EPISODE TRANSCRIPT

Everything You Need to Know About Independence

A conversation with Jason Diamond.

Mindy Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is, Everything You Need to Know About Independence. It's an industry update with Jason Diamond. I'm Mindy Diamond, and this is Mindy Diamond on Independence.

This podcast is available on our website, diamond-consultants.com, as well as Apple Podcasts and other major podcast platforms. If you are not already a subscriber and want to be notified of new show releases, please subscribe right on your favorite podcast platform or on the episode page on our website. For Apple Podcast users, I'd be grateful if you'd give the show a review. Your input helps us to make the series better and alerts other advisors like you who may find the content to be relevant. And while you're at it, if you know others who are considering change, or simply looking to learn more about the industry landscape, please feel free to share this episode or the series widely.

The notion of independence has driven more intrigue and movement in the wealth management world than any other concept or model. Because as you've heard us say it many times before, the desire for greater freedom and control amongst advisors continues to grow, and as such, so have the options to satisfy their quest. But while independence has become a more mainstream path for advisors considering change, we find that many advisors are still not completely aware of the options available in a continually evolving landscape. And even more so, many top folks wonder if they can equally or better serve their clients without the support of a large firm and a big brand name behind them. Yet in conducting due diligence, these same advisors often find out that there's a wide array of options available for those who have a desire to become business owners.

So in this episode, our goal is to get everyone up to speed on the independent space. I've asked Jason to join me to answer the many questions that many of our advisor clients ask us during their exploration process. We'll dive into the different flavors of independence and the varying degrees of support available, as well as the potential benefits to clients and the ability to serve them. Plus we'll discuss why so many advisors are foregoing the short term windfall of a recruiting deal and instead opting to bet it on themselves and much more. It's a quick yet thorough education on the space that's rocking the landscape. There's lots to discuss, so let's get to it. Jason, thanks so much for joining me today. I'm excited about this conversation.

Jason Diamond:

Yeah, likewise. Thanks for having me. I'm thrilled to be here.

Mindy Diamond:

Okay, so most advisors, whether they are perfectly content where they are and certain that their firm or their current model is the very best place to practice, are at least curious about why advisors they respect are leaving their firm, or probably more specifically why advisors they respect are moving toward the independent space. They don't get it. Why would they leave for no upfront money? Why would they leave when there's so much money to be made in the short term? Why would they bet it all

on the long term? So what I want to start out is asking you that most advisors are pretty familiar at this point with the traditional options in the independent space, the notion of leaving Merrill Lynch to join Wells Fargo FiNet or leaving Morgan Stanley to go to LPL. But what they may be less familiar with is the notion of supported independence. So let me start out by asking you this, why was supported independence born? What was it born to solve for?

Jason Diamond:

Yeah, it's a great question. So I think maybe taking a step back, first I would say you hit the nail on the head. It's not that every advisor coming from a wirehouse ultimately lands at an independent option. It's just that increasingly we're seeing these top sophisticated advisors at least consider it or at least curious about it and want to understand more about, tell me everything that independence means or could mean. And you're right that most advisors tend to be familiar with to use your terms, the Wells Fargo FiNets and LPLs of the world, which we would consider the independent broker dealers, but that's not the complete picture of independence. So I think it's important for us to understand some context, which is that historically an advisor who wanted to be independent had really two routes. They could have gone that independent broker dealer route via one of the LPLs of the world, or they could have started their own RIA with very little support.

They were probably working with a third party asset custodian. Maybe they hired a consultant or a few other thought leaders, but that was really the extent of the support they were receiving. And for a lot of top teams, even if the notion of starting and running their own RIA was attractive, that was just a bridge too far. So enter the supported independence space, it's essentially firms or platforms or service providers that help advisors get from here to there. If here is a wirehouse or a traditional firm model and there is owning and operating and running their own independent business, that's what these service providers or supported independence platforms were intended or created to do.

Mindy Diamond:

So, makes sense. And we know that before they existed, there were a lot of advisors that were interested in independence but couldn't or wouldn't consider it because as you said, it was a bridge too far. So maybe let's take three minutes and walk us through what does the independent landscape or the waterfall of possibilities within the independent space look like today?

Jason Diamond:

Yeah, I think that's probably a good place to start and we can sort of hit on the pros and cons of each of the buckets or each of the flavors of independence as we go. So just to review, if we think about the independent options from sort of the most restrictive models to the least restrictive models, we would start with the independent broker dealers. The independent broker dealers are going to feel more familiar to most advisors, A, because some of the names advisors will be familiar with, but B, because it sort of continues that all resources under one roof sort of mentality that they're accustomed to at say a wirehouse or a regional firm. Continue to use LPL as an example because they are the largest

independent broker dealer, an advisor affiliates with LPL, they are independent, so they own their equity, they own their data, but they're still leveraging LPL for asset custody, for investments, for technology.

