



Fox Rothschild Podcast

AdvisorEsq

Episode 10: Planning Ahead: The Valuation Equation

Featuring Matt Baum of Fox Rothschild and Jeff Nash of Bridgemark

Announcer: All rise. Welcome to "AdvisorEsq," where we discuss the financial services industry through a legal lens. This episode is now in session. And now your host, practicing attorney, Matt Baum.

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Matt Baum: On this episode, we have part one of a truly educational and on-the-pulse chat with Jeff Nash, CEO and Co-Founder of Bridgemark Strategies, a recruiting and consulting firm. Among other topics, Jeff discusses his views on the valuations we're seeing in the advisory space, what factors go into valuing an advisory practice, how EBITDA plays a role in valuation, and why private equity is so interested in the advisory space.

Jeff, welcome to AdvisorEsq.

Jeff Nash: Matt. Great to see you here. Great, thanks for having me. Thanks for having me as well.

Matt Baum: My absolute pleasure. I appreciate you taking the time to speak with me. You ready for your cross-examination?

Jeff Nash: Yeah, it doesn't happen often, you know, I've done a lot of these and getting examined, it, you know, an attorney here. I don't know. It's going to be interesting. We'll see how it goes.

Matt Baum: That's a good thing that you haven't had a lot of experience in that. So, Jeff, what do you spend most of your time on with advisors?

Jeff Nash: You know, it's a great question. The high-level answer to that is really educating advisors is the high-level answer.

So what we do every day, right, is we're talking to advisors that are in motion. What that really means is they're not really happy with their current state of kind of operating environment. Whether it's their current broker dealer, their current RIA, even their organizational structure. Maybe they want to

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merge or sell their business. Maybe they're looking at retiring. Right? So there's some kind of organizational change that they're at a crossroads.

And so, what I do every day is working with, talking to advisors, helping them understand what their goals are to then better help them understand what the marketplace is and what their choices are and how to find the right solution for those needs. And that's really what we do every day. It's really about educating the advisors.

You know, we have, as a firm, we're very fortunate, right? We've built out a great firm. We have 16 people here at the team. You know, this year here, 2024, we'll move probably 100 or more different teams to as many as 25 different firms. And we just have such a cross section of knowledge of the marketplace. This is going to be advisors leaving wire houses. Advisors, leaving regionals. Advisors selling their businesses. And so it starts off with understanding what the advisor is looking for, what their goals are, if they're even achievable, and then helping them kind of find and evaluate and even negotiate with, you know, those firms that can help them solve those goals.

Matt Baum: And Jeff, we've all seen some pretty eye-popping numbers thrown around in industry news about high valuations in the M&A transactions. Are the halcyon days over? Have higher costs of capital made those significant valuations a thing of the past? Or where do you see it going?

Jeff Nash: Honestly, we're still in the early innings. It's a great question. I love that question. How much longer can it last? And, you know, we, and we saw this when interest rates were at zero. We've seen it now continue when interest rates, Fed funds at five, you know, 5% and higher. And honestly, the macro trend on this is we've got at least another five years, probably another 10 years of this happening.

Now, clearly, I don't know what's going to happen with cyclical. You know, we could see recessions and things like that can change things on a cyclical basis. But the trend line, based on the numbers of advisors and the consolidation and the money that's in the marketplace, this is easily another five to 10-year window of opportunity for folks.

Matt Baum: You've written about the acronym PRICE, P-R-I-C-E: people, revenue, increase year-over-year, clients and EBITDA. Would you walk us through, kind of, why you came up with this acronym and why you utilize that and what the benefit is?

Jeff Nash: Yeah, it's a great question. And so I came up with the acronyms just to kind of make things simpler for people. You know, I get the question all the time, hey, what drives price in a deal? And everybody wants to know, you know, what is the driver of price, you know? And so I literally turn the word price into the acronym of what drives price. And, you know, and there's not one component of it that can really supersede another.

Each one of them can influence both positively and negatively when you're looking at selling or merging your business, right? So recognizing, you know, the marketplace first of what drives price.



