MINDY DIAMOND ON INDEPENDENCE — A PODCAST FOR FINANCIAL ADVISORS CONSIDERING CHANGE

EPISODE TRANSCRIPT

Valuation Expert FP Transitions: On M&A, Growth, and Maximizing Enterprise Value

A conversation with Louis Diamond and Brad Bueermann, CEO, FP Transitions.

Mindy Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is Valuation Expert FP Transitions: On M&A, Growth, and Maximizing Enterprise Value. It's a conversation with Brad Bueermann, CEO of FP Transitions. I'm Mindy Diamond and this is Mindy Diamond on Independence.

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Fidelity's latest M&A report signaled that despite headwinds of a turbulent market and interest rates as well as a banking crisis, the M&A wave is still flowing strong. The first quarter of 2023 saw 67 acquisitions representing some $83.5 billion in client assets. And while there were more deals than the previous quarter’s 57, there was a decrease of $84.2 billion in total client assets.

No doubt, there's still a hunger for quality firms with strong P&Ls and growth trajectories. And it's this very space that at firms like FP Transitions play in. The firm was founded in 1999 by industry legend David Grau, Sr. Who literally wrote the book on buying, selling, and valuing financial practices back in 2016. FP Transitions became one of the standouts in the wealth management world specializing in the valuation and analysis of the intangibles that make advisory practices unique and valuable.

They do this by employing strategies that build upon a lifetime of work and trusted client relationships and execute a plan for succession designed to both realize the value for the founder and perpetuate the business for the next gen of advisors. Earlier this year, FP Transitions reached a milestone having performed over 15,000 independent business valuations.

Today, the firm CEO, Brad Bueermann joins the show with my partner, Louis, to tell us more about the firm's background and how they develop their unique methodology. Brad shares advice on key areas, wealth management business owners and advisors alike need to pay attention to when striving to maximize growth and value. They discuss FP Transition's own leadership transition from David to Brad plus succession planning, M&A, and much more. It's an episode filled with practical advice, so let's get to it.

Louis Diamond:

Brad, thanks so much for joining us today.

Brad Bueermann:

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You're welcome, Louis. My pleasure.

Louis Diamond:

Let's get started. Can you tell us about your background and your origin story?

Brad Bueermann:

Sure. Well, my origin story starts right here in Oregon. I was raised on a ranch just outside of Portland and then left and went to Stanford and started my career from there. It has been very varied, but the last 18, 20 years has been at FP Transitions.

Louis Diamond:

There's a lot of interesting things in your bio, so listeners will have to take a look, but it looks like you started in the M&A business in the agribusiness, working in the food processing sector as well. Can you talk about this and what led you to the world of financial advice from there?

Brad Bueermann:

Sure. Lots of steps in between, but one of my first careers, I actually started my career at Citibank, and then I ended up in the brokerage world in the business brokerage world and helping people buy and sell companies. I had a early partner who had been a CEO in the food businesses, so that's really where I concentrated. From there, I went on to the company that I was affiliated with, was part of a network of some 200 brokerage firms around the country, and it was owned out of the UK. I joined the home office and ultimately became the COO of that particular company. We were based in Boston.

Louis Diamond:

Yeah, that's a very interesting background, and I think also you moved into the biotech arena.

Brad Bueermann:

The company that I ran, which was based in the brokerage company, was based in Boston. And I lived in Cambridge. Cambridge, Massachusetts is a super interesting place to be. I was there for about 17 years actually, and during my time there met lots of interesting folks, and one of my things that I did was after leaving the brokerage company, I ran a biotech company in Cambridge for a number of years.

So I've done that. I also owned food businesses. So most of my background has been very entrepreneurial, different kinds of companies, different things. I didn't get started in the wealth management industry until I moved back to the West Coast in the early 2000s and that's when I met socially David Grau. David and I started working together and I became a partner with David in 2006.

Louis Diamond:

So what was it about your prior M&A experience that brought you into wealth management? So I know David Grau, of course as an industry legend, but have a big jump from food processing and biotech into the world of wealth management. So I'm curious what you saw as the appeal of joining David in this endeavor.

Brad Bueermann:

At the time that I joined David, the company had four employees, and what it primarily did in the very early days is that it had been organized as a platform for buyers and sellers of registered investment advisory firms, businesses to find each other, and it was really the first of its kind, which offered a national marketplace for doing that.

My background in terms of the business brokerage company that I had run with, the 200 offices was exactly aligned with that. In other words, we had created a national marketplace, but for a much broader number of businesses, not just agriculture, but manufacturing, distribution, retail service companies, et cetera.

