Selling your IFA **Business**

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So when making the decision to sell, you want to be certain you've got all the information you need – for yourself and your clients. We have experience and expertise in the acquisition process; we understand this is likely to be a life-changing decision, which is why we are happy to pass this knowledge on with no obligations.

"For the past ten years, I've been meeting with advisers who are thinking of selling their business.

Some have found their way to us directly, others have been introduced through brokers, but whatever route they've taken, I've noticed a common theme: vendors are often confused and misinformed about what selling an IFA business entails.

The complexities around selling your IFA business are plentiful, and there is much to consider. From tax implications to business integration, and the many different ways a deal can be structured, all represent potential pitfalls for the uninformed seller.

Whether you're thinking of moving to a larger firm or just want a smooth exit from the industry, it pays to be informed. We're happy to pass on what we've learned in the hope that you can benefit, too."

– **Alan Hudson**, CEO, AFH Financial Group

The process

There are lots of factors to consider before you begin the process of selling your business – while it certainly isn't going to happen overnight, being prepared means you can be certain you are making the right decision, while ensuring each stage runs as smoothly as possible.

Is this the right decision for you?

No matter what your reason for selling – perhaps you are beginning your journey into retirement, or wish to develop your business with access to new resources, or release capital – the first thing you need to consider is whether you are making the right decision for you and your family.

How important is confidentiality?

Confidentiality is essential for protecting both the buyer and the seller throughout the acquisition process. To ensure a smooth process, you wouldn't want it to be known in the marketplace that your business is for sale, and you probably wouldn't want your staff to be aware of the transaction until all details have been finalised. In most cases, a confidentiality undertaking will be entered into at the outset of negotiations.

Working with agents and acquisition brokers

Some buyers will choose to use an acquisition broker to represent them during this process and also assist in finding suitable buyers for their business. This is an extremely important decision, as you'll want to be certain that the acquiring firm will be the right place for your clients and perhaps for yourself as an adviser. A broker should have the relevant expertise and be on hand to arrange as many meetings as might be required.

Typically, a broker will charge between 1-5% of the deal consideration (plus any VAT that's applicable). As a seller, it's important to be aware that some acquisition brokers believe they are justified in charging a fee to both the seller and the buyer. By analogy, this would be the same as an estate agent charging 4% of the property price to both the buyer and 4% to the seller, for one to sell to the other. However, this dual fee might be couched by the broker, which is clearly not ethical nor standard practise in the IFA market. Not only is it exploiting the vulnerable seller, there is an obvious conflict of interest here on behalf of the broker. Ordinarily, as one might expect, the broker's fee should and usually is paid by the acquiring party only. Of course, you can also approach acquirers directly, should you prefer.

The stages: what to expect

How quickly and smoothly the process goes will depend partly on the willingness of the parties concerned, but you also need to be organised. It pays to gather all of the information and paperwork right at the start, as doing this will help to make the process of acquiring or selling a business a straightforward one.

In brief, the most important checkpoints are as follows:

- Negotiate and outline the deal terms and enter into heads of terms
- The purchaser will carry out legal, financialand compliance due diligence
- Formal acquisition documentation is prepared and negotiated
- FCA change in control consent obtained, if required
- Advisers are authorised with the acquiring firm
- Advisers will attend an induction hosted by their new firm
- Transaction completes
- Client letters are distributed
- Novations are sent to all providers and tracked on the acquirer's back office system
- Online access activated as and when novations are processed
- Letters of authority processed and distributed for those providers that do not novate
- Further post-induction training arranged bythe acquirer and undertaken by the adviser

Whether you're planning on staying with your business once it's sold, or leaving all together, the process of selling is essentially the same. Some of the stages listed – such as the acquirers' due diligence, FCA applications and FCA change in control process – will usually happen at the same time, so it's important that you have all your paperwork together before you start.

