FINCONNECT
ADVISORY GROUP
A venture of Accru Hobart

How to Succeed at Succession

We achieve your version of GREAT

Today

- FinConnect Advisory Group
  - Who are we?
- The 3 elements of succession
- Myths addressed
- Lived experience
- How succession ready are you
- 25 years of lessons

Who We Are – FinConnect Advisory Group

A venture of Accru Hobart

- 25 staff
- 5 current partners
- Strong compliance and advisory teams
- Small wealth management division

Tim Lane FCA, Partner

- Involved in succession planning, and valuations for accountants and financial planners since 1999
- Plenty of Mistakes = Experience

Succession Fundamentals

What is succession planning?

Understanding the strategies available to you to retire and exit your business.

Strategies, include but are not limited to:

+ Full market sale
+ Internal transfer of equity to other owners or employees of the business
+ Combined approach

Why is this important?

+ Life's work
+ Legacy

Are you a DIY-er in disguise?

The Three Elements of Succession Planning

Succession		
Maths	People	Timing

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The Mathematics

Valuation

- Accounting firms 4 * profitability = implies 25% ROI
- Financial planning 5 to 6 * profitability = implies 16.66% to 20% ROI
- Mortgage broking 3 * profitability = implies 33% ROI

Myths

Myth 1 – Financial Planners

You can not afford it.

They can not afford it.

The Tale of $100 dollars of EBIT			
Financial Planners			
	No Growth	10% Growth	20% Growth
EBIT	100	100	100
Valuation at 6 x	600	600	600
Payback Period	6 Years	5 Years	4 Years
Value of Asset	600	966	1,242

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Myth 1 – Accountants

You can not afford it.
They can not afford it.

The Tale of $100 dollars of EBIT			
Accountants			
	No Growth	10% Growth	20% Growth
EBIT	100	100	100
Valuation at 4 x	400	400	400
Payback Period	4 Years	3 Years	2.5 Years
Value of Asset	400	585	691

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Fact

The implied multiple in a balance fund is 15 times.

You take 3 * the risk in your super fund than in your firm.

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Myth 2

I need to hold the majority of the equity for most of the time.

$100 dollars of EBIT			
Growth	Nil	5%	10%
Price at year 10	600	931	1,415
Price achieved over 10 years sell down	600	755	956
Difference	Nil	176	459
Outcome to seller	No Difference	Effectively same price	About 10% higher, But!

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Myth 3

Debt is a bad thing.

Debt is Cheap – Financial Planners

We have used debt to our advantage to get an easier buy in position.

Conclusion

- Sensible use of debt is logical

Financial Planning Practice 5% Growth					
	Year 1	Year 2	Year 3	Year 4	Year 5
Multiple	6				
Return	16.67%	17.50%	18.38%	19.29%	20.26%
Estimated cost of Debt	3.50%	3.50%	3.50%	3.50%	3.50%
Cost of tax @ 25%	3.29%	3.50%	3.72%	3.95%	4.19%
Surplus to pay debt and equity holder	9.88%	10.50%	11.16%	11.85%	12.57%
Implied term in years	10.13	9.52	8.96	8.44	7.96

Debt is Cheap – Accounting

We have used debt to our advantage to get an easier buy in position.

Conclusion

- Sensible use of debt is logical

Accounting Practice 5% Growth					
	Year 1	Year 2	Year 3	Year 4	Year 5
Multiple	4				
Return	25.00%	26.25%	27.56%	28.94%	30.39%
Estimated cost of Debt	3.50%	3.50%	3.50%	3.50%	3.50%
Cost of tax @ 25%	5.38%	5.69%	6.02%	6.36%	6.72%
Surplus to pay debt and equity holder	16.13%	17.06%	18.05%	19.08%	20.17%
Implied term in years	6.20	5.86	5.54	5.24	4.96

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What is the relevance of my view of the value of our business?

Nothing.

You’re not buying it.

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Conclusion

There is no mathematical problem which leaves people and timing.

You can never do succession too early, but you can do it too late.