So it's not as true open architecture model. There are absolutely benefits to that model. Chiefly, a lot of advisors like having everything under one roof, right? It's nice not having to sort of shop the street. And while that perhaps restricts or limits your freedom and flexibility in some ways for a lot of advisors, that's worth the trade-off. The other thing is that many independent broker dealers offer transition capital in some capacity. It's not wirehouse money. So it's certainly not the 300% give or take that an advisor might get from moving from say, Merrill Lynch to Morgan Stanley, but it can still be, call it 40-70% of an advisor's trailing 12 months production. So a nice way to sort of de-risk the move. So that's the independent broker dealers. As I said, skipping ahead to the sort of most flexible or the most free model that would be just starting your own RIA from scratch, and it's sort of the opposite or the antithesis of the independent broker dealer space.

It's you have control over every single moving part. You are the CEO and the COO. You have to put toner in the copy machine, you have to choose your tech stack, your investment platform, your real estate, your hardware, your software. So every moving part you have control over. And the pros and cons of that space are really the same answer. It's two sides of the same coin. The pros are, yeah, it's great that you get maximum control, you can choose every single piece of software and every single thing that goes on your investment platform. But the drawbacks are for many advisors, as we said, that's a bridge too far. People don't want to have to vet 20 different CRM softwares. You really have to have an entrepreneurial spirit and sort of know that that's what you want for that to be for you. Most advisors who want to pursue or consider that route kind of know it straight out of the gates.

And the other piece of it is not only is there no upfront capital, obviously because you're really starting your own firm, it can cost a fairly capital intensive amount of money upfront to set up your business. So that leaves us with the third and final bucket, which as we mentioned in the beginning, supported independence. You'll also hear them referred to as platform firms, which are effectively these firms that help advisors to launch and run their independent businesses. In some cases that means launching their very own RIA. And in other cases that means joining the service provider or the platform firm's RIA, but operating an independently branded, independently run independent business underneath that sort of umbrella. So effectively what you're doing is offloading the minutiae or the day-to-day headaches of running a business. The service provider or the platform firm is providing compliance and middle and back office support and taking sort of various pieces of the day-to-day business running off of your plate in exchange for a revenue override.

So the benefits are you look and feel an awful lot like an RIA owner, right? You look and feel an awful lot like somebody who runs their very own independent business because you are, but you're just paying a fee to offload a lot of the headaches. In some cases, these sort of platform or independent firms will indeed provide transition capital in other cases they will not. But it's a really nice middle ground

between, call it the limitations or the restrictions of the independent broker dealer space and the bridge too far too much choice space in the do-it-yourself create my own RIA model.

Mindy Diamond:

Okay, that's a lot and really helpful. So let me ask you a couple other questions to unpack it further. So back to the independent broker dealer space, is it a space where a lot of top teams go? So if I am the senior advisor on a team that's generating $7 million in annual revenue and managing say a billion or more, am I more likely to consider the independent broker dealer space or the RIA space in any of its forms?

Jason Diamond:

Yeah, it's a fair question. And while I hate to give sort of a blanket answer, I will say that generally speaking, most top sophisticated teams in the industry feel like the independent broker dealer space is not independent enough, excuse the expression, or it's maybe perhaps not sophisticated enough for their needs. And there's a couple reasons for that. One is those limitations I mentioned that there's this notion that they'll outgrow the model in some period of time, maybe not right out of the gates, right? Maybe if you're coming from a wirehouse, for starters, the independent broker dealer space maybe just fine, but a couple years down the road, you might feel limited by the inability to choose all of your software or to customize your investment stack.

Another major area where we'll see concerns from top teams is compliance. When you go the independent broker dealer route, you're using their compliance to sort of regulate or govern your business. And many teams have spent their entire career sort of trying to get away from that model. So typically the largest and most productive and most sophisticated teams in the industry tend to move more towards those latter two buckets I described, either creating their own RIA or launching an independent business akin to an RIA with the help of a supported independence firm or a platform firm.

Mindy Diamond:

Thank you for that. So it begs the question then, and it's probably a good time to ask the question, what then are the benefits of the RIA space for both the advisor and his or her team and their clients?

Jason Diamond:

So from the advisor perspective, it's maximum freedom and control over every single thing that they do. So that would certainly include their suite of technology. That would certainly include their investment platform. And most importantly, perhaps, or I think what most advisors would say, most importantly it's compliance. So when you own or run your own RIA, you're responsible for making the compliance decisions. No one is telling you, Hey, you can't communicate with your client in this way, or you can't hire John Smith or you can't buy X, Y, Z business. That notion is a little bit different when we talk about some of these supported independence firms because they are indeed handling compliance for you in many cases. But typically those compliance regimes are much less sort of stringent and rigid and much more flexible and nimble than the traditional firm world. So that's one of the big things.