The acquirer should arrange for you to be formally inducted so that you are familiar with their internal processes, whilst ensuring competency and effectively embedding firm culture. This will also be a good opportunity for you to meet key individuals in the acquiring firm, as well as your T&C supervisor, with whom you can agree a training & CPD focus for the coming year. Ordinarily, you would expect an enhanced monitoring & training program to be provided along with tailored T&C support for newly inducted advisers.

The transition from your existing firm to the acquiring firm will not be without its challenges. Vendors will find that it takes time to adapt to their new environment and learn all of the new systems and processes that are in place. Whilst the acquiring firm can't eliminate this 'transitional phase,' experienced acquirers can ensure there are robust processes and measures in place to make this move as smooth as possible, for both you and your clients.

Valuation models

Your business is probably the most valuable asset you own, so now that you've arrived at the decision to sell, you need to determine how much you are going to be willing to take. Setting the right price is essential, so find out how you can maximise your valuation.

What's your business worth?

You might be tempted to take the first offer you receive in order to achieve a quick exit, but this could mean missing out on the real value of your business. If you're an astute seller, you will consider every aspect of your business, from cash flow to profitability and from employee terms and conditions to culture. You must prepare to be scrutinised from every angle. An objective approach to valuation is essential and there are a number of established valuation methods – this guide looks at each one.

Recurring income

In the IFA market, businesses were traditionally valued on their recurring income. Over time, the model has become more complex and has moved away from commission to ongoing adviser charging. This has led to a more complex analysis of what recurring income actually is in relation to any particular business. However, valuing the funds under management that generate recurring income is still appropriate, particularly for smaller businesses.

As a rule of thumb, calculating 3-4x recurring income is common for this kind of valuation, although more complex models have developed which use multiples twice this amount. The larger the multiple, the greater the returns your buyer will expect – and the more caveats and requirements they are likely to require. Our advice is that you should be fully aware of these details, and to be especially careful of 'profitability overlaying' – this is where your buyer asks for a percentage of profitability that you have to achieve in order to realise the agreed target multiple. If this level of profitability is not achieved, the multiple is significantly reduced, along with the final price achieved.

Reductions often operate on a multiple of the difference between the target recurring income and the actual recurring income. This means reductions can be substantial, even when the difference between the target income and the actual income is modest. It's therefore very important to look at the small print and conditions of the offer being made and decide whether the target is achievable.

Deferred consideration

Deferred consideration is common. You can expect your buyer to pay a percentage on completion and then to pay the remaining balance over a two-year period. We tend to see a payment profile of 50% of the projected consideration on completion, with two further payments of 25% of the deferred consideration on the first and second anniversaries of completion.

With deferred consideration, there are a number of things to bear in mind:

- Deferred payments will often be adjusted so that the multiple of recurring income is reflected in the overall price. The multiple might be agreed as 3.5x the recurring income over the two years following completion. The first and the second payments would be adjusted to reflect the actual, rather than projected recurring income
- If you're accepting deferred consideration from a buyer, it's important that you consider the financial ability of the buyer to make the deferred consideration payments
- As the seller, you must have the right information and relevant accounting support to make sure the deferred consideration has been calculated correctly and include this in the agreement between you and your buyer
- You must agree the timings of deferred consideration payments and if there are any conditions attached to payments and any interest rate. You should ensure these details are written in your agreement

Net asset value

When a buyer purchases the shares of the business, the company carries on as normal with all of its assets and liabilities. It's usual for the buyer to ask that certain assets, (generally fixed assets, but could include current assets), are disposed of. Conversely the seller may also wish to take dividends prior to completion.

Unless your contract specifically states that the buyer pays for the net assets in addition to the purchase price of shares, the net assets are considered as part of the sale within the value placed on the shares.

However, some buyers may agree to pay for the net assets in addition to the share price, typically based upon a multiple of revenue or profitability, giving an additional benefit to you.

