Rate	Fixed & Variable	Fixed & Variable
Amount	Varies by Bank *(Up to $20MM)*	$5,000,000
Collateral	Business Only	Business & Possibly Real Estate
Personal Guarantees	Yes	Yes
Seller	Can stay on indefinitely	Limited to 12 months
Flexibility	Yes	Limited

Conventional Loans

Conventional loans are those offered directly by a lender without any government guaranty. Often these offer the most flexible deal terms and can vary by lender. Many specialty lenders have continued to evolve their offerings to meet the needs of the changing advisory market and can work directly with the advisor to structure terms that are most favorable to the deal itself.

SBA Guaranty Loans

SBA loans are small business loans made by banks where a large portion of the loan is guaranteed by the government. This allows the lender to mitigate a majority of the risk that they may deem inherent in lending to small businesses. Therefore, the primary purpose of the SBA lending program is to make capital accessible to small businesses which otherwise would not be able to secure a loan.

Despite their intent to make capital more accessible, SBA loans typically come with limitations and less flexibility. As a result, most advisor acquisitions are done through conventional loans.

As the chart demonstrates, SBA loans have limitations when it comes to the many needs of financial advisors. Not only does the SBA have a maximum loan amount for a specific transaction or the total amount they can lend over multiple transactions, they also have limitations on the type of transaction that qualifies (i.e. buy-ins and partial equity purchases do not qualify for SBA loans).

The biggest hurdle SBA loans present for advisors is in terms of flexibility since the program available accommodates all types of businesses, not just investment advisors. This typically differs from a conventional lender who will have designed a loan program specific to the needs of advisors which can evolve over time. The SBA's rigid guidelines cannot always be adjusted to meet the needs of a specific deal. Conventional loans, on the other hand, can be structured in a way that meets the needs of the deal, while providing protections for both the buyer and the seller.

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How To Approach A Lender About A Loan

As mentioned earlier, many specialty lenders have entered the market. These lenders have a strong understanding of the industry and work closely with financial advisors to develop loan terms that meet the needs of the business and the deal. Still, there are some best practices for advisors looking to engage with these lenders.

Contact Them Early On

It's important to reach out to a lender as soon as possible, especially if you are actively looking at a deal or are engaging with a seller or partner. Experienced lenders in the advisory market know what it takes to get a deal approved both within the bank and within the frameworks that govern an advisor's practice. They can advise you on what will or won't be approved in terms of deal structure, as well as help you identify risks and protections to safeguard your investment. You can also eliminate any potential lenders who don't have relevant experience in the advisory market.

Be Forthcoming

Most specialty lenders take a consultative approach to the lending process. For them to properly advise and guide you in the process, they need to have all the information. The more forthright and complete you are with information, the clearer picture they have of your situation, and the better able they are to direct you toward the right loan products, deal structure, and resources.

Know Your Practice Financials

When it comes time to start talking specifics, a lender wants to start by examining the financial health of the borrower(s) and the business. You not only want to be able to produce key financial documents, but you also need to know and understand how profitability, cash flow, and other key factors impact a lender's decision. An advisor with a firm grasp on their practice financials instills confidence that they will be a good steward of bank funds and will be able to make good on repaying their debt.

Be Proactive

As you move deeper into the process, your lender will provide you with a checklist of items needed to start putting together the loan package. The underwriting and closing process can move much more quickly when a borrower(s) is responsive to requests and supplies the needed documentation in a timely manner. Most commonly, they will require loan applications, business and personal financials, business entity documents, copies of identification such as a driver's license, and other items related to the purpose of the loan.

So be ready to have these available for the lender, and openly communicate any questions or challenges that you run into so they can help you navigate the process. Don't worry if it is your first time seeking a loan for your financial advisory practice. If you are honest, open, communicative, and ready to respond to their questions and needs, a lender will happily educate you and guide you through the process.

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3 Biggest Mistakes

Advisors Make When Seeking An Acquisition Loan

Many advisors fail to educate themselves properly about acquisition loans. This can lead to major mistakes.

Mistake 1: Not Shopping Around For A Loan

Each bank develops its own lending criteria and offers different terms and conditions. They each also have different levels of understanding about how a financial advisory business operates and is valued. Just like with any purchase, it's important to shop around. Competition is key to the free-market and commercial lenders will compete for opportunities to lend to the strongest and best candidates. Also, because many advisors who engage in acquisitions tend to do more than one, advisors will want a lender who can be a long-term capital partner.

Advisors looking to grow will want a lender who can be a long-term capital partner.

Mistake 2: Choosing a Lender Without Industry Experience

Most lenders aren't familiar with the financial advisor industry and don't know how to evaluate the credit worthiness of a financial advisory practice. Lenders who are inexperienced with financial advisory firms have very low comfort levels in terms of how much debt they will extend. Typically, they are willing to lend far less than your specialty lenders who have a track record of lending to advisors and advisory firms.

Mistake 3: Waiting Too Late To Engage With A Lender

It is never too early to engage a lender when pursuing acquisitions. In fact, talking to a lender before you approach a seller will allow you to learn about your options and know for certain what you can offer to a seller. The standard acquisition can take months, even as a many as 12-18 months. The lending process also takes time. Engaging a lender early allows you to better manage timelines and expectations for both you and the seller.

Bottom line, you need to engage with an experienced lender as soon as possible – even before you have a deal on the table. A lender who knows the industry and has a track record of lending to financial advisory firms can advise you on your financing options as well as on items that could impact the structure and timing of the deal.

