EPISODE TRANSCRIPT

Industry Update on M&A: If You Build It, Will They Buy It?
–Part 2 of a 2-Part Series with Louis Diamond

Mindy Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is an industry update on M&A. If you build it, will they buy it? It's part two of a two part conversation with my partner Louis Diamond. I'm Mindy Diamond, and this is Mindy Diamond on Independence.

Mindy Diamond:

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Mindy Diamond:

In our last episode, Louis and I talked about the continuation of the super active M&A market. And no doubt, it's hard to ignore the headlines, which exclaim high valuations for the sale of wealth management businesses of all sizes. So, when advisors get to a point where they're thinking about their future, whether they are reviewing their firm's retiring place program, considering another firm's recruitment deal, or feeling the tug of their entrepreneurial spirit and desire to be a business owner, the idea of building something that can sell on the open market is appealing.

Mindy Diamond:

But simply building an independent firm doesn't guarantee the high multiples you may be seeing other firms garner, nor does it mean you will attract acquirers with deep pockets. So, what can a prospective business owner and even those who currently own their own independent businesses do to be attractive to acquirers and garner the highest valuations?

Mindy Diamond:

In this episode, Louis and I explore the different paths one can take when building out of firm and some pitfalls to be aware of. Plus, share some real world examples of breakaways whose firms were recently acquired. So, let's get to it.

Mindy Diamond:

Louis, thanks again for continuing the conversation with me.

Louis Diamond:

Most definitely. Again, lots to talk about, so let's get to it.

Mindy Diamond:

Okay. I'm on it. So, I guess let's start there. Who are the buyers?

Louis Diamond:

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Yeah, so I think in prior episodes, we've either interviewed many of these serial buyers in the industry or we've talked at a high level about the different types of buyers. So, without getting into the nitty gritty specifics, because there are so many different acquirers out there, I'll first point to four or five different categories of buyers, just to give a preview of who might buy your business at the end of the day. There isn't really a one-size-fits-all approach to what category is the best, and it's not always obvious what's going to be the best fit for your business. It's much more based upon your goals, your outlook for the business, your underlying business and it's size, and also what you're most trying to accomplish.

Louis Diamond:

So here's a couple of examples of types of buyers in no particular order. First, would be a platform acquirer is what we would call it. So these are firms where you're joining their RIA and they're buying a minority or up to a majority stake of your practice. You're still keeping some cash flow and ongoing profits interest, and you're keeping your brand and your investment approach and your unique way of operating. But what you're getting from the platform is capital, is compliance, operations and their scale, and the ability to take some work off your plate. Hightower advisors would be a really good example of this, and many of our listeners are familiar with Hightower.

Louis Diamond:

Another type of buyer would be a private equity investor or a financial buyer. So these would be firms that invest directly in an RIA, so you'd have to build your own ADV and likely build a very successful and relatively large business to garner the attention of one of these platforms, because really what they're looking for, in addition to return on their investment, is a platform that they can put capital behind and then have that firm or platform go out and complete sub acquisitions.

Louis Diamond:

So, if you're looking at this as a succession deal or your business just isn't large enough or isn't attractive enough to be a hub for additional recruitment and acquisitions, this type of buyer may not be the best fit. But similar to the platform acquirers, the unique part of this is they don't really want to get involved with how you run your business, so you can keep your own form ADV, you can keep your own infrastructure, your brand, and your value proposition. You now just have more capital to reinvest in the business or to use it, to take chips off the table. Examples of the would be Focus Financial Partners... is the largest and most prolific financial backer in the industry and kind of created the category for RIAs. You also have Bain and Blackstone and many other private equity firms. Parthenon Capital. There is way too many to mention, but a lot of interest from these folks that get into the space.

Louis Diamond:

Next category of buyer would be a national acquirer, some would call them integrators, some would call them roll-ups. There's a lot of different terms. But these are firms like Mercer and Mariner and CAPTRUST and Wealth Enhancement Group that do many, many deals a year, and they've built the platform that has a very unique value proposition on its own. They solved for organic growth. They all have lead development programs. They all have many different services that firms being acquired can tap into. And they're all backed by major private equity money. So these firms certainly take over everything from compliance and technology to branding, to investments in many cases. So, once you settle these firms, you really just have the responsibility of servicing your clients. Most every other function is taken away, which some would see as a negative. Some would see it see as a positive.