Another piece of it is you can't have this conversation around independence without thinking about M&A. Both the ability to buy businesses as an independent business and the ability to sell your business at day's end and both of those exercises, both of those activities are certainly easier as you get away from the independent broker dealer space. Maybe I shouldn't say easier, but maybe I should say more lucrative, meaning your pool of buyers and sellers is much more unlimited in the RIA space. And one of the main reasons for that is because as I mentioned, broker dealers custody assets typically in-house or perhaps they leverage sort of their version of a custodian's offering like at Fidelity NFS as an example. Most RIAs use a major third party custodian like a Schwab or a Fidelity. So, if and when an advisor wants to buy or sell other businesses, it's much easier to do so in the RIA space than in the independent broker dealer space.

When you think about client benefits, because I think oftentimes that's sort of what gets lost in the noise of this is that okay, it's easy for me as an advisor to understand why I'll be happier if I leave the wirehouse world. Let's set economics aside, but it's easy enough for me to understand that if I leave the wirehouse world for any of these versions of independence, I will probably be happier because I just don't have to deal with the pressures to cross-sell or the management bureaucracy or the really rigid compliance organizations.

But what about from the client perspective? And that's where I think advisors are often surprised pleasantly about the benefits of independence is how much clients really notice that influx or that proliferation of choice and open architecturenness. Because most advisors will tell you that they're much better able to serve clients in the independence space. They're not limited to one set of investment products. They can shop the street like an institutional client can. Their advisors are able to communicate with them in a much more nimble and real time kind of way. So a lot of times what we'll hear is, look, I knew this move would be good for me as the advisor. I don't think I realized how much my clients would notice and appreciate the change. And that's really ultimately what I think is most exciting about independence.

Mindy Diamond:

And how do clients of independence typically respond to, I'm giving up the advisor, I'm giving up the name brand name Merrill Lynch or UBS, which my clients are certainly familiar with, and I'm going to start Diamond Wealth Management, which obviously no one has ever heard of. How do clients reconcile that?

Jason Diamond:

This is probably one of, if not the single biggest concern that any advisor has when considering a move to independence is that my firm's name brand has value, or at least I perceive that my firm's name brand has value, clients know and like the name Merrill they know and like the name Morgan Stanley, even Raymond James, RBC, right? Those name brands have real value to them. I think what we are overwhelmingly seeing is that not to oversimplify, but clients perhaps just care less than advisors think. I think, A, clients tend to be fairly loyal to the advisor to the point where we've heard stories where

clients don't even necessarily know the firm that the advisor's at when advisors go to tell them that they're making a move. Sort of funny stories like, oh, you're leaving Morgan Stanley for JP Morgan? I thought you were already at JP Morgan.

That's one thing. The other thing is that it's important to remember that the assets when you're in this RIA space do not sit. So to use your example of Diamond Wealth Management, the assets are not sitting at Diamond Wealth Management. The assets are sitting at a massive institutional custodian. Again, typically Schwab or Fidelity or Bank of New York Pershing are sort of the big three players in the space. So it's this separation of safe asset custody investment products and advice that really makes the independence space interesting. I just hate to oversimplify, but I think overwhelmingly what we're seeing and hearing is that clients just value the work they do and trust their particular advisor and the name brand is perhaps just not as important as it once was.

Mindy Diamond:

Yeah, I actually agree with that. I think that that's absolutely right, that as long as the advisor who's done good work for the clients remain the constant, clients actually appreciate this model, which is the model that was started many years ago for ultra-wealthy multi-billion dollar families in the family office space. So I think it resonates and you're right. Let me ask you something else. So what are some of the economics of ongoing independence? What does net payout typically look like? How much does it cost to start an independent business and how do you get access to capital depending upon which model of independence you choose?

Jason Diamond:

Well, that is a big topic and there's a lot of sort of ins and outs to it. I think first and foremost, it's important to understand the distinctions between the independent broker dealer space and the RIA space when we talk about ongoing economics, because I think we kind of have to tackle them separately. So quickly to touch on the independent broker dealer space, that model is probably the model that's more familiar to advisors where the independent broker dealer, like I said, will offer something in the way of transition capital. So that's one way to sort of monetize the business. Again, it's not going to be life-changing 300% of trailing 12 money, but it's something. And then on an ongoing basis that independent broker dealer charges some form of a revenue override or a platform fee or both, or occasionally they'll also layer on some admin fees and tech fees and custody fees.

But the punchline is that you start at a hundred percent the broker dealer deducts their charges and then from that number you have to pay your local expenses. So things like real estate and human capital, that's the independent broker dealer space. The RIA space is the true pay for what you need and leave the rest model. So it's really à la carte, where you're starting at a hundred percent payout and you're just paying for every piece of software, every service provider, every vendor that you need. We'll talk a little bit in a second about where you might expect to net out in both or all of these models, the supported independence space that we've referenced falls somewhere in the middle. It's more akin to the RIA space in that it tends to be a little bit of an à la carte pricing model, but the service provider or

the platform firm is typically charging some form of revenue override for all those things that they're taking off your plate for compliance and middle and back office support.

