3xEquity

2016 Valuation Report

ROGER JONES
JONES, DOUGLAS & ASSOCIATES

MARCH 23, 2016

Jones, Douglas & Associates Executive Summary

Per your request, we have completed the Valuation Report for Roger Jones of Jones, Douglas & Associates.

Based on the information provided by Jones, Douglas & Associates, our analysis indicates that the current market value for your business is approximately $1,686,750 as of March 23, 2016. In the report that follows we detail the basis for this valuation.

As always, if you have questions, please don't hesitate to contact us.

3Xequity®

About Us

A financial firm that provides valuations & transition comparisons, along with many other tools. Through our sleek website, we offer real-time data analysis, which enables advisors to make crucial business decisions. If you wish to expand, sell, establish partnerships, or evaluate broker dealers; 3xEquity is the premiere online resource for growth opportunities in the financial services industry.

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Valuation

$1,686,750

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3xEquity and our Valuation Service

About 3xEquity

At 3xEquity, we are a group of financial service professionals who have spent our entire careers growing one of the best firms in the country while earning many distinguished awards along the way.

3xEquity helps financial advisors:

- Determine practice value
- Maximize practice value
- Compare practice performance to industry
- Compare deal terms when buying or selling
- Review tax implications when buying or selling
- Analyze breakeven points when buying or selling

3xEquity can introduce sellers to buyers and buyers to sellers. We can help a junior advisor purchase a senior advisor's practice. We can even provide financing. If you want the process of selling, buying or financing to be SIMPLE, FINANCIALLY REWARDING, and conducted with the HIGHEST LEVEL OF INTEGRITY, then 3xEquity could be your answer.

Valuing a Financial Services Business

Many factors determine the value of a business, but the key drivers are 1) recurring gross dealer concessions (GDC and/or ongoing revenue) and 2) assets under management (AUM). Sometimes overlooked, but equally important, are profitability and the age demographics of clients. Age demographics and the generational planning of your clients (or lack thereof) are two key factors that roll up under the risk barometer of your practice. Although it is often misunderstood, the terms of the deal you structure are often more important than the actual price of your practice when it comes time to buy or sell.

How does this affect the valuation of a firm?

Recurring revenue (or fee-based) is earned through fee-based investments. Examples of fee-based investments include wrap accounts, C Shares, annuities, and financial planning fees. Fee-based accounts are charged as an asset fee or percentage on AUM. Transactional revenue (or non-recurring) is earned from a one-time transaction for a commission payment.

Practice Valuation and Deal Structure

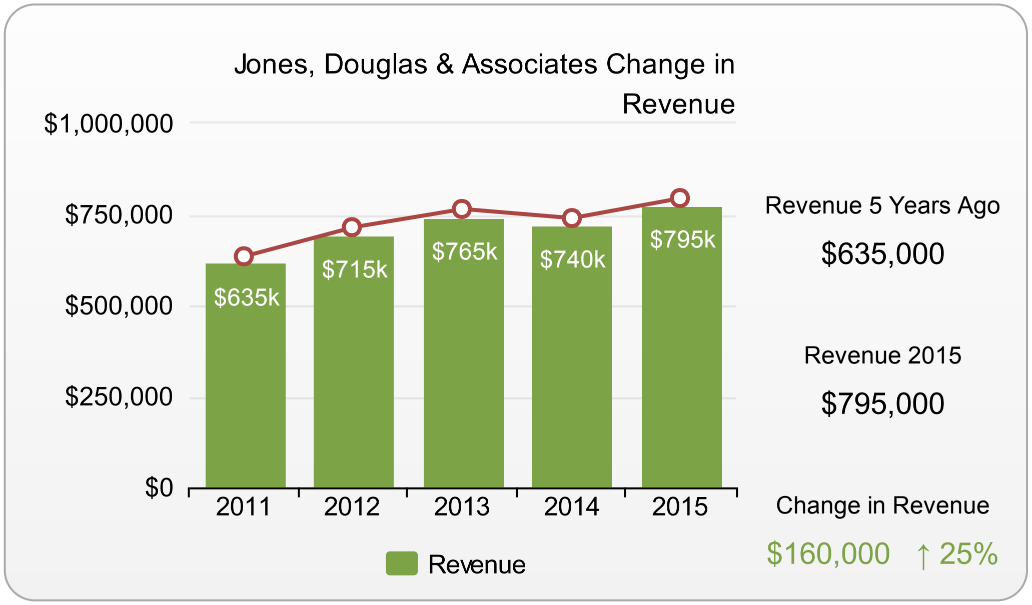
The deal structure is typically more critical than the actual price. The seller oftentimes wants the highest sale price, and the buyer wants the best terms, which typically equates to a lower down payment and/or a longer note. Making a deal could be as simple as giving the seller his price and extending the note one more year for the buyer. The risk to the seller is that the buyer defaults on the note. The risk to the buyer (other than violation of a non-compete agreement by the seller) is that some clients may leave the practice. Both of these risks can be avoided with the proper deal structure. The deal structure is almost always more critical than the price of the practice.

