EPISODE TRANSCRIPT

Bourbon, Real Estate, and Golf Courses: How Innovations in Investments, Training, and Client Service Built a $9.4B Business

A conversation with Gary Furukawa, Founder, Senior Partner and Erik Morgan, President, Senior Partner at Freestone Capital.

Mindy Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is Bourbon, Real Estate, and Golf Courses: How Innovations in Investments, Training, and Client Service Built a $9.4B Business. It's a conversation with Freestone Capital's Senior Partners, founder Gary Furukawa and President Erik Morgan. I'm Mindy Diamond and this is The Diamond Podcast for Financial Advisors.

This podcast is designed for advisors like you, who are interested in learning more about the evolving wealth management industry through candid dialogue with breakaway advisors, those from the C-suite and industry thought leaders. It's available on our website, diamond-consultants.com, as well as Apple Podcasts and other major podcasts platforms. So be sure to subscribe and share it with your colleagues.

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What does it take to thrive in the ultra-competitive wealth management world? Sure, it's about customer service and delivering on expectations. And of course, having access to the best platform and technology stack helps. But for those in the multi-billion dollar range, it's well more than that. Their success is often driven by innovation, thinking well outside the box to create unique solutions around how they serve clients, train their teams, build their businesses and even manage investments. For Freestone Capital's founder Gary Furukawa, it all starts and stops with one core concept. We're here to solve problems for clients, period. A self-proclaimed risk-averse person, Gary admits that launching an RIA firm might not have ever happened if his 1995 angel investment in Amazon hadn't left him financially set. Yet, life at Smith Barney made him realize he could do things differently outside of the brokerage world, that clients could and should be first above all else.

So in 1999, Gary launched Freestone Capital. A self-finance firm he built from the ground up, a much harder endeavor than he imagined. Erik Morgan joined in 2000 after working in the private client services group at Arthur Anderson. Erik's goal as president was to help to lead the firm's growth initiative. And it proved to be a dynamic combination that propelled the Freestone team from $250 million in assets under management to over $9 billion today. But it's their secret sauce you need to pay

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attention to. Like their intense drive to serve what really matters most to clients. Their initial focus on organic growth before hiring experienced advisors. Their scalable training program for new college grads to ensure a consistent experience. Their management structure and perspectives on succession. Their novel approach to investing, serving as a direct private equity investor. And it's the latter that you'll find most interesting as their roster of investments includes golf courses, real estate and even barrels of bourbon. But you have to listen in to learn more about that. Gary and Erik are here to share the details with Louis, so let's get to it.

Louis Diamond:

Gary and Erik, thank you so much for joining us today.

Erik Morgan:

Thanks for having us.

Gary Furukawa:

Yeah, great to be here.

Louis Diamond:

Well, I'll ask this question to both of you, which everyone wants to start. Can you walk us through your backgrounds and how you became advisors in the first place?

Gary Furukawa:

Yeah, sure. This is Gary. I was a accountant, a CPA, at the old Deloitte Haskins & Sells, and a friend of mine was a stockbroker and I'd only been there a year. And it just sounded like what he was doing was way more fun than what I was doing. So I left Deloitte and joined EF Hutton 14 months after I graduated from college and was a retail stockbroker for a long time until we started Freestone in 1999.

Louis Diamond:

Very good. And we'll get into the EF Hutton and Smith Barney and your motivations to leaving and going independent. But maybe Erik first, if you want to share your background before we get rolling.

Erik Morgan:

Sure. Mine is not that much different than Gary's. I graduated from college, took a job with Prudential, what I thought was Prudential-Bache at the time, turned out to be Prudential Insurance. That lasted about six weeks, took me that long to figure it out. Then was fortunate enough to come across a company by the name of the Rainier Group, a small RIA here in Seattle that focused on working with owners of private companies. I did that for a number of years, then was recruited away to Arthur Anderson and then had the good fortune or misfortune, depending on how you look at it, of hooking up with Gary in 1999, 2000.

Louis Diamond:

Yeah, definitely an interesting time to come into the RIA world during the, I guess, the beginning of dot-com boom. So Erik, I'll pose this question to you. To help frame the discussion today, can you tell us about Freestone? Its value proposition, assets under management and size of the team, even just the high level stuff?

Erik Morgan:

Sure. I'll just hit the highlights really quick. As far as our assets under management, we're about, call it $9.4B, $9.5B, depending upon how you want to calculate that. We have roughly 100 folks. I think one of the things we're very proud about as an organization is that we've really specialized, we have people that are focused exclusively on clients, people that are focused exclusively on investments, on operations, on planning. So we've really built out a robust full team that's designed to take care of clients. When I think about what Freestone does today and what we bring to clients, the way I like to look at it is that we're really firm of no excuses. You can come to Freestone and receive fantastic planning work, fantastic estate work, tax work, philanthropic work, concierge, consigliere and investments. All of which you can get here and really have, world-class gets overused a lot, but I really do believe for the clients between $5 million and $100 million dollars, we really are a differentiated opportunity for them.

Louis Diamond:

Yeah, I would agree that Freestone does have a differentiated value proposition. And we'll spend some time going through the particular elements that you mentioned and how specifically you go to market to service your clients. Before we get into some of the motivations for founding Freestone, I'm curious, Gary, as the initial founder of the company, did you ever imagine or vision that you'd have over 100 employees and be close to $10 billion in assets when you founded the company?

Gary Furukawa:

No. I always believed I would be successful and the firm would be successful, but actually when we started the firm, my original idea was I didn't want to grow at all. So no, I didn't think we'd be where we are. And now that we're here though, I like it. So it's all worked out great.

