Focus, TD and Live Oak hit especially hard by coronavirus crash

Leveraged RIAs, their custodians and even a key lender have unique pain points that put them at risk.

by Ian Wenik for Citywire

Nearly every RIA is a privately held company. But if their best public market analogues are any indication, the industry is entering a serious period of financial stress.

Shares of Focus Financial Partners, the KKR and Stone Point-backed buyer and financier of RIAs, have cratered has the coronavirus crisis has roiled US markets. Shares of the company changed hands at $15.47 on the Nasdaq on Tuesday morning, down around 45.2% in March.

Focus is the closest thing to a traditional RIA available on the equity markets right now and its recent performance points to the trouble for advisors who are reliant on assets under management (AUM) fees correlated to market performance. Around 70.5% of Focus Financial Partners' $340.2m in revenue for the fourth quarter of 2019 is correlated to financial markets, the company reported in February.

'We might be seeing concerns over their leverage (debt) and uncertainty over dealmaking,' said Brandon Kawal, a principal at RIA consultancy Advisor Growth Strategies. 'We may see dealmaking slow for a short period.'

Focus Financial Partners' net leverage ratio – which compares its outstanding indebtedness to its earnings before interest, taxes, depreciation and amortization (Ebitda) – sat at roughly 4x at the end of the fourth quarter of 2019. However, that figure is poised to increase in the first quarter of 2020, as ongoing market turmoil drives Focus' Ebitda lower.

How Focus contends with its indebtedness in a time of decreased revenue from AUM fees could have implications for its private equity-backed peers, such as Hightower, the Wealth Enhancement Group and Mercer Global Advisors, which have all been recapitalized in the past several years.

'After a market downturn, [a lot of RIAs'] margins do not look very good,' said Michael Henley, chief executive of $750m Brandywine Oak Private Wealth. 'Even a 30-40% drop in financial markets, their margins are pretty much squeezed to damn near nothing.'

The recent market decline has not spared RIA custodians, either. Shares of Charles Schwab have dropped 29.3% in March to $29.69 on the New York Stock Exchange, while shares of its merger partner, TD Ameritrade, have plunged 33.5% on the Nasdaq to $29.03.

The two discount brokerage firms may be getting hurt on multiple fronts – and may be getting punished for their fall of 2019 decisions to eliminate their commissions on US stock, options and ETF trades.

‘Schwab and TD are going to track closely with the market, given their reliance on market-based (advice) income and interest income (cash and lending,’ said Kawal. ‘Having trading income drop to zero takes away a revenue line that would potentially perform well during this type of volatility.’

Another RIA-linked firm taking a beating in the market is one of the industry’s key lenders. Shares of Live Oak Bank, which funds RIA acquisitions and succession, along with wirehouse breakaways, have collapsed in March. The company’s stock price has plunged 43.4% in March to $8.94.

Many of Live Oak’s loans are partially guaranteed by the federal government’s Small Business Administration (SBA). But a liquidity crunch to the firm could have a ripple effect.

‘If something happens to that lender, that’s a problem,’ said Henley. ‘I bet you’d probably see a bunch of lenders follow suit.’