So when I first met David and saw what he was trying to get off the ground, that was a very, very interesting look. And of course David brought a different kind of background to the party. David is a securities lawyer by training and really concentrated on the legal side of putting together transactions.

Mine was much more about how the marketing and also how valuation and fit could play into doing that, and that's how we in the early days created the models that became FP.

Louis Diamond:

It's a perfect segue. So can you explain the FP Transitions story? So he mentioned a little bit how it was founded, but what were the initial intentions and what do you think was the major catalyst that propelled it to success?

Brad Bueermann:

Sure. One of the things, and I think that I always emphasized as a takeaway, that when you start building a company, you have to be ready for all of the changes and metamorphosis that that company will go through. In the case of FP, we've reinvented ourselves over and over and over. So we are not the company that we started long ago. We are a far different company because you follow the paths of where your client's needs are and what strengths you are bringing to the party that match those particular needs.

So in our case, when I joined FP, the missing piece of the puzzle was valuation. Valuation at the time, back in the early 2000s. And you have to understand that now you take it for granted that an RIA, an entrepreneurial RIA with one or two or three members in it has a value, and when they grow to 10 people in the firm, they have a large value.

But in the early days, and now what we're talking about is simply back to the early 2000s, many RIAs, and registered reps as well, did not believe that they had a value period. Most of my speaking engagements were out telling people that they did have a value, that they could sell their practice. Their big pushback, they said, nobody will ever work with... Nobody other than me could take care of my clients.

In other words, when I'm done, my clients would never go to somebody else. Well, that was wrong. That was completely wrong actually. But to the benefit of the RIAs who had built these businesses. So there was value. There was tremendous value in having built those relationships provided they had done so in the right way. So the question was how do you value them?

At the time the industry had a really simplistic model. That model was so simplistic that it essentially required multiplication by a whole number. One or two. We multiplied transactional revenue by one and recurring fee revenue by two. And that's how valuation was done. But obviously, that couldn't have be right. And that's where I really started to begin.

So while David was working on propelling the parts of the company around putting together transactions, I invented a new type of valuation, which became our benchmark of our comprehensive valuation report. That took a different type of approach because the valuation looked at how you would value a firm from a buyer's perspective. What were the things that buyers were worried about? Well, they were worried about transition risk. They were worried about cash flow quality, and they were worried about whether this was in a place in a market that was going to continue to grow for them.

So by taking those elements, putting them together, and then creating a report that not only talked about what their value would be, but also what was the value under different circumstances of sale I.e whether you were going to sell it for cash, very unlikely in those days or whether you were going to sell it for bank financing, also very unlikely in those days or whether you were going to have seller financing involved.

Depending on those, those were different answers. Fast forward to today and many, many different iterations and changes and evolutions of that model, we've valued over 15,000 advisors out in the marketplace.

Louis Diamond:

Wow. There's a lot to unpack there, but one of the things you mentioned that was most striking to me was that back in 2006, 2007 and before that advisors didn't really believe there was value in the business, or at least the buyer wouldn’t ascribe value to an independent business. Today, we know that's the complete opposite. There's never been a larger appetite for acquisitions and for buying into these annuitized businesses.

Maybe give us a quick snippet of what life was like. If I was an independent advisor in 2005, I'm approaching retirement. Business just passes on to the next generation or just fades away like a dentist at a dental practice, or was there something else that happened?

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Brad Bueermann:

Yeah, exactly, Louis. I mean you have the analogy just right. You said a dental office. At that time you had a similar thing going on with other professional practices. Professionals and an RIA, a registered rep consider themselves a professional in their field, of course. And when they reached the end, many of them wrote a letter to their clients and said, "I'm retiring. Good luck. I hope your..." And sometimes they would recommend other advisors that somebody could go to, but the idea that these intangible relationships with clients could be sold altogether was really not very common.

When David entered the business back in as an attorney, having been a regulator before, he was approached out of the gate in probably in the late 1990s by advisors coming to him saying, "Is it possible to sell an RIA?" That's how far we've come. So what happened during that period of time is that we got over that hurdle of thinking that clients were wedded to one client, one advisor only.

While that still is oftentimes the case, we now know that there are a lot of different factors which play into whether the client can be moved to a new advisory firm or new ownership of the advisory firm. And that's why our original valuation concentrated so much on what we call transition risk. What was the risk of transferring that book of clients, if you will, to a new advisor? As we prove that out over and over through literally hundreds and then thousands of transactions out the other side was, "Hey, this works. There is value. Clients are very much used to this. And as a matter of fact, clients not only are accepting, but generally speaking, applaud the change." Because at the point that somebody is ready to retire, presumably they're not working quite as hard as they have in the past. And by introducing somebody new into the equation, the client is being better served.

