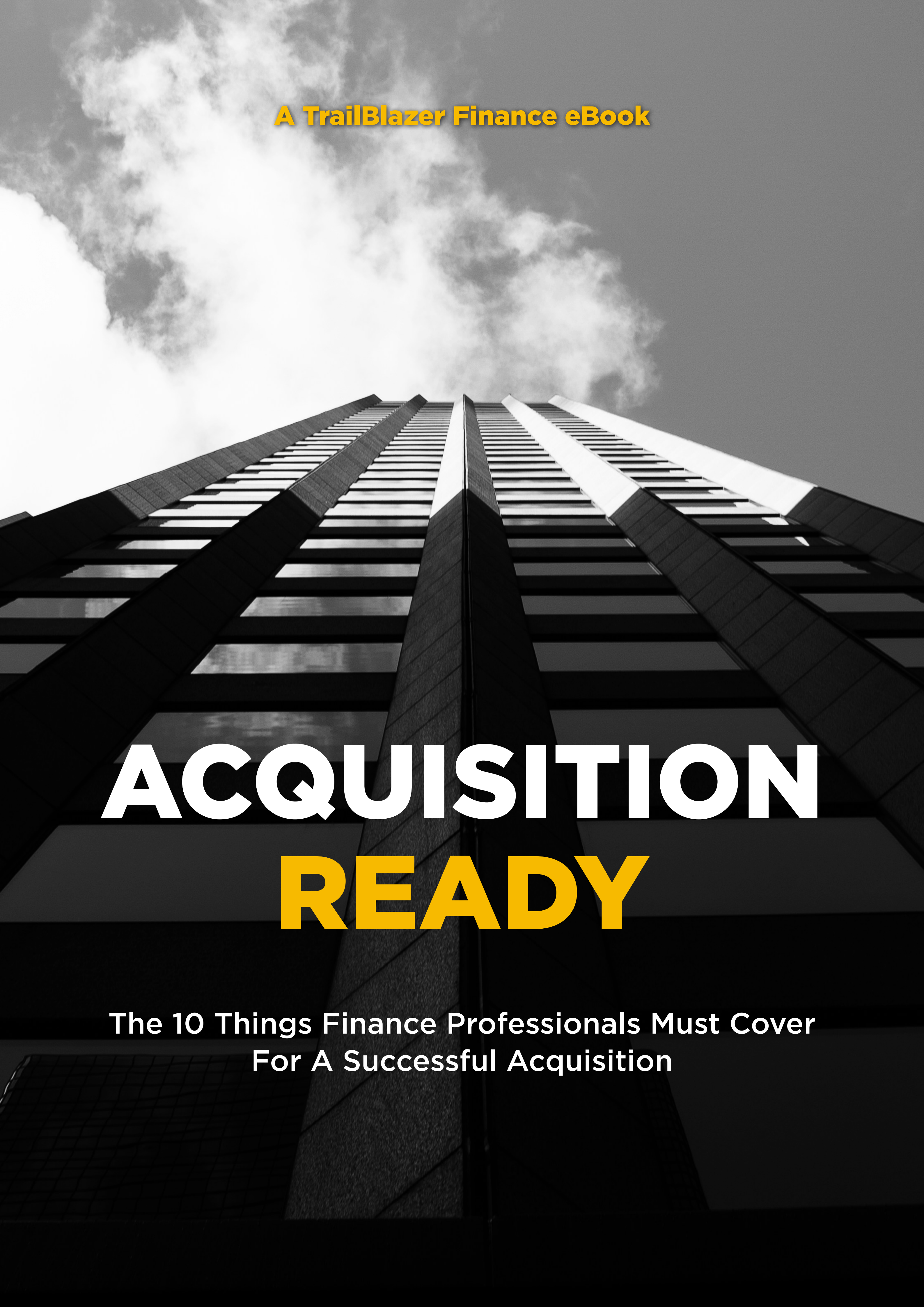

A TrailBlazer Finance eBook

ACQUISITION READY

The 10 Things Finance Professionals Must Cover For A Successful Acquisition

Intro

Dear reader,

This eBook will arm you with the information you need for a successful acquisition.

