Stone Point and KKR Buy Focus Financial for $2 Billion by Employing Massive Leverage

4/19/2017 Originally Published by Brooke Southall, RIABiz

Stone Point Capital LLC and Kohlberg Kravis Roberts & Co. LP will acquire a majority stake in Focus Financial Partners LLC in a deal that values Focus at approximately $2 billion.

In doing so, the Greenwich, Conn-based investor of $13 billion and the iconic New York private equity firm will put to rest the question of how restless investors in the giant roll-up will cash out. Those investors include Centerbridge Partners LP of New York; Summit Partners of Boston, Menlo Park, Calif. and London; Polaris Partners of Boston; and San Francisco and Dublin -- not to mention Focus advisors and employees.

Focus, the New York-based roll-up, was founded in 2006 and its 11 years of existence is like two lifetimes in the private equity world. Focus has had other liquidity events but none as robust as this one. Why Focus Financial is risking it all -- including the advantages of privacy and private stock -- for a successful IPO.

Four years ago, Focus Financial was valued at $750 million.

The senior management team at Focus will continue to lead the business. Members of the management team will also remain significant shareholders and receive a boost from Stone Point, which purchased NFP Advisors, the giant roll-up founded by Jessica Bibliowicz in 2016.

The deal is go-go stuff in the sense that it relies on Focus growing quickly enough to handle the staggering debt service that sources say comes from the $1 billion in leverage that fueled the deal.

"A key reason for our partnership is the vision we share for continued growth. We remain committed to creating value for all of our shareholders, including our clients, partner firms and affiliates, and employees."

That growth will come in an atmosphere in which management has "less control than ever" and perhaps more pressure to grow than ever, according to **Dan Seivert**, CEO and managing partner of **ECHELON Partners** of Manhattan Beach, Calif.

"Growth will have to come in different ways as it will be harder and harder each year to generate a 20%-plus internal rate of return on 10 to 20 RIA deals and on a higher base of AUM and revenues."

He adds that Focus completed 20 acquisitions in 2016 and has six already announced for 2017. Focus has more than 45 partner firms and affiliates across the United States, Australia, Canada and the United Kingdom, with a joint venture in China.

Those deals may be harder and harder to come by says Jeff Spears, who was founder and CEO of Sanctuary Wealth Services LLC, roll-up-like venture in San Francisco.

"We've seen that with HighTower. Their breakaway model stalled." HighTower picks up $6.4-billion roll-up on the cheap but the valuation may reflect WealthTrust's stagnant growth and profitability.

"Why is that?" he asks. "The advisors controlling 59% of their assets are pretty well taken care of. The wirehouses have adapted."

By way of example, Spears references UBS's 50-50 program designed to retain brokers who have passed the half-century mark. He observes that the earnings of Merrill Lynch, UBS and Morgan Stanley are going up even as their headcounts decline, illustrating that those giant financial services firms are willing to err on the side of keeping big producers happy.

If there aren't going to be more deals, then bigger deals need to start cranking up now to make this KKR-led round of funding pay off.

"This third round of investors should be expected to usher in a new level of much larger deals…yes there will be the deals with larger wealth managers with $5-10 billion-plus in AUM," Seivert says. "…especially the ones that are private equity backed that need a liquidity event. Keep in mind there are over 60 private equity firms that are currently investing in the industry. There will also likely be some unconventional deals that may involve banks, insurance companies selling out their wealth management businesses.

Investors can rest reassured that they've bet on the right horse, says Chuck Davis, CEO of Stone Point Capital.

"Rudy and his team have built a remarkable business model that provides relentless support to their independent wealth management advisors. We are excited to enhance their continued expansion with our sector expertise and deep network of relationships throughout the financial services industry."

"By consistently delivering value to its clients and partner firms, Focus has distinguished itself as the partner-of-choice for leading independent wealth managers in the U.S. and beyond," says Henry Kravis, co-founder, co-chairman and co-CEO of KKR, sounding a similar note in his company's release.

"We look forward to supporting the firm's continued success by leveraging our global network and resources."

But Spears warns that Kravis and the other investors may not quite grasp what they are buying into.

"They don't understand a business model positioned as customizing a solution," he says. "It makes economies of scale harder. From my experience, [Focus hasn't] done that."

By comparison, The Mutual Fund Store sold last year for $560 million and had about $10 billion of AUM at the time. Focus Financial declined to name an AUM and because each of its advisors has its own ADV, making arriving at a figure a involved task.

Focus Financial's biggest RIA is BAM Alliance of St. Louis. BAM Alliance includes BAM Advisor Services, an outsourcer in St. Louis with 140 firms and 15,500 clients comprising $18 billion of assets using its services and Buckingham Asset Management, which manages about $9 billion for its own clients.

Whether or not Wall Street-style private equity firms like Stone Street and KKR end up walking away from the RIA business based on the Focus Financial investment, and deals like it, with a good taste in their gold-plated mouths may rely on their ingenuity in modifying hybrid advisors who exist more on their side of the old-style Wall Street, Seivert suggests.

"Of course a big question will be if this new team can find a way to transform the economics of the B-D business model and do some deals in this part of the industry…or will they just be responsible for increasing the departures of advisors leaving B-Ds for other business models," he says.

"We know they have tried to build an effort in this area in the past with Matt Sonnen…perhaps they were just too early."