By Thomas D. Giachetti

How to Prepare Your Firm for an Acquisition

Here are the red flags to avoid when readying your firm for that all-important sale, especially if you want the right price.

With advisory firm mergers and acquisitions at an all-time high, many of our clients wonder if now is the time to market their firms for sale. The obvious factors to consider in making this decision are whether the financial multiples are in your favor: revenues, EBITDA, earnings before owners compensation, profit margins.

But other issues that come into play as buyers evaluate the feasibility of a potential sale should be as important to your firm in preparing for a potential sale.

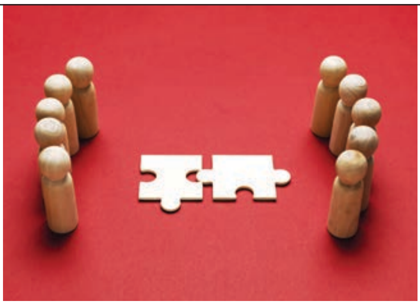
We have assisted firms throughout the United States for decades on such M&A matters. I recently spoke with my partner, and chair of our M&A Group, Rachel Lilienthal Stark, to discuss issues critical to the M&A process.

BEST PRACTICES

First, if your compliance efforts are neither adequate nor up-to-date, your ability to attract a prospective purchaser will be hurt. Diligent compliance processes protect both your brand and the value of your entity.

Also, because the value of an advisory firm is primarily based on the goodwill of its relationships, the client-facing employees (both owners and non-owners) will be the focus of any potential purchaser's inquiries. In fact, losing professionals who have significant client contact will adversely impact the purchase price. It is essential to put strategies into place to prevent this — including restrictive covenants and bonus or equity incentives.

Ironically, many firms think about selling because they do not have an internal succession plan. However,



ANDRII ZASTROZHNOV/STOCK.ADOBE.COM

Rachel cautions that owners who wait until they are ready to retire to form a succession plan can hurt a sale as a potential purchaser will worry that client relationships will not transition after the owner leaves.

To attain the highest value for a sale, prepare ahead with both an internal and external succession plan (even though the internal plan may not transpire).

Also imperative is that a firm's client contracts are up-to-date, both from a business and legal perspective. Under the Investment Advisers Act of 1940, with "potential" narrow arguments to the contrary, any change of ownership of 25% or more will result in a change in control, by regulatory standards, and would trigger an assignment of the investment advisory agreements.

If your client contract requires written consent to assignment, any firm sale will require affirmative written consent from each of your clients, without the potential ability to rely on negative consent. If written consent is not required, a "negative consent" (i.e., no action taken by the client after notices have been provided of the proposed assignment) is potentially permitted, although we always recommend that parties first attempt to obtain affirmative consent prior to relying on a negative consent provision.

TAX STRUCTURE AND BACK OFFICE

Rachel advises that tax structure also can result in a change in the transaction economics. Because there is generally a "lookback" period to any change in tax structure, it is too late to make changes if you focus on this at the time of a sale. Tax laws change. Thus, reviewing tax structure — for both "day-to-day" and exit purposes — makes the most sense on at least an annual basis.

Most purchasers will focus on client revenue, but "back-office" issues can derail a transaction. These issues include problematic office leases and vendor contracts, litigation, poor bookkeeping and record keeping, technology and cybersecurity issues, failure to protect your name and other intellectual property, and liabilities not covered by insurance that could affect the potential purchaser.

Before going forward with a transaction, have professionals dig into these issues in advance so you can address any concerns rather than have surprises come up by the potential purchaser during due diligence.

The sale of your firm can be one of the most meaningful experiences in an investment management firm owner's life; therefore, be prepared to ensure a smooth business transition for all parties. **IA**

Thomas D. Giachetti is chairman of the Investment Management and Securities Practice Group of Stark & Stark, a law firm with offices in Princeton, New York and Philadelphia that represents investment advisors, financial planners, BDs, CPA firms, registered reps and investment companies, and is a regular contributor to Investment Advisor. *He can be reached at tgiachetti@stark-stark.com.*