5-Year Revenue Trend

How do you feel about your trend line the past 5 years? To get the most equity for your practice, you need to understand your net flow of assets. Changes to your trend line include:

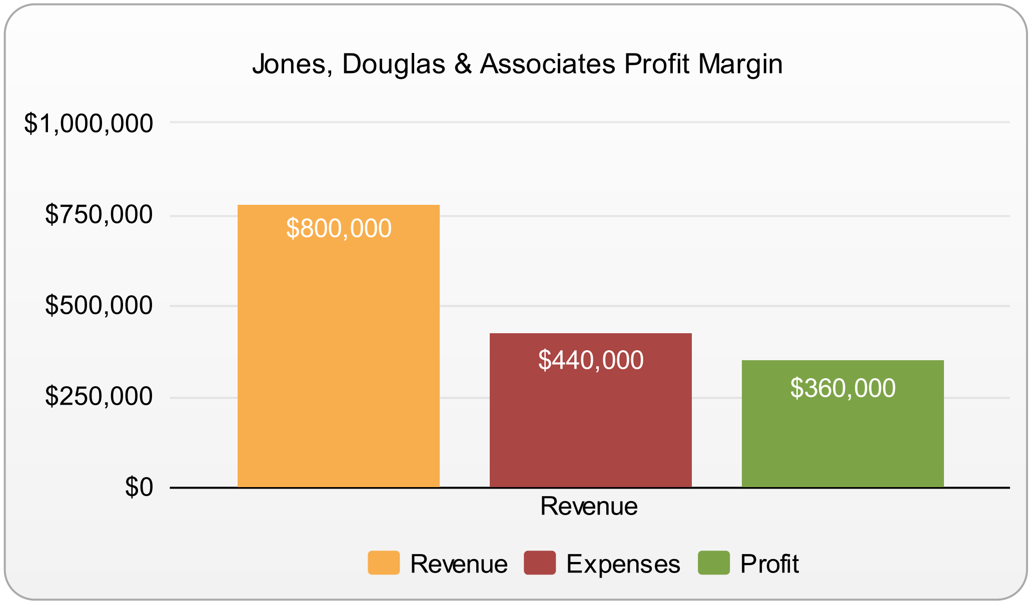
- market growth/decline
- new assets
- asset attrition
- acquiring another practice
- selling clients
- purchasing new clients
- changing your book to more recurring revenue

In order to get the most equity for your practice, you need to understand what your net flow of assets was over the past 5 years.



Practice Profit Margin

Despite positive financial performance and a rebounding equity market over the past years, median AUM was essentially flat for the industry. Since 2003, overhead as a percent of revenue has remained virtually unchanged, hovering at just over 40% of revenue.[1]