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It's always an interesting question because some advisors or business owners, they have that vision or that desire to be $100 billion, to be the next Morgan Stanley or UBS. While others, it seems more like you, where they do one thing after the other, it snowballs, and before you know it, you're a wild success. So I'm always curious just about the mindset. Speaking of mindset. So Gary, this question will be for you. You were with EF Hutton and then you went to Smith Barney. Can you just talk about what it was like working for those two firms prior to starting Freestone?

Gary Furukawa:

Yeah, sure. EF Hutton was super fun, very pro stockbroker kind of place. It turned out, I didn't know this because I was young, but it wasn't very well run. So I started there in 1982 and in 1987 we had a stock market crash and the firm almost went under, EF Hutton almost went under. And that was the first time I realized, oh, the firm actually isn't very well managed. It was such a fun place to work, and that was a Wild West, cowboy era of retail stockbrokerage anyway. So a neighbor of mine and a guy that went to the same high school as me, he was the manager of the Smith Barney office in Seattle and so he recruited me to leave. And actually the whole office left pretty much because the firm was a sinking ship. And so then we went to Smith Barney.

Louis Diamond:

If you could remember back this far, so you left Smith Barney in 1999. What motivated you to want to leave Smith Barney? We'll get into the separate question of starting an RIA, which was very unexpected back then. But what were your motivations for considering leaving Smith Barney in the late '90s?

Gary Furukawa:

I loved working at Smith Barney. Actually, I love being a retail stockbroker. I love the whole thing. But I realized, and I'd ask my managers this all the time, "Why don't we track how the clients are doing? We always tracked how much revenue we were generating and commissions and things like that." And they would just look at me like I was from Mars. In 1995, I made an angel investment in Amazon.com. I was investor number five. And by 1998 I realized I was going to be financially set.

So I started thinking, I love what I'm doing, but the way we do it here at a big wirehouse, it doesn't really make sense because the client's not first, everything else is first. Mostly our revenue that we were generating from the clients, but it made no sense to me that we didn't put the clients first. So I thought that if we just had a firm where the client was first, and we always thought that would be really successful because I didn't really see anybody doing it. And so that was the motivation to leave Smith Barney and the motivation to start an RIA. I would've never done it had I not had the Amazon money because I'm very risk-averse and it would've been too scary for me. And I was doing great at Smith Barney, so why leave? So that was the catalyst to start Freestone.

Louis Diamond:

Wow, investor number five in Amazon. That was not what I was expecting you to say. And it's such an interesting origin story because that is something that a lot of advisors grapple with is, I'm doing well, I'm growing. How do I justify the risk? But being able to take the risk issue off the table, you got to just sit back and say what's best for the client? And I would assume too, where am I going to have some fun? So do you think if it wasn't for Amazon, as we're recording today in 2024, do you think you would've still been at Morgan Stanley or Smith Barney and gone the RIA route? It's hard to think like that, but if the Amazon investment hadn't happened, do you think you would've stayed at Smith Barney for much longer?

Gary Furukawa:

Yes, I think I would've. I was making a lot of money and I was having a lot of fun, and by then I had four kids, so I didn't really want to put myself out to do something like this. And starting Freestone was awful. It was hard and we didn't have the infrastructure that we do today to start an RIA. Everything was on your own, you just had to figure it out. And for three years after we started Freestone, I regretted it. I would come home every night and talk to my wife and say, "Yeah, I probably should have stayed. This is a lot of work." I wasn't getting paid, I didn't take a paycheck for three years, I was putting lots of money in the business. And it's just a stark reality that when you work for a big firm, you don't realize how much they're doing for you. And when you start an RIA, you realize, no, you're doing all that, you have to do it and you have to figure it out. And we did. But it was tough for the first three years. Very tough.

Louis Diamond:

Yeah, I would like to think that today advisors have it decently easier when they're considering going independent because of all the infrastructure providers, the advancements in technology, and even how much more helpful the custodians are with launching businesses. But back in the late '90s, I would guess you probably can count on one hand or maybe one finger, how many people you knew who had broken away from a major Wall Street institution to go independent. So I'm curious, how did you even learn about the RIA channel? It was certainly not on the radar of most advisors or brokers back then.

Gary Furukawa:

Yeah, I think we had talked to Schwab and Schwab was emerging at that time to service RIAs as well. But it was very early days, everything was very rudimentary. I just think of the stuff we used to do. Gary

Smart, one of the guys I started the business with, bore the brunt of the operational stuff, and he was really good at it. And the whole firm was built on spreadsheets. Yeah, we had just lots of spreadsheets and it was very manual. And I just laugh now when I look back at what we had to do. Much easier today, still hard, but much easier than it was. And so yeah, I'm pretty sure I would've stayed at the wirehouse had I not had the Amazon event because I'm risk-averse and was doing great, so why take the risk?

Louis Diamond:

I get it. And I'm curious, when you launched the business, how much in assets did you have and how many people did you bring with you from Smith Barney?

Gary Furukawa:

I had a team of five that worked with me at Smith Barney and they all came with me and we started with $250 million in assets. And my original plan was I was just going to run my own money. And I had a $550 million book at Smith Barney, but I only took the clients that would fit in the new model because a lot of the clients at Smith Barney were commission clients and they didn't fit in a fee-based model. So I basically took $250 million and thought that I'd just run my own money, take my favorite clients with me, and that was going to be it. But after about six months, my five employees came to me and said, "Hey, look, if you don't grow the business, there's no opportunity for us. So we want you to grow the business." And I said, "Oh, okay." And so I stumbled onto Erik and he was our growth engine in the early years.

Louis Diamond:

I like that. So it was the threat of employees walking out the door if you didn't grow that catalyzed you to build one of the top RIAs in the country. Not a bad chain of events.

Gary Furukawa:

Yeah, it worked out. And two of them are still here, so they stuck it out and they're benefiting from what's happened.