The calculation of net assets should reflect the realisable value of your assets, minus all current and future liabilities of the business at the date of sale. This calculation will be based upon a set of completion accounts. These will be drawn up by you and your accountants and agreed with the buyer within a set time period.

Completion accounts

In all share purchase agreements, it's necessary to establish the assets and liabilities of the business on the date of acquisition. This will be undertaken irrespective of whether there is an agreement to pay an additional sum for the net assets.

The work will generally be undertaken at the vendor's cost by their accountants who, within a set timeframe, will prepare draft accounts under UK accounting standards for review and agreement with the acquirers and their auditors. These accounts will form the basis of the net asset value calculation and where included in the contract, will result in an adjustment to the purchase price. Whilst some acquirers may offer to carry out this valuation themselves, the final figures should be agreed by both parties and not imposed on you as the seller.

EBITDA

(Earnings Before Interest, Tax, Depreciation and Amortisation)

EBITDA is a measure used to calculate the amount of cash generated by the operations of a business, before financing costs and taxation. As such, it's frequently used to value a services business. However, whilst this is a simple concept for a standalone business, it can be subject to a different basis of calculation within a group context. When EBITDA is discussed, first determine whether it's being defined as 'pre-acquisition EBITDA,' generally measured by the latest management and statutory accounts of the company, or 'post-acquisition EBITDA,' which reflects the ongoing profitability of the business in its new format, as part of the enlarged group.

The advantage of post-acquisition EBITDA is that the value is inflated by the cost savings generated by the enlarged group and should result in a higher valuation. However, care should be taken to ensure that the acquirer doesn't add 'apportioned or allocated' costs in this calculation – and that you fully understand the financial impact of these charges to your total consideration. EBITDA can also be used as a hurdle to prevent the full payment of your consideration; an example would be a requirement to achieve a certain level of profitability, say 30%, measured by EBITDA divided by total revenue. If this is the case, ensure that you're clear on what costs can be included in the calculation and that they relate solely to your business.

Above all, carefully consider subjective or unquantified costs and ensure that the contract provides suitable protection for the calculation of deferred payments, since subsequent renegotiation is unlikely to be successful. Whether you've made a decision to sell your business, or are still in the consideration stage, it's critical that you plan properly, do your research and get the advice you need. Remember, all companies are different and there are many factors that can affect your value.

Taxation explained

Selling your business can mean a substantial tax bill, which could lead you to pocket less than half of the purchase price. Effective planning when selling your IFA business can help minimise your overall tax liabilities, so be sure that you understand the tax implications before signing on the dotted line.

The potential to minimise tax liabilities will depend on the way the sale is structured. It may be possible to withdraw capital in tax-efficient ways, such as payments into your pension scheme. It could also be possible to defer capital gains Tax by reinvesting the proceeds in a qualifying investment.

What are my tax responsibilities?

The main tax liability is capital gains tax (CGT) – this is the tax you'll pay on the profit from the sale of your business. For example, if you sell your business for £100,000 and you originally bought it for £70,000, your capital gains liability will be calculated on £30,000.

You won't pay CGT on the full amount you make. Everyone has a yearly tax-free allowance, which for 2020-21 is £12,300. Therefore, CGT only applies to profits made above this threshold.

Individuals pay CGT at 10% when their combined income and taxable gains are below the income tax basic rate band upper limit, and 20% for gains (or parts of gains) above that limit. For sellers who are individuals

Sale of shares

It could be more tax-efficient for you to sell shares rather than selling assets. Business Asset Disposal Relief (formerly Entrepreneurs' Relief) can also result in considerable tax savings and help reduce your rate of CGT to 10% on certain disposals. There's currently a lifetime limit of £1 million of qualifying gains, so this will cover all but the very largest of disposals. Certain costs can also be deducted when calculating gains, such as the legal fees you'll need to pay in arranging the sale.