So it's usually either an override on revenue or they'll charge like a basis points on assets fee. That's the ongoing economics piece. I think the punchline is that almost regardless of which model you choose after local expenses and after paying either the broker dealer or the service provider, you probably net out again all in somewhere in the range of 60-70%. A well-run independent business should probably net out and call it the mid-60s, which is presumably higher than almost any advisor is making in a traditional model. So that's one thing is you sort of have to be a little bit long-term greedy because the important thing to keep in mind is any advisor who considers this is foregoing a 300% check from a traditional firm. So one is the ongoing economics will typically look better in the independence space than they would in the traditional firm world.

To answer your second question, which I think is honestly probably the more impactful of the two of how to monetize along the way, kind of a couple different ways to do it. One is, as I said, some of these firms provide upfront capital, so that's probably the easiest. The second is there are banks that will provide working capital loans. That's not many advisors' preference, especially in an environment where rates are going up. But I think it's a more attractive opportunity for many than the third option, which is selling equity. And we can talk a little bit about sort of equity or RIA, M&A valuations and what it means to sell equity, but a lot of particularly advisors who are just getting out of the gates or have a lot of runway ahead of them, they don't love the idea of selling equity, but there's a really robust market for independent business ownership right now, which means that advisors who do need to take chips off the table and sell a portion or all of their business are able to do so in a lucrative way.

Mindy Diamond:

So one quickie question about that, we are going to spend a good portion of time talking about M&A and valuations and buy-side and sell-side economics of this. But what about the question we get often, I am an advisor or I run a top team at pick any traditional broker dealer, let's say UBS, and I am thinking about going independent. Are there acquirers that might be interested in buying my practice or my business out of the gate, and is that a smart thing to do?

Jason Diamond:

The short answer is maybe. Could we find you a private equity firm or serial acquirer or a large RIA who's willing to take a shot at buying your business straight out of the traditional firm world maybe/probably, right? I'm certain that you could find somebody who's willing to buy, that assuming some success in client portability. But the reality is it is almost never the economically most rational or the best economic decision. And here's why. You as the advisor would be selling your equity at a nadir, at its low point because you have zero proof of concept. You're not running and operating an independent business. You're basically asking a firm to take a leap of faith that you'll be able to move clients over and that you'll be able to ultimately run a successful independent business. So while you might be able to find a buyer, it will certainly be at a discounted valuation.

I think it's important to note that there is absolutely a middle step whereby, let's just use your example, you're an advisor who works at UBS. Step one is launch and run your independent business. Again, regardless of how you choose to do that, whether it's an independent broker dealer, whether it's by starting your own RIA from scratch or by leveraging one of these supported independence platforms, that's step one, proof of concept, run and operate your independent business. Step two then down the road is sell either a portion or all of your business valuations will be much more attractive at that time and the pool of buyers will be much more unlimited at that time.

Mindy Diamond:

Yeah, I agree with that and I think it was an important topic because we get asked it a lot and in the end, I don't know that we've ever seen it happen, although we've had many people interested in it because in the end they find what you just said, that the valuations are at a low point until you've established a business with a real runway.

I want to get to the conversation about M&A, but I do think there are a couple of things worth talking about. We talk about the fact that when advisors go independent today, a lot of times or more often than not, it's via some model of supported independence. So we know that one thing they can do is hire a transition consultant and there are more and more of them to help them make that transition, but more often than not, it happens via leveraging some model of supported independence. So maybe we could talk for just two minutes. What are some examples of some of the top models of supported independence and what do they do?

Jason Diamond:

Yep. It's a great question. So just really quickly want to make the distinction that you just brought up, which is an important one. So the difference between a transition consultant, which is, quote unquote, "supporting your independence" and these supported independence models that we're referring to is that the transition consultant is hired exclusively for the period of transition. Maybe it's a couple of weeks prior and a couple of weeks post transition, but then the relationship terminates. These firms that we're talking about and that you're asking about now are ongoing relationships. So they help with yes, the transition, but then the relationship sort of stays and they provide various functions post-transition as well. Some examples that advisors may know just from being in industry press and having success in recruiting, mainly wirehouse teams, firms like Dynasty Financial Partners or Sanctuary Wealth Partners, there are countless new entrants into the space every day.

LPL recently launched a model maybe two or three years ago now called Strategic Wealth Services, that sort of their version of supported independence. Kestra, which was an in or which is an independent broker dealer, launched a version of supported independence called PWS, Private Wealth Services. So there are many new entrants into this space, and what they provide varies. I think that's honestly what's most exciting is that you as the advisor have the choice. What areas of my business do I want to offload? What do I not enjoy? And there are probably platform providers or supported firms that help with that. So one common answer you'll hear is I have zero interest in securing my own real estate. Well, to use an

example, Kestra Private Wealth Services will actually secure the real estate on behalf of the advisor. Thus, sort of taking it off the advisor's plate.