Erik Morgan:

It's interesting, we were all in our late 20s, early 30s back then and I don't think that we really connected the dots that if there's no growth, there's no opportunity. And Gary was looking around, as I understand it, going, "What? Isn't it fun?" And they were like, "Yeah, for you." So it was really something that they pushed and I'm glad Gary took them up on it.

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So Erik, let's pivot to you. Why did you join Freestone from Arthur Anderson? Obviously, Anderson at the time was one of the top companies in the United States and to take a flyer on a new business and an emerging part of the wealth management ecosystem, what motivated you to partner up with Gary?

Erik Morgan:

Well, I was fortunate in that my first real job was an RIA here in Seattle that was focused on working with owners of private companies. And so early on in my career, I got an MBA of working for rich people. And so I was familiar with the RIA model and the benefits associated with it. I was then brought into the Arthur Anderson family, for lack of a better term, and then was exposed to a group of clientele that from a net worth basis were significantly larger than the clients I was working with at my first job. And what I realized in working with those folks is that working for a billionaire, it really sounds great, but the fact of the matter is you're really not working for that person, you're working for the person that works for that person that might work for that person.

And there really wasn't a lot of psychic income. I didn't feel like I was doing a whole lot to really help people out. And so I spent two and a half years at Arthur Anderson, had great experience, but then a colleague of mine from my first job reached out to me and said, "Hey, I have a high school friend of mine..." So it's a little bit of serendipity. "A high school friend of mine that started an RIA here in Seattle, we think you'd be perfect for this opportunity. Do you want to come in and talk?"

And after some back and forth it became very clear to me that I wasn't a big company person, I enjoyed getting my hands dirty, I enjoyed plugging in my computer, I enjoyed the benefits of being nimble. And I saw in Gary, quite frankly, somebody that was going to take the very best of what an RIA can offer, which is a very capable investment acumen and ability and then marrying that with a desire to help clients. And in the RIA space that I left, I did not see those two together. What I generally saw was somebody that was really good in planning but not so good at investing or vice versa. And when I walked in the doors and met Gary, I really felt that we could do something special.

Louis Diamond:

I think you were right. So today you both are the senior leaders of Freestone. I'm curious how you think about splitting responsibilities. What's the day-to-day for the two of you? And where do you share responsibilities?

Erik Morgan:

Gary takes all the credit and I do all the work.

Gary Furukawa:

Not true at all.

Erik Morgan:

That's not true at all. I'll let Gary go in a second, but I think we've done organically a very good job of recognizing each other's unique skills and strengths and being comfortable and confident in the other to let them do the things that they're good at. If I had to define it, Gary takes the leadership role on the investment side of the equation and a lot of the business decisions in terms of allocating capital and that sort of thing. My responsibilities really are more on the day-to-day, team building service offerings, those types of things. And then as a board, we'll sit together and think about long-term strategy.

Louis Diamond:

Very good. Thank you for sharing that. And it's an important question because most practices that are launching an independent firm for the first time or just thinking about how to scale it, having the right people in the right seats on the bus is critically important. And we've had some interviews with folks that have co-CEOs or where there's a very broad management team, others where power is concentrated with one person. So it's always interesting to hear how the biggest and best firms think about allocating responsibilities as a way to go and scale the business and make sure each of you is focused on your most lucrative areas of the business. So thank you for sharing that. Let's fast-forward to today and talk more specifically about Freestone. So I guess this question will be for Erik. On your website, I'm reading verbatim, it says, "We recognize that life extends well beyond investments. We address all aspects of our clients' lives for seamless, smarter advice." Very succinct and seems to make sense. But can you explain what this means specifically?

Erik Morgan:

You bet. So even more succinctly, internally, what we tell each other or what we remind each other is that we're here to solve problems for clients. That's what we do, period. If I expand on that, what that means is that if a client has an issue that's even tangentially associated with their finances or their families, we want to be their first call. And what that generally means is that we are focused on areas around financial planning, where they want their assets to go and how, their taxes, there's their philanthropy. But then there's concierge. How do we help them with the structuring of an airplane that they may have recently purchased? Or do we sit there and help them with some estate kind of management pieces? Do we get them in touch with the right people that may help them with a family emergency? So it's very broad. A lot of people in our world will sit there and say, "We are financial advisors." But I really think we take that a step further and really focus on providing clients life advice, in a lot of respects.

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Louis Diamond:

I really like it too that your mandate is to help clients solve problems. So with that in mind, do you charge separately for some of these services? And is there a limit to what you'll do for clients?

Erik Morgan:

The short answer is we do not charge separately in most cases, there are exceptions from time to time. But 99% of the time we do not. And we instill upon our advisors the confidence to be able to tell clients, "We can't do this. This is not in our skillset. It's beyond our capabilities. But we will help you identify and connect with the people that can." So we've found that in areas where we can add value and we can deliver for clients, we do that. In the areas we can't, we make sure that those clients are connected with the appropriate people.

Louis Diamond:

And I can guess by the types of services that you mentioned, the types of clients you're targeting. But can you just share a few minimums and who is the ideal target client of Freestone?

Erik Morgan:

Absolutely. So our stated minimums are in dollars. I would say that is a soft minimum, there are always exceptions in our business. But $1 million is the target minimum. I think between $1 million and $2.5 million from an investment perspective, it's going to be a different flavor of ice cream from one firm to the next, given the types of things that you can do. From $2.5 to $5 million, I think we differentiate quite a bit. And from $5 million and above, I think on the investment side we differentiate, not just quite a bit, but it's dramatic in the way that we go to market and try to allocate capital for clients. In terms of the services that we provide, that's almost independent of their net worth. As I alluded to just a minute ago, we're here to solve problems and so whatever those problems the client may have, our job is to solve them and help them address them. We found that if we do good work for clients, independent of their net worth, we'll get paid in spades over time.