Louis Diamond:

Very interesting. It seems like FP Transitions came about at the right time. As the RIA space professionalize and developed, you've created kind of a standard or a benchmark for valuations. Would you say, and it's okay if you're not humble in this answer, that the emergence of FP Transitions and the valuation work you did, did that really begin to put a value, a real fair market value on independent businesses? Or were there other factors at play, whether it was NFP in the early days or early aggregator and acquirer models that began to look at this business and say, "It's actually very attractive." And even if the lead advisor is retiring, there's still a lot of resale value?

Brad Bueermann:

Well, let's back up. Let's make sure that RIAs did not have value or weren't being bought and sold at that period of time, but they tended to be large wealth management firms or institutions. So we knew that if a billion dollar firm at that time still had tremendous value and would be bought and sold, and the headlines at the time would be the NFPs of the time who were aggregating and doing other work around it. But the sub billion dollar market that makes up sub billion dollar in AUM market, which makes up the vast majority of advisors and advisory businesses was really what we're talking about.

But the transformation only started with that valuation. What the difference was, and it doesn't mean that there weren't valuations out there at the time, but valuations were appraisals for the most part, and they were quite expensive to do, and people only undertook them at a time when they were looking to either sell if they thought that they could or more often because there was some sort of dispute or something, a dissolution of the firm.

So what we did was to create a valuation, which if you will, could be broadly brought in. And by doing literally thousands of them, we got more and more people thinking about, "Hey, what I'm doing not only brings in income," they knew that, but it also is building value in something. But what is that something that it is building value in? And that's what are the next transformation for FP, which was to help people transfer their thinking and transform themselves from simply being an advisor with helpers into being a business. That formation is still taking place.

Louis Diamond:

Yeah. I mean, that's a very valuable service and there's still plenty of businesses that struggle with that. How do I take it from a sole proprietorship or lifestyle practice into more of an enterprise model? And as you know, the enterprise style businesses sell for more, so it's in everyone's best interest to try to crack the code and work with firms like yours to do that.

So today, how would you describe the value proposition of FP and what are the services that you're offering your independent wealth management clients?

Brad Bueermann:

Yeah, very good question. Thanks. Well, as I told you, when we started, we had four employees. We just passed through 60. So what we discovered along the way and where the transformation came is that as our clients understood that they had value, they wanted to understand more importantly the second part, which is how do I increase that value? How do I scale what I'm doing? And that really led us to the consulting side of our equation.

What FP does is it helps people with managing the equity value of their business. That's what we do. We first do that by identifying the value for them, helping them then understand what are the value drivers, and then help them create what is the plan for increasing that value overtime. And usually our focus is not on, there are lots of coaches and lots of people that they need to be in touch with to help everyone from marketing consultants and people who can help them with increasing client and help them with back office efficiencies.

But ours is really concentrated on creating a structure for the business and a compensation system, which ultimately spreads out the equity to incentivize all of the key advisors in the business to help build this business, and ultimately to help the owners of the firm realize the value. So we basically provide that sort of end-to-end service. What we have done is to bring together the professionals that you would need in order to accomplish all of those things.

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So we have credentialed appraisers who help with the valuation and credentialed valuation team. We have business consultants, many of whom have a background in having run RIAs and registered reps in the firms, in the industry. We then also have an analytics team headed up with CFAs that provides the sort of modeling that you need to think about where the firm is going, what are the implications, how do you scale, what are the tax implications of that?

And then finally we have a legal team, which now consists of 10 lawyers. So we're actually, if you will, a small law firm as well to create the documentation which is needed to support the business as you build, as you spread out the equity, and ultimately as you do it. And then we have of course our M&A team, which helps, and does well over a hundred transactions a year that helping people find external partners if that's the direction that they want to go.

So we do both internal succession plans and external succession plans, but our goal is to provide that sort of end-to-end service so that we have it all seamlessly integrated between legal, between analytics, valuation, all in one place so that we're all working together toward one end.

Louis Diamond:

So it's really one stop shopping because the alternative would be, I'm looking to sell my business. I can hire a consultant or an investment banker. I might look to a third-party appraiser evaluation firm. I need to hire my lawyer. I need to hire a marketing firm to help me come up with the structure around what this new business is going to look like from a marketing standpoint. Or I guess you can turn to FP. So I'm curious then, because it seems like there's a lot of touch points between what FP would do and what an investment banker would do.

