Episode 61

FS Thrive x Truelytics: Unlocking Value: AI, Technology and the Future of Financial Services

Ginevra Czech (00:03):

Welcome back to FS Thrive, a podcast by FS Investments. My name is Ginevra Czech, director of Client Value-Add Programs, and today we're talking with Jeremi Karnell, the SVP and Head of Product for the Wealth Channel at Envestnet Data and Analytics. We've partnered with Jeremi to offer advisors access to a technology platform built for financial advisors and RIAs that help define practice value and analyze the health of your advisory business. Today we're talking about how the tool works, what drives value for your advisory business, and what action can you take to unlock possible unrealized value. And, finally, how are AI and technology going to impact the industry going forward? I hope you enjoy the conversation.

Excited to be here today. I've got Jeremi Karnell from Austin, Texas, visiting us. He is the, what's your official title over at Truelytics these days?

Jeremi Karnell (00:58):

Well, it's no longer Truelytics. I'm the Head of Product for the Wealth Channel at Envestnet Data and Analytics.

Ginevra Czech (01:04):

Alright, awesome. And you might remember Jeremi from last summer when he joined Kyle Simpson, who formerly ran the Value-Add programs. I'm so excited to have you back with us today. Would love to see what you guys have been up to. And I think there's some really relevant topics. We've obviously been talking a lot about AI recently. Curious about different trends that we're seeing in the industry. So let's just start with a quick refresher on what you guys are offering and go from there.

Jeremi Karnell (01:34):

Great. So Truelytics was founded back at the end of 2016, early 2017 as a transition management platform. It was under the thesis that we needed to solve, help the industry solve for the fact that we were seeing major demographic pressure lead to what we're calling a great transition. So that means we've got, I think, 40 to 50% of advisors are expected to retire in the next four to five years. And the problem in the industry was just a real overdependence on utilizing certified valuation analysts, professional services to do all of this type of work. And given the tsunami of transitions that were going to hit the industry, we thought, well, it's probably about time that we brought digital transformation to the concept of how you value firms, how you can solve for continuity since 80% of the industry doesn't have anything in place for that, and how you can better help with the matchmaking for people looking to grow strategically, people looking to exit the industry, maybe even people just looking for successors.

(02:38):

And so that was the basis of how we got underway. And our original go-to market was really supporting enterprises, so primarily right out of the gates, independent broker dealers. And we got the who's who, right? We got Cetera and LPL and the Kestras and the Avantax, and that was on the broker dealer side. We then began to see some traction in the asset management space with FS Investments. You folks actually were our first asset manager and then CAP Group. And then, most recently, I think it was about the beginning of last year, BlackRock and both are solving for the same thing. They're wanting to help their network of financial advisors, be they independent advisory reps or RIAs with practice management and success and succession planning. And so they leverage Truelytics as a way to evaluate the health and wellness of these independent businesses.

(03:34):

And we can get into how that happens, but we do that across three scorecards, 50 key performance indicators, and we generate four valuations, a discounted cash flow valuation, multiple of revenue, multiple of EBITDA, multiple of EBOC. So that is the health and wellness score for these businesses. And then we have an emergency continuity locker and private matchmaking networks that allow either independent broker dealers or asset managers to drive plan succession within network to give them a fighting chance to keep those assets under management in the event that a succession or a transition event occurs. That's—

Ginevra Czech (04:12):

Pretty robust. Yes. There's a lot there. Yeah. I'm curious for a financial advisor who's maybe interested in utilizing this tool, they're probably going to want to start with—

Jeremi Karnell (04:23):

True Performance, which is the valuation piece of it.

Ginevra Czech (04:25):

Yeah. And you mentioned that there's a couple of different ways that you look at valuation. How did you guys, what are those and how did you define those?

Jeremi Karnell (04:32):

We wanted to calculate the four standard values valuation approaches, right? The discounted cash flow, multiple revenue EBITDA, EBOC. Now the cornerstone of our application is the discounted cash flow. I mean, what we wanted to do is look at an advisor's business through the lens of a buyer. So buyers generally have some interest in what happened in the past, but they're more interested in what the future cash flow looks like. And given the fact that the overwhelming majority of firms in the industry, even still today, are small businesses. Right. It's the more appropriate way to value those. And what made us unique in the industry is that the three scorecards, we have a client revenue and business stability scorecard that make up those 50 key performance indicators. We use all 50 of those key performance indicators as factors into our discount rate associated with the discounted cash flow valuation.

