

## WHAT'S YOUR BD WORTH?

FINRA reports that the number of broker dealer (BD) member firms dropped from 5,361 in 2003 to 3,726 in 2017, and the number of member firms continues to drop in 2018. Small firms make up the majority of the firms that closed. The majority of voluntarily closed firms report that they merged with other firms because of increasing costs of operations and shrinking profit margins.



Most remaining small to mid-sized BD firms recognize the need to implement a consolidation strategy that includes a component to improve overall enterprise value. Both acquiring and acquired firms can benefit from achieving higher valuations. For firms choosing to be acquired, owners want to achieve the best price possible for their equity positions. For acquiring firms, improving firm valuation can a) reduce the number of shares issued for stock-for-stock acquisitions and b) increase borrowing power for debt financing.

Buyers of BDs use a variety of factors to value target acquisitions. While no one factor determines the value, revenue multiples continue to be the primary starting point for most valuation calculations. For firms under \$50 million in revenue, these multiples can vary widely depending on many other factors that affect profitability, growth, and business model sustainability. Such factors as the ratio of commission revenue to fee revenue and the revenue per registered representative (RR) can have significant impact on valuation of these smaller BDs. To a lesser extent, the BDs business model and organization structure influences value (e.g., the number of offices, the number of employee RRs versus contract RRs, and the percentage of non-producers). Some buyers prefer to use EBITDA multiples or EBITDA margins as a valuation starting point, but these methods prove to be less reliable with closely held businesses that provide above-market salaries and benefits to owners.

Using data from recent acquisition transactions for small to mid-sized firms and reviewing valuation reports of BD appraisers, an algorithm can be derived to approximate current market value for BDs. This approach, while limited to the factors evaluated, can be particularly helpful for sellers who are considering a consolidation or disposition plan for their BDs. Additionally, sellers who use this approach can point to an objective process that supports their asking price with buyers.

Stone Toro, LLC developed its own algorithm to help value the BDs and RIAs that it represents in M&A transactions. Contact Richard Jenkins for a free evaluation report of your firm's value.

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