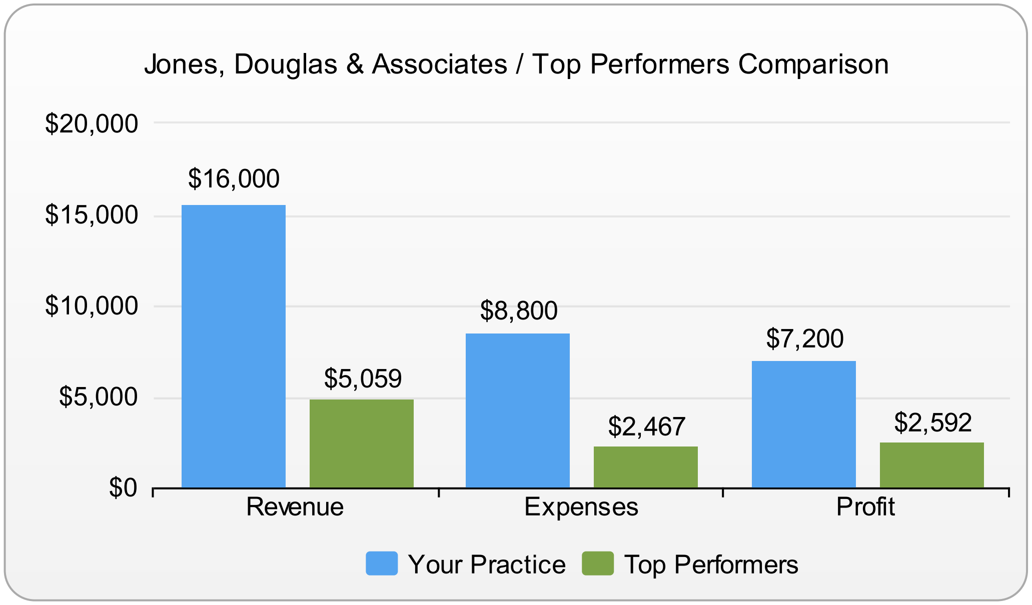
Profit Margin per Client

We find top advisors can do more with less, which results in higher productivity and higher margins. (The exception to this rule is when you expand or hire staff before you need them, or when you rent office space before you need it.)

Overall, Top Performers continued their faster growth in clients – adding more new clients and more large clients. As a result, they continue to show higher revenue per client and are growing revenue per client faster than other firms.

The higher clients-per-professional ratio, combined with slightly larger clients, slightly less staff, and lower expenses translates into higher revenues with much better margins for Top Performers. In sheer dollars, owner income is significantly higher at top performing firms.

Top Performers are also more productive and more successful in controlling costs: they serve significantly more clients per adviser, and per total staff. Their overhead cost is significantly below the industry average, while overhead at other firms is slightly above average.



Profit margin per client = Operating profit divided by the number of active clients.

Practice Metrics

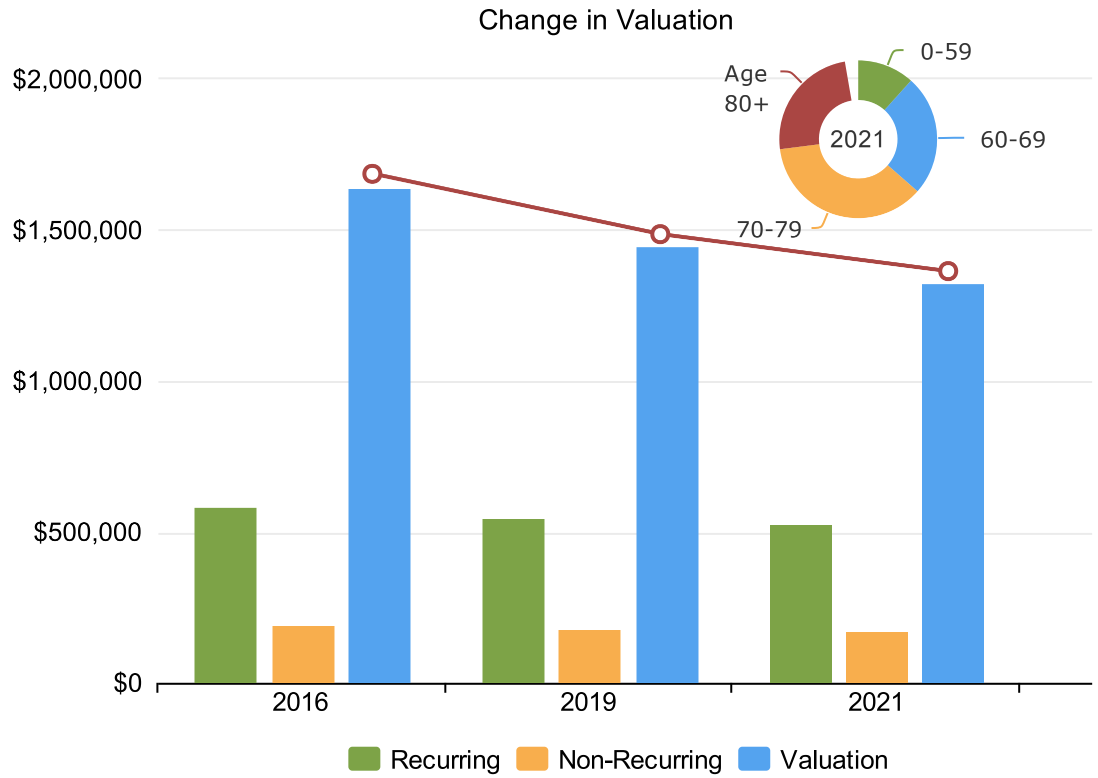
Your Customized Valuation

Jones, Douglas & Associates

Current, 3, and 5 Year Customized Valuation

Here we include the 7 critical variables you provided to determine your valuation. Notice the difference in your valuation today compared to 3 and 5 years down the road. The three variables that have the greatest impact on your practice valuation are 1) growth/decline of your assets, 2) age of your clients, and 3) percentage of recurring revenue.