Louis Diamond:

These firms too, because of their scale, and because they can find synergies in a lot of areas, they do tend to be in the higher end of the valuation scale because they know how to grow these businesses, they have more control over how it grows, and there's cost synergies that they can find in the deals.

Louis Diamond:

Two other types of buyers, they're really similar, but just their scale is different. One would be a regional acquirer, so similar story to the national ones we just talked about, but these are firms instead of having a national footprint, they're focused on one or two states, or they want to build scale, but they're not trying to be all things to all people across the country. They want to focus on the Midwest for example.

Louis Diamond:

And then lastly would be more of a local firm merger. So this would be more of a like-minded firm, it could be a friend who shares a similar business methodology as you do, and you have two firms that are either subscale, maybe one needs a succession plan. The other one's younger and you can solve some of each other's issues and a rising tide lifts all boats. So, this is attractive because you get to have more of a direct input into the future of the business. The downside though is local firms tend to not have as much capital as some of the larger ones and sometimes firms like this, getting together, you just make your problems somewhat worse, because now you have double the problems. So, two subscale firms come together, now you have double the amount of problems because now you're still not of scale and you may still not have the requisite capabilities to compete with some of these larger firms.

Mindy Diamond:

Okay, so that's a dizzying set of options and it's especially dizzying because, I mean, I'm in this business more than 25 years now and many of these are just... Forget about the firms weren't around as acquirers, but the categories weren't even there. So, how would an advisor who's thinking about becoming a seller... So how would a business owner thinking about becoming a seller, what questions would they ask themselves? What are the things they need to think about in order to determine which category of buyer is right for them?

Louis Diamond:

Yeah. One of the first ones is what activities or functions are most important for you to retain control over versus what do you want to relinquish? So, most advisors would probably say, compliance or technology, but many would not be comfortable parting with their brand or their investment approach or their planning methodology. So depending upon those answers, that will skew which end of the control to autonomy spectrum, if you will, you may fall. So I think that's that's the first one is what do you want to keep control over versus what do you want to relinquish?

Louis Diamond:

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Another one is financially, what are you looking to accomplish? Do I want it to be more of a merger where I get equity out of the transaction? Do I want it to be an all cash deal? Do I want to keep more upside earning potential for myself? These again are important questions because it will determine which type of buyer makes the most sense and there's many, many more. We've developed a proprietary M&A assessment that's available for download on our website and we'll include the link in the episode page description, but that assessment takes you through probably 30 or so questions that will help determine if you're ready for M&A, but also if you are, what type of buyer makes the most sense? So, that's a resource that I'll offer up to anyone.

Mindy Diamond:

That's awesome, so let's move forward then. If you are building an independent practice today, either you're an employee and thinking about breaking away or you're already a business owner, what are some of the things you'd recommend to keep in mind so that your business will be most attractive in the eyes of the best buyer or acquirer?

Louis Diamond:

Yeah. So the first thing is to begin with the end in mind. I think it's Jim Collins that can coin that phrase, which is brilliant, and that's definitely the case here. So, even if a sale is 15, 20, 30 years on the horizon or may never be on the horizon because you want to bring family in and just transfer it to generation and generation. If you build your business using the playbook of what acquirers value most, it's never going to fail you. So what I mean by this is thinking about if I were to sell my business, what would be the positive and negative attributes that an acquirer would take from it? So, some of the things that acquirers look for, and this will determine what end of the multiple scale you're on and even just who's going to be interested in the business.

Louis Diamond:

I'll give you a couple of characteristics. One would be a next generation team, so other than the G1 advisor, is there a next generation that works with clients and that can be slotted in should the first generation advisor either leave the business, retire, or God forbid something happens to them. So multiple generations and having different age gaps, but also folks with different time horizons within the business. That's one area. Another one would be a cohesive service model with everyone rowing in the same direction. So instead of having 15 different practices where one person is picking stocks, another one is allocating to alternatives, another one works with mass affluent, another one works with ultra-high-net-worth; these are firms that have one comprehensive service model that is going to provide a similar service or offering to any client that comes to the door. The reason this is attractive is because it's scalable and it's repeatable and it takes away some of the risk because there's confidence that everyone is kind of doing something similar.