I think when folks think of selling a business in this industry, hiring an investment banker or an M&A advisor is certainly top of mind. So how would you compare and contrast what FP is doing to the services a sell side banker would provide?

Brad Bueermann:

A lot of the people that come to us, we do, we compete directly with the investment banking firms that are out there. We are a lawyer-led model instead of a banker led model. But our approach is entirely different and it's entirely different on a couple of different scales. First of all, we don't endeavor to find our clients at the point that they're ready to sell. We're endeavoring to find their clients five years, 10 years, 15 years before they want to sell.

That's when we're working with them. We are helping them put the plans in place to grow the business oftentimes to a value goal that an owner has. So we're actually a consulting first company. We're not out banging on doors saying, "Do you want to sell your firm?" We're saying, "Where are you with your firm? What are your goals with your firm?"

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Many of our clients are saying, "I love it. I love what I do. I don't ever want to leave." But what I do want to do is that I want to make sure that I have maximized the value that I'm taking out equity at a price that is commensurate with the value that I believe that I've built.

I want to put together a team that will also benefit from what's going on and will be happy with it. In other words, we are involved in that. The other thing that sets us on a different course than an investment banking firm is that we are not buy side or sell side. We are non-advocates when it comes to selling a company. And that-

Louis Diamond:

Can you explain what that means?

Brad Bueermann:

Yeah. That's the question that stops people and they go, "What?" And we go, "We're a non-advocate." What that means is this, and part of it is the bias that I had coming out of the M&A and brokerage industry where those were hard fought battles between buyer advocate and seller advocate, buyer lawyers, seller lawyers. We had a tussle that ended with an arm wrestling match over the closing cable. Sometimes that's a good way to do it and it maximizes value, but it's not the best way to do it in this industry.

And the reason is 'cause what's being sold are client relationships. That sometimes gets lost in this. That's where the value is. And in order for client relationships to be seamlessly transferred from seller to buyer, buyer and seller need to leave the closing table, if not as friends, at least as a very close working partners. That's what makes for the best transition.

So if this has been a bloody skirmish, a battle over putting together this transaction, this is a place, Louis, where you can win the battle and totally lose the war. And so we discovered that early on. We transformed into only doing... We do often sometimes represent people solely on one side, but the vast majority of our transactions where we come to the party as a non-advocate, and it doesn't mean that we are not advocating for our seller client. We are. And it doesn't mean that we're not helping the buyer. We are.

We think that the best transaction is going to be a win-win between the buyer and the seller where we can help them think through all of the different approaches that can be taken that we can work through. And it's why we use lawyers. Our M&A is headed up by a lawyer. We have other lawyers on that particular team so that we can talk to the advocates and there will be advocates on the sell side. We'll be advocates on the buy side, but we can help them understand what the ultimate goal is, which is to take care of clients and make sure that a fair value is being had by both parties. And that's our approach. Others take different approaches, that's ours and it's been super successful for us.

Louis Diamond:

So it's basically sitting in the middle, almost being like a neutral referee. Your client is the deal or the transaction rather than just the buyer or just the seller.

Brad Bueermann:

That's correct. Also, interestingly enough, we took that and we offer a private transaction service which provides exactly that service for people that have already found the buyer for their firm or they're a buyer and they've found a seller. They bring us in at the LOI stage and we take over from there, and we charge a reduced fee, but we take over and help them do it. Why? Because generally speaking, we end up being less expensive than if you had lawyers do it.

But that's not the driving force. The driving force is that when we're brought in an assignment like that, we close over 80%. That's double what the open market, what's somebody trying to do deals by themselves. And it's because we know where the landmines are. We know where this deal could stray and blow up. We know the kinds of things that lawyers will put into contracts that will set the other party on edge.

We're able to get ahead of that and put together not... And also offer our valuation and analytics around it to say this is a fair deal or this is higher than market or lower than market. We can help them determine those factors so that there's a win-win.

Louis Diamond:

Yeah, and that's fascinating. I was not aware of the model like that existed. And from experience, I'm with you that so many deals break down after the letter of intent is signed in the enhanced due diligence and kind of purchase agreement phase because of either unreasonable demands by one side or because just there's too many kind of hills to climb when it comes to negotiating the purchase agreement.