There are some advisors who don't want to do investments anymore. They want to sort of give up investment autonomy to a central CIO type office. And there are models that do that. But in most cases, in almost all cases, what they're providing is some version of compliance. There are a few notable exceptions to that, and then this ongoing sort of middle and back office support where things like interfacing with the custodian if there's an issue, so you're using Fidelity to hold your assets, but you're having a hard time sending a transfer, how do you sort of rectify that, right? There's no Morgan Stanley branch support to contact. So all of those little kind of minutiae that most advisors find frustrating and honestly not the exciting parts these platform firms will provide. And the goal is let the advisor be an advisor, let the advisor talk to clients, prospect for new business and manage money in some cases and let us handle everything else.

Mindy Diamond:

Okay, so now I'm feeling a little bit overwhelmed and I'm saying that tongue in cheek because as I'm listening to you talk about it, I know how many options there are, how robust this ecosystem born to support the breakaway advisor has become in the last decade or so. And if I feel overwhelmed by it, it's hard to imagine how overwhelmed an advisor must be as they sit either happily or unhappily at their firm thinking about what they want to do next. How do they go about discerning not only which model of independence they want? Is it independent broker dealer? Is it supported independence? Is it do-it-yourself independence, which supported independent model, et cetera, et cetera. But should I stay or go? What are the questions I should ask? So how do we break it down? If we're talking to an advisor, how do we help to make it less overwhelming? How do we help them to determine what comes next?

Jason Diamond:

Great question. So I had an advisor the other day say to me he was going to use a dart board, and I don't recommend that approach. Little bit of a shameless plug here, but honestly, I think this is a lot of the value we add. Of course, some of it is just here's what the options are, but okay, now you've told me the options. How do I determine what is the right bucket or model or option for me? And the answer is via a lot of questions and a lot of trial and error. So we will curate effectively a list of questions, things like how important is upfront capital, how important is maintaining investment autonomy, how important is self-branding? And all of those answers will help us to come up with, using our years of industry knowledge, what is first and foremost, what's the right bucket or the right model? And then from there, within that model, what are the right firms to consider?

But we are never going to come to an advisor with just one option. I honestly think that's almost never the right approach, even if we're pretty clear that one option is going to be the front runner or the favorite, this has to be an exercise in compare and contrast. And a lot of times what advisors will do is they'll say, okay, I know that creating my own RIA is a bridge too far. I don't want that, but maybe the independent broker dealer space makes sense for me. So let me look at two or three independent

broker dealers and get a flavor for the space. But simultaneously, maybe this concept of supported independence or these platform RIA firms makes sense to me. So let me look at one or two or three of those.

And then it's a iterative process. It's a living document, a living list. So you'd say, okay, I just met with two independent broker dealers and two of these platform supported independence firms. I hated the two independent broker dealers. That's great. That's helpful feedback, not a waste of time. Now we can go deeper in the supported independence or platform space. That's sort of how we approach the process.

Mindy Diamond:

Right. And this episode is primarily about kind of demystifying the independent space, the questions we get asked every day by teams as they begin to think about their options. But it's worth mentioning that while this conversation is focusing on independence, that one of the reasons why boutique firms like Rockefeller or First Republic, for example, and many others are doing so well, is because many advisors who look at any of these versions of independence whom we have these conversations with and certainly understand the benefits of independence from better payout to more autonomy and more control and self-branding and easier messaging and all that other stuff, it feels any version of independence feels like a bridge too far for them. And so one of the things we say to people is that the most exciting thing about just the industry landscape today overall is that it's not just one size fits all. It's not if I don't like my firm, my current firm, the only other option is to go to another firm within the same model or bucket. There are many other options as well. Do you agree with that?

Jason Diamond:

Wholeheartedly. And that's I think where we started, which is that this conversation is not to suggest that every sophisticated or big or any advisor chooses independence. It's merely to suggest that advisors typically know less about this space, and most advisors are curious about this space. They're seeing the headlines in advisor hub and in investment news, and they're at least curious about it. Many choose though this is still a bridge too far, this ultimately isn't for me, and ultimately end up that a First Republic or a Rockefeller or even another wirehouse.

Mindy Diamond:

Yes, I agree wholeheartedly. All right, so I want to spend some time now talking about the M&A impact or the concept of M&A within the independent space because many advisors, when they begin to assess stay versus go, and if I go, where do I go? And if I go, do I want to be an employee or do I want to be a business owner? Do so because they begin to evaluate or think about the ability to add M&A or inorganic growth to the mix. So let me first start out by asking does every independent minded advisor want M&A? Or said another way, do you need to have a desire to do M&A to acquire or sell to be a successful independent?