First of all, it's financial advisors or advisory firms that are looking to kind of sell or merge their business. You know, typically the buyers that we're seeing in the news all the time are these multi-billion-dollar private equity-backed buyers. And they're the ones that are driving price higher, where we used to see multiples on the independent side of two-times recurring revenue, maybe two and a half. And then it pushed to three-times recurring revenue.

And now these private equity-backed buyers have come in and they've introduced EBITDA pricing, right. EBITDA is free cash flow, right? It's profit. It's after you're paying your expenses, even after you're paying an advisor's salary. And if you're the owner and advisor, you have to bifurcate your own income to salary as an advisor to service the business. And then the owner's comp after that.

And so these firms have introduced this EBITDA pricing and we've seen pretty significant EBITDA multiples on the business. The cool thing is, an EBITDA multiple and a revenue multiple are somewhat synonymous, it's just a different math problem. And so in the past when we looked at two or three-times revenue, right? Now today we're looking at multiples of EBITDA of six, eight, 10, 12, even 15 and higher on EBITDA. Where your average profit ratio is, you know, in the 35 to 50% range.

And so when we just think about a really simple math problem, if-- and just to make it even simpler for me-- if profit is 50% of revenue and if EBITDA multiple is 10-times profit, that would be the same as five-times revenue.

And so it's really important to just keep that really simple, but to understand that. The reason that's so significant is because I myself this year alone have done transactions where firms have been very profitable and advisors have gotten five and even six times revenue. Now, again, that's by getting it to a point of multiples on profit, not the actual multiple on revenue, but the math formulas we just discussed.

Long-winded answer. So now we come back to what drives price. Why are people getting so much money? Well, it's not just because these private equity firms have a lot more money to spend. They're actually looking at it from a very analytical perspective. And they want to see firms that have really checked all of the boxes. And these are the firms that are getting the maximum prices.

So what are those boxes? Well, that's the acronym PRICE that I came up with. The first letter P is people. And P, or people, is the firm right, balanced. So do they have how many advisors are in the firm? Does it have junior or next-level generation, next generation of advisors, right? What kind of support staff. And the better-rounded firms-- that's including those that have next-generation advisors --will get a better multiple.

The R in PRICE is for revenue. And revenue is what is the revenue made up of? Certainly fee-based, versus commission is a huge driver. In addition to that, it's how are you managing that fee-based revenue? Are you managing individual client portfolios or are you running models? You know, so there's a lot of nuances to the nature of the revenue that's really important from a buyer's perspective that makes the business more transferable, and again, more profitable.



The I in PRICE is for increase year-over-year. And that's really about growth rate. One of the things that I've seen is there are buyers-- very large, substantial buyers-- who literally will walk away from firms that aren't growing. And the growth is based on net new assets. It's not just based on market growth. And so, increasing year-over-year is a big driver of price as well as the buyer pool.

C, of course, is clients. And clients ... Really important. Do you have one or two very high-net-worth clients that are barbell the nature of the business, creating more risk? Are the clients very old, right? Or are the clients young? So the client component to this whole thing is really important as well.

And the last thing I would add is E, which is EBITDA. And as we spent a few minutes here earlier talking about EBITDA, the higher the EBITDA, more often than not, the higher the multiple. And so multiples and EBITDA can be directly correlated with bigger numbers for both.

Matt Baum: Now I --

Jeff Nash: The only thing I would add-- sorry, real quick. The only thing I would add is going back to revenue. A really important component of revenue is not just how you're managing the portfolios, but are you doing financial planning? That's the one other thing kind of within that revenue mix is financial planning is really key for these buyers.

Matt Baum: Sure, thank you, Jeff. And what a great overview for someone who's relatively new to the space or trying to think about valuing their practice, what they could get for it on the marketplace. Very good guidelines to focus on.

One thing that I've heard from clients over time, especially in the M&A space, is this concern that we're not big enough for EBITDA to matter. Have you found that matters? Meaning the size of your practice, the size of your revenues before EBITDA even becomes something worth thinking about with your practice?