There are a number of conditions that apply to Business Asset Disposal Relief:

- you will need to have owned shares in the company for the previous 12 months;
- the shares you own at the time of the sale must be more than 5% of the voting rights; and
- you must have been an employee or officer of the company for the year prior the sale

Selling as a sole trader and partnerships

(including limited liability partnerships)

If you run your business as a sole trader, partnership or, limited liability partnership (LLP) then entrepreneurs' relief will apply for any assets used for business purposes. The capital gain made by the seller is taxed at 10%, up to the lifetime limit of £1 million.

The business must have been running for at least one year to qualify and any assets held as investments will not be eligible for entrepreneurs' relief.

If your business is a partnership, each partner owns a share of the business assets, which means that a partner is liable to CGT on the gain arising on their share of each asset. Business Asset Disposal Relief is available if a partner has owned their share of the assets for at least one year.

Deferred consideration

You may wish to sell your shareholding for cash, but a buyer could offer shares or loan notes, or a mix of each. A big advantage if it's not a cash purchase is that you don't have any immediate CGT liability and the gain on the disposal of your shares will be rolled over until you sell them. You may be able to make use of several years' annual CGT exempt amounts, but in some cases, you will lose the benefit of entrepreneurs' relief. Unless you're likely to obtain entrepreneurs' relief on a subsequent sale of any consideration shares, paying tax with the benefit of entrepreneurs' relief could be an option to consider.

Similarly, if you decide that an 'earn-out' in shares or loan notes is better for you, it's possible to defer your tax liability. However, if you qualify for entrepreneurs' relief based on your original shares, but not from your new shares, the cost of deferring the tax increases the total amount of that liability.

For corporate sellers

Sale of shares

If you're a corporate shareholder, you may qualify for the 'substantial shareholding exemption' – this provides a tax-exempt gain on a sale of shares, if they have been held continuously for 12 months, starting no more than two years before the day the shares are sold.

It will not be classed as a chargeable gain for the purposes of corporation tax, if you meet the following conditions;

- the company disposing of the shares has owned a substantial shareholding – usually 10% of the ordinary share capital;
- the company in which the shares are held is also a trading company or a holding company of a trading group

It's important to identify exactly what is being purchased, this is because from a tax perspective, the sale of a business makes up a series of separate asset disposals. Unlike a single disposal in the case of a sale of shares, the tax consequences depend on how the consideration is allocated between the assets.

Sale of assets

As a seller, you'll need to consider the following:

- the tax implications of selling different types of assets;
- any tax-relief that is available to reduce your tax liability on the sale;
- any profit on the sale of goodwill or intangible property will generally be taxed as income for a corporate seller;
- the tax treatment of deferred cash consideration and consideration in the form of shares or loan notes

Where a corporate company sells assets, it's common for them to be liquidated so they can receive the sale proceeds. However, our recommendation if you're planning a corporate sale is to take expert taxation advice, due to the complex rules relating to the treatment of assets on a liquidation.

Buyers

Following the Summer Budget of 2015, acquirers are no longer able to claim tax-relief on amortisation of goodwill and customer-related intangible assets in their accounts. Therefore, from a corporation tax position, the acquirer is indifferent to an asset purchase or a share purchase.

Do you have all the information you need?

Whether you're considering selling your business, or need to move ahead and complete your sale, it's critical that you plan properly and get the advice you need. Remember, all companies are different and there are many factors that can affect how much tax you will need to pay.

Tax rules are highly complex. This guide has been developed to help you understand your tax liabilities and is not a substitute for specific taxation advice.

Tax reliefs are dependent upon personal circumstances, and pension and tax rules are subject to change by the government.

Closing down and advice liability

If you sell your IFA business, as opposed to shares in a limited company, you may need to close down your existing structure. This may be a sole trader, partnership or LLP structure. Alternatively, the business and assets of a corporate entity may have been sold to the purchaser leaving the shell company behind.