Jason Diamond:

Yeah, it's funny, I laugh a little bit when people say, "Do M&A", because it doesn't specify a direction, it doesn't really specify. Are you talking about the act of buying or acquiring businesses or the act of selling your business at day's end? And it's an important distinction, so let's tackle them separately. Let's start with selling your business at day's end. Look, I understand that for a lot of advisors, that's sort of a nebulous concept that's years down the road, but you have to at least place some premium or some weight in the notion that you'll be able to sell your independent business at day's end for a significant multiple. Because otherwise, frankly, the math often just doesn't make sense. You're better off taking a 300% check from a wirehouse. Again, that's thinking about it purely from an economic perspective, but the point remains, you have to place some weight in the ability and it's real that you'll be able to monetize your business at day's end.

The pool of buyers is robust right now. Everybody wants to buy well-run independent businesses. That's the reality of why we've seen multiples really take off. It's buyers like private equity firms, it's these roll up or sort of mass acquiring RIAs, it's smaller, regional or local RIAs, it's minority investors. So there really is a robust ecosystem of buyers. I think, yes. I think when advisors say to me, I have zero interest in selling my business, I don't care about it, independence becomes a little bit of a harder conversation because just when you talk through the math, it's hard to overcome the 300% in transition dollars that a wirehouse is offering. As an advisor, you have to assign some weight to the ability or the notion that you'll be able to sell your business for a meaningful multiple at day's end or the math often just doesn't make sense. And we'll talk a little bit about how and what numbers you could assign as an example to selling your business and what valuations might look like after this.

Mindy Diamond:

Right. So let me ask you a question about that. A lot of the advisors that say, I will never want to sell my business, I want to create a multi-generational legacy that will succeed me by many, many years. What they really mean is I will at some point when I retire as the senior leader of the firm want to unlock my liquidity, want to create a monetization event for myself, but I don't have an interest in selling it to an outside buyer. I want my next generation, my staff, my team, my partners to be able to buy me out. How do those folks who don't wish to sell to a third party monetize their investment or monetize their life's work?

Jason Diamond:

Yeah, good point because that's a totally fair response. In fact, I think many business owners or many independent advisors would say exactly that. It's not that I want to sell to a PE firm, but maybe I should have said it better, is that you have to have some confidence in the ability to take your chips off the table and monetize your life's work at day's end. And the answer is that there are just countless creative capital solutions that your next gen inheritor can employ to make you whole, to provide you with liquidity.

In some cases that's taking a loan from a bank. In some cases that does mean they will have to sell an equity stake. Maybe it's a minority stake, but an equity stake in the business just to unlock the liquidity

to be able to pay you as the retiring advisor out. But in other cases, and this is what I think is exciting about the independence basis, you don't have some massive financial organization telling you how to structure your glide path. So you can get really creative with the length and the timing and the structure of your buyout. And maybe that just means that your next gen is going to be paying you out via the earnings of the business for a longer period of time.

Mindy Diamond:

So I want to come back to valuations when the owner of a firm decides to sell. But let's pivot or let's back up a second and talk a little bit about buy-side economics. So what does it look like when after a year or so of getting their sea legs of being independent, the owner of an independent firm says, I think there's an opportunity to recruit or acquire. Who do they acquire? How robust an opportunity is it? How does it work? What does it look like?

Jason Diamond:

So this is probably my favorite question and it's the question that almost every advisor asks along the way, and this one is a little bit less cut and dry than the selling at day's end. Not every independent business owner is interested in recruiting or acquiring businesses, and that's fine. We'll talk a little bit about why recruiting and acquiring makes your business more economically attractive and why adding assets and revenue really amps up the math when it comes time for you to sell. So I think from an economic perspective, every independent business owner should want to acquire or recruit, but the truth is it's really hard. I mean, I mentioned a handful of who the potential buyers are.

It's just super competitive to buy independent businesses because most of the deal flow gets done by a handful of firms who do this for a living day in and day out. Firms like Focus Financial or a number of other sort of private equity firms in the space that do the lion share of the deal flow. Also, a number of large RIAs that have sort of gotten a reputation as serial acquirers because they're constantly buying up smaller RIAs, but it is doable. Oftentimes what it means is one of two things. Either you as the independent business owner will hire advisors underneath you. That I think of as a little bit less of an M&A exercise and more of a traditional recruiting exercise whereby you're probably just putting a junior advisor sort of on a payout. Maybe you're offering them some equity in the larger enterprise, maybe you're offering them some cash up front. That's a little bit less of a traditional M&A exercise, which I think of as John runs an RIA down the road, he manages $100 million in assets, my RIA is $500 million in assets and I'm going to buy John's business.

And that conversation, we can sort of tackle both sides of the math equation at once of what does it look like, and how do you value that business? But the truth is it oftentimes that the hardest part of that exercise is sourcing the lead flow just because it's such a competitive market to buy other businesses. So it's something that should be on every independent advisor's radar. They should always be on the lookout for these opportunities. Firms like ours can help to source these opportunities, but it is competitive and I do like to set those expectations.

