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Slow train coming...

In light of the announcement that the UK authorities intend banning commissions from 2012 and local discussions that commissions could be banned, one of the interesting side debates is the impact a ban could have on the value of Financial Planning Practices and client books.

Financial Planning Practices have historically attracted quite high valuations compared to small businesses in other industries. This is in part due to double digit projected long term growth rates in superannuation (SGC), the certainty of annual income provided by trail commissions and the baseline valuations set by Institutions offering buyer of last resort type facilities for the buyback of clients.

Traditionally valued on a multiple of their annual recurrent revenue, what happens if you remove the certainty of income i.e. the trail commission tap is turned off? Will it be anarchy with lots of sellers and no buyers, or will apathy rule, where there is limited market response?

Centurion Market Makers Chris Wrightson says that views on the impact this might have are polarised. "There is a prevailing view that given the valuation reliance on annual recurrent revenue, eliminating trail commissions could reduce the value of Practices and of client books.

An alternative view, is that there is unlikely to be a change to commissions that would be retrospective, therefore books of business with trail commissions attached become 'quarantined'. In a market where all new business might require explicit Advice fees to be charged, books with the certainty of trail commissions may in fact, become a valuable legacy. Over time the diminishing supply of these books could potentially increase their value."

In truth many Practices are well down the path of redefining their advice and business models, recognising that 'theres a slow train coming'

In practice" says Wrightson, "established Practices began separating advice and investment management fees some time ago. Separating the fees is one way of producing greater ownership of the Advice fee, and delivering certainty to the annual income to a Practice."

In many cases, redefining the Advice offer and illustrating the value this delivers to clients, has provided the opportunity for Practice owners to increase their revenue. "Redefining the Advice offer is often completed in parallel with designing a lower cost investment solution. This often means the explicit fees for Advice can be higher than the prevailing product or platform commission" says Wrightson.

Those who are concerned about the saleability of their Practice and want some certainty in business succession are selling call options over their Practices. "If you're worried about the future value of Practices, then with the right structures, Practice owners can lock in a valuation formulae and terms now, stay in the business, and then exercise a call option typically sometime in the next 3 -7 years ".

Contact Chris Wrightson (Director – Centurion Partners Pty Ltd)

Ph 1300 766 156

Mob 0411445997