Jeff Nash: Absolutely. Yeah, it really does. EBITDA starts to really come into play with a \$100 million in assets and more. Certainly at \$200 million. But below \$100 million in assets, it really starts to just become a revenue multiple is what you're looking at. And those revenue multiples are still in the three, three and a half times range that we're seeing.

You know, again, assuming it's entirely fee-based and a financial planning-centric approach and the clients and some of the other things I talked about still are applicable. But that's what we're seeing.

One of the big drivers though when you talk about the people side of it, when it comes to price, it comes back to, is this a succession or is this an opportunity for merging? And that's something that people really need to think about when they understand, in understanding this. For somebody who is-- regardless of age right? So I could say the stereotypical 65-year-old, but it really doesn't matter. It really is about your window of time. And if you're looking to sell your business and retire in the next one to two years, your price will absolutely be lower versus sticking around for five years or longer.

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Frequently, these buyers are really looking at this as an acquisition strategy to acquire talent to grow. And they look at the advisor as acquired talent to be able to continue to grow net new assets at the firm level with the firm support.

Matt Baum: Let me ask you, Jeff, do you think that's a little bit wrong-minded from the perspective of if an advisor sells their book of business for a large amount of money, and is now getting paid something, but probably not as much as they were making before they sold the business. Are the incentives aligned for them to continue performing, continuing triggering the growth that they historically had?

How have you seen that play out in the industry?

Jeff Nash: You know, it's a great question. Because of course, a lot of the buyers are going to say, look, you're going to, this is going to be a better trade for you long-term. And this is why the buyers are selling this. But the reality is, there are some buyers where that does work, where one plus one actually does equal three, right?

It's a part of the analysis and the comparison that you have to look at. But it absolutely can and does work. Remember, when we think about why multiples go so high, I like to use an example of just what's going on with Nvidia stock price right now. And --

Matt Baum: The one I should have bought years ago, you mean?

Jeff Nash: Yeah, exactly. All of us, right? And Nvidia stock price is, you know, it's going through the roof. Why? Because the future prospect of the Nvidia chips for over the next, whatever numbers of years, are continue, are very high. And so the higher the price is based on future growth prospect. And that's why these firms are buying, you know, advisors that want to grow their business after the transaction. They're paying more money for that collective and combined growth. And that's what they're realizing.

Matt Baum: Why do you think PE is so interested in the wealth management space? Obviously, they're making a splash with these valuations and the EBITDA multiples.

Why are they so interested? Is it the recurring revenue or something different?

Jeff Nash: You know, that's kind of a softball question for me. I actually wrote an article on some of this. And there's honestly, there's five reasons why PE is so interested in this space. And--

Matt Baum: I'm sure you have an acronym for it, though. I want the acronym.

Jeff Nash: You know, I didn't come up with one for this one, but I should have. But there are five reasons where they came up. And honestly, I'd go back and I would look at like Apple stock or Nvidia as a company. And why do investors buy these and why are these stocks trading so well?



It's the same reason PE is interested and invested in the space, right? So what are those reasons specifically? Well, number one, and this is in no particular order, these firms, these RIA firms are growing, right? They're growing at a very aggressive rate separate from the markets and the markets just add to that growth.

So you've got a company that you can invest in with a high growth rate is an appealing investment opportunity. Again, I can go back and look at Apple or Nvidia over the years, right? It's an appealing investment opportunity.

Number two, right, within the wealth management space specifically, very high percentage of reoccurring revenue. Now we could go back and look at that, maybe like Apple. Apple, very high reoccurring revenue. Wealth management, 99% reoccurring revenue. These folks are RIAs and it's all reoccurring revenue.

Matt Baum: Sure.

Jeff Nash: We could add growth rate to that. Their growth rate, excuse me, not growth rate, their client retention. So again, they're looking at upwards of 99% client retention.

And then you're looking at profitability as the fourth reason why they're investing in these firms. And the profitability is, you know, 30-plus percent profitability. So when you have a firm that has 99% growth, reoccurring revenue, 99% retention, you know, double-digit growth rate and 30-plus percent profit margins, that's a pretty lucrative investment.