Louis Diamond:

Another big one, this might even be the number one in the list, is organic growth absent market returns. So, a buyer not surprisingly would much prefer to pay more for a firm that's going to keep growing. So, having proof that you're able to bring in new households and grow the asset base, and you're not just relying upon the S&P 500 to go up is of major importance. And this is one of the first questions a buyer would ask as part of a data gathering exercise.

Louis Diamond:

Another attribute would be multiple avenues of growth, so that there's a diversification of growth. So, it's great to have a repeatable business development approach, let's say it's referrals from CPAs. But a buyer would also like to see other areas of growth, whether it's we have a very strong social media program or we do paid advertising in markets or we target doctors and we get a lot of referrals from them. So, having multiple ways that you can grow in addition to just kind of your normal bread-and-butter referrals from existing clients is really important. And this can also be extended to firms that have grown strictly by mergers and acquisition and recruitment. So, while that is attractive and it's tough to pull off deals and that is a very viable way to grow, that firm would be more attractive to a buyer, if not only were they able to successfully buy and integrate firms, but that they can also grow those firms organically, so you're not just relying upon buying in order to fuel the growth of the firm.

Louis Diamond:

And then the last one I'll mention... There's many more, but just to kind of keep it simple, and this concept is K.I.S.S., keep it simple, stupid. Somewhat tongue in cheek, but it's important. A business that's simpler and easier to understand is going to be more valuable. So there's nothing wrong with being a firm that's big into alternatives and hedging strategies, and does all of these really interesting things for clients. The harder part is it's going to be really hard to find a compatible buyer. So, businesses that are more streamlined, the investment approach is easy to understand, it's duplicatable and the service model is duplicatable, is going to pay dividends because you can attract more buyers for the business.

Mindy Diamond:

That all sounds great. And in fact, we've interviewed several investment bankers throughout this podcast series that have talked a lot about the things that business owners can do to impact growth, and who and what makes them most appealing, and we'll be showing links to some of those episodes as well. But what's the downside? So what are some potential pitfalls to thinking about selling?

Louis Diamond:

Right. So beginning with the end in mind, I think is a sound strategy for really anyone at any phase of their career or their business' life cycle. The downside though is if you're so laser focused on we're building this thing to sell is, one, you can lose your uniqueness. So, while I said, businesses are more valuable if they're simple and more streamlined, you don't want to do that at the expense of what makes your firm and your process unique. So, you don't want to standardize everything so that you lose the high touch nature of your firm, or you lose your ability to win business in the marketplace. Or if you're looking to recruit and acquire, that you lose what's going to make you stand out from a crowded field.

Louis Diamond:

Another downside would be focusing on the money and losing sight of why you are in business in the first place. And that's to service clients, it's to provide a career path for your team. You could fill in the blank for what's most meaningful to you. If you focus on the dollars and cents, you sometimes can be blinded by the joy of running the business. So, I think a better way to think about it is do the right thing and the money will follow, and I think that's the right order of operations. Nothing wrong with focusing on the dollars and cents, but there is a little bit of danger to that.

Mindy Diamond:

Yeah. And the truth of the matter is that there are many examples of independent businesses that are very comfortable and have no interest in ever building enterprise value or looking to sell. It's a lifestyle practice, they make good money, they're very comfortable and very happy with the services that they provide, and while everybody and anybody might think about selling one day, it's not their raison d'etre. It's not their reason for being, it's not what gets them out of bed in the morning. So I think it begins and end with what's most important to you. What we're talking about is how to impact enterprise value in a positive way, if doing so is important to you.

Louis Diamond:

Absolutely. I completely agree. And put another way, you make it more about you than your clients. We talk about all the time when positioning a transition to clients, there's a lot of reasons why it might make sense for you or your team, but it's harder to take a step back and say, what's in the best interest of the client? Same thing here with building your firm for a future of sale. If you just build it and strip out what makes it special, then your clients suffer. So again, focusing on the right things, and I think good things happen.

Mindy Diamond:

So let's go back then to the business owner that is interested in boosting enterprise value, are there certain supported, independent platforms that can help with doing so?

