

RIA MILESTONE: FOCUS STOCK BEGINS PUBLIC TRADING

7/26/2018 Originally Published by Charles Paikert, Financial Planning

Shares of the long-awaited Focus Financial IPO began publicly trading today, marking a milestone in the RIA business.

Although Focus is a holding company with preferred interests in over 50 advisory firms, it is widely viewed as the first real public market stand-in for independent advisors and the impressive growth of that industry in the past decade.

"This was many years in the making, and Focus got it done," says Matt Crow, president of research and consulting firm Mercer Capital. "They've proven a lot and gotten further than others have, which is not a trivial accomplishment."

The Focus IPO was priced at \$33, although the firm originally anticipated an opening price of between \$35 and \$39. As a result, Focus' estimated market value dropped by around \$400 million and anticipated proceeds from the IPO were cut by over \$90 million.

The stock price ticked up during the day, however, ending trading on the Nasdaq at \$37.55.

As an industry bellwether, the long-term performance of Focus' stock (ticker symbol: FOCS) will closely watched in the months and years ahead.

The company's ability to achieve organic growth will be the biggest test of the sustainability of Focus' business model, according to Crow.

In 2017, organic revenue at Focus firms grew 13.4% over the previous year, Crow noted in a report on the Focus IPO. The prior two years, Focus reported mid-single digit growth.

"We think this will be a closely studied metric for Focus as it matures," Crow wrote.

Peter Nesvold, managing partner of the investment banking firm Silver Lane Advisors, agrees.

"In order to defend its IPO valuation, Focus will need to prove that it is not merely an aggregator; acquisitions are helpful to supplement growth, but the market puts a greater premium on organic growth," Nesvold says. "To this end, investors will be looking for strong asset inflows excluding any market uplift."

Focus needs to post better financial results, says Chip Roame, managing partner, Tiburon Strategic Advisors.

"Strong growth in topline revenue has been due primarily to acquisitions," he notes, "so organic revenue growth is critical. Focus faced variable gross margins, uneven gross profits, and uneven cash flow from operations to date and it must achieve synergies as a larger firm."

For investors, Focus will need to differentiate itself against publicly-traded money management firms that have been de-valued by the market as passive investing has chipped away at active management, Nesvold adds.

"The business model in wealth management is markedly different than it is in money management," Nesvold notes. "The challenge is that Focus does not yet have a critical mass of wealth management peers in the public markets; accordingly, Focus will be at risk of being swept into a peer group of stocks that trade at lower multiples."

Focus will also face comparisons to wealth management companies such as Edelman and National Financial Partners that had unsuccessful stints as public companies and were subsequently taken private again, says **Dan Seivert**, CEO of **ECHELON Partners**.

"Fifteen percent growth per year is pretty much the minimum threshold for public companies to thrive," Seivert says. "I think Focus's past growth positions them well to surpass this hurdle. Investors then just need to focus on what valuation multiples make sense given their expectation for growth. If investors don't believe Focus can surpass 15% a year in growth they could find themselves thinking like boat owners."

"As the saying goes, the two happiest days of a boat owners life are they day they buy and the day they sell their boat," Seivert says. "For low growth companies that go public, the best day after the IPO is the day they go private again."

Another critical indicator for Focus will be how closely the stock is identified with the RIA business.

In a promotional video touting the IPO, Focus CEO and co-founder Rudy Adolf claimed that the company is "the only pure-play opportunity" to invest in the \$2 trillion RIA market.

If the market agrees, that's great for Focus, says Dennis Dolego, director of research for Optima Group.

"The RIA business is very solid and the market is becoming much more knowledgeable about it as it begins to consolidate, and looks very favorably at the aggregators," Dolego says. "Focus is perfectly positioned to take advantage of these factors."

But Brent Brodeski, chief executive officer of Rockford, Ill.-based Savant Capital Management, says Focus "may not be a good comparable" for other RIAs.

"Unlike investment management firms that are a single operating company, Focus' earning is an amalgamation of preferred interests of a variety pack of legacy firms," Brodeski says. "In one way this might be good, as the preferred interest they take in RIAs has certain downside protection since they shift risk to their portfolio companies. On the other hand, many legacy firms' growth rates are lackluster as the founder has moved on and the firms frequently lack next generation rainmakers."