(05:29):

Why that's important is that not only can we give a firm an idea of their intrinsic value, we can also then identify the areas where they're not scoring high and put a value on that. And so we have a notion what we call unrealized value. And on average, when we looked at five, we've got 30,000 firms on our platform. But when we looked at a cohort of 5,000 over a half decade, we were able to identify that on average, an advisory firm leveraging True

Performance that again, assess their health and wellness, are, we're able to identify on average 1.9 million of unrealized value.

Ginevra Czech (06:08):

Are there any areas that's really stood out?

Jeremi Karnell (06:11):

Here's actually a really great, great one. So the best valuations on our platform are firms that have 75% or greater of leveraging model portfolios, where those with the worst valuations are 25% or less. Right. Same with outsourced account management. So OCIO or TAMPS. It's a 70/30 split. So those who do that, that have that, that's greater than 70% best valuations on our platform, lower than 30% worse valuation on our platforms. That's interesting. So those are, I mean, there's a whole handful of stats like that.

Ginevra Czech (06:46):

And I know we talked a lot about continuity plans. And, and it's interesting you talk about, uh, buyers are often interested in looking in the, the future. And so of course, if you have no plan for That's right. For what the future could look like, that's obviously something that's –

Jeremi Karnell (07:00):

Succession readiness is one of the biggest drivers of, of value, especially from a DCF perspective. So when we see firms that there is a massive delta between their current value and their unrealized value, there's a huge segment of that that has to do with the fact that they don't have a continuity or succession plan in place. All of that.

Ginevra Czech (07:19):

And are you seeing things change? I mean, you guys have been in the business with this product for a while now. So how are advisory practices adapting? You've already hit on a couple of things that make some practices more valuable than others, but how are things changing?

Jeremi Karnell (07:36):

We talked about this earlier. I think there's just been a general maturation of the professionalization of financial advice. It has gone from these little mom-and-pop shops, right. Almost part-time in nature, very lifestyle in nature, right. Their book of business has allowed them to buy, you know, their second home and they've got a boat and they work maybe 15 hours a week and they can play golf. And it's just, it was all very lifestyle related. A lot of them, this is funny, someone made mention o' this, there was, I forget, I'm not, well, I won't name names, but I remember being in a meeting with one of our enterprise customers, and they were talking about how a lot of advisors couldn't spell P&L let alone know what a P&L is. Like, it was just that lack of understanding of just basic blocking and tackling for business that's changed pretty dramatically over the last half decade.

(08:28):

You're beginning to, and again, that's happening because you're seeing, you know, a lot of the older generation begin to retire. You're seeing some massive consolidation occur both at the independent advisory rep layer as well as the RIA layer, especially the RIA. And so, with the entrance of a lot of these larger aggregators now that are pulling, that are taking a pretty fractured space. And consolidating it and generating scale, that's then coming with a lot of new leadership, a a new perspective on how these businesses need to scale and build over time and how that drives their value.

Ginevra Czech (09:05):

And so I know it sounds like there's definitely some change. Demographic pressure seems to be one of the biggest ones. I think that's probably something that we can anticipate. I mean, advisors are going to get older, they're going to retire. There's going to be consolidation. One thing that we're seeing affect every industry is technology. We're seeing AI. How do you see that disrupting businesses and benefiting businesses?

Jeremi Karnell (09:32):

It's already beginning to disrupt. Obviously. We're beginning to see in the industry. I was just in Raleigh last week meeting with our data science group, and we're already beginning to leverage our relationship with open AI to drive some new innovations within investment wealth data platform. You've got the likes of Orion that just announced last week. They're leveraging ChatGPT to help drive their CRM and help advisors to use more declarative actions to be able to understand what they should do for engaging with their customers versus what would be considered imperative. Traditionally, you know, hunting by pointing and clicking and having to go through and, and just search and then build on your own is now being replaced by a more declarative, like, tell me like, this is what I want to do. What should I do? And then having AI be able to help really save you time and be able to also give you insights that you wouldn't otherwise have.