Louis Diamond:

We feel the same way. If you do the right thing, then the riches tend to follow. I'm with you there. Can you talk a little bit about how your value proposition stands out relative to your competitors? So your value proposition for attracting clients. We'll spend a little bit of time later talking about the value proposition for recruiting advisors. But as you're going to market, trying to find the next ultra-high net worth family to bring into the firm, what's making your value proposition stand out? And when?

Erik Morgan:

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I'll take the first part of this and then I'd like Gary to talk on the investment side of the equation. But our value proposition for clients from a planning perspective is that you can come to Freestone with a whole host of issues, with a very complicated or very simple situation, and we can help ferret out your objectives, understand what your goals are going to be, what your risk tolerances are, what the appropriate issues may be, and we can help craft a plan, a strategy around that to help you accomplish your objectives.

And client's objectives are all over the map. There is no right, there is no wrong. Our job is to help them achieve the goals that they lay out and that they set out. So I think one of the ways that we're able to differentiate in the marketplace is to be able to do that from a planning perspective in a way that there are other good firms out there, but we are certainly as good as any of the rest of them when it comes to bringing out the planning benefits. While we differentiate a lot for the advisors in the marketplace, the area where we very much differentiate is on the investment side of the equation.

Gary Furukawa:

Yeah. I think our private investments. Firms, it's just a hot area now and a lot of firms say they have them. But we've been doing this over 20 years, we've made lots of mistakes, we've had lots of success, and we've morphed into something that I think is way different than our competitors. So we started out in the beginning doing fund to funds and we quickly realized that's not a very good thing for the clients. You have a double set of fees. This idea that you can pick managers in advance that are going to outperform, it's the same problem that stock pickers have with picking stocks in advance that they think are going to outperform or picking mutual funds that are going to outperform. It sounds great, it really is tough to do. And then the double sets of fees, especially when we had 0% interest rates, it really makes it tough.

What differentiates our private investments now is that we do almost all of our investing direct. So we have a real investment team, we're actually making the investments, whether it's real estate or bourbon or private equity. We're not investing in a fund so when clients come to us, they're actually getting direct access. We want the control. That's what we've learned a lot of about being in funds is that you lose control and we need to have that control. And so that just requires a different set of people, a different skillset than most firms have. And our performance has been really good and I really love what we're doing and we keep moving more and more in this direction of just making direct investments, not putting money in a fund or something like that.

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And I think it's important to point out that for our clients, if you're a $5 million client, you may have 20% to 30% of your investible portfolio in these alternatives. Whether that is, as Gary alluded, to bourbon, whether it's litigation finance, whether there's golf courses. We really will look at any opportunity that we think we can exploit value out of and that we can have an edge. And the fact of the matter is the only thing that we really haven't invested in ironically is venture. Given where Gary was when he started the firm. But from an investment perspective, we were demonstrably different than our competitors here on the West Coast.

Louis Diamond:

I think you knew my follow-up question was going to be talk more about investing in bourbon. I have not heard this before. So how'd you stumble upon that and how does it even work? So are you physically buying barrels of bourbon and storing them in your basement?

Gary Furukawa:

Yeah, somebody's basement, not ours. So because of what we do and because we have a lot of capital now, we get pitched constantly and we have a team of about four people that go through all the ideas. We probably get pitched 1,000 times a year. We do 2, 3, 4 things a year. And bourbon was one of these funny things where we got pitched, I don't know, five years ago, we went to Kentucky with this person, didn't believe it. And his premise was that you can buy a newly made barrel of bourbon. So it's in an oak barrel, 50 something gallons. And you can pay $600 for this barrel of bourbon, store it for four years. $25 a year of storage and insurance, so you're in $700. And you could sell it for $2,000 at the end of four years. Four years is when, if you go look at liquor brands, bourbon brands, almost all the bourbon is bottled at the four-year point. So that's a key metric.

So it's a form of inventory finance if you think about it. But we didn't understand why a distiller would sell their barrel for $600 when they could wait four years and sell it for $2,000. That didn't make any sense to us. So we spent a year meeting all the distillers in Kentucky. We hired, as our attorney, the former head of the Liquor Control Board of Kentucky. And we just really learned about the industry and we realized, you know what? Actually this is true. It didn't make any sense other than the distilling business really isn't a very good business. These guys didn't have a lot of capital. They didn't really have the capital to store the bourbon four years and hold it. So we are a form of inventory finance. And the banks, because of liquor laws, they were usually hamstrung on loaning to the distillers also.

So that was the opportunity. So again, like a lot of things we do, we started out small, we bought some barrels, learned about the industry, and then we realized it was true. So then we raised money four years ago. We raised, I don't know, $150 million. The funds, it's been a double so far and we think it'll be a triple by the time we're done. And it's been super fun. We've learned a lot about doing business in Kentucky, which is not all good. And the whole thing has been a great learning experience. We actually had a Freestone branded bourbon made that we gave to the clients. And it seems so corny, but it's been probably the most welcome thing we've ever done for the clients. They love it. You also get to figure out what your clients drink a lot because they come back and they want more right away.

And so the whole thing has just been a really interesting experience. The sad thing is that out of the four distillers that we were buying our supply from, three have been purchased by multinational liquor brands in the last three years. So we're not going to get to do another fund. We would probably do another one if we could, but this is it. So it was a one and done. But is this an illustration of how flexible we are. We are always looking at things. We've done other interesting things, not as interesting as this, but always on the lookout for some sort of thing. And BlackRock or Blackstone or something, they can't do this kind of thing, it's too small. But we can do it, it's a meaningful thing for some clients. And just illustrates how we work. We're always looking, always finding things. We have some other things in the works now. And yeah, super fun.