A lot of that is sometimes created by the attorneys representing either or both the buyer and seller. So I think that makes a lot of sense and I see the value that FP brings. If you don't mind, let's talk a little bit about your partner, David Grau, Sr. He is a major name in the industry. He's written a bunch of books and valuations and he's kind of a legend, an industry rockstar right along with you. How has FP evolved under your leadership and what have been some of the concepts around succession and transition planning that you as CEO have driven forward since you took over for David?

Brad Bueermann:

Yeah, great question. It's actually a story that we share with our clients as well, and David shares a lot. So when we partnered, what you want to do, and we've always advised is when you build companies, you don't want to have everyone that doesn't have the same talent. You want to bring together different talents and different roles and define those particular roles.

So when David and I separated the role of CEO, which is mine and president, which is his, David was much more client facing and consultative while mine was strategic and organizational. By building out from there, we then started to add into the FP as we built the FP business, we wanted to eat our own cooking. And because of that, we started to add partners and those partners, they bought into it using our type of approach.

Since that time we've had partners who have left, cashed out and made money doing so, and other partners in other junior partners who have bought into the business as well. So we really have pushed forward that type of concept.

Now at this point, David has moved over. We have a project that we do with a very large project with Northwestern Mutual where we are helping them internally, many of their top advisors to setting up businesses and creating a lot of the things that we just talked about, creating equity pathways, et cetera. We do that and have done that for several hundred of the top Northwestern Mutual group. David heads that effort on the consulting side there. So he's very active in terms of helping those Northwestern folks with that.

But as the company basically became larger and the organizational and strategic side, the executive side if you will, of the business grew, David's role stayed much more on the consulting side while our executive team took over the day-to-day responsibilities and the long range goals that go with it.

That's not dissimilar from our clients, many of whom have a talented and brilliant relationship manager who is a great advisor. But that doesn't necessarily always translate to running or scaling an advisory business. So they are then going off and creating in order to create a successful ensemble to having one or even bringing somebody in from the outside to be that CEO role, to be the one who runs the organization. And that's a great formula. It's worked well for us, it's worked well for many of our clients, and it's something that as you transform from just being an advisor or just an advisor led practice to being a wealth management business and ultimately a wealth management firm, you have to consider all of those things.

Louis Diamond:

It sounds like you eat your own home cooking because you've had a front row seat to a very tricky transition from a well-known and charismatic founder and CEO to you as the next generation. Even though you were one of the founders of the company, it's still a transfer from one to the next. And like you mentioned, the business needs change, the skillset that is in the executive suite needs to change with it. So I would imagine as you guys are consulting with your various clients, you're able to call upon your own institutional experience to really inform the process and also to kind of think in their shoes, be a little bit more empathetic about the challenges of the transition from G1 to G2 to G3.

Brad Bueermann:

That's exactly right. I think that you do have to experience that yourself. We have also worked to make sure that our team is also very multi-generational. So our team has 20 somethings and 30 somethings and 40s, and also the gray hair as well. So by bringing that to the party, and oftentimes we will sit as a team when we're working on a particular client project and make sure that those different inputs, that's the perspective.

We've got the perspective of the G1, but what is the perspective of the G2s? What do the G2s want to get accomplished and are we aligning those goals? So having those discussions in your own business helps a lot when you're now talking to a client.

Louis Diamond:

So let's pivot to talk a little bit about the M&A environment right now today. We've talked a lot about the evolution of valuations in the independent wealth management arena, but I think our listeners are probably most curious about the, "So what? How does this impact me today?" So there's a lot written about valuations there. They've been at a high or near a high. But I'm curious, given your in the lab on the ground experience, how would you view valuations at present and do you see there being room to run and where evaluations are today to where they'll be in the future?

Brad Bueermann:

Yeah, great question. So let's start by saying that coming out of the gate for 2023, we had one of the strongest quarters ever. So we are seeing that the activity level out in the marketplace is still very strong. The demand levels, when we put new practices out on the market, for those of you that might be getting our emails and they see the flashes of a practice going out, those are bringing in 40, 50, 60 inquiries.

Our institutional buyers that are out there, the aggregators in the market are also still very active and have an appetite to be deploying capital. That having been said, I think that valuations are settling down a bit. In other words, I think that we're beginning to see a higher level, but it's coalescing around a higher set point than we were at pre-pandemic, but not that much higher.

And the dispersion of deals is that's definitely narrowing around it. The number of outlandishly priced things or what appears to be outlandishly priced things on an EBITDA multiple, those are becoming fewer and farther between. I have to say though that a lot of the valuation frost, some of it was real. There was certainly some headline transactions that everybody read about that had them scratching their head going, "Wow, valuations have really gotten out of control."