FCA Authorisation

If you've sold the business and assets of your firm, you'll still retain your FCA authorisation; it will be up to you to apply to the FCA for de-authorisation. The FCA have a defined process for this that you'll be required to go through. One of the key questions the FCA will ask when considering whether de-authorisation is appropriate, is what arrangements have been put in place to deal with complaints arising from advice given in the past.

Who is liable for prior advice?

Generally, buyers will not assume liability for prior advice, meaning you will remain responsible. The financial responsibility for prior advice is usually addressed by taking out run-off cover; this provides professional indemnity insurance cover for the benefit of the clients of the business.

Do you have professional indemnity insurance?

The FCA will look at a number of factors when dealing with de-authorisation requests. One of the key factors is whether or not there are sufficient resources in place to deal with prior advice problems. Of course, having professional indemnity insurance will help with meeting this requirement.

For sole traders and general partnerships (i.e. not limited liability), it's very important that run-off cover is considered at an early stage. There are two reasons for this:

Firstly, the purchaser may not be prepared to take on prior advice liabilities. Sole traders and unlimited partners could face potentially significant liabilities if they don't have the benefit of insurance.

Secondly, even if the purchaser is prepared to take on prior advice liabilities, it's not possible to transfer prior advice liabilities without the consent of each and every client with a potential claim against the business. A buyer may agree to meet those liabilities, but if they go out of business, the client can still come back to the original adviser.

If a limited company (or LLP) has sold its business and assets, then it will also face the question of prior advice liabilities. De-authorisation should be sought, particularly if the shareholders or officers of the company or LLP intend to continue to trade within the financial services sector. There is also, once de-authorisation has been permitted, the question of what happens to the corporate shell. Most sellers liquidate the company or LLP to extract the sale proceeds.

Networks

If you're a member of a network, you will need to comply with the exiting procedures set by your network provider.

Often, the network will have a procedure in place when exiting, which you would have signed up to when you joined. Networks will provide a 'consent to transfer' letter, which will then be sent to the providers along with the novation. Usually, networks will also arrange for run-off cover to be put in place and for this reason insist on retaining client files.

You may need to discuss the liabilities that can result from closing your business with our specialist team who have 20 years' experience of IFA acquisitions.

Performing due dilligence

Once the deal has been agreed between yourself and your buyer, the transaction will progress to the due diligence stage.

Due diligence will be carried out by the buyer on your business. However, due diligence works both ways. When you sell your business, you should conduct your own due diligence on the buyer, especially where the consideration will be paid on a deferred basis.

What should a seller's due diligence process include?

A good starting point is to request testimonials from other vendors when they were acquired by the same firm. Most buyers will understand this is an important safeguard and should be happy to support the request.

Some IFA buyers are referred to as 'consolidators', who look to maximise the value of their acquisitions over a short term, with little emphasis on longevity. Where acquirers focus on quantity as opposed to quality and 'fit' of the target, there's far more risk and exposure undertaken by the seller. Emphasis on the buyer's complaint and PI history should be factored into your seller's due diligence.

You should consider the financial stability of the buyer. This is particularly crucial where the deal consideration is paid on a deferred basis, or includes shares in the buyer firm. You should ask about the buyer's growth plans and whether they are taking on secured debt to fund them. You are likely to feel more confident with a self-funded acquirer, as opposed to one with a complex or geared capital structure.

You should also examine the buyer's culture and values to ensure they are compatible with your own. This is important if you plan to remain as an adviser; equally, if you are retiring you will want to ensure the buyer is a good fit for your clients. There should be ample face-to-face meetings accommodated at the introductory stage, so that you have full knowledge of the buyer and their philosophy.

You should also consider a buyer's acquisition strategy. Do they target both the mass affluent and high-net worth markets? Ideally, you would seek a purchaser who can accommodate all acquired clients, irrespective of the size of their investments, and not insist on an arbitrary cut-off point based upon portfolio size.

It's crucial that you are aware if the purchaser is provider-owned and reliant on the migration of assets, as this will shape the integration of you and your clients and could impact on your deferred consideration.

