Report: Focus Financial is preparing SEC paperwork for its initial public offering -- but is it jumping the gun?

Tuesday 7.7.15 by Brooke Southall

Brooke's Note: If you are a reporter covering roll-ups, you get an earful from the CEOs about two things. First, their firms are not roll-ups. Second, their firms are destined for IPOs. The reason, they say, that their roll-ups are not roll-ups is because roll-up connotes financial engineering, not business management. The irony they miss is that an IPO, which they readily agree is their endgame, is the free enterprise system's pinnacle act of financial engineering. Overnight a company leaps in value — typically at least 30%. There are good reasons for this — namely the ability to generate liquidity without having to grovel before dull-minded bankers or sharp-penciled private equity guys with seven-year clocks. It's like throwing the first log on a fire just as the kindling and paper get going. But pile logs on a fire with insufficient kindling and it never really gets started — or just goes out. If that were to happen with Focus, it might set the RIA roll-up momentum back years. That is not something to wish for. The roll-ups are one free-market derived solution to various RIA challenges of scale, brand, succession planning. Roll-ups worthy of IPOs are part of the end game for captive brokers looking to break away, do wealth management right and create a countervailing power to Wall Street.

Focus Financial Partners LLC is engaged in legal and regulatory preparations to file an initial public offering — and along with that action come plenty of questions about its timing and whether anyone other than a vulture investor is in line for a significant payday.

The New York-based roll-up is reportedly preparing to file an S-1 document with the SEC, according to a July 6 article in industry publication Financial Advisor written by Evan Simonoff. The article cites multiple unnamed sources; no one spoke for attribution.

An S-1 document is considered a serious step toward an initial public offering because of the hundreds of employee hours it takes to complete. Once it is filed with and accepted by the SEC, a company has a three-year window in which to file an IPO.

Focus Financial also declined to comment for this article, though one of its partners, Adam Birenbaum, chief executive of Buckingham Asset Management, commented. [See below.]

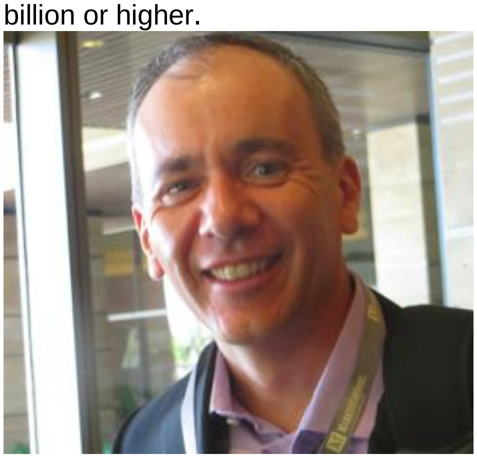
A Focus IPO was also mentioned in a July 1 article in Financial Planning by Charles Paikert.

"For some time Focus has had the scale and profitability to tap into the public markets," said chief executive Rudy Adolf in response to Paikert's question about the possibility of a longrumored IPO. “However, we have a very strong balance sheet and all the resources to support our growth for years to come.”

Back-of-the-napkin numbers

Focus Financial appears to have the scale needed to seek an IPO if indeed, as cited by Simonoff, its EBITDA (revenue minus expenses but then adding back in expenses related to interest, taxes, depreciation and amortization) is $120 million, says Dan Seivert, chief executive of ECHELON Partners, an investment bank in Manhattan Beach, Calif.

Seivert estimates Focus Financial could command a multiple of EBITDA of 14 to 16 at the time of its IPO six to12 months from now, which could lead to an enterprise value of $1.5 billion or higher.



John Furey: Seems the timing is a little early,

David DeVoe, chief executive of DeVoe & Co. in San Francisco, is supposing a lower valuation because he estimates a lower multiple and cash flow.

“If an advisory firm consolidator is generating $325 million in revenue, one might assume that the margins of its combined acquisitions is 20% to 40%, which would yield $65 million to $130 million in affiliate EBITDA,” he writes in an e-mail.

“So, if Focus has acquired 50% to 60% of the EBITDA of the firms that it owns, it may have $40 million to $80 million of EBITDA before its corporate expenses. At a 10x to 15x multiple, this yields a valuation of $300 million to $1.2 billion and perhaps several $10 million less, given there is corporate overhead….However, Focus was valued at $540 million two years ago, based on Centerbridge’s 40% stake at $216 million. So, with the limited data that we currently have, one might assume that Focus could be worth between $700 million and $1.2 billion in today’s market.”

All in the timing

Since its founding in 2007, Focus Financial has made no secret of its intent to pursue its destiny as a public company — a dream rudely deferred by the 2008-2009 financial crisis.

Since then, its assets have rebounded with the markets and the company has shown renewed vigor in its inorganic growth. Its asset under management stand at around $35 billion — and its advised assets are much higher.

Most recently, the company closed a deal to buy Relative Value Partners, a $1 billion RIA based in Northbrook, Ill., bringing its total of partner firms to 34.

But whether Focus Financial, which offers no metrics other than to say its run rate is at about $325 million of revenue, is filing for its IPO from a position of strength or necessity is unclear, and the answer may determine the success of such a move, according to **John Furey**, principal of **Advisor Growth Strategies LLC** in Phoenix.

"Seems the timing is a little early," Furey comments in an e-mail. "The challenge is there only two other examples — NFP and Edelman — that both tried IPO and wound up going private. For me, valuation will be difficult as it still pretty opaque for private wealth firms. We must remember, Focus has partner firms that are all operated independently. The public market will certainly realize they are buying into a basket of smaller businesses."