But the valuations of transactions last year and last year was a really strong year as well were actually still in a relatively conservative range. Whereas you saw headlines of EBITDA, multiples of being 20... Transactions were in our space which is primarily the sub-billion dollar AUM marketplace. Those transactions were taking place in a range of eight to 14.

So I think that as you looked at it, and then of course one of the things that we've cautioned over and over, and I don't want anybody listening to this to go out and grab their calculator and start saying, "Whoa, wait 14 times, that would make me understand that you can't translate those numbers unless you know the deal terms."

So the deal terms are what drives what's going on. Deal terms can vary tremendously between whether you are doing an all cash deal, whether we are doing a partial stock. There's stock involved in it, or there's paper being taken back or there's financing of some other kind. But also many of the transactions, the majority of deals that we did last year, I think 70% were sell and stays. And under our sell and stay type of approach, something that we've worked hard on developing methodologies around those sell and stays where somebody sells their practice and continues to work normally have an upside, which would actually allow them to hit that 20 times number if you will.

But the transaction number, this stated transaction number is going to be lowered. So there's a lot going on, but I would say that the takeaway is that the M&A market is still healthy. The demand for these firms is still very much real. Private equity is still playing an important part in doing this. The aggregators are, for the most part that we work with are still quite healthy in this marketplace and are looking, but there's a tier of businesses below that who are, I would call the sub-regionals, who are also quite active in the market in the price range of the folks who are say sub $300 million AUM.

Louis Diamond:

So to, I think, encapsulate some of what you said, you read about 20 times EBITDA multiples that's out there, but it's for a very, very small subset of firms. But for the most part, most of the transactions are happening with the sub billion dollar community, eight to 14 times EBITDA is what you were seeing. And with that in mind, do you see for the year 2023 for 2024, 2025, et cetera, do you think that range creeps up, it goes from eight to 14, to 10 to 16? Does it pull back a little bit or does it stay consistent?

Brad Bueermann:

I think it'll stay consistent or begin to pull back. Interest rates will begin to bite for sure, just at a cost of capital calculation. We also have to see what happens in terms of the market because growth is also a pricing factor. So depending on whether the firms are continue to grow, and remember we came off of a very, very strong through the pandemic. We came through this very strong period of growth that then flattened out.

We're now sort of sitting whether that is going to come back or not, and that will impact pricing. Our guess is that you will see pricing stay relatively steady. The frothy upper end is probably gone for those multi-billion dollar sellers that were getting in outsized multiple. That ship probably has sailed, at least for now, but for the rest of the market and certainly the sub-billion dollar market, it was never priced that high to begin with. And therefore I think you're going to see it stay relatively steady.

You also have some of the firms who basically have not hit larger firms that have not hit their growth, have not hit their growth targets, have an appetite around acquisition to make sure that they keep growing their AUM base. So there's also an external factor that is adding to it that actually might have from the market not growing in the last year.

Louis Diamond:

And for some of our listeners, they hear a wide range, I think most folks they hear eight to 14 or, six to eight, or whatever the range is, and immediately you latch onto the higher number. But you and I know that's not always the case. From all the valuations you've done, what makes folks tilt toward the upper end of the valuation ranges versus ones that are at the lower end?

Brad Bueermann:

Yeah. Great question. And it goes below eight, by the way. So I think that most of it has to do with the transformation of are we selling at one end of the spectrum where selling an enterprise, something that has been built, has structure, has growth, has consistency. It has strength of revenue. It has strength in terms of the demographic spread of its clients. It's established a niche in its marketplace that is defensible and reputationally strong.

Those are the blue ribbon firms. And those blue ribbon firms are the ones that attract the premium. At the other end of the spectrum are people with a book of business. They're an advisor and they might have two or three helpers, or they are two or three different advisors each who are operating in more or less a siloed fashion, but they are shared services and shared marketing. They're roommates, if you will.

At that end of the spectrum, we're going to see pricing which probably want to switch from EBITDA because EBITDA becomes less meaningful in companies where everybody takes the profits home, in that particular scenario, we're probably looking at multiples of gross revenue and in multiples of gross revenue, we're probably talking somewhere between two and a half times revenue to maybe a low or to a high of three, maybe a pair over.

So it really depends on, first of all, whether we're even talking about a company that has a defensible bottom line, defensible cash flow, and the consistency of that cash flow, or whether we're talking about somebody who has built a very credible practice and that practice has steady clients and now has partners that want to leave and they bundle it together and sell it. Still, those are attracting great values, but you have to switch your frame of reference in order to price it.

