Why Focus Financial is risking it all -- including the advantages of privacy and private stock -- for a successful IPO

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Focus Financial Partners LLC is poised to pull off one of the more impressive acts of alchemy in the annals of the RIA business. But completing that act of financial legerdemain, with its associated gush of liquidity, could usher in an awkward, perhaps painful, phase for the notoriously private firm, observers say.

Last week, The Wall Street Journal reported that the New York-based roll-up had confidentially filed for an IPO with the Securities and Exchange Commission, a move that would transform Focus Financial's 41 autonomous advisory firms into a publicly traded entity valued, according to WSJ, at a $1 billion.

The Focus IPO is almost certainly good news for its CEO, Rudy Adolf, who founded the firm in 2006, and his many big-ticket private equity backers. But a downside looms in the process of turning relatively useless private stock into publicly traded liquid assets — on a behavioral, if not a financial, perspective, especially if you go by National Financial Partners' post-IPO phase. Once that stock is converted to cash, the incentive to chase a downstream payday largely disappears.

Cautionary tale?

New York-based NFP Corp. went public in 2003 only to become unglued in the 2008-'09 crisis. At the time, collective wisdom viewed advisors who had cashed out, and therefore had little incentive to rebuild, as chief culprits.

To be sure, that analysis ignores the heavy insurance sales bent of the NFP roll-up and the fact that insurance sales were subject to particularly harsh market conditions. Another thing people forget is that the Jessica Bibliowicz creation did eventually stage a reasonable rebound.

NFP was taken private for $1 billion with Madison Dearborn as principal investors, at a share price, under the old public company rubric, of about $28. At the lowest point in its free fall, NFP traded in single digits and that is what people remember.

New York-based PE Madison Dearborn Partners LLC was principal investor in taking the company private, in the $25-per-share range. At its deepest point of free fall, NFP's shares traded in the single digits, and that dominates many people's memories on the matter.

Stock, paper, scissors

All that said, taking Focus public is a "huge risk," writes Charles "Chip" Roame, managing partner of Tiburon [Calif.] Strategic Advisors.

"Private stock is paper. Public stock is cash that I can spend on my new beach house," says Roame, who adds that he suspects that beach houses are exactly where Focus members will be tempted to spend more time, post-IPO.

Dan Seivert, CEO of **ECHELON Partners**, an M&A and consulting firm, strongly suspects that the IPO is driven by board members who were never in it for the long-haul — namely private equity investors, who normally operate on a three- to seven-year cycle.

"They need to do a deal to get liquidity for existing players," Seivert says from his offices in Manhattan Beach, Calif.

Hard swallow

The biggest player in the Focus ecosystem is Buckingham Asset Management in combination with its sister company BAM Advisor Services of St. Louis — a DFA turnkey asset management program for accountants that also give financial advice. CEO Adam Birenbaum says he is pleased about Focus's planned IPO.

"I have always had the utmost confidence in the Focus leadership team to make decisions that are in the best interests of all constituents," he says. "Each and every partner firm that has joined Focus has gone in with eyes wide open about all of the possible scenarios that may exist. I am as excited today as I have ever been about the future of both Buckingham and BAM as well as Focus."

Indeed, when the owners of Focus accepted $216 million of fresh capital from Centerbridge Partners LP in 2013, they experienced a dilution of their shares known as a "cramdown" — a financial reversal that is as uncomfortable as the name suggests. The firm was forced not only to sell shares at reduced prices but to give up some control of the company as well. Polaris Venture Partners and Summit Partners were the two private equity firms that took cash out of that deal in addition to shareholders across the company.

Focus owns big RIAs including Colony Group of Boston; and LLBH of Westport, Conn.

Expedited timetable

In a 2013 RIABiz interview, Adolf downplayed the significance of the cramdown.

"The partners and management gave up their majority ownership. It is not an issue whatsoever. The reason is, Centerbridge is investing in a very successful business model, and Focus's business model won't change. We'll continue to help invest and grow our firms. The technical ownership of the business isn't that important. The partners and management still own a very large minority percentage."

But Jeff Spears, CEO of Sanctuary Wealth Services, disagreed with Adolf back then, saying control by Centerbridge made a liquidity event — for better or worse — much more likely in the near future.

"Those private equity owners want an exit strategy and they will likely have a fast timetable. Private equity ownership is a double-edged sword. It's good that they've got the money but it's bad that they have a different timetable than you do. Now, you're playing by their rules and their timeline. That's where the game has changed for Focus."

In the larger picture, Roame wonders if the Focus move signals increasingly skittish sentiment among PEs.

"There has been a trend of late to forego IPOs and grow larger as a private firm. Focus seems like a firm that would benefit from that strategy. Are the PEs maybe wanting to cash in now at the peak?"

Shock to the system.

For the Focus management team, the transition to a public could be bumpy in unexpected ways, says Roame.

"Being public, at a very practical level, will force him to reveal many details of their debt, transaction costs, synergies, etc. Competitors will eat that stuff up," Roame says of the firm, which has a reputation for being almost obsessively private in its dealings with the public, and even with its RIA and roll-up colleagues.

RIAs under the Focus umbrella may not appreciate the increased scrutiny either.

"Shock to culture? Maybe. Aside from Rudy, also remember that likely few of his acquired firms have also been public companies. 'I did no sign up for this' may be a common refrain later," says Roame.

Singular situation

On the bright side, the Focus IPO may enhance the roll-up's ability to … roll-up.

"I think it will help, not hurt, recruiting," Roame says in the email. "We must appreciate those that sold their life-work to a private firm, but I'd rather sell my business to a public aggregator than a private one.".

Seivert likes Focus's odds for a successful offering, valuing the firm at $1.1 billion as opposed to the Journal's flat billion-dollar estimate. He figures that the firm throws off about $400 million in revenue from about $50 billion of managed assets, about $75 million of which will filter down to shareholders. The investment banker says there's a price-to-earning ratio of 15 by the $75 million of earnings before interest, taxes, depreciation and amortization.

Underwriting the Focus offering is Bank of America Corp. and Goldman Sachs Group Inc., which may pull the IPO trigger by the end of the year, the Journal's sources say. Companies can file confidentially for IPOs on U.S. exchanges if their annual revenues don't exceed $1 billion.

Roame — like Adolf, an alum of global management consulting firm McKinsey & Co. — says Adolf's position as point man in creating a $1-billion payday for investors from a group of small advisors is singular.

"New kind of leader? Maybe," Roame muses. "Picture the transition between LPL Founder Todd Robinson and current LPL CEO Mark Casady."