Louis Diamond:

Yeah, so take a step back to find what we mean by supported independent platform. So these would be either service providers or vendors or RIAs that advisors who either haven't ran a business before or who want to run a business but don't want to deal with the middle and back office, can opt to outsource certain functions to. So, guests we've had on the podcast that would be in this category would be LPL, Strategic Wealth Services, Sanctuary Wealth Partners, Dynasty Financial Partners, and many more.

Louis Diamond:

An advisor may choose to partner or affiliate with one of these models when they're transitioning, because they want to stay focused on the transition and they don't want to deal with many of the... say, the non-core functions of running the business. But the other piece of this is how can these platforms actually help the business improve its value? So, I think there is a very clear answer for how these platforms can help the business boost its value.

Louis Diamond:

I think one of the first things is a good platform and the right relationship is going to allow the business owner to focus on organic growth versus being in the weeds and being a full-time business operator. So that goes back to the concept of focus on organic growth and that's a characteristic that buyers enjoy. Another one is these platforms tend to be very good at sub acquisitions. So sourcing potential recruits and acquisitions, structuring the deals and providing capital. That's another nice way to grow. Another way would be they make you more efficient; so they have scale, they have best practices that can make your practice more efficient than just trying to figure it all out on your own. And then lastly, they have a community of advisors who can share ideas, and also might be a built-in acquirer for your business. And an extension of this concept is the platforms themselves actually can be an acquirer for your business at the end of the day.

Louis Diamond:

So aside from the network of like-minded folks around the country, who could be a potential buyer, or you can buy them in the future, the platform itself may be interested in acquiring; either buying a portion of the business or buying the whole thing. And of course you have the option to sell in the open market afterwards. So, enterprise value is top on the list of what these supported platforms can provide, but at the same time, they're also relatively expensive, so if you're not going to get the benefits out of the platform then they could be a drag on your P&L, which could also impact your valuation. So there's trade offs, but I think the folks that lean into the services that the platforms provide, they're going to grow faster, they're going to be more efficient, and they'll tap into a very wide universe of buyers at the end of the day.

Mindy Diamond:

And how about an independent broker dealer practice, meaning an advisor who chooses to go independent and practice under a broker dealer umbrella. Do those practices have similar valuations at the end of the day to an RIA?

Louis Diamond:

Yeah. Very fair question. So I would say it really depends. A practice that's independent under a broker dealer has a ton of value. They own their clients, they own their data. In most cases: they have a brand, they have a process, et cetera. So those businesses would be valued in a very similar way as an RIA. The reason why it depends, though, is depending upon the broker dealer that you're at, there is a finite pool of potential buyers for the business. So let's say you're at a more boutique broker dealer with 500 advisors, they're spread around the country. So that you don't have to repaper the business in transition, the likely pool of buyers is going to be folks that are a similar size or larger than you, are probably within a certain geographic proximity, and who are affiliated with the broker dealer. So just by virtue of that, you're going to have less bidders or suitors for the business, and also probably less access to capital than an RIA would.

Louis Diamond:

On the flip side, though, there's plenty of independent broker dealers that allow advisors to operate as RIAs or to move on to an RIA platform without repapering. In that case, there's ample buyers. And you also have the ability, if you're an independent advisor, to move the business to another platform in the future, you would have to transition, but you're still unlocking similar value as an RIA would. So it really depends, supply and demand somewhat comes into here, and if there's more suitors for the business, there's seemingly a higher value. So that could be the key a with a practice under a broker dealer, but it does depend. We've worked with many larger independent practices that leave their broker dealer in order to solve for succession, but got a very similar multiple as an RIA counterpart would have.

Mindy Diamond:

And for more on the topic, so we don't belabor it here, we've done several episodes talking about the differences between the independent broker dealer in RIA spaces and things to think about in each. So again, we will link to some of those on the episode page of this episode as well.

Mindy Diamond:

One more question. So, what about finding or identifying a partial acquirer on day one? What are some of the pros and cons of that, and can we talk about any examples?