Louis Diamond:

So, Brad, it does seem like there's the subject development of valuations, which is how much is someone willing to pay? There's always going to be someone who might pay more than the next person, which is outside of the seller's control. But for those listening to this thinking about how do I maximize my value? I want to be at the upper end of the range if I sell now or in the future, what are a couple of things that they can think about or work on to kind of take away and try out in the lab to bolster their enterprise value?

Brad Bueermann:

Absolutely. So we have an approach that says, do this first. Start with understanding where your value is. Don't guess at this. Valuations are not expensive. It's something that you should have done and you should use valuation as one of your KPIs. So we start with valuation. The next thing is you need good benchmarking. One of the things that FP as a result of doing 15,000 valuations is that we have data on 15,000 advisory firms.

So we can help with looking at where somebody is benchmark wise, and we benchmark a lot of different things. If we look at efficiency, we look at profitability per client, we look at the growth rate in terms of your clients, and you look at the efficiency of how many clients per advisor and what's the cost of doing that. What you want to do is say, "Where am I compared to my peers? And then where am I compared to a firm that is twice my value?"

Because that's the starting place, what do I have to change? And it's usually a lot more than simply saying, "Well, let's just grow revenue or let's just grow AUM and hope revenue grows as well." It has to do with creating and looking at and then setting goals around the KPIs that the business can accomplish. And by setting those in place and having them be realistic, i.e. tied to benchmarks of what your peers in the industry are doing, that'll set you on the right course.

Louis Diamond:

What are some examples of these KPIs that someone can look to?

Brad Bueermann:

Sure. One of the things that you need to look at is how your pricing compares. Oftentimes that pricing is a factor. You're looking at what the client base is and how you could potentially change the client base over time. If you're bringing in clients, are we targeting the right clients? Are we bringing in those that will impact the AUM and revenue from a growth standpoint?

We look at a lot of different expense ratios. Where are you spending the money? Most of the firms way underspend in certain areas. Marketing is one of them. Oftentimes how what they're paying in terms of their key staff is sometimes lower than what it needs to be not higher. Those are factors that you need to bring into play.

I mean, does that affect your growth? Absolutely. It affects the motivation. Marketing affects what is coming in the door, the amount that you're spending on outside consultants, on bringing in consultants to help you with marketing, to help you with client development. What are you spending on technology? Is that technology spend in line with what your competitors are doing?

Valuation Expert FP Transitions: On M&A, Growth, and Maximizing Enterprise Value

A conversation with Louis Diamond and Brad Bueermann, CEO, FP Transitions.

There are a lot of different things that you can point to. What you need to understand is each firm has strengths and it also has weaknesses. The trick is how can we build on those particular strengths and accelerate them while trying to patch or at least ameliorate the weaknesses that might be in there? And there are literally so many different ones.

Our consultants will sit and go through a benchmarking report and spend hours going through and looking at each one and discuss each one of those KPIs and how it can be changed. We are sending them to outside consultants to help with the specifics around each one of those points to say, "Could this be better? What could be done on your technology? What could be done on your marketing efficiency? What can be done to do a better job of recruiting talent and retaining the talent that you have?"

Louis Diamond:

Got it. Yep, I think that makes great sense. That's what people want to hear. So what can I actually do to take action and make improvements and fund my business and then ultimately when they look to sell or monetize, or transition internally to set themselves up for success. Brad, let's do three more questions. We'll call it Brad's hot takes on a couple of, I think, interesting questions or maybe myths about valuations in the industry.

The first one is, do you believe there's a difference in valuation between, let's say, the same business that have the same KPIs that operates as an RIA, meaning it's their own ADV without any sort of broker dealer, a hybrid RIA, meaning their own RIA plus a broker dealer affiliation, and then a practice that sits on an independent broker dealer's platform, whether it's Northwestern Mutual or LPL Financial or Cambridge.

Do you believe there's difference in value between those three businesses, the exact same business on those three different operating platforms?

Brad Bueermann:

That's a hot seat question. The answer to the question is really that ultimately the values in each one of those platforms can be the same, but when you look at the cost structures of those, those are very different kinds of businesses. What I would say is that when you look at the cost differentials between a platform business and a totally independent business, that there are those platform costs that are associated with it. Are you getting leverage for that?

If you're getting leverage, then those platform costs are not going to impede in any way your value. As a matter of fact, they could increase your value. It's really that ultimately as we set a goal, it's very, very hard to say, "Hey, if I take a company with $750 million AUM and I place them in each one of those three buckets that you named, which one is going to be worth the most?

