

## RIA MILESTONE: FOCUS STOCK BEGINS PUBLIC TRADING

7/26/2018 Originally Published by Jeff Benjamin, InvestmentNews

Focus Financial Partners' initial offering price of \$33 was bid up by investors when the stock started trading Thursday afternoon. Despite the below-target offering price, the stock closed its first day of trading at \$37.55, representing a 13.8% gain.

The S&P 500 Index lost .3% on Thursday.

With the initial public stock offering officially behind it, Focus Financial Partners is now relying on the public equity markets to value the RIA roll-up.

Coming in below the target range of \$35 to \$39 on Wednesday cut the market value of the company by about \$400 million and reduced the IPO proceeds by \$65 million.

While waiting for the shares to start trading Thursday on the NASDAQ Global Select Market, analysts and market watchers said it was too early to write the IPO off as a failure.

Kathleen Smith, principal at Renaissance Capital, said the unique nature of Focus as a consolidator of registered investment advisers was likely lost among the lower-valued category of asset management companies.

"Right now, the market is not looking at this company and giving it a premium relative to other asset managers," she said. "This is a roll-up, and you have to really look under the covers to figure out the value."

Ms. Smith added that the market overlooked the pre-IPO valuation on Focus of 17 times forward earnings, which compares to an average valuation of 12 for the asset-manager category as a whole.

Another factor likely affecting the Focus stock offering was the fact that six other companies priced shares Wednesday, making it the second-busiest day of the year for IPOs, according to Ms. Smith.

"As active as the IPO market is, the investors are still pros and they don't want to lose money," she said. "You can't make a big deal of this price, because I think there was good price discovery. And the underwriters are pricing these deals to trade above the offering price" once they start trading.

**Carolyn Armitage**, managing director at the investment bank **ECHELON Partners**, believes the issue might be that investors paid too much attention to the pre-IPO details.

"The underlying fundamentals are what investors are thinking about," she said. "The fact that they intend to use at least half of the offering proceeds to pay down debt is a noble cause, but as an investor you want your money to go toward future growth, when they're asking investors to pay for growth they've already had."

Focus raised \$535 million after the market closed Wednesday by selling 16.2 million shares.

The initial public offering price valued the company at \$2 billion.

Focus Financial did not respond to requests for comment for this story.

During the run-up to the offering, which included a video "road show" presentation, Focus executives were hoping to raise at least \$600 million by selling the shares in a price range between \$35 and \$39, which would have valued the company at more than \$2.4 billion.

While there was much hype around the Focus IPO, which occurred in the midst of one of the hottest stock-offering cycles since 2014, there were also skeptics.

Peter Raimondi, founder and chief executive of Dakota Wealth Management, acknowledged the uniqueness of a publicly traded wealth management operation, but he wasn't sold on the high valuations.

"Focus is an owner of RIAs that are run by legacy teams, which makes the company an amalgamation of multiple RIAs contributing to the mother ship," Mr. Raimondi said. "That's much different than any single, branded RIA."

Focus had 2017 revenue of \$662.8 million, 90% of which is recurring revenue from the RIAs that Focus has acquired all or part of since launching in 2006.

The company's earnings before interest, tax, depreciation and amortization, a measure of its operating performance, was \$145 million last year.

During the road show presentation video to promote the stock offering, Focus co-founder Rudy Adolf said the company has acquired an additional \$28.6 million worth of earnings this year, and has completed four acquisitions since April.

Three more firms that have already signed to join Focus will add another \$9.9 million to the base earnings, Mr. Adolf said.

"We believe we are the only pure-play opportunity to invest in this market," he said on the video.

"For anyone who believes in these mega trends [toward independent, asset-based financial planning], Focus is the only opportunity to invest in a pure-play wealth management model," Mr. Adolf said.

Even acknowledging the benefits of scale, Mr. Raimondi questions an EBITDA valuation in the range of 17, when BlackRock Inc. (BLK) is trading at 16 times and paying a 2.5% dividend.

Other examples of asset management companies, but not specifically wealth management, that Mr. Raimondi used for comparison include T. Rowe Price Group (TRW), which is also trading at 16 times and paying a 2.5% dividend, LPL Financial Holdings (LPLA), which is trading at 11 times EBITDA, and Affiliated Managers Group (AMG), which is trading at 8 times.

"This is not Focus Financial's fault; they are smart as hell to get what they can get," he said. "Granted, they are doing something that none of the other public companies are, but they only have about a seven-year track record of doing what they're doing at this size."

According to company statements and public filings, at least half of the proceeds from the stock sale will be used to pay down part of the company's nearly \$1 billion in debt. The rest will be used to help expand the size of the company, including more acquisitions of RIAs.

The stock sale came during an uncharacteristically busy summer period which could see 11 IPOs this week, following the 10 IPOs priced last week.

---

This year, more than \$30 billion has been raised through 115 IPOs, which is on pace for the best year for IPOs since 2014, when \$85 billion was raised through 274 IPOs.

"Typically, July is supposed to be a quiet time for IPOs, but the stock market is doing well and there's lots of cash sitting on the sidelines looking for investment opportunities," said Joseph Schuster, manager of the \$1.1 billion First Trust US Equity Opportunities ETF (FPX), a fund that invests in newly public companies.

Part of the appeal of Focus Financial, according to Mr. Schuster, is its unique exposure to the predictable revenue of asset-based financial advice.

"There is immense interest in specialty deals like this," he said.

While it is true that Focus gives investors rare access to a highly regarded segment of the wealth management industry, time will tell if the market priced it correctly.

Leading up to pricing of the stock on Wednesday, an online poll by the IPO tracking firm Renaissance Capital showed an anticipated first-day gain of between 10% and 25%.

"Focus is growing faster than all the firms we've used in picking comparables, and investors will pay a premium for growth," said Kathleen Smith, principal at Renaissance Capital.

Focus shows a compound annual growth rate of 9.5%, which compares 5.4% for the industry average, according to Ms. Smith.

The Focus IPO follows the Feb. 8 offering by Victory Capital Holdings (VCTR), which raised \$152 million as the only other wealth management company to go public this year.

Victory's stock price has declined 11.6% since the IPO, which compares to a gain of 9.7% by the S&P 500 Index over the same period.

While Focus is promoted as offering broad exposure to a predictable revenue stream, it is also a company that has generated most of its growth through acquisitions, and it's owned by private-equity investors, which are not typically long-term investors.

According to Mr. Adolf's video presentation, none of the executive equity holders or the private equity owners will be selling shares at the IPO.

Focus has been partially owned by PE investors for 12 years, and in April 2017, a 70% ownership stake in the company was acquired by Stone Point Capital and KKR.

---