Louis Diamond:

And you mentioned that you're not investing in alternatives through private equity funds or hedge funds, more of the traditional way to access the alternatives universe. So I'm just paraphrasing or restating what you said, when you're offering alternative investments to clients, they're direct deals that your team is sourcing outside of a traditional fund structure?

Gary Furukawa:

That's correct. We've moved into private equity pretty heavy and we're buying the businesses directly. We have a whole template on what we're looking for there. And when you add a double set of fees onto this stuff, it's really a drag on return. So we're trying to get rid of that double set of fees.

Erik Morgan:

The combination of double set of fees, the fact that for clients like ours, they're generally not getting the A level, the type of investments, they're usually getting the B or the C level. Having the direct benefit of the tax savings that you get from being closer to the assets, that matters a lot. And this is something that we learned in 2007 and '08. When things go wrong and you're in a fund, nobody cares about your clients. When they're in our strategy, we care and we make sure that we're looking out for them, not for the GPs.

Louis Diamond:

So you mentioned you're moving into private equity, but this is Freestone as a private equity investor buying companies directly. Can you give an example of companies you've bought? How big was it? And then what sort of returns do your clients typically experience? If you're able to share that.

Gary Furukawa:

Yeah. So recently we bought a company that does dredging in Houston. So you think about dredging, most have never heard of it. But if you're a business on the water, every year your area around your dock gets silt and pretty soon boats can't get in there. And so it's an annuity business, you have to do it. So this company does dredging. It was owned by two guys in their 50s, two brothers. A very successful business. They wanted to sell, but they also wanted another bite at the apple so we bought 70% of the business, they kept 30%. And they know that they have three other markets they could expand into, but they're in their 50s, they were making good money, they didn't really care to do it, they wanted us to take the risk to do it.

But we could build another dredge. Every dredge does about $20 million of revenue. So we're in the process of, over the next few years, we're going to build three more dredges. They had two to start. It was a $40 million revenue business. If we build three new dredges over the next three to five years, we can get it to $100 million. And so that's an opportunity we're looking for where you have founders that have the knowhow, they want to second bite at the apple with us. So they'll sell most of their equity, but they want to hold some equity, we want them involved in the business. And there's something that we could bring our financial expertise and our capital to grow the business.

And we also like something that we pay a really low entry multiple for. So private equity, typically if it's a big fund or something, they're paying 12 times earnings for companies, things like that. We're paying five times EBITDA for most of the businesses we're buying. So we're getting a 20% yield right in the beginning. We use little or no leverage. So leverage is one of the things that can sink companies and we just try to avoid that. But if you're paying five times earnings, you really don't need a lot of leverage to make it work because it's already generating a 20% on EBITDA return.

Erik Morgan:

If you haven't connected the dots yet. This was not by design, the ideas led us in that direction. It sounds eerily similar to what Warren Buffett did early in his career, which is buying these little companies at good prices and then letting the operators do their thing and bringing value where he could.

Louis Diamond:

Bourbon, Real Estate, and Golf Courses: How Innovations in Investments, Training, and Client Service Built a $9.4B Business

A conversation with Gary Furukawa, Founder, Senior Partner and Erik Morgan, President, Senior Partner at Freestone Capital.

Yeah. And I have to say, we've interviewed some of the most successful RIAs and financial advisors in the country on this podcast, I have never heard of an investment approach as novel as what you've shared. Which I think is a interesting pivot point to talk about the incredible growth of Freestone. I noted that the firm has more than doubled since 2018, which is absolutely incredible. Obviously from where Gary founded the business in '99 with $250 million, it's grown even more than that. But maybe just looking at the last couple of years since 2018, how do you attribute this doubling? Obviously some of it's market related, but what is it that you've done that has driven this level of growth? And I assume part of it's going to relate to the investment side, but maybe you can elaborate.

Erik Morgan:

You bet. I would say there really are three elements. You touched on one of them, it helps to have the wind at your back and that's the case for everybody. But what we did coming into that period of time is we spent a lot of time making mistakes in the past, professionalizing the business. And I think that somewhere around 2016 we really started to grow up and move from a firm that had gone from childhood through adolescence and now it was in adulthood. And from an investment perspective, we really started to hit on all cylinders and really identify opportunities. We had a lot of flows coming through that allowed us to take advantage of things that we may not have seen in the past. And so we had a real lift in terms of the performance of those investments. But then we also were able to tell an incredible story in the marketplace that was so differentiated and unique, as you said, that attracted a whole bunch of clients.

So I think the market coupled with our maturation helped. And then there was a moment in time where we lifted our heads up and we said, you know what? We have $4.5 billion in 2018. We have, call it, six, maybe seven full-time advisors. We were all in our late 40s, early 50s. And the simple fact of the matter is that group of guys, that cast of characters, they're not going to be the ones to take us from five to 10. We need to get some new blood in. And so we went pretty aggressive trying to identify new advisors, bringing them in, mentor them, developing them, and then getting them out in the marketplace to tell our story. And so we've gone from, call it, seven to 24 client advisors over that period of time. And so definitely, just getting the story out there has helped a lot.

Gary Furukawa:

Yeah. We've had actually incredible success with our young advisors where they come in, no book, no nothing, they start and we have a whole program to develop them professionally. And we really have had almost no failures, everybody has been really successful. And it's been super fun also. And we also realized we needed to develop a bench of next generation people because we're not getting any younger and we owe the clients the chance to have continuity with a future advisor. So we've really had great success with this whole program of developing people on our bench and we're actually accelerating that now.