Helpful Hint: The positive and continual flow of assets has the greatest immediate impact on your practice valuation.



See the data for this graph on the next page.

Valuation Today

$1,686,750

Valuation in 3 years

$1,486,812

Valuation in 5 years

$1,364,309

Change in Valuation

$322,441 ↓ 19%

Jones, Douglas & Associates

Current, 3, and 5 Year Customized Valuation (Continued)

Customized Valuation Data

YEAR	RECURRING REVENUE	NON-RECURRING REVENUE	TOTAL REVENUE	AGE 0-59	AGE 60-69	AGE 70-79	AGE 80+	VALUATION
2016	$600,000	$200,000	$800,000	15%	45%	30%	10%	$1,686,750
2017	$588,000	$196,000	$784,000	14%	42%	32%	12%	$1,617,853
2018	$576,240	$192,080	$768,320	14%	37%	33%	16%	$1,551,231
2019	$564,715	$188,238	$752,953	13%	34%	35%	18%	$1,486,812
2020	$553,421	$184,473	$737,894	13%	29%	36%	22%	$1,424,527
2021	$542,353	$180,784	$723,137	12%	26%	38%	24%	$1,364,309

Jones, Douglas & Associates Deal Terms Comparison

Regardless of whether you are the seller or buyer, how you structure your deal is typically more important than the price of your practice. We include three different deal models below to illustrate this. All Equity (i.e., a cash deal), Mainstream Deal (an average deal), and Cash Flow Deal (primarily an earn-out deal).

All Equity Deal

All equity deals are becoming increasingly more relevant as liquidity is freeing up in our lending market. Sellers can invest their newly acquired capital at their expected rate of return. All equity deals normally go for a 35% discount. These deals offer a large risk to the buyer.

$1,096,388

Option 1
All Equity Deal

See page 7 for details

Mainstream Deal Structure

The mainstream deal provides the most balanced shared/risk model for the buyer and seller. Depending on the opportunity cost sellers place on their all equity deal, the mainstream deal could provide sellers with a higher effective overall rate of return than the all equity deal, up to 9% or higher.

$1,686,750

Option 2
Mainstream Deal

See page 8 for details

Cash Flow Deal

The cash flow deal provides the seller the highest price, the most income, and the highest rate of return, but it also offers the most risk to the seller. The cash flow deal costs the buyer more money over time.

$2,243,378

Option 3
Cash Flow Deal

See page 9 for details

Option 1

All Equity Deal

We don't see many all equity deals because most buyers don't have the cash to purchase a practice outright. Sellers typically don't like the all equity deal because it normally requires up to a 35% discount on the purchase price, and the seller is typically out of the business right away. All equity deals often take place as a result of termination, disability, or unexpected life events. An all equity deal could be beneficial to sellers if they feel their opportunity cost is greater than their earning power in their businesses.

Helpful Hint: We assume a 6% rate of return for sellers on their cash. If sellers believe their opportunity cost or expected rate of return could be much higher by having access to 100% of the cash in an all equity deal, then taking a lower price could be advantageous.

All Equity – Net to Seller

YEAR	DOWN PAYMENT	DOWN PAYMENT OPPORTUNITY COST	SELLER DEBT SERVICE	EARNOUT	ANNUAL TOTAL	CUMULATIVE TOTAL
Total	$0	$0	$0	$0	$0	

Option 1 – Jones, Douglas & Associates All Equity Deal

All Equity Deal Terms

Multiplier	65%

Note: This transaction normally demands a 35% discount and that the seller no longer work in the practice.

Seller receives **$1,096,388**

Option 2

Mainstream Deal

The mainstream deal is most common. It typically offers a reasonable down payment, note payment duration, and interest rate on the note; often an earn-out is structured in the deal. The interest rate has the least sensitivity to this deal structure.

The mainstream deal pays about 54% more than the all equity deal (assuming sellers earn 6%). This deal often consists of a down payment that sellers use to pay their tax obligation for the sale. The lower down payment and longer note helps the buyer get close to a breakeven or positive cash flow for their practice.