Louis Diamond:

Yeah, so what I assume you're talking about is if I'm an advisor at fill-in-the-blank firm, and I'm interested in transitioning to independence, but I either want liquidity to buy out a partner. I want liquidity for my succession plan. I want liquidity for de-risking the transition. Or I just want to have a strategic partner that can help me with the transition, but also help me through mergers and acquisitions in the future. I believe that's what you are talking about, so there are a lot of benefits to that. I just mentioned a couple of the use cases, mostly around succession, but some also thinking more about future growth.

Louis Diamond:

The downside of this approach is a business in transition has less value than one that's a steady state practice or firm. There's transition risk, so any acquirer would either pay a discount or structure the deal to kind of share the risk.

Louis Diamond:

Also, if you're breaking away, presumably most of the time you're doing, because you want to capitalize on your growth and you want to get the highest possible valuation at the end of the day. And if you sell a portion of your business, you typically are selling that component of the business into perpetuity, so you are limiting some of your upside earning potential. But for many advisors, it's a very lucrative path, and one even that may have enabled them to go independent when they couldn't have before.

Louis Diamond:

So a couple of examples, I'll share some representative breakaways, also, folks that happen to have been on our podcast in the past, but also the types of firms that they partnered with. One example would be Gerry Goldberg, his firm GYL Financial Synergies in Connecticut, broke away from Wells Fargo [inaudible 00:24:11] in 2016, and they sold the portion of the business to focus financial partners, since then, they've done a number of sub acquisitions. So in Gerry's case, and he shared it on the episode, it wasn't about retiring, it wasn't about getting rich in the transaction, it was more about having a partner to help fuel the growth into the future, and they've done that through acquisitions.

Louis Diamond:

Another example would be Monish Verma, who sold a portion of his business to Summit Financial. Monish was a $350 million UPS advisor in the transition to Summit, who's a supported independent platform. He opted to sell 20% of his business and had a very interesting liquidity option at the end of the day with that platform.

Louis Diamond:

Third example would be Melissa [inaudible 00:24:55], who [inaudible 00:24:56] Focus Financial Partners as well, in 2018, left Merrill with about a billion in assets. And that was in the episode, she shares it. It was for liquidity, it was to have money to reinvest in the business, and it was to fuel the growth of the business into the future.

Louis Diamond:

And then finally would be John Klaas, his company Puzzle Wealth Solutions left UBS in June of 2021 with about $1.2 billion in assets. He's leveraging the Gladstone Wealth Partners platform in conjunction with LPL Financial. And with that model, he opted... my understanding at least... to not sell a portion of the business today, but there is an interesting monetization aspect at the end of the day. So a lot of different ways to go about accessing liquidity day one. One example, aside from forgivable loans and debt would be sell a portion of the business.

Mindy Diamond:

So, lots of different options, and there's so much more to talk about, and I think we will probably wind up doing a part three to this series as we get more questions about it. But the biggest thing, and to conclude, is will the frothy M&A market continue? Of course, no one knows for sure, but real potential exists for those with their site set on building a business that could be attractive to an acquirer and command a high price tag at the end of the day. There is one thing that is certain, and that is success is more likely to come to those with clarity of vision and the desire to build something bigger than themselves.

Mindy Diamond:

So Louis, this was awesome, and I thank you once again for joining me and look forward to continuing the conversation.

Louis Diamond:

Absolutely. This was a fun one. And again, we have a number of resources. We have this M&A assessment. We have tons of articles we've written. And if you're interested in just understanding your valuation or how your business might be valued as an independent, definitely feel free to reach out, and confidentially without cost, we can walk you through an exercise.

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Mindy Diamond:

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. You'll also find a link to subscribe for regular updates to the series. And if you're not a recipient of our weekly email perspectives for advisors, click on the articles linked to browse recent topics. These written pieces are an ideal way to stay informed about what's going on in the wealth management space, without expending the energy that full on exploration requires.

Mindy Diamond:

Feel free to email or call me if you have specific questions, I can be reached by cell at 973-476-8578 or by email at 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.

Mindy Diamond:

Again, if you enjoyed this episode, feel free to share it with a colleague who might benefit from its content. And if you're listening on the Apple Podcasts app, I'd be grateful if you gave it a star rating and review, it will let other advisors know it's a show worth your time to listen to. This is Mindy Diamond on Independence.