(10:29):

I think the biggest thing to think about with AI is that it's come from the back office to the front office. This is like, let's use healthcare as an example. Like in healthcare, AI's been around and machine learning's been around for a long time, same with financial services. But now when I go to see my primary care physician, they have a digital device that's in their hand while they're meeting with me. That digital device is connected to large language models and the entire corpus of knowledge related to healthcare. And I actually find that very comforting, because on one hand, my primary care physician is the empathetic sort of middle person. Between that data and my healthcare financial advice, it's going to follow the same path. And so it's now coming from the back office where it has already made some really important sort of innovations within the financial service in industry, especially around robos and things of that nature.

(11:25):

Now, with things like generative AI and obviously just the buzz around ChatGPT and how that is just changing the way we interface with digital technologies, that is going to empower, and this is where advisors should, their mindset should be, they should go through the process of making sure that they understand how to use that and start leveraging it sooner rather than later. Those who do are, it's going to be asymmetric related to the efficiency and the level of personalization and services that they can provide to their customers versus those who don't, those who want to avoid it. And so the best thing that could happen right now is that they lean into it, learn how to leverage it, obviously embrace those innovations that come out either within the home office or with their strategic partners, and just understand that this is the new world that we're living in. This is, it's no different than sort of Web 1.0 when that came and had a major impact on how information was distributed.

Ginevra Czech (12:28):

So I hear two homework items for you and I, one, you're going to have to add a KPI in there for whether or not people are leveraging AI. That's your homework assignment. And then for me, I'm going to have to find a value-add program where I'm somehow teaching advisors how to leverage these type of technologies.

Jeremi Karnell (12:45):

We're already talking about how we're potentially just going to rebuild all of Truelytics, True Performance in particular. That will be the first within a ChatGPT interface. The entire application can be leveraged and delivered via that. And that's just the tip of the iceberg, like our traditional understanding of how digital products get created and leveraged and how it engages end users is changing before our eyes. And again, what we normally would have are user interfaces and information architectures and dashboards. And again, this whole model of imperative engagement with digital technologies is as more and more people leverage ChatGPT and competitive solutions, it's going to begin to lean more towards that. A declarative like, you know, an AI model can learn. They can look at our database of 30,000 firms, know exactly the best driver's evaluation, be able to make connections that we could not even make, frankly, and be able within one or two prompts provide all of the value that our platform currently does that requires someone to sit down and, and engage with it for 20 or 30 minutes.

(14:02):

That will be reduced down to 20 seconds. Wow.

Ginevra Czech (14:05):

So, I mean, I'm, you know, I'm thinking, I'm trying to think of this through a lens of a financial advisor. There's obviously, I think it's exciting. On one hand, there's so much opportunity. To have a more efficient business. But it can also be a little bit overwhelming. There's, you know, where do you even start? So if we think about some of the stuff we've talked about today, whether it's leveraging the tools that you guys have with True Performance and thinking about some of the KPIs or identifying realized value, recognizing that change is going to happen, whether it's in the form of technology. And, you know, I think a lot about regulation in my time in the industry, that's been one of the biggest disruptors I see. From your perspective, how do we sift through all of that? What are the things that we should focus on?

Jeremi Karnell (14:50):

I think that's what True Performance does best. Right? It, it really takes a really complex and continuing to grow in complexity concept of how to optimize the health and wellness of a business. Not of a lifestyle, but of a real business. To ensure that by the time that you either want to exit the industry, or again, as new younger advisors start taking over these businesses, they'll want to grow strategically. Like the whole concept of M&A 10 years ago, 15 years ago, has changed and growing strategically is now going to be part and parcel of the industry mov'ng forward, even after this demographic change. And so because of that, you've got individuals that are looking at this through, I think, more professional lenses that are saying, okay, what are the drivers of value in my business? Spending time with an application like True Performance really hones in like it really will say, these are the things you're doing great.

(15:54):

You can take those off the table. These are the things that aren't so great, and here, this is how it's impacting your intrinsic value from a low, medium, high perspective. This is how complex it is from easy, medium, or hard. And this is the timeframe that you need to look at as far as it's a quick fix or it's a longer-term fix. And that really helps advisors be able to sort of understand what are the low-complexity, high-value things they should focus on first from a practice management point of view and attack 'em.