Louis Diamond:

That point in particular is worth staying on because most businesses, but especially in this industry, struggle with developing next generation talent. Either there's a high failure rate, people struggle with finding experienced advisors with books of business. You fill in the blank of the excuses or things that happen that makes it really hard to develop people the way you have. Can you talk just a little bit more about the strategy of bringing in people without a book of business? What was their background before? And maybe even just a little bit of, what do you think is the most impactful part of your curriculum that has helped make them so successful?

Gary Furukawa:

What makes it work is that we have a structure that we can communicate to somebody, a young person. One thing I observed when I was at the accounting firm is accounting firms actually pay really low starting wages, if you work for a big firm like I did. But what attracts people to the accounting firm is that accountants are low risk kind of people. And you go to a big firm and you know exactly what the program's going to be. You're going to work like crazy for a couple of years and then you're going to be what they call a senior, then you're going to work like crazy for three more years maybe, and then you're a manager and then you're going to kill yourself for five years and then you're going to be partner. But people will buy into that because they know the program coming in.

And I think a lot of people, they like certainty, they don't like uncertainty. So one thing that Jim Hughes has done since he's come, and we were already starting it before Jim came, is we have a defined program for somebody coming in right out of college. They'll start out as a CSA, working with an advisor, then they'll take the CFP and start doing financial planning as part of a senior advisor's clientele. And then we only pay our advisors on a certain number of clients. And so our older advisors have an incentive to pass on these clients to this new advisor. And they learn with that. And then they also work with Schwab, which refers them business. So they get a lot of at bats on selling and persuading and that sort of thing. And so people come in and we can show them, "Hey, look, you're 22 or 23 or 24 now, but this is what it looks like for you." And we find that's been really successful.

Louis Diamond:

It also seems like what you've built is immensely scalable. It's repeatable and you have the blueprint so you can just, with a pretty high degree of predictability, hire someone, bring them through your program and then have a sense of where they're going to be after a period of time.

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Erik Morgan:

You're absolutely right. One of the things I'm most proud of in terms of the things that our firm's accomplished is that we have a demonstrated track record over and over again of bringing people right out of college, putting them in a seat, getting them some background, putting them then into a CSA state, getting them some more background, then putting them in a client facing role where they're working with an experienced advisor and then moving them to the next seat and getting them out in front of our distribution partners, whether those are CPAs, investment banks or Charles Schwab. Getting them the opportunity to learn how to sell and how it is to interact with affluent people. And to seed them so that they have the opportunity and the staying power to make a career out of this. And while I'm sure I'm forgetting somebody, our track record on developing people is well in excess of 90%.

Louis Diamond:

That's absolutely incredible. There's a lot that's impressive and different about your story, but I think what you're doing, aside from the fact that it makes good business sense, it's also an amazing benefit to the profession. I think you might have a separate business, which is helping RIAs develop training programs because there isn't really a playbook that is widely successful. The wirehouses for a while were the source of talent for the industry. You have that to an extent, but many RIAs I think struggle with developing the next generation talent, which is why many are forced to sell even if they would like to stay private.

Which is a very good bridge into the next question, which I know in speaking with you guys offline, that a big part of your value proposition, especially to prospective advisors is that you are not private equity backed. Most of the big RIAs in this country, probably almost all of them that are of your size and larger, are backed by a private equity sponsor or some outside pool of capital. Can you talk about the decision to not sell to private equity? And I believe too, at one point you bought yourself back from private equity or from an outside parent.

Gary Furukawa:

Yeah. In 2006, I was burned out. Erik wasn't burned out, but I was burned out because I'd been doing six jobs at the firm. So I said, "I'm going to hire an investment bank and just see what's going on." So we hired an investment banker, we had eight offers to sell. The two biggest buyers were Wells Fargo and E-Trade. And I just said to myself, "God, what am I going to tell the clients? It's everything we sell against and I can't sell to these guys." So we ended up not selling. And then a year later we met a group in Seattle, a private equity firm. They seemed great and so we sold to them at a price quite a bit lower than what we could have got from one of the other buyers. And it just wasn't a good fit. They didn't really understand our business and they were very focused on their economics, which I guess is what private equity does to price.

And so it was just a tough thing. I had to stay five years. And so we closed the transaction in 2007. We had the financial crisis that was tough on the business, tough for them. And then after five years, our key people, we all met and talked and they said, "Hey, look, you need to buy the business back. These guys are ready to sell. They're tired of us and we're tired of them." And so we ended up buying the firm back. And the lesson I learned is that private equity firms buy a lot of businesses, they know what they're doing. When you own a business like ours, you only sell once or twice in your career. So you just don't know that much until you go through it. And what you learn is that it's unpleasant.

And I think one of our advantages with people is that, yeah, we've done this, we've seen that. That's really not our model. And the fact that we can develop our own talent means that we don't need to do acquisitions. We've never done an acquisition. We might do one if it were at a really great price, but generally I'd much rather grow organically. I think it's a better value proposition for us. I think it's more fun. I think it keeps our culture intact. We have a really great low ego, everyone pulling on the orders culture. So you learn a lot when you sell and we're just not interested in that.

Erik Morgan:

We learned a lot.

Gary Furukawa:

Yeah, learned a lot.

Louis Diamond:

It seems like a good decision to buy yourself back for a lot of different reasons. And can you talk about why you believe that being employee owned and I guess founder owned rather than private equity owned is an advantage to clients and to future advisors you bring on?

Gary Furukawa:

I think that sometimes founders are a problem. I try not to be a problem. I don't know, you guys tell me, am I a problem?

Erik Morgan:

Could you leave the room for a bit?