Mindy Diamond:

And I think that it's worth noting that very often, not all of the time, but very often when an independent firm decides they want to become acquisitive and they want to do it not just as a one-off but become real players in the acquisition game, because as we're going to talk about next, they see the power of inorganic growth. Very often what they will do is look to take on a capital provider, at that point, either selling to a minority investor or merging with another firm or something of the sort because that minority investor or partner can be helpful not only in giving them capital in order to be able to be an acquirer, but also to source the opportunities

Jason Diamond:

And the expertise of how to structure and close the deal as well. Yeah, very good point. Very well said.

Mindy Diamond:

So let's pivot then to the notion of how does becoming a buy-side acquirer impact overall valuation, and how does it work?

Jason Diamond:

To tackle that question, let's take a step back and let's just talk about what are valuations, and what does it look like when an RIA or an independent business owner wants to sell his business at day's end. So this is all illustrative examples. Quick back of the envelope math, the old adage of your business is worth what somebody's willing to pay for it is very much true, but just for example, purposes, let's talk through some math. So the first thing to keep in mind is that oftentimes wirehouse advisors think in terms of trailing 12 months revenue, which is really top line revenue. That's not the metric by which independent businesses are typically valued. So remember that what a firm that's looking to acquire really cares about is profitability, right? Is how much your firm is actually making.

So we'll take top line revenue and we have to strip out sort of two buckets of costs. The first is just regular old expenses. So I used the example before that a well-run independent business should net out at 65%. So right out of the gates, we're taking a 35% haircut on our revenue. Right now we're at a 65% sort of take home, but even that 65% is not the number on which a multiple will be applied or not the number on which independent businesses will be valued. Because what a buyer's going to say is, that's great that you want to sell your business, but I'm still going to have to pay you Mr. Advisor to service those clients. Or if not, if you're going to retire, I'm going to have to pay somebody to service those clients. So a lot of times what you'll hear is replacement cost, where on top of those expenses we laid out earlier, a buyer will also strip out replacement costs or FA comp.

Typically, that's approximately another 30% of revenue to arrive at the number that they will apply the multiple to. You'll sometimes hear it called EBITDA. So in my example, if we're going to strip out 35% for our expenses and then another 35% for FA compensation, we're left with 35, excuse me, if we strip out 30% for FA compensation, we're left with 35% of revenue, which will be the number will apply this EBITDA multiple to. So to keep the math fairly simple, if we assumed a $10 million top line revenue

business, in my example, that's $3.5 million of EBITDA and a $10 million revenue business, I think reasonably could expect to fetch a 10X EBITDA multiple. So we would take that $3.5 million, we'd multiply by 10. So I think it's reasonable to expect, in my example, there basically a $35 million valuation on the business. Now that analysis assumes no growth either organically or inorganically. Where I think it gets really exciting is when we start to talk about growth either via M&A or just organic growth via your existing client base or prospecting.

Mindy Diamond:

Okay, so what does that look like? Let's make it somewhat tangible by using an example. So use that same $10 million firm who now decides to go out and acquire one firm, one business. What does that look like?

Jason Diamond:

So let's just assume that the business they acquire adds an additional $3 million in top line revenue. So we can use my exact same math. So now my $10 million business is now a $13 million business. Let's assume that we're still operating at 65%. That may or may not be true, but let's just assume that it's true for the purposes of this. So that means that our sort of after expenses revenue number is $8.45 million. But again, we have to now strip out, let's call it 30% for advisor compensation. So if we're going to take our $13 million, 30% of $13 million is another $3.9 million in advisor compensation. So if we take our $8.45(mm) and subtract $3.9(mm), that leaves us with an EBITDA of $4.55 million. Now, there's two things here that we could think about as a sort of theoretical valuation on this business. One is we could assume that same 10X multiple.

So even if we assume that same 10X multiple, because we now have an additional $1.05 million in EBITDA, our business went from being worth $35 million to $45.5 million. So we've added another almost $10 million in business valuation by only adding $3 million in revenue because of how the multiple works. But the other piece that's worth noting is that in all likelihood, because we've now grown, that multiple that somebody's willing to pay for my business will also increase. So maybe now instead of being valued at 10X, I'm valued at 11X EBITDA. So now I have $4.55 million of EBITDA at an 11X multiple. That's over a $50 million valuation. You can see how the math quickly gets more compelling the more you're able to grow.

Mindy Diamond:

And that example is based upon doing one acquisition. What does it look like if you do multiple acquisitions?

Jason Diamond:

That math just quickly spirals to the point where we've seen some eye-popping numbers, and it doesn't just have to be acquisitions. A lot of times when people think about their independent valuation, they're thinking about their revenue number as they sit right now. But remember that that interim step we talked about where you're thinking about your $10 million business at a wirehouse, but you're going to

go and be an independent business owner, or you're going to launch your independent business, and let's say you're going to run that business for 10 years, in all likelihood, you're going to grow organically as well. And that organic growth will absolutely also translate to a higher multiple and a higher EBITDA number. So anytime we can assume growth, it's going to massively amplify that valuation.