Ginevra Czech (16:23):

Is it overly simplistic? I've used this analogy sometimes when I'm explaining the tool. If I have a house, a home, I know the general value of my home, and I know that there's a lot of different factors that add into it. Yeah. If I renovate my kitchen, not only is that going to probably improve the value of my home, but it's also probably going to improve the quality of my life while I'm in the home. Totally. Could I think of the tool in, in kind of the same way?

Jeremi Karnell (16:49):

Talked about the tool in the same light as Zillow, right? We are a Zillow of the wealth management industry. Right? So Zillow will give you a Z estimate for your home. Now, is that a certified valuation of your home? No. You would use another source to actually hone in on that. I know a lot of people like the idea of sometimes what Z estimates tell them, right. Their home, their home value is, a lot of people depend on that just for their, you know, again, ego or what. But we're like that. So the valuations that we calculate that assess the health and wellness of these businesses, again, are algorithmic. They're pretty accurate. But in the event that you were going to do a transaction, we've had transactions based off of our value, most people would go get a certified valuation. It's called an E-valuation for a reason. E being it's digital. But we go one step further than something like a Zillow, where Zillow will be like, here's the estimate for your house. Our platform says, okay, but if you go ahead and remodel kitchen or add a third car port or add a pool, this is your new home value, or this is what it can be. if you do those things, that's where Zillow stops. Right. And we begin. Those are the fundamental differences. So I think that that's really the, I think the power of our platform is that.

Ginevra Czech (18:06):

So I want to thank you. I know we've covered a lot in a short amount of time, but I think if I had to summarize the key takeaways, I think the biggest takeaway I have is that there's a professionalization of financial services that's happening, and that change is inevitable in the industry. So if we're going to think about how do we embrace it, I'm a big believer, I do run value add programs, so I have to believe in this. Let's leverage resources. So let's start with something simple. Come partner with us and do a health evaluation of your business. See what are those unrealized values? Get a game plan. Absolutely. And then I think there are a lot of other themes talking in that same idea of identifying the opportunities, embracing technology, but it definitely goes back to the first step, which is you have to do something that—take some action to figure out where are there opportunities for unrealized value or, or efficiencies. That's right. That's—

Jeremi Karnell (19:02):

Right.

Ginevra Czech (19:03):

Anything you would add or that you think we need to know today? We need to know now?

Jeremi Karnell (19:08):

Since Truelytics got acquired by Envestnet last year, that's probably a really important thing to make sure everyone understands we were acquired and now we are a tool within Envestnet's wealth data platform. And so that means that we're being seamlessly integrated into both their home office enterprise data and analytic dashboards as well as their advisor workstations. And so what's great about that is that we've mapped the data that investment has on their E-platform and Tamarac platform, both for advisors and RIAs. That data is now being imported into Truelytics. So it's going to make that basically the one plus one equals three scenario through this acquisition. It's going to bring that to life. It's going to require less data from either the home office or the advisors. We're marching down the path of really focusing on that data set, driving the entire assessment so that there is no self-reported data, that there's not even a requirement for the home office to provide data.

(20:08):

We're really looking at the investment, the wealth of data that in Envestnet has and throughout the entire industry, but in particular to advisors as evolving our platform and driving that in a way that again, not only does not require much, if any data from the advisor, but then also as we evolve and, and start leveraging generative AI, allowing that to be very precise on what are the next best actions these advisors should take to drive their maximum valuation. So yeah, I would just keep that in mind. Like it is, you know, for those of you that are familiar with Truelytics starting a half decade ago, we are becoming a very, very different platform under Envestnet leadership.

Ginevra Czech (20:53):

That's good. You're eating your own cooking. That's right. If we're telling advisors that's right. That they have to embrace change and iterate, then it sounds like we are also absolutely embracing change and iterating. Absolutely. So thank you again so much for joining us. We actually, we're going to be meeting with a, a group of RIA this afternoon, so excited to deliver this tool to them. If you're interested in learning more about the partnership we have with Envestnet and the True Performance Tool, you're welcome to reach out to fsthrive@fsinvestments.com and learn more about the rest of our value-add programs there as well. FS Thrive was produced by Ginevra Czech with help from Aaron Sherman. It was edited and engineered by Aaron Sherman. Special thanks to show advisor Kim Pollock. If you enjoyed this episode, be sure to like and subscribe to the FS Fireside podcast wherever you stream. Thanks for listening.