Every one of the 10 topics has been specifically chosen because it covers an area that is absolutely essential for a successful acquisition but often overlooked or poorly understood.

A successful acquisition can catapult your business to success.

You can double your business (or more) overnight, saving years of painstaking organic growth. An acquisition can give you scale, efficiency and the capacity to remove yourself from the day-to-day. Your margins, buying power and market share can all improve in an instant.

Sounds great, but what's the downside?

Well, there's another side to this coin. Far too often we see acquisitions go bad. Acquisitions, like most things, are wonderful when done well but a disaster when done poorly.

If you're not ready for the acquisition, if you haven't done your due diligence and if everything is not water-tight from a compliance perspective, you can end up destroying the value of your acquisition and possibly the value of your existing business too.

We've seen many things go wrong; purchasers paying too much, purchasers over-leveraging themselves, under-hiring staff, taking their eye off their existing business, falling victim to unscrupulous vendors (oh yes they're out there), and the list goes on...

For a successful acquisition you really must know what you're doing.

TrailBlazer Finance has funded and advised on hundreds of acquisitions. Each has its own nuance but fundamentally there are certain things you must cover to give yourself the best chance at success. Here are the 10 things you absolutely must cover for a successful acquisition.

Wishing you the best of luck,

The team at TrailBlazer Finance.

Contents

1. Am I ready? "Is this something you ought to be doing?"

The very first question you should be asking yourself is, "is this the right acquisition for me?".

There are three things to consider in determining whether this is something you ought to be doing:

#1 Do you have the capacity?
Too often brokers and planners acquire add-on books and squander much of the upside because they simply can't invest the time in looking after and transitioning those clients to maximize the value.

#2 Is the timing right?
Are you at a stage in your personal career and business development where you are established enough to really take advantage of the acquisition? Acquisitions are not necessarily good for cutting your teeth. They are good once you've established a process, protocols and experience so that every acquisition then translates into the greatest potential to convert and either upsell or renew those clients and therefore not only acquire a recurring trail or a base, but to maximize that.

#3 Do you have the right skills for the book?
And third of all, do you have the requisite skills for the book you're buying? If these are sophisticated property investors, do you have that type of experience? If these are first time home buyers, do you have the type of experience necessary to give them what they require?

Ask yourself these three questions before you do anything else.

2. What exactly are you buying?

In other words, if you are considering an acquisition, this could take one of four forms.

Basic Level: Buying a Book
At the basic level, you could simply be buying a book. What is a book? It's a stream of recurring revenues.

In the case of Financial Planners, it is what we call CSR or customer servicing rights.

And in the case of Mortgage Brokers, it's the future entitlement to be paid trail commissions as long as they arrive, or 'trail' as it's colloquially known. When you acquire a rent roll, it is future management fees to the extent that those leases remain in place. So, at the base level, that's what you're getting.

2nd Level: Going Concern Acquisition
What if you want more than just the book? What if you want the trading entity's core identity? Its website? Its phone number? Its URLs. Things that identify it so that you can continue to run the business ongoing - that's a going concern acquisition which has tax advantages that you can explore with your tax advisor or accountant. It gives you more than simply the stream of revenues. It gives you the tools that you will require in order to continue to operate the business as a going concern.

3rd Level: Buy a Business
The third level is when you choose to buy the business. You buy all of the infrastructure, the assets and the liabilities or those that you choose to cherry pick that you want that go with it. You may be taking over a lease, you may be taking over staff, you may be taking on contractual commitments and advertising that's pre-booked. You are essentially going to get more than even the going concern you're getting all of the elements.

4th Level: Change Places with the Existing Owner
Finally, you might want to change places with the existing owner, change nothing and buy the company. Buy the shares in the company or a share in the company and in so doing inherit the past liabilities, of course subject to the right warranties, but also everything that comes with it in a single swoop.

You need to be clear, with the right advice, as to what you are acquiring and what you really need because this is at the heart of the structure.

3. What approvals will be required?

What approvals are required when you make an acquisition? This may take several forms.

Aggregator, dealer group, or franchise approval
The most common is that you may need the approval of the aggregator or dealer group or franchise in order to acquire and take legal ownership of the acquisition target.