Matt Baum: Yeah.

Jeff Nash: The fifth reason I think is because of the innovation side of it. These firms are innovating at a very fast, at a faster clip. They're more nimble. You're going to see them on the leading edge of AI and how to use AI to drive an advisor's efficiency. How to use tax and estate planning to enhance an advisor's services to their clients. That overall these firms, I believe, in the future are actually going to have a better client delivery model for the advisor-client relationship, again, driving a lot of that growth. Those advisors will be employees. A little bit we could even say back to the future of the old wire house employee days. But they'll be shareholders in these companies and they will still be able to make very large salaries, a lot of money, with that support and providing a better deliverable for the client.

Matt Baum: Do you think I'm sure I know where you're going to go with this anyway, but I'll ask it because I'm curious of your opinion on this topic. Do you think private equity is somewhat participating in like a greater fool's theory? You know, we're paying these big multiples, but when we aggregate more businesses this larger behemoth should go for an even bigger multiple and someone will pay for that? Like some public company, perhaps, even though, frankly, a lot of private equity funds can match public companies with capital. What's your thought on that?

Jeff Nash: Yeah, I absolutely see that as a risk. I really do. There are absolutely, there are deals happening today. And I see these deals happening. And I scratch my head, you know, because we



could go back to the dot com right of the late 90s, and all you had to do was be a publicly traded company that had a dot com in your name and you've got a massive multiple. And we're seeing prices like that as well.

And it's interesting, because I'm working with my clients who are selling to some of these firms, or looking or evaluating some of these firms. And I came up with, I did come up with another analogy on this one. And the analogy I came up with to try to figure out okay, is this firm sustainable for the future or not? And I compare it to an airplane. And within the airplane-- and I'm not, I don't, I'm not a pilot, I don't know that much about airplanes. But I know there's airplanes with one engine, and I know there are airplanes with four engines. And it's my belief an airplane with four engines is probably safer than airplane with one engine, and, right for redundancy?

Matt Baum: Yeah.

Jeff Nash: And so I look at the future of these RIA firms, and what's their ability to continue to sustain their growth if they, if growth falls? Again, we can look at go back and look at the stock market, Nvidia or any of these other companies. If growth rate falls, stock price falls. And that's what will happen in some of these cases.

And so I think about the four-engine plane is four different channels of growth that some of these firms offer. And others don't have those built out yet and they will aspire to build them out. Some may never. But again, aspiration is a risk versus somebody who's already established and building out those four channels of growth, right?

And so the four channels of growth, real quick, that I see in the marketplace. One is just efficiencies that firms can gain with great leadership and taking tasks off of an advisor's plate. Most of these firms will get that box, that's that one engine plane.

Matt Baum: Sure.

Jeff Nash: But then the other engines really come back to acquisition growth. Do they have a proven method that they can continue to acquire? Do they have an organic growth system that they can continue to grow organically? And then the last one is even in that custodial referral program, where we know billions of dollars are being raised at individual firms by being in those custodial referral programs, which is another channel of growth.

When I think about those four channels of growth, the one last thing I'll say is, look, any one or two of those channels could shut down in the future. Which will clearly affect growth. But it doesn't mean the plane's going down.

Matt Baum: Right. Having a diversified portfolio, so to speak.

Jeff Nash: Exactly right.



So, yeah, there's, the long-winded answer to your question is, there's no question that I see things out in the marketplace, and I'm seeing prices and I'm seeing deals that are being thrown around, and I'm like, I'm not sure this is real, you know. And I'm not sure how they're ever going to pull this off. And I see advisors actually subscribing and buying into it in some cases. I'm like, well, good luck, you know.

Matt Baum: This concludes part one of our conversation with Jeff Nash. Please stay tuned for the release of part two for more great insights from Jeff.

Disclosure: Thanks for listening. Matt Baum, your host, is a practicing attorney and partner at the law firm Fox Rothschild. To contact Matt, you can call him at 212.878.1429 or email him at mbaum@foxrothschild.com.