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Protect Your Investment

Buyer Protections During An Acquisition

A basic overview of the three most common buyer protections included in acquisition deals.

Claw-Backs

Many acquisition deals include some form of a claw-back or look-back provision. It is one of the most common and straightforward protections against client attrition; especially for sellers looking to exit the business within 1 year or less after the sale. In the simplest terms, it's an agreement between the buyer and seller that allows for an adjustment to the purchase price based on client retention at the end of a predetermined transition period following the sale (i.e. 12 months).

To accommodate this provision, a portion of the selling price is held back, retained in escrow, or held as a seller note in order to provide financial incentive to the seller to assist with the client transition and maximize client retention. While there is typically an attrition allowance ranging from 5% - 10%, those remaining funds owed to the seller are then paid at the end of the claw-back term based on what percentage of clients are retained by the new owner.

Earn-Outs/Revenue Sharing

We often see these provisions in the RIA space, though they are not uncommon in the IBD space either. Generally, they are structured over a term of 3-5 years and are a good option if you have a seller who wants to stay on longer than one year, such as in a "sell and stay" scenario. This scenario has become more appealing as it allows both parties to extend the transition period and gives the new owner time to build rapport with clients and staff, which generally leads to lower attrition rates. Lastly, this can further incentivize the seller to bring on new clients or uncover new assets from the existing client base during the period in which they are retained.

Non-Compete and Non-Solicitation

Many advisors are familiar with the non-compete and non-solicitation clauses as it relates to their own employment agreements. They are also useful instruments in acquisitions and add an extra layer of protection against client attrition. Non-competes generally extend for 3-5 years. Non-solicitation generally last for 3-10 years and are not bound by geographical limitations.

Again, it's always best to seek out the advice of an experienced acquisitions consultant along with an attorney. You may also need to work with someone inside your broker dealer to help you with any rules and requirements specific to your platform.

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Getting an Advisory Loan Across The Finish Line

Things you can do as the borrower to help drive the loan to completion.

Be Responsive

As your loan moves from underwriting to the closing team, it passes through another layer of due diligence. Additional documentation will be required and the more responsive you are, the faster they can work through their internal checks and balances in an effort to get your loan funded on time.

Communicate Material Information

In addition to being responsive, it's also important to proactively communicate any material changes that could impact the loan. This means changes in your organization, the deal, or anything else that may influence the terms of the loan. Some changes are easy to make or have no impact at all on the loan, while others may significantly impact the originally approved loan structure. The sooner you communicate changes to your lender, the sooner they can address anything that impacts the loan, as well as advise on what to do to ensure the deal will go through.

Have Key Documents Ready

With any loan, you provide several documents when you first apply, such as an application, tax returns, and deal related documents. As your loan moves to closing, documentation about your business, the acquisition, purchase and/or partnership agreements, etc. will be required to close and fund the loan.

Generally, the closing team will ask for the following documents:

Business entity documents:
This includes shareholder/owner information if there are multiple partners, articles of incorporation, etc.

Draft purchase related documents:
Depending on the type of transactions this can include purchase agreements, seller notes, consulting agreement, and a look back provision if applicable.

Verification of various insurance requirements:
This will consist of life insurance, professional liability, and commercial liability and contents coverage.

The closing team may ask for other items based on the specific loan type or the deal itself, but in general, the above documents are required to close the loan.

The key to success in any loan is open dialogue between all parties and a proactive borrower who is engaged throughout the process. It also helps to work with a specialty lender who is experienced in lending to financial advisors. Unlike traditional lenders, specialty lenders in the advisor space know and understand how an advisory practice operates and is valued and can proactively provide resources and tools to make the lending process easier for the advisor.

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Looking for an Acquisition Loan?

Planning to expand your financial advisory firm is an exciting time. You realize that your business is primed for growth, and you can accelerate that process by acquiring another firm. But when you need to address acquisition financing, where do you go to find a loan that's right for your needs?

That's where PPC LOAN can help. Growth Loans™ enable investment advisory firms like yours to secure financing tailored to their specific needs. Our investment advisor funding experts have in-depth experience helping advisors prosper with business acquisition loans attuned to their goals.

We work with you to meet your needs by offering competitive rates and flexible terms that help protect your financial health while you grow your business. We customize every business acquisition loan to suit your financial priorities. That means not only the best deal but unmatched support, too. Here is a snapshot of the benefits that come with a business acquisition loan with PPC LOAN:

Reasonable rates and flexible loan terms

We offer rates that aren't a burden to your firm paired with flexible loan terms designed to meet the unique needs of your firm and the deal.

Simple three-step process

We are committed to making the loan application process as quick and seamless as possible, making it easier for you to get the right loan.

Comprehensive support

Whether you're dealing with our analysts, our closing team, or our customer concierge team, you'll have unmatched guidance and support.

Learn more and apply by visiting

https://investment-advisors.ppcloan.com/service-offered/acquisition/

About PPC LOAN

PPC LOAN has been serving financial advisors since 2007. We offer competitive rates and flexible financing for a variety of needs. We are committed to your firm's success, which is why our specialists ensure the quality of your financing option is second-to-none. Transparency underpins every interaction you have with PPC LOAN. We're upfront with you about any concerns or issues that might emerge, because we value the trust you place in us. Let us be your lending partner and help your practice grow.

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Contact us today to learn more. | www.ppcloan.com | 800.456.2779