You should determine whether the deferred consideration is based upon remuneration or whether there is any financial incentive for you to migrate assets. It's not Treating Customers Fairly (TCF) to incentivise the

transfer of client assets at the detriment of the client. Even if migration of assets is not insisted upon, the seller should be advised as to exactly how and when clients will be transitioned onto an appropriate service proposition. This is to ensure that both parties are RDR compliant and are treating their customers fairly.

Second capital event or practice buy-out policy

It's important to consider the adviser model adopted by the acquirer after completion. Is this an employed or self-employed structure? If you are to be employed, would you have considered working for the acquirer if you weren't selling to them?

It's likely that a practice buy-out will only be offered to a self-employed adviser. A practice buy-out (PBO) allows you to continue to create a capital value in your client base and for this reason is often referred to as a second capital event. Therefore, it's very important to consider exactly what opportunity is offered by the acquirer.

You would expect the acquirer's PBO policy to include:

- an indication as to valuation of the client base in terms of an indicative multiple
- process of the PBO and contracts
- any eligibility criteria stipulated by the acquirer
- a payment profile

Many selling advisers who join a new firm no longer have the regulatory burden of running an authorised business and relish the opportunity of having more time to advise and build their client bank. A realisable PBO, therefore, should not be overlooked.

What will a buyer's due diligence process include?

Acquisition due diligence will be carried out by the buyer on all target firms, whether they operate as a limited company, LLP or sole trader. It should give the buyer sufficient understanding of the legal, regulatory, financial, tax and operational aspects of your business to make an informed decision to proceed with the purchase. It will require a vast amount of documentation from you, the seller, so it's best to be prepared early.

The buyer's team, or their legal and tax advisers should co-ordinate due diligence and conduct a detailed analysis.

The length of the due diligence process will depend upon the structure of the deal. Due diligence for a share purchase will be more in depth than an asset purchase, because of the extra liability involved. As an estimate, the process may take one month for asset deals and two months for share sales, depending upon how quickly you can gather the information.

The buyer will provide a due diligence questionnaire and usually set up a Dropbox or DataSite facility. This will let you provide and collate documentation for the buyer's team to review. Information you can expect to provide will include:

- corporate structure details and set-up
- accounts
- details of service propositions and charging structures
- compliance systems and controls
- complaint history
- client demographics
- IT and back office system

- company construct
- employee details

The buyer's team will examine the questionnaire and supporting documentation.

Have you obtained FCA approval for a change in control?

Individuals or companies intending to acquire or increase control of an FCA-regulated firm must obtain prior approval from the FCA. This is known as a change in control application under the Financial Services and Markets Act 2000 (FSMA). This is required where you are selling the shares of your directly authorised business. It's a criminal offence under FSMA Section 191F to acquire or increase control without notifying the FCA first.

Notifications for a change in control are known as Section 178 notices; this is usually made as a joint application by the buyer and seller. Quite often, the acquiring firm will complete the application and send it to you for signature, once the deal terms are agreed. The change in control process usually runs alongside the due diligence.

Along with the notification forms, the FCA will require various supporting documents, including:

- post-transaction structure charts of the target and the acquirer
- CVs for individual controllers and directors/members of corporate controllers of the acquiring firm
- accounts for corporate controllers
- proof of funding for the purchase
- post completion business plan
- any negative disclosures for the controllers and supporting information
- other documents as requested

The FCA can take up to 60 working days to process a change of control case – this is an important consideration when scheduling a deal.

Contracts

Once the deal has been agreed between yourself and your buyer, the transaction will progress to the due diligence stage.

Buying and selling companies and businesses is a routine process. The buyer and the seller will enter into a contract, which contains the following elements:

- a methodology for calculating and paying the purchase price
- restrictive covenants preventing the seller from competing with the buyer and taking the client base back
- provisions dealing with prior advice liability and how this is to be dealt with after completion
- warranties
- indemnities
- costs

If the purchase price has been agreed, calculating it and ensuring it's paid is generally straightforward. However, there are elements of the transaction which are more heavily negotiated.