Mindy Diamond:

So it is worth saying here that whenever we talk with someone who is considering independence, we honor and acknowledge the fact that in the short term, the math is not all that compelling. Yes, you're getting a higher payout, a higher net payout over time, and that's worth something. Yes, absolutely. You are probably enjoying work more, you have more freedom and control. You've got more of the things we've been talking about here. But if the only thing you're looking at is the short-term economics of independence, it likely won't be compelling enough. But where it begins to get interesting is when we begin to talk about this part, and I bring that up I think because it's important to note that not everyone who goes independent does so because they want to become acquirers, because they want to exponentially increase acquisition.

There are plenty of advisors that start out, I just want to be independent because I want more freedom and control. I don't want to be vulnerable anymore to compliance, et cetera. But almost always over time, the notion or the opportunity to really impact valuation because of buy-side economics or M&A becomes pretty compelling. But let's talk then about, so now you've built this enterprise by both organic and inorganic growth. You've had more fun along the way, and now I am a senior advisor, I want to retire at some point. I want to either sell my business internally to my team, my next generation, whatever it is, or I want to sell it to a third party. Who are the buyers?

Jason Diamond:

So I think the best way to think about who are the potential buyers is in buckets or categories. So the first bucket is these national acquirers. You'll also hear them called roll-up firms. These are the firms that you probably see most commonly in the news because they are prolific, they do a lot of deals, they're very good at it. They're buying businesses constantly. Firms like Beacon Pointe and Mariner, perhaps worth noting Beacon Pointe into in and of itself has an equity backer. So they took an investment from KKR, I believe it was last year, and that valuation was rumored at I think over 20X. So you can see how these massive RIAs achieved some pretty astronomical valuations. So national acquirers or roll-ups is the first bucket.

The second bucket, which is somewhat similar in that these firms are in and of themselves, RIAs is regional RIAs. They're probably more like partnerships or maybe mergers of equals as opposed to acquisitions. So this is the example of there's an RIA in the suburbs of Philadelphia that's looking at another small RIA in the suburbs of Philadelphia because there's synergies, there's commonalities in client base, and they can achieve some economies of scale. So these buyers are not as prolific in terms of the number of deals they do, but some sellers prefer that because they think that type of buyer will resonate more with their client base as opposed to selling to some massive financial entity.

And then the last bucket is equity investors. We can kind of further sub-buckets equity investors into minority or majority investors. So minority investor is an example of a firm called Merchant buying approximately 20% of an RIA or of an independent business. It's a great way for an independent business to unlock some liquidity but to maintain operating control. And then majority investors, we gave the example of a Focus Financial, HighTower is another example in this bucket whereby they're buying on some cases 51% of your business or in some cases a hundred percent of your business, and the deal structures will vary, but the gist is they are financial buyers. They're less sort of strategic buyers.

Mindy Diamond:

Okay. So it's pretty clear how exciting it can be, but you and I were on a call just the other day with an advisor that runs a pretty significant team, and he asked us an interesting question, which is, so if I go independent now or a year from now, have I missed the boat? Are there still opportunities to acquire smaller firms? Are there still opportunities to be acquired at day's end by some of these prolific acquirers?

Jason Diamond:

So I don't have a crystal ball, so I'd be lying if I gave a 100% concrete answer. Either way, my gut and my experience tells me that while valuations may sort of ebb and flow as market conditions ebb and flow, there's always going to be a robust market for well-run quality independent businesses, both on the buy-side and the sell-side. And I think this sort of continued consolidation or this continued benefits of economies of scale, we're going to see now for some time where a lot of these smaller firms are going to continue to sell their businesses because there's just benefits to being bigger in this space, pricing, client service, synergies. So I would be hesitant to say, yes, 1000% this robust M&A activity we've seen is going to continue and you will absolutely be able to sell your business at day's end. But I would be shocked if we saw this activity cease in its entirety.

Mindy Diamond:

While there is a whole lot more we could say on the topic, I think we've given our listeners a pretty good overview of the kind of topics or the kind of conversations we have with advisors when they call us and want to really understand the space. Much more to come, we've covered a lot of these topics also within the interviews we've done with the hundreds of breakaway advisors we've interviewed. That's been a privilege and a gift, and we will continue to do so. But Jason, I want to thank you so much for joining me. This was so much fun.

Jason Diamond:

Thank you. This was a pleasure. Really enjoyed being on.

Mindy Diamond:

While we certainly covered a lot of ground in this conversation, every advisor, their business and their clients have unique needs and goals. And that's why as part of our process, we work with advisors to get

clarity around those goals as part of their due diligence process. With a complete vision on how you will best serve your clients and grow your business, the path forward becomes much clearer, whether it be with your current firm, a traditional model, or independence.

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 link to browse recent topics. These written pieces are an ideal way of staying informed about what's going on in the wealth management space without expending the energy that full on exploration requires.

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