Roll-up Firms Get Squeezed by Backers and RIA Firms

Originally Published By Jed Horowitz, Investment News

Businesses that specialize in consolidating independent-advisory firms — particularly, consolidators known as roll-ups — are under strain, according to participants in the ventures, investment bankers and consultants.

The founders of some registered investment advisers who sold interests in their firms to monetize their life's work and promote a growth path for younger partners are repurchasing their stakes. Others are banking the cash they received in the initial deal by retiring early without the payout that they expected for sharing in the parent consolidator's growth.

Several consolidators that focused on practices with $500 million or more in assets are said to be hunting for capital to satisfy private-equity backers — and refinance high-interest loans — while pressuring RIA affiliates to reduce costs. New deals to replenish consolidators' revenue, meanwhile, are at a near standstill, and some of their affiliated firms are having trouble making payments to the parent firms, some insiders said.

"The entire business school consolidation model has a T-shirt now with a question mark on its back," said Philip Palaveev, president of Fusion Advisor Network, an independent broker-dealer that focuses on financial planners.

"Acquisitions were driven by projections of 20% growth in assets."

Fusion uses the brokerage services of National Financial Partners Corp., one of the earliest and most troubled consolidators, but Mr. Palaveev said that his firm has no financial link to NFP.

Principals of the consolidator firms said that their struggles are no more extreme than what other financial services firms face, and insist that they are well-positioned for a revival.

"The model is under stress, but the industry of consolidating the fragmented independent-RIA space is not going away," said M. Rush "Rusty" Benton, chief executive of WealthTrust LLC, which has majority interests in 10 RIAs with a combined $6.5 billion in assets under management.

STAYING THE COURSE

The partners of a former Wealth-Trust advisory firm repurchased that firm last summer and renamed it Kingfisher Capital, fueling rumors that Mr. Benton's firm is winding down to repay a hedge fund loan and satisfy demands of private-equity firms. The firms, Circle Peak Capital LLC and Falcon Investment Advisors LLC, recapitalized WealthTrust in a series of deals beginning with their acquisition of WealthTrust from regional brokerage Morgan Keegan & Co. and a bank affiliate in 2006.

Mr. Rush "Rusty" Benton: "The model is under stress, but the industry of consolidating the fragmented independent-RIA space is not going away."

Mr. Benton said that the Kingfisher partners left because they were gravitating from wealth management to investment management, and he insisted that his firm is staying the course.

Instead of doing deals, Wealth-Trust is focusing on helping its remaining 10 affiliates operate more efficiently, Mr. Benton said. It cut about 30% of expenses at the corporate level last year, and affiliates cut expenses by about 15%, he said.

His private-equity owners pressed for more-severe cuts but didn't ask for anything excessive or put pressure on the affiliates, Mr. Benton said.

An executive at one of the affiliates, however, said that pressure is being felt at all roll-ups.

“We got into this as a wealth-building opportunity ... but they can't access capital now for their private-equity backers or the affiliates, and we worry about headline risk if they go bankrupt,” said the executive, who asked not to be identified. “Some people are buying themselves out because they can't stand it.”

The troubles of some consolidators that are already public are well-known.

Boston Private Financial Holdings Inc. last week said that it will sell back Westfield Capital Management, an RIA in Boston that manages about $11 billion of assets, to its management team. Last summer, the bank returned the ownership of three smaller wealth management firms — Boston Private Value Investors, Rinet Co. LLC and Sand Hill Advisors — to their principals.

“I really wanted to return Westfield to being 100% employee-owned,” said chief executive Will Muggia, sounding frustrated at his inability to have a direct share in the firm's equity as assets grew more than tenfold since his arrival in 2000.

Mr. Kaye said that Boston Private has no plans for further divestitures and will use the sales proceeds to spur growth at its nine affiliates.

Some consolidators have been buying, particularly those that specialize in smaller advisory firms and startups, while keeping a tight rein on their operations.

United Capital Financial Partners LLC, for example, has acquired nine RIA firms this year and recently captured $15 million of new capital backing. But it remains to be seen if its model is sustainable through retained earnings and motivation of its participants, consultants said.

Daniel Seivert, chief executive of **Echelon Partners**, an investment bank and consulting firm, estimates that every year, about five new consolidators announce startup plans, and five fold.

“The roll-up model is all about timing, and if you have a disruptive event like the market correction we just had, it disrupts the timing fatally for everybody involved,” said Mark Hurley, president of Fiduciary Network LLC, which finances buyouts of RIA founders by “second-generation” RIA principals.

Mr. Hurley insists that his firm isn't a roll-up, because it eschews majority equity stakes in the advisory firms and doesn't offer equity in the ventures with promises of an initial public offering or big liquidity event. But deals are relatively slow because founders are taking a long time to work out their intergenerational plans, he said.

Fiduciary Network is spending more time than expected on helping clients grow through hires and in-market mergers, Mr. Hurley said.

Ruediger "Rudy" Adolf, CEO of Focus Financial Partners LLC, acknowledges the hard times but emphatically denies some bankers' talk that the aggressive multiples he paid in some early deals have come back to haunt him.

The firm claims to be the biggest consolidator of RIAs, with 16 majority-owned acquisitions since its founding in 2006.

"We are profitable and in a very strong financial position," he said.

The firm could take itself public today if it desired, Mr. Adolf said, claiming it is larger than many firms that have recently floated IPOs.

Summit Partners, the private-equity firm that invested $35 million in Focus, is content with Focus' cash flow and progress, he said, adding that his firm is servicing its debt and meeting all its bank loan covenants. Although the company hasn't publicly announced a deal in more than a year, Mr. Adolf said, Focus has done five transactions in 2009.

He declined to name them or comment on Focus' debt levels.

Mr. Adolf confirmed that he's consulted with some additional private-equity firms recently, but he said it wasn't at his initiative. "When someone's interested in this space, rest assured that the first call comes to us," he said. "We may be interested in adding capital, but at this point, we have nothing to announce."

About ECHELON Partners

ECHELON Partners (ECHELON) was formed in 2001 to offer investment banking and consulting to a subset of the financial services industry known as "investment product developers and distributors" (IPDADs). Since that time, ECHELON's professionals have helped hundreds of senior executives envision, initiate, and execute a multitude of complex business strategies and transactions. ECHELON's business is making companies more valuable through delivering advice and orchestrating transactions. Accordingly, ECHELON measures its success in the enterprise value it creates for its clients. Companies that strive to outperform their peers choose to work with ECHELON because we are as passionate about their results as they are.

Daniel Seivert

Managing Director

dseivert@echelon-group.com