Gary Furukawa:

And so I'm very sensitive to staying out of the way and letting people do their thing. When you own a business, you think differently than when you're an employee. The example I use in this, a really corny example, is that when you walk to the bathroom in our office, if I see a little piece of toilet paper on the floor, I pick it up and I put it in the garbage. I think if you're an employee, you walk by. And I just think there's a different level of care. I think it bleeds through. I think the clients feel it. The employees certainly feel it. We have a lot of shareholders in the firm. The firm's really profitable, so everyone wants to be a shareholder. I get that. And so I think that there's a psychic advantage. People are always looking for purpose. I think that's missing in society today. And I think being an owner of a business and working together, I think it provides a purpose to people that maybe it's hard to get in today's modern world.

Erik Morgan:

That's right. I also think that there's just the perspectives that employees/owners come from and an investor comes from. Most of the people that get into this business are in the business to serve clients, to take care of them and do the right thing and make a nice wage over time and things will work out. A private equity investor comes in and writes a big check. They're beholden to their fund members and their objective is to maximize profits. And oftentimes that conflict results in a bad outcome for clients, in my opinion, and a bad outcome for the employees that are working at the firm. And so I just think it's very difficult to sync up.

Louis Diamond:

So it begs the question, when the two of you ultimately decide to retire or scale back, how would you then go about monetizing your equity? Because one of the double-edged swords of the wealth management industry today is that businesses like yours have become so incredibly valuable as multiples have gone up, that it's become almost impossible for next generation team members to have the liquidity to write a founder a check that's going to be meaningful enough to recognize the value that they've created throughout their careers. So as you guys think about this, obviously you have the experience of what happened to selling to private equity. How do you think about casting your eventual succession plans?

Gary Furukawa:

I think at some point we'll sell. It's a long way off and we're not looking to sell right now. But what we would do is we would try to sell to an acquirer where we retain control, whether it's a strategic kind of acquirer or something. Getting the highest price, we've already proven that's not our objective. So if we wanted to get the highest price, we'd sell to private equity. We know what the multiples are and they are really spectacular. But I started the business, I didn't need the money when I started the business, I don't need the money now. Erik doesn't need the money. A lot of our main shareholders, they're very wealthy already. So it's not getting the most money, it's about getting the situation where it works best for everybody. And that means it probably wouldn't be private equity, there's other things we've looked at that seem better, but it's a long way off. I noticed, I'm in Seattle, Pete Carroll was 72 coaching an NFL football team. I look at that and I go, "Yeah, our president's almost 80 years old." Is he 80? Something like that.

Erik Morgan:

He's pushing it.

Gary Furukawa:

So I think in the end, yeah, we will sell I'm sure way down the road, but we would try to sell it in a situation where not trying to get the highest price, just trying to get the best situation. And I think it can be done.

Erik Morgan:

I think that's right. I think one of the, I guess, obligations, one of the responsibilities we have is to make sure that when there is a transition, that it's structured in a way that takes care of our clients, takes care of our people. And that will probably mean a much lower price than we otherwise could get if we just would go to the highest bidder.

Louis Diamond:

And I commend you for being so open about what the future holds. I think most RIA owners, even if they do have plans to sell in the future, they probably wouldn't be so open as to say that. Or they'll say, "Oh, we'll just keep doing this forever." But I think recognizing that things change and ultimately to set up your clients and your people, like Erik said, it's potentially going to take a transaction at some point in the future, but at least for the time being, you keep all options open. You have an amazing culture of fostering the next generation, so it buys you the ability to be patient and to be picky about what the future holds.

Erik Morgan:

We share with our shareholders, our partners, there's a non-zero chance that we never sell. There's a lot of benefits to never selling. So while I think that's an unlikely outcome, it's a long ways away from zero.

Louis Diamond:

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Makes sense. So let's talk a little bit about your pivot into inorganic growth. It seems like completely organically you've grown the firm to an incredible amount of assets and headcount, et cetera. But I know you hired Jim Hughes, who has a background at Merrill Lynch and within the RIA channel, to help lead your inorganic growth charge. So as you're thinking about the next chapter of Freestone, can you describe what the value proposition is to prospective advisors and who are you looking for? Who's the ideal fit within your organization?

Gary Furukawa:

One of our key tenets internally is that we're looking for people that are low ego people. I think our culture is one where people check their egos at the door, we all work together, everybody pulls together, there's not a lot of politics. And Erik and I actually hate that kind of thing. So I think our value proposition to perspective advisors is that, hey, you can come to a place where we're going to help you and we can demonstrate what we've done with other advisors because we've hired a lot of advisors and they've crushed it.

Erik Morgan:

They've grown like crazy.

Gary Furukawa:

They've grown like crazy. And we can just show them over and over, this is what's going to happen with you. We have lots of referral business coming in from different sources that is really robust. So it's not like you're going to come in here and then you're going to be cold calling. You're going to come in and we're going to have stuff teed up for you and you just need to execute. And so I think that's really attractive to people. If they're successful or if they have a decent size book of business now, they become shareholders right away. The company's very profitable, so being a shareholder means you're getting people.

And then I think just the idea that we are all here to help you. It's not a competitive thing. I worked at a wirehouse where I was doing my estate planning. We had 50 stockbrokers in my office, back in the day, and my wife asked me, "Well, if something happened to you, who would I talk to in the office?" And there was one guy and it's like, oh my God, I sat there and go, "One guy out of 50. That's really awful." So our culture is, I think, if something happened to one of our partners or shareholders, they could talk to anybody. Everyone would just bend over backwards to help each other. And I think that's the culture that we have.

And so I think for someone coming in, they can just see the growth they're going to have. If they want to grow, they're going to see the support. If they need someone to help with estate planning, we have that. They need someone to help with financial planning, we have that. If they need support with a younger advisor who's going to grow with them, we have that. So I think that's the kind of person we're looking for. We can't compete with the wirehouses and pay three times gross revenues. We're not going to do that. We don't actually want that kind of person. We want someone who wants to come in and grow and can see that in the long-term, they'll actually be better off being a shareholder here.

