The Basic Principles of Valuation

FUTURE PROFITABILITY
is the only thing that determines current value.

ADVISORY PRACTICES
do not have many tangible assets, so the real value is in the cash flow generated by clients over and above the cost of running the business.

THE MORE RISK
assumed by a buyer, the less they're willing to pay. However, less risk warrants a higher price. The greater certainty there is around future cash flow, the higher the valuation.

VALUE
is in the eye of the beholder.
The final price determined will depend on both the buyer's and seller's motivation to complete the deal. Ultimately, did everyone believe they received fair value.

VALUATION
is the marriage of Science and Art. Objective crunching of numbers + Subjective review of qualitative values: client profile, retention rate, staff tenure, etc. = What makes one book of business worth more than another - even with similar generated revenue.

7 Steps to Determine Your Price

#1

ANALYZE INCOME STATEMENT
Income tax returns are usually prepared to show the least amount of tax payable, not the most profitability.

#2

DETERMINE DISCRETIONARY CASH FLOW
What would you pay for an advisor role? The balance of income equals profit or cash flow.

#3

CALCULATE DISCOUNT RATE
Market Risk + Business Risk = Discount Rate

#4

ESTIMATE GROWTH RATE
Be conservative in a growth assumption to account for market volatility and fluctuating revenue.

#5

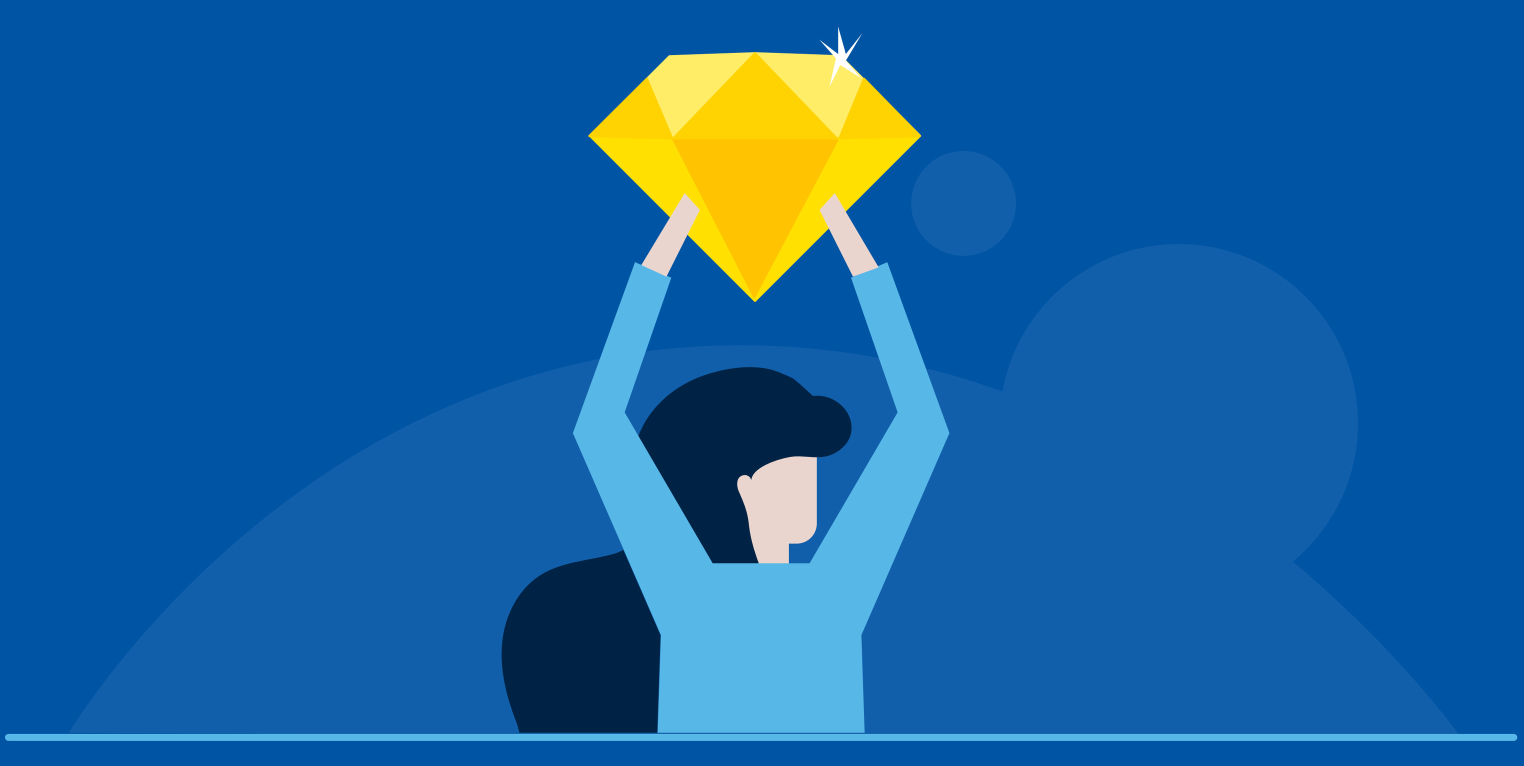
CALCULATE CAPITALIZATION RATE
Cap Rate = (Discount Rate - Growth Rate)

#6

CALCULATE THE RANGE OF VALUES
Determined by dividing (Step #2) the discretionary cash flow by the capitalization rate (Step #5).

#7

CALCULATE RATIOS
Investors want to know ratios like price-to- earnings (P/E), multiple of revenue, and percentage of AUM.



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