Warranties

Most business and share sales involve the seller giving warranties to the buyer. Warranties are contractual promises about the business and its operation prior to completion. There are two reasons for warranties.

Firstly, they allocate risk between the parties. Some risks are taken by the seller under the warranties, whilst others remain within the target company or business and will, therefore, be borne by the buyer.

Secondly, the warranties allow disclosure. This is where the seller has the opportunity to disclose where any warranties are not, in fact, true. Where disclosure is made formally to the buyer, the seller will be excused of liability in relation to the matters disclosed.

A very common warranty is as follows: the business is not involved in any litigation or similar process and the seller knows of no reason why it may become involved in litigation.

Warranties are generally limited in time (seven years in relation to taxation warranties and between two and five years in relation to commercial warranties). They may also be limited in amount and in other ways under the business or share sale and purchase agreement.

Indemnities

Unlike warranties – where the buyer has to show that it has suffered a diminution in value of the company or assets, as a result of the breach of warranty – indemnities provide for a pound-for-pound reimbursement, if any of the indemnified events take place. Effectively, indemnities are a promise of payment should specific events happen.

They can be broken down into two types.

Firstly, in any share sale, the buyer will expect to obtain an indemnity in relation to taxation, arising prior to completion. Therefore, if the tax affairs of the target company have not been dealt with properly, the sellers will be liable for the tax not paid.

Secondly, the buyer may require that indemnities are given on specific risks. For instance, if claims have been made against the target business prior to completion, then the buyer may wish to obtain an indemnity in relation to dealing with such claims.

Costs

Usually, the buyer and the seller pay their own legal, accounting and other professional costs for drawing up the contract.

Brokers' fees should be taken into account as part of the deal cost. Most brokers will only take fees from one side of the transaction, depending on whether they are acting for the buyer or the seller. Broker fees can range from 1% to 5% of the purchase price.

Legal fees are potentially in the range of 1% to 3%, depending on the size and complexity of the transaction.

Heads of terms

Often buyers and sellers enter into a preliminary document known as a 'heads of terms', 'heads of agreement', or a 'term sheet.' These set out what the parties have agreed on in terms of price and other key terms of the deal. They tend to be non-binding at this stage.

There could be a danger of spending too long negotiating heads of terms, rather than getting on with the main transaction. It may be that it's better to get on with the actual transaction documentation and negotiate the points as part of this, rather than dealing with them at heads of terms stage.

One part of the heads of terms which may be legally binding is an 'exclusivity' period. This enables the purchaser to have certainty that the seller will not try to run competing transactions.

Restrictive covenants

It's usual for the sellers of a business to undertake not to compete with the new owners after the sale. It's understandable that buyers would not want to pay significant sums to a seller who might set up a competing business and take all the clients back. Restrictions are designed to legally prevent the seller from competing with the business, soliciting clients or poaching staff – this come in two forms:

- the buyer will usually expect a restrictive covenant in the business or share sale agreement. Courts usually enforce a longer restriction in a business sale and restrictions of between three and five years are usual
- if you stay on with the business, the purchaser may expect you to enter into either an employed or self-employed contract and include a restrictive covenant of up to 12 months after termination of the contract. The shorter term of the restriction reflects the fact that the courts are less likely to enforce a long restriction in an employment contract or self-employed agreement

Assessing your staffing requirements

There is a distinction between share and business sales in relation to staff. If shares are being sold, the staff will continue to be employed under their current contract of employment, unless the buyer and the seller agree that a change should be made. However, on a business sale, the Transfer of Undertakings (Protection of Employment) Regulations 2006 will apply.

These regulations make any redundancy in connection with the transfer of business automatically an unfair dismissal.