Helpful Hint: Buyers may include the opportunity cost (i.e., debt service) on their down payment as an expense (i.e., cost of capital) in their cash flow model. We encourage buyers to account for the down payment as an investment from their personal portfolios instead.

Mainstream – Net to Seller

YEAR	DOWN PAYMENT	DOWN PAYMENT OPPORTUNITY COST	SELLER DEBT SERVICE	EARNOUT	ANNUAL TOTAL	CUMULATIVE TOTAL
1	$421,688	$25,301	$230,682	$50,603	$728,274	$728,274
2		$26,819	$230,682	$50,603	$308,104	$1,036,378
3		$28,428	$230,682	$50,603	$309,713	$1,346,091
4		$30,134	$230,682	$50,603	$311,419	$1,657,510
5		$31,942	$230,682	$50,603	$313,227	$1,970,737
Total	$421,688	$142,624	$1,153,410	$253,015	$1,970,737	

Option 2 – Jones, Douglas & Associates Mainstream Deal

Mainstream Deal Terms

Initial down payment		25%	$421,688
Amount of valuation financed		60%	$1,012,050
Length of term in years	5		
Interest Rate	7%		
Earn-out		15%	$253,013
Earn-out % of current revenue	6.3%		
Length of term in years	5		
Amount per year	$50,603		

Comparison

54% more received over Option 1

9% effective rate over Option 1

Seller receives $1,686,750

Option 3

Cash Flow Deal

Most buyers prefer the cash flow deal due to less money up front, lower risk, and positive cash flow. If sellers accept a cash flow deal, they may want a more advantageous tax treatment on the sale of their practice, a personal guarantee, or both.

The cash flow deal typically benefits the seller who wants an income stream for a longer period of time. Additionally, in the cash flow deal, the seller oftentimes accumulates more money over the duration of the contract than either the all equity or mainstream deals.

Helpful Hint: If the seller does not need the cash up front and wants to disengage from the practice, but still wants income for a longer period of time, then the cash flow deal could make the most sense.

Cash Flow – Net to Seller

YEAR	DOWN PAYMENT	DOWN PAYMENT OPPORTUNITY COST	SELLER DEBT SERVICE	EARNOUT	ANNUAL TOTAL	CUMULATIVE TOTAL
1	$224,338	$13,460		$252,380	$490,178	$490,178
2		$14,268		$252,380	$266,648	$756,826
3		$15,124		$252,380	$267,504	$1,024,330
4		$16,031		$252,380	$268,411	$1,292,741
5		$16,993		$252,380	$269,373	$1,562,114
6		$18,013		$252,380	$270,393	$1,832,507
7		$19,094		$252,380	$271,474	$2,103,981
8		$20,239		$252,380	$272,619	$2,376,600
Total	$224,338	$133,222	$0	$2,019,040	$2,376,600	

Option 3 – Jones, Douglas & Associates Cash Flow Deal

Cash Flow Deal Terms

Initial down payment		10%	$224,338
Earn-out		90%	$2,019,040
Earn-out % of current revenue	31.5%		
Length of term in years	8		
Amount per year	$252,380		

Comparison

105% more received over Option 1
33% more received over Option 2

9.36% effective rate over Option 1

Seller receives $2,243,378

Tax Implications on Sale

The more you understand the tax implications on the transaction, the more confident you will be with the deal structure. To illustrate, we show two scenarios: 1) Seller treats 70% of the transaction as goodwill (i.e., capital gains to the seller) and 30% as consulting income (i.e., ordinary income to the seller), and 2) 90% as goodwill and 10% as consulting income.

Deal Terms

	Scenario 1	Scenario 2
Sale price	$1,686,750	$1,686,750
Capital gains income, %	70%	90%
Capital gains income, $	$1,180,725	$1,518,075
Ordinary Income, %	30% (29% consulting, 1% non-compete)	10% (9% consulting, 1% non-compete)
Ordinary income, $	$506,025	$168,675
Other income, $	$0	$0

Tax rates

	Scenario 1	Scenario 2
Capital gains rate	20.0%	20.0%
Ordinary income tax bracket	39.6%	28%
Healthcare tax (on net investment inc.)	3.8%	3.8%
Washington state tax	0.0%	0.0%
SS tax on first ~114k of ordinary income	12.4%	12.4%
Medicare tax on ordinary inc. (no cap)	2.9%	2.9%
Additional Medicare tax on high income > 250k	0.9%	0.9%