I think it's kind of a false question. I think the better question is if you have all three of those in those three different buckets, which one is going to get to a billion dollars faster and will that billion dollars be close enough between the pricing on those three platforms to make it worthwhile? I think that the pricing will evens out between them and that the real question is, "Are you in the right place to continue to accelerate your growth?"

Louis Diamond:

I'm with you. How about this belief that I think it was Mark Hurley who's a pioneer or a visionary in this field of valuation and RIA acquisitions. And also Mark Tiebergien the former head of BNY Mellon/ Pershing.

Brad Bueermann:

Great character as well.

Louis Diamond:

Absolutely. He's hilarious. But the prediction is that similar to the accounting profession, that there's going to be lifestyle practices and then the mega firms, the big four public accountancies, and then everyone else pushes to one side or the other, or grows extinct. Do you believe that the only two categories are firms are going to be lifestyle practices and then the mega cap firms?

Brad Bueermann:

Yeah. Mark and I would tangle with that over and over and over. My answer is a real succinct one, I think that we are not going to experience back to the future. Remember, wealth management came from that world. We came from the world where there were giant players, Wall Street firms that controlled most of wealth management in the United States. And we split it apart into independent businesses. And now we're in the process of the universe starting to come back together again.

Will the aggregators do well? I think, yeah, absolutely. Is there a market for those kinds of national type branded services? Absolutely. Will we end up with 25 name brand RIAs across the country? No chance. And here's the reason. The reason is what is the benefit to clients? When we take an analogy, if you look at the P&C world where you have the property and casualty insurance agents, for example, there was a huge amount of consolidation in that industry and it's continuing to go on.

It had a very similar analogy that it had private equity that poured into that marketplace, got behind aggregators in that, and those aggregators gobbled up independent P&C firms all over. And to an extent, they now dominate that particular market. There's still lots of independence, but the concentration has been impressive over that period of time. But there's a big difference. When you concentrate a P&C firm, you have pricing.

In other words, they're able to help consumers or at least the customers of the firms that they take over by offering effectively a better value prop. If you have a better value prop, if you are offering better pricing, better services, better whatever, and those services that pricing those services, those things can't be offered by your smaller competitor, then the market is going to tend toward larger.

But in the wealth advisory space, what is it that a large wealth advisor can offer to a client that a small one can't? There's a list, and I've heard the list many times and we're going to say access to product and we're going to say technology, and we're going to say diversity of services and lots of other things that go with it, but the base level of service actually doesn't change a whole heck of a lot.

Pricing doesn't change very much, if at all. Sometimes it goes the other direction. And so given those factors, it's does scale really have an advantage? And that's what everybody has to discuss. But I think that you are going to still continue to see strong independent practices, but they will need to transform themselves into businesses because they are competing against businesses. So anybody that does that, I still think it's an open running field.

Louis Diamond:

I think that's the perfect place to end here. It's an open running field, and if you want to keep staying relevant, you have to keep working at your business and transforming it from a practice into a business because your competitors are only getting stronger. I completely agree with you, Brad, that I do think it's maybe a little bit bold to say that there's only going to be these two categories, these kind of small lifestyle practices and the mega firms.

I do think this industry was built on innovation and creativity and individuality, and there's certainly a place for mid-size firms who don't really want to tilt on either end of the spectrum. So I'm with you. Brad, this has been enlightening and really interesting to hear how FP has gone through its own transition, how that relates to your M&A clients and how FP has really played a critical role in the development professionalization of M&A across the industry.

So look forward to the next time where we can dig a little bit more. I'll come up with maybe 10 to 15 hot take questions for you. So be ready. Brad, and this has been amazing and we really appreciate you taking the time today.

Brad Bueermann:

Great. Louis, I really enjoyed it. Your questions were great and I'd love to get together again.

Mindy Diamond:

Brad shared a wealth of advice for those looking at the future of their business with an eye toward growth and maximizing value. But the real takeaway lies in his comments around what makes the best transaction. And that is one where it is a win-win between the buyer and the seller. That is a transaction where both sides of the table walk away happy. I thank you for listening, and I encourage you to visit our website diamond-consultants.com and click on the tools and resources link for valuable content.

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You can feel free to email or call me if you have specific questions. I can be reached at 973-476-8578 which is my cell or my email, mdiamond@diamond-consultants.com. Please note that all requests are handled with complete discretion and confidentiality. And keep in mind that our services are available without cost to the advisor. You can see our website for more information.

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