Restricted approval
Now, that may be restricted. Some aggregators only allow you to buy, if you are a member, some mortgage managers can only be acquired by those who have signed up for the same guarantees and have the requisite qualifications. And almost all franchises will only allow you to acquire a book providing you are prepared to sign up and become a franchisee.

Without the requisite approvals, your acquisition can be null and void and you risk losing either the deposit or whatever monies you pay.

So, up front, it's essential that you familiarize yourself with any legal documentation that gives rise to the right to future payments.

4. What due diligence should I do?

There are several layers of due diligence. Again, let's break these up into three areas of due diligence that we would recommend you do on any acquisition.

1st Level: Due Diligence
At the first level, there's due diligence on the actual value of the collateral or the asset that you're acquiring. For this, you would typically get a third party to conduct a detailed valuation verifying the true worth and the fungibility or the ability to borrow against that asset. Some people have the skill set, the patience, the models, the experience and the temerity to do it themselves. Most go to objective third parties.

2nd Level: Referenceability checks
The second level is you should do referenceability checks on the character or quality of the vendors. Here we recommend you speak to BDMs, partnership managers, people who have worked as either referrers or staff of the target acquisition because if the character is not good and the reputation is poor, you might acquire something and find that you have acquired a poison chalice.

3rd: Level: Searches
And thirdly, searches. Do not forget to do the requisite searches to make sure you can get a clear title. Make sure the owner is in fact the owner. Ensure they have not encumbered or hawked the asset and that money is not owing to a funder and therefore you don't get a clear title and find yourself enmeshed in problems.

5. What Legal documentation is required?

The legal documentation that supports a purchase or assignment will vary slightly depending on the circumstances, but one can ordinarily expect to look for four major categories of documentation that you should put in place.

Heads of Agreement
The first is what we call a Heads of Agreement or a Memorandum of Understanding. These are the key commercial terms that have been agreed between the parties. One of the greatest problems we encounter is that these terms are often not comprehensively or properly discussed between the parties, leading to strife and confusion and often a breakdown of the deal later on. So that is the first requirement.

Deed of Assignment
The second one is a Contract of Purchase/Sale, otherwise typically known as a Deed of Assignment. This is typically produced by your lawyers and takes the commercial terms that have been agreed in the Heads of Agreement and wraps them in proper legal language.

Documentation
The third one is a document from your aggregator, franchisor, dealer group or umbrella body allowing you to effectively assign the purchase between two different parties. Every organization is different, some aggregators have their own assignment deeds. Some simply have transfer forms. And the content of these should not be confused with the need for a proper Deed of Assignment, because often these transfer forms are self-serving to protect your aggregator or dealer group and really are there to make sure that the terms of the transfer are understood and they take no or little responsibility.

Legal Agreements
And finally, there is a generic category that may be in standalone form or might be embedded in your contract of sale or purchase and that is non-disclosure agreements, non-compete or restraint provisions so that clients can not be poached and staff cannot be taken away by the vendor. And it could also be referral agreements for ongoing new business.

6. How can I fund the acquisition?

There are various funding options available. These can be broken into three major categories.

#1 Third Party
Third party external funding provided by a bank, non-bank or specialist lender (such as ourselves). The more specialized the lender, the more likely they are to understand the asset you are acquiring and attach value to it or indeed to be able to help you to discern whether you had overlooked anything with the purchase because they will place requirements which will be good from a business sense for you.

It's not uncommon for parties to be able to fund all of the acquisition using a third party if they have some assets to leverage and if they can then leverage against the target book or business that is being acquired.

#2 Related Party
The second category is a related party. This is where you either go to a family member or friend or perhaps use your own savings or equity in your home.

#3 Vendor Financing
The third category is vendor financing, where the seller agrees to take a deferred payment in exchange for you often agreeing to pay either interest or a higher price or releasing some of the terms.

You may use a combination of the above three, it will depend on your financial circumstances as well as your appetite for risk and the assets that you have available.

How much debt to use is the final element

That is again very dependent on the security and the predictability of the cash flows that come from the book or business that is being acquired.