Changes to employee contracts and redundancies should therefore generally not be made at the time of a business sale. However, most buyers will reassess the staffing needs of the business they are buying and it's unusual not to make changes to staff. This can be done prior to or after completion.

Payment

The payment or consideration offered by the buyer is a fundamental part of any transaction. The simplest form is cash paid upfront or on a deferred basis. There are, however, other options:

- Loan notes: the buyer can issue loan notes, these are evidence of indebtedness and are repayable on agreed terms. A buyer might accept loan notes because they can help create a more tax-efficient position. However, loan notes are not common in sales of financial advisory businesses
- Shares: shares in the buyer's business are more common than loan notes. A buyer might offer shares to a seller for a number of reasons;

Firstly, shares reduce the need for the buyer to find cash. It can simply issue more shares, giving the seller a stake in the purchasing company.

Secondly, issuing shares (particularly if the buyer is a private, unlisted, company) may be a mechanism to bind the seller into the buyer. This is particularly useful if you are staying on and working for the business and gives you some control over the buyer. However, ensure the shares issued give sufficient rights to income and management control. Sometimes shares are issued as a token of value and have no value until a defined event, such as a trade sale or listing on a public market. If these events never happen, you have received consideration in a format with little value.

Thirdly, if the shares are listed on a public market, they can be translated into cash by selling them in the market. Sellers often take a view that they may increase in value, thereby increasing the overall consideration. However, listed companies tend to have a lock-in period during which consideration shares cannot be sold. This is to stop sellers dumping shares into the market and depressing the share price.

Integration of clients

Integration of clients

Your established client base may be regarded as the chief asset of your business and the major source of value that attracts your buyer. However, because of the need to protect your clients, there are certain steps required to transfer and integrate your clients into your buyer's business.

Client migration

Transitioning clients from your firm to the acquiring business may be done by way of a novation, or by Letter of Authority (LOA). A novation is essentially a bulk letter of authority. They don't require individual client signatures and only need to be signed by the director of the existing firm and a director of the acquiring firm. Novations are therefore an easier solution to use during an acquisition.

During the due diligence process, the acquirer will request an up-to-date agency list, detailing all of the providers that you use and their corresponding agency number. The acquirer should then prepare a novation for each provider as soon as possible after completion to prevent too much interruption to your client's service.

However, some providers won't process novations and will insist on Letters of Authority being completed by every affected client. Other providers will novate, although they require additional forms or information. It's imperative that the purchaser makes you aware of these providers in advance to allow the necessary relevant documentation to be prepared. Any delay in transfer of your clients may impact the service they enjoy. You don't want a lack of knowledge on the acquirer's behalf to delay transfer of your clients & impact your ability to service them.

An experienced acquirer will therefore aim to process the novations as soon as possible following completion, to allow for a smooth transition. Novations and LOAs should then be monitored on the buyer's back office system and managed until all are completed.

Client correspondence

Details of the acquisition will be strictly confidential until completion of the transaction is announced to the market. Your clients should then be informed without delay; it's an FCA requirement that when novating, you have informed all affected clients about the acquisition.

It's usual for the acquirer to manage this communication. You will have been required to provide them with an accurate client list during the due diligence stage.

The purchaser will work with you to draft a suitable letter, to help ensure that your clients feel informed and included. Acquirers should recognise that it's important for you to personalise the letter and introduce the acquiring firm to your clients. This is especially relevant where you are exiting the industry. It's you who has built the relationship and trust with clients and your involvement is important to provide the impression of a continuity of service.

With a buy-and-go scenario, you'll also want to ensure that the buyer has adequate resource and appropriate geographical coverage, so that a client meeting can be arranged promptly. It's good practice for the acquirer to also send a welcome letter to each client, to provide a positive impression and establish their own relationship with the client.

Why not arrange an initial informal discussion to talk about your business, your priorities and what your company's future might look like as part of AFH.

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A1490-05/21-01