Huge validation

It's no shocker that Focus may be ready to pull the trigger on a public offering, says Mindy Diamond, president of Diamond Consultants in Chester, N.J.. She recruits for Focus and has worked on deals with its advisory firms.

"We always knew they were going public. It's not even a little surprise to me. They're growing tremendously and doing great things."

Diamond is a big believer in Focus and says in speaking with a number of their advisors she has learned that advisors who sell part of their business to Focus are able to recover what they lost in the Great Recession.

"The teams are back to the pre-deal cash flow in three years [of selling half their cash flow to Focus as part of a standard deal]. I'm a huge fan of the Focus story and the independent space is cheering for them. Focus's success in getting this done and going public would be a huge validation for the space and it's the desired end game and everyone would love to see it happen.

Sizing up the competition

Dan Seivert; It's had many tailwinds
and very little competition.

Still, many of Focus-owned "smaller businesses" are among the largest of their kind. Focus owns majority interests in The Colony Group in Boston, which manages about $4 billion; Buckingham Asset Management and BAM Advisor Services, both in St. Louis, which have a combined $27 billion of assets including assets under advisement; and LLBH Private Wealth Management, which manages about $1.4 billion in Westport, Conn.

The $2 billion question is whether Focus can convince Wall Street that its model is sustainable and replicable. Probably, says Seivert, adding that the company has had a good run of luck.

“It’s had many tailwinds and very little competition.”

Seivert dismisses United Capital Financial Advisers as a competitor because the Newport Beach, Calif.-based company demands a firm change its brand and business model. Chicago-based HighTower Advisors was purpose-built for breakaway brokers. West Palm Beach, Fla.-based AMG Wealth Partners Inc., based in Prides Crossing, Mass., is looking for elite $4-billion-plus RIAs.

The result of such slim competition for deals among autonomy-minded RIAs in the $1 billion range is that Focus has been able to buy RIAs for “ridiculously good prices,” Seivert says.

But the biggest tailwind is the ever-rising stock.

Circling low

Although Birenbaum says he is not privy to the Focus game plan, he appears sanguine about the possibility of an IPO.

“I have great confidence in the entire board of directors of Focus to make decisions like this as to if or when it makes sense to tap into the capital and liquidity of public markets,” he writes in an e-mail.

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“For us to even be having a conversation about the ability for Focus to consider taking part in a public offering though is such an amazing testament to what has been built in a relatively short amount of time — from an economic and business perspective. I personally take a lot of pride in that as I know so many others do at

Buckingham and BAM and also throughout the collective Focus partnership. I guess we'll all just have to wait and see what fun and excitement Focus has in store."

Adding to the funding from venture capital firm Summit Partners LP of Boston in 2007 were VCs Polaris Venture Partners and New York-based Centerbridge Capital Partners LP, which invested $216 million in July 2013 — perhaps in the spirit of vulture capitalism.

"Centerbridge, which bills itself as a private equity and distressed debt investor, is believed to own about 40% of Focus's equity and probably is calling the shots when it comes to decisions about the IPO," writes Simonoff in his FA article. He adds that Centerbridge had the leverage to force earlier investors to accept a dilution of their shares, known as a cram down, and that Focus is believed to have $500 million in debt and about another $220 million in preferred stock outstanding.

Centerbridge's co-founders, Mark T. Gallogly, who previously headed private equity at the Blackstone Group, and Jeffrey Aronson who led the distressed-debt operations at hedge fund Angelo Gordon, invested $750 million in the Dana Corp., "a car parts maker struggling to emerge from bankruptcy protection," according to a 2007 article in the New York Times.

Who's on first?

This positioning factor vis-à-vis private equity is a real consideration, Furey adds.

"Certainly Focus's investors — Summit/Centerbridge — will be in first position. So the question is how/when can advisor firms that are partners participate in the liquidity event? I'm not sure anybody knows the answer at this point. The IPO market is healthy and market timing may be on their side. It should also be accretive to Focus as an IPO would help bring liquidity to shareholders and hopefully build confidence with advisors considering joining them."

If history is any guide, Focus' member firms may find themselves crowded out at the feeding trough, says DeVoe.

"To their credit, Focus has attracted and partnered with some of the very best private equity firms in the country." he says. "However, partnering with leading private equity firms can be a double-edged sword for a pre-IPO shareholder. Seasoned private equity firms have literally worked on hundreds of transactions, which has made them experts in creating a path to a liquidity event. But through these hundreds of transactions, they have also become experts at crafting arrangements that help ensure that their own position is extremely well cared for when the liquidity event occurs."

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Focus executives declined comment to Simonoff.

Cautionary tale

By way of example, Simonoff says one needs look no further than the last major roll-up IPO of Jessica Bibliowicz's National Financial Partners Corp. in New York.

Its chief investor, Apollo Global Management, did fine; advisors not so well.

"[Apollo] was able to sell NFP shares as they soared from an IPO price of $23 per share to north of $50, while many advisors were stuck and couldn't sell their equity until years later," Simonoff writes.

"In some cases, the lifting of sales restrictions came after the stock price collapsed into the teens and ultimately single digits during the financial crisis. By then, Apollo reportedly had sold more than 90% of its position. Madison Dearborn Partners, a Chicago-based private equity firm, ultimately took NFP private in 2013 at $25 per share, or $1.3 billion. It went public at $23 a share."

In the last month, Focus has doubled its credit facility to about $1 billion Simonoff states in the article.

So will we know more about Focus once its S-1 is officially filed?

Maybe not. The documents can be filed on a sealed basis and need only be made public 21 days prior to the IPO road show.