Focus performed well in Q1, but Q2 presents a challenge

The RIA financier's stopped-up deal pipeline and its partner firms' advance billing practices may cause issues.

by Ian Wenik for Citywire

Focus Financial Partners' earnings report for the first quarter impressed. But a bigger challenge may loom in the second quarter.

The metrics Focus reported on Thursday morning show that the company's acquisition model — in which it takes a preferential stake in a partner RIA's earnings — gives itself downside protection. Focus' revenue in the first quarter of 2020 dropped by just 0.9% sequentially, to $337.1m. That preferential stake means that Focus gets paid first out of its partner firms' earnings, no matter what market conditions may be.

'The earnings report was impressive,' said Brandon Kawal, a principal at RIA consultancy Advisor Growth Strategies. 'The results do reinforce the model as they have preferred economics that protects in downside scenarios.'

However, the pain of the coronavirus pandemic's effect on markets won't fully reveal its effect on Focus' earnings until the second quarter of 2020. That's because a majority of its partner firms bill their clients in advance — at the beginning of a fiscal quarter — rather than in arrears, at the end.

US markets did not begin their slide until February, and the crash came in March, which means that revenues generated by advance billings do not account for the effect of the coronavirus pandemic.

Roughly 73.3% of Focus' revenue, around $247m, comes from market-linked fees such as assets under management fees and tax fees. Of that $247m, around 70% ($172.8m) was generated from advance billings. Focus said in the form 10-Q that this structure 'generally result[s] in a one-quarter lagged effect on our revenues.'

The lag is reflected in Focus' guidance for the second quarter of 2020: the firm projects revenue to slip to a range between $290m and $300m.

Historically, Focus has been able to grow revenue through acquisitions, either by adding new partner firms or financing subacquisitions for its existing partners.

There appear to be few deals on tap at the present moment. Focus chief executive Rudy Adolf said on the company's earnings call that its deal pipeline will be subject to delays into the third quarter. Still, Focus partner firm Buckingham Wealth Partners said recently it plans to purchase $425m RNP Advisor Services.

Will RIAs be willing to partner with Focus in a down market knowing that the company will get first crack at their earnings?

‘This is less about the current partner firms and more about future acquisitions,’ Kawal said. ‘The public record shows what it’s like to partner with FOCS during a downturn. So far, it looks okay, but it will be interesting because there is more competition for deals.’

Focus’ best bet for keeping its M&A machine running may be to look for acquisition targets other than traditional RIAs. The firm has bought several business management firms in recent months.

‘I think they’re making smart investments on the certified public accountant (CPA) side that I think will help stabilize and diversify revenue streams,’ said Jay Hummel, a partner at RIA consultancy Wealth Advisor Growth Network (WAGN).

After rising sharply on Thursday and adding to those gains on Friday, Focus shares fell 6.5% on Monday as of midday trading.