Tax comparison of Scenarios 1 & 2

	Scenario 1 (70%)	Scenario 2 (90%)	Difference
Capital gains			
Capital gains tax on sale	$236,145	$303,615	$67,470
Washington state tax	$0	$0	$0
Healthcare ($200k exclusion) (Applied only to the capital gains, not ordinary income)	$6,868	$19,687	$12,819
Total tax liability (CGI)	$243,013	$323,302	$80,289
Ordinary income			
Income tax	$148,032	$34,695	$-113,337
Washington state tax	$0	$0	$0
SS tax on income	$14,099	$14,099	$0
Medicare tax on income	$14,675	$4,892	$-9,783
Additional Medicare tax on high income	$2,304	$0	$-2,304
Total tax liability (OI)	$179,110	$53,685	$-125,425
Total tax (combined)	$422,122	$376,987	$-45,135
Tax – effective rate	25.0%	22.3%	-2.7%

See tax disclaimer in the Statement of Conditions.

Jones, Douglas & Associates Report Inputs

We include here key data points that we think are most important for your valuation report.

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Practice Metrics

NAME	VALUE	DEFINITION
Revenue	$800,000	Gross income over the Last Twelve Months (LTM).
Recurring Revenue	75%	Recurring revenue is generally referred to as fee-based income or recurring income, not transactional income.
Active Clients	50	How many clients or households do you have?
Net Asset Flow	-2%	Are your net asset flows on average positive or negative? What is your percentage per year?
Average Rate of Return	0%	After you charge your asset fee, what annualized rate of return do you predict to earn for the next 5 years for your client assets?
Client Age Distribution	0 59: 15% 60 69: 45% 70 79: 30% 80+: 10%	Based on national averages for client age, we have assumed the national average of age grouping for your clients.

Peer Comparison

NAME	VALUE	DEFINITION
Assets under Management	$100,000,000	Assets under management, or AUM, is the total amount of assets your practice is managing.
Assets Acquired in 2014	$11,000,000	The number of new assets acquired in your practice in 2014.
Expenses	$440,000	Total number of fixed overhead costs on an annual basis.
New Clients in 2014	24	The number of new households acquired in 2014.
Years in Service	12	The number of years you have been advising your client base.
Years until Retirement	2	How many years until you would like to retire?

Jones, Douglas & Associates Report Inputs (Continued)

Practice Trends

NAME	VALUE	DEFINITION
Revenue in 2010	$635,000	What was your revenue in 2010? This will give you “rearview mirror” perspective to help your forward planning.
Revenue in 2011	$715,000	What was your revenue in 2011?
Revenue in 2012	$765,000	What was your revenue in 2012?
Revenue in 2013	$740,000	What was your revenue in 2013?
Revenue in 2014	$795,000	What was your revenue in 2014?

Tax Treatment / Strategy

NAME	VALUE	DEFINITION
Capital Gains (Scenario 1)	70%	What percentage of the sales price would you like to be treated as capital gains? (Industry standard is approximately 75%.) Most sellers want more towards capital gains, and most buyers want less.
Capital Gains (Scenario 2)	90%	What percentage of the sales price would you like to be treated as capital gains? (Industry standard is approximately 75%.) Most sellers want more towards capital gains, and most buyers want less.
Other Income for Taxes	$0	Income earned through wages, bonuses, investment income, and any other ordinary income.
Filing Status	Married Filing Jointly	Do you file your taxes jointly (Married Filing Jointly) or as an individual/separately (Single)?

References

All peer comparison uses data from the *2014 InvestmentNews/Moss Adams Financial Performance Study of Advisory Firms*. This bi-annual study is conducted by IN Adviser Solutions (www.inadvisersolutions.com), InvestmentNews (www.investmentnews.com), and Moss Adams, LLP (www.mossadams.com).

The 310 respondents were split into 4 groups; Solo, Ensemble, Enterprise Ensemble, and Super Ensemble. For our report, the Solo firm data was used, as it is the comparison of an independent finacial advisors' data, not a group of advisors data. In the report we use "Top Performers" to represent the top 25% of all Solo firms in the study. We use "national average" to represent all other Solo firms in the study. Some data used for comparison, in the 3xEquity Valuation report, uses calculations based on data from all 310 respondants and normalized for the Solo firm averages.

Notes:

Siracuse, Suzanne and Bruno, Mark and Sirinides, Matt. *2014 InvestmentNews/Moss Adams Financial Performance Study of Advisory Firms*. New York: Crain Communications Inc.

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