Responsible lenders will invest time in understanding the limit of the serviceability so that they should aim to never make a loan which overreaches or places the borrower in a difficult position. Unless their strategy is to earn penalty interest or in fact to find a back door way to acquire the asset through you defaulting.

The loan to value ratio (LVR) and servicing are specialist credit skills that a good funder will have and be able to assist you with as opposed to possibly a family or private member who is trusting in you but may not be able to add value over and above providing the funding itself.

7. What prices are people paying for books?

This is one of the most commonly asked questions and one of the most vexing.

First of all, it will depend on the type of book that is being acquired.

Mortgage trail books have historically traded initially at a multiple of 1.5X annual trail, then 2X annual trail became the benchmark. More recently it was common to find 2.5X and of late as this asset class has become better and better understood it is apparent that more and more books of high quality are even fetching in excess of 3X

However, there are enormous variances in quality and one should think of the price one pays a little bit like what you would pay for a used car. A low mileage, well cared for, mint condition Mercedes-Benz is likely to fetch far more second-hand than a badly serviced, poor quality Daihatsu which has done hundreds of thousands of kilometers on bad roads.

It's imperative that in determining a price you don't simply look at the purchase price but you also look at the quality of the asset that is being acquired and seek to have it externally valued.

Financial Planning books used to historically trade, as a rule of thumb, 3X annualized recurring revenue, or (CSR). However, as the market has matured and become more sophisticated, it has become clear that there is a gulf between what people will pay for books depending on their revenue streams eg. risk books including life insurance, trauma and related commissions versus self-managed super versus general advice versus assets under management. Each of them need to be considered on their merits as does the stickiness of the client base and the aging. It's recommended that before determining a price one gets a valuation done and analyzes the breakdown of the revenues in the recurring revenue book of a financial advisor.

Real estate rentals, or rent rolls as they are known, have again typically traded in a range between 2.5 and 3.5. Here the distinction will be client stickiness, concentration, quality of the underlying vacancies and rental reliability. And a focus is principally on the management fees as opposed to other fees that might be derived by the agency.

Accounting practices have historically traded in the range of 0.8 to 1.2 times annualized revenues. Those figures are then reviewed to see what EBITDA can be achieved because below a certain level there is a set fixed cost and as a result there is very little that goes to a purchaser. These books will again be influenced a great deal by the stickiness of the client base, who is available to service them, and in fact, who is eligible to acquire an accounting practice and its recurring revenue base.

8. How do you protect yourself from unscrupulous vendors?

We start from the position of recommending that if you doubt the integrity or honesty or motives of the vendor, do not transact with them, because any methods you use will be safeguards, but unscrupulous operators can be ingenious at finding ways to circumvent these.

It is imperative that you perform due diligence, not just on the asset but on the character of the vendor and seek references to ensure that you have a proper understanding of their past conduct as it tends to repeat itself. However, even when you have satisfied yourself, we would recommend two important safeguards:

#1 Proper restraint provisions

If a vendor is claiming that they wish to leave the industry and that they want to exit, then they should have no problem signing appropriate restraints that they will not come back and compete with you. After all, they have the existing relationship with their clients and could quite easily unseat you if you are just establishing fresh relationships with their clients.

If they are not willing to sign such restraints, you should question why.

A final observation is that we often see people try to put in place restraints that are not commercially reasonable and when this happens you actually run a risk that they could be read down and found to be overreaching and completely ineffective. Sometimes less is more.

#2 Requisite searches need to be done

Do not assume that somebody else hasn't already taken security over the asset, book or business that you are acquiring. If they have, you may not get a clear title and you need to do rigorous ABN and ACN searches to determine and satisfy yourself that there are neither encumbrances on the title and also that you have a vendor who actually has the right to enter into the agreement. Well-experienced lawyers and corporate advisors will assist you in this process.

9. What are the steps and timetable in an acquisition?

If you do not regularly buy or sell trail books or businesses, you may find yourself frustrated or unintentionally misleading the vendor or the other contracting party as to an appropriate timetable.

The high level steps would be as follows:

#1 Identify the target
To identify the target asset, be it a book, business or company, and to enter into a commercial agreement for the acquisition. This is typically subject to step two.