Erik Morgan:

There's no doubt that our culture around the growth of the advisors different than most firms. Gary and I both spent time at accounting firms where it was the responsibility of partners to grow the next generation, to help them build their books and to provide client opportunities for them. And so all of our client facing senior partners, they're measured on the opportunities that they're providing to younger developing advisors. And that's something we just don't see in the marketplace very much at all.

Louis Diamond:

Yeah, I am with you there. And I think you hit on some of the most appealing aspects to prospective advisors. Growth, being part of something bigger than themselves, tapping into a variety of services to better serve clients. So it makes sense. I'm curious just in knowing the mindset of advisors, especially experienced ones. So people who have a successful book of business, not the folks without one, which clearly you've done a good job of capturing. Financially, why would someone be better off joining you guys rather than either building their own RIA or turning down a massive check from a wirehouse? You've mentioned you're not going to be the 300% deal. So why would someone turn that down? How would they look at their spouse or their loved ones and say, "I'm either not building my own equity and building my own RIA or I'm turning down this massive deal and instead I'm joining Gary and Erik and team at Freestone."

Gary Furukawa:

I think building your own RIA today, if you have the ability to do that, you should do that. But I can tell you, even though it's easier than it was when we did it, it's hard. Because I think now, today you need to get to scale really quickly.

Erik Morgan:

Costs are so expensive.

Gary Furukawa:

It's gotten so much more expensive. So when we started at $250 million, we were making pretty good money at $250 million. I don't think today you can do that. I think if you're sub $1 billion, it's going to be hard to make much money. So if you are the kind of person where you think you can do it and get over that $1 billion threshold quickly, then by all means you should do it. But if you're not, and most people aren't, advisors are usually good at one or two things, and to build a business, I think you've got to be good at four or five things. And if you're just not that kind of person and don't want to go through the brain damage, I think we offer a great alternative where you're going to still grow your net worth.

We can show you over and over people that are here, what they've done when they've started. We have people that have started with $100 million of AUM and now they're at $600 million. We have lots of those. We could just show you, "Hey, this is what's going to happen here. You just have to work and execute and we're going to support you." And I think in the end, if you look at the value of our stock and the value of our distributions and then the help you're going to get, it's like, yeah, this is what it is if you're willing to do the part. Plus you get to live in great places. We're in Seattle and San Francisco and those are great cities to live in too. So I think that's our value proposition. I think it's just really a few people can start RIAs and get over that $1 billion threshold quickly and more power to them. But if you're not one of those people, then we're a great alternative.

Erik Morgan:

And I think if you're an advisor that's in the latter part of their career and they're just looking for a check and not looking to grow, and I don't mean this in a negative way, but you're indifferent as to where your clients go, that 300% deal is hard to turn down. But if you're in the stage of your career where you want to grow, you want to take care of clients, you want to be part of something that's bigger than just yourself and you want to build something, then I think when you do the math and look at our economics, you look at the environment that you can work in and then you look at the growth potential. I think it's a really compelling story as opposed to taking a two times or even three times deal at one of these firms, but to be stuck in the same old thing, but a different day.

Louis Diamond:

Well said. Two last quick questions to take us home. This one will be for either or both of you. Where does Freestone go from here? What's in an initiative or something you guys are...

Gary Furukawa:

I think one thing we've gotten really excited about, and it's not going to sound very exciting, but it's exciting to us, is I think Erik and I have both realized, Erik, probably sooner than me, how important estate planning is to the very high net worth clients. When you look at how much you can save a client that's got a $100 million dollars net worth, it just dwarfs anything we can do in the investment area or the tax planning or anything. And so we are hiring attorneys that work for us to help with estate planning. It's been well received. The clients love this idea.

I have one client who's very fee conscious and she met with our estate planner and she says, "I can't believe we're getting all this and I don't have to pay the fees. We're ecstatic." And this client's never ecstatic. They're always tough. And so I'm just sitting there going, "Wow, that was world changing for me." And so I think we're very excited about continuing to expand that. We're excited about expanding our next generation advisors. And then in the investment side, I just think we've gotten so much better at ferreting out opportunities and figuring out how to attack certain areas and really generate returns for clients. And so I'm very excited about that. Erik.

Erik Morgan:

Yeah, this is going to sound a little corny, but Gary founded this firm, I came in six months or so after it started. It's really been the labor/love of both of our lives. And when I look at where we're going and I see the people around us that are helping take us there, I'm just really excited for this Freestone 3.0. We've had two distinct chapters in our life. I think we're at the beginning stages of a third where we can really be, not just a leader here in the Pacific Northwest and Seattle area, but up and down the West Coast. And really, I think we are a thought leader in the industry. I think we kept our story pretty close to the vest. I'm excited to get that out to more people so that we can help more clients, bring in new talent and really, not make this the biggest firm in the country, but really make it the best.

Louis Diamond:

Very compelling. That was a pretty nice bow to put on this. And I really do thank you both for joining our show today. You hit on, I can't even count the number of different things that Freestone does in a world-class way. Hearing about investing in bourbon was my highlight. But hitting on how you develop fresh talent in a scalable way, the incredible growth, what you're doing on the estate planning side, et cetera, is something that I think most advisors or business owners can learn from. So we really appreciate you sharing your wisdom today and being so open about what made you successful and where the company's going from here.

Erik Morgan:

Thank you.

Gary Furukawa:

Thank you very much.

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Mindy Diamond:

Curious about where, why and how advisors like you are moving? Download the latest Advisor Transition Report to learn more. Including intel on recruiting deals and our insight and analysis on the latest trends in the wealth management space. You'll find it at diamond-consultants.com/transitionreport. Or if you'd like to talk, feel free to give us a call at (908) 879-1002.