Why is this

- Early succession creates a market for your equity
- Early succession provides options to vary timing and people
- Staged succession, i.e. over time, reduces risk and therefore can enhance price

Lived Experience
Accru Hobart

Live Case Study - Courtney Telega

Details

- Bought 10% in July 2017
- Pathway to 25% ownership over 3 years
- Director in 2 years
- Valuation process changes
- No third party / accountability factor
- Exiting equity holder, 6 years prior to retirement (reduced ownership from 50% to 20%)

Buy in 1 July 2018	Buy in 1 July 2019	Buy in 1 July 2020	1 July 2021
10%	7.5%	7.5%	
Title partner	Car and telephone benefits	Become director with ASIC	Paid out vendor finance
	Completed public practice certificate	Renumeration equal with other directors	

Issues

- No shareholders agreement
- Valuation methodology not committed to
- Plan for equal 25% ownership, for 4 partners, did not consider timeframe for remaining 50% to reduce

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Live Case Study – Fiona Ettles

Details

- Bought 10% in July 2020
- Director in 2 years
- External assistance helped the partners accountable an[d] helped smooth the progress

Issues

- No shareholders agreement
- Valuation methodology updated so quoted prices changed
- Uncertainty around timeframe to becoming equal, due to brining in other equity holders
- KPI for further equity to be released is still not formalised

Buy in 1 July 2020	**Buy in 1 July 2021**	**1 July 2022**
10%		
Title partner	Car and telephone benefits	Become director with ASIC
	Completed public practice certificate	Renumeration equal with other directors
	Subject to KPI before further release of Equity, EBIT based.	

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What We Learn From the Lived Experience

Adaptability

- No trying to solve succession for the next 10 years vs short term
- Differences between Courtney and Fiona

Ego

- 3 valuers working on a valuation methodology

Even people with experience need help

Information

- No shareholders agreement, letter of offer provided 1 month before 1 July

Pricing expectation

- Information discussions different to formal offer price, uncertainty around sweat equity discount and where it was coming from

Timing

- Not dedicating time to progression
- Not being accountable

Be careful of the politics of exclusion

People – What is Best Practice?

- Equity holders identified early
- Annual information memorandum update so all parties informed
- Valuation mechanism agreed and detailed annually
- Communication equity opportunity is communicated regularly and in an articulate manner
  - There should be no information vacuums
- Decisions should be based around merit and realistic valuations
  - Funding is a secondary issue that needs to be solved once people and mechanism are agreed

Timing

You can never do succession too early, but you can do it too late.

Experience tells us there is a needs to be time for a plan B.

How Succession Ready Are You?

How succession ready are you?

1 point per YES

- The business owners understand the value of our business based on a Reoccurring Revenue Valuation, dependent on the size of the business and likely succession
- The Business has a fully developed client value proposition
- The business can demonstrate organic client growth
- The business has a well-developed profit and loss statement showing consistent earnings with well divided revenue buckets
- The business understands the profitability after a true market salary
- The business has a relationship with others to help us manage our emotional connection to the business to reduce stress and impact of any succession
- The business owners understand their CGT position for the business and any likely gain
- The owners and business have systems to efficiently produce an information pack on the business and client base metrics
- The owners have a clear, and well communicated between the group, expectation of the time frames for retirement and exit
- The owners understand the need to plan for exit and have flexibility should the first succession planning options not work out

25 Years of Observations

25 Years of Observations

Adaptability

- Talent leaves rural location and moves to the city, railing the plan
- Talent leaves the business because of delays to the plan
  - Making the feel undervalued
  - Promised for too long
- Talent, or family member, falls ill

Ego

- Belief that "I am the business"
- Believe that clients will not transition
- Inflated believe of business value
  - Want to brag about the multiple

Emotion

- Not acknowledging that you need assistance
  - Would you to sell your family home?
- Not being accountable to other throughout the process
- Not having a sounding board
- Not having a feedback buffer

Information

- Providing information clearly
- Providing information in writing
- One opportunity

25 Years of Observations

Pricing expectations

- Personal expectations, not value
- Is this material to your retirement?
  - Death trap
- What do you think the business is worth?
- Do you understand the plan to improve the expected sale price?
  - Assuming you have time
- Considering payback period for incoming party
- Does the dividend policy support the price?

Right parties – money an issue

- Judging who can and cannot afford to buy in
- Making it about payment
- Not considering vendor financing
- Not considering debt in the business to reduce but in price

Timing

- Leaving it too late, lead time
- Preparing information
- Time to focus on planning vs working in the business
- It is a process

Succession for Your Clients

It has got to be a top 10 issue for them

- Skill up
- Apply the learning from your own succession to lead succession with your clients

Over a 15 year period we have led a number of succession engagements that have led to long and deep client engagement

No one adds up the clients assets and applies 5%

Conclusion

There is no mathematical issue,
just people and timing.

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