#2 Due diligence or obtain funding
Step two may be due diligence or obtaining funding or the satisfaction of certain condition precedence such as ensuring that if there is security in place, because there has been a loan against those assets that is first removed.

#3 Legal contract stage
Once you have satisfied or at least identified anything from a due diligence perspective that needs to be remedied it is the legal contract stage. Here is where you either create one yourself or use specialist third party advisors or lawyers, brief them and have the appropriate legal documentation put in place so as to reflect the commercial terms and to give you the protections in terms of warranties and indemnities that you would expect to see.

#4 Settlement stage
The next step is the actual settlement stage. This is where any items that were identified in the due diligence are worked on and put in place and that might be the preparation of letters that are prepared jointly, maybe meetings with significant clients, maybe meetings with members of staff, and this will depend widely and vary based on the type of book you are buying or the type of business or company. Finally there is the settlement which involves the payment of funds once the legal assignment has been processed or the sale is settled and that can be again conducted in a number of ways depending on whether property is involved, whether the settlement needs to be in person.

#5 Handover
And the final stage that we put in is post settlement and that's where there may be transitional consults with the vendor or they assist and work with you to ensure a smooth handover.

Continued...

What are the steps and timetable in an acquisition?

As you can tell, this process can vary enormously

Deals can be rushed through and if very simple, and the parties know what they're doing, could be achieved in theory in as little as a few weeks.

However, any attempt to rush a process where you are unfamiliar or you are reliant on third parties such as aggregators, dealer groups, franchisors or accountants and lawyers who have to prepare financial or legal data, is fraught with danger and can often lead to the purchaser parting with funds before they can get proper title.

We have seen transactions sometimes drag out for over a year while things are sorted out, but typically from the beginning of the process to the time of settlement, it is not unreasonable for a transaction to take in the vicinity of two to three months.

10. What are the most common mistakes we see when acquisitions are made?

Over the course of the years we have seen mistakes occur, both avoidable and sometimes unavoidable and they take varied and multiple forms. However, these can loosely be categorized into one of five and are typically avoidable.

#1 Performing poor due diligence
The first one is performing poor due diligence. When that is not done, it doesn't matter what follows, the purchaser will often be ruining the day they made the acquisition.

#2 Inappropriate restraints
The second is where the vendor has not entered into appropriate or proper restraints or any restraints at all and then sells only to seek to rewrite the underlying client's business, be it loans, financial plans or taking back the accounting business, either themselves or through fronts that they utilize.

#3 Ineffective legal contracts
The third one is ineffective legal contracts because they either don't confer proper clear title or they are so vague as to confuse the parties and become unenforceable, leaving the purchaser without any recourse when they thought they had it.

#4 Clawbacks
The fourth one is when the purchaser does not take into account appropriately the amount of clawbacks that might occur in the case of a mortgage trail book. Then, not only is mortgage trail lost, but the funders will take back upfront commissions that were never paid to the purchaser. If that hasn't been appropriately dealt with in the contracts and in the commercial agreement, this will become the problem of the purchaser who will now bear the double brunt of lost trai and paying money out to refund the upfront which was never actually paid to them and if the purchaser has no recourse or the vendor has gone they will suffer that loss themselves.

#5 Misunderstanding who wrote the business
The final one is to determine who really wrote the business. If the vendor employed staff and those staff hold key relationships and they are free to go off and potentially take those clients with them and the associated revenue that is a significant problem to buyers.

Continued...

What are the most common mistakes we see when acquisitions are made?

Those are the most common mistakes and they often occur as a result of not clearly understanding the acquisition or taking the time to do things properly because of pure excitement and haste. However, if one takes one's time, does this methodically and gets the assistance of external experts, many of these problems can be avoided

TrailBlazer Finance

TrailBlazer Finance is a specialist funder that works with Finance Brokers, Financial Planners, Accountants and Property Managers, assisting them with funding and valuations.

If you're ready to explore an acquisition opportunity you can reach out to our team for a free confidential discussion about your situation. Just mention this eBook and we'll look after you.

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Or, you can make an online enquiry Here