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FOCS.OQ - Q2 2019 Focus Financial Partners Inc Earnings Call

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PRESENTATION

Operator

Good morning. I would like to welcome everyone to the Focus Financial Partners 2019 Second Quarter Earnings Call. Joining today's call are Rudy Adolf, Founder and CEO; Jim Shanahan, Chief Financial Officer; Rusty McGranahan, General Counsel; and Tina Madon, Head of Investor Relations and Corporate Communications. (Operator Instructions) As a reminder, this conference is being recorded.

Now, I would like to turn the call to Mr. McGranahan. You may begin.

J. Russell McGranahan - Focus Financial Partners Inc. - General Counsel & Corporate Secretary

Good morning, everyone. Before we get started, let me remind you that during the course of this call, we may make a number of forward-looking statements. We call your attention to the fact that Focus's results may of course differ from these statements. These statements are based on assumptions made by and information currently available to Focus Financial Partners and involve risks and uncertainties that could cause the results of Focus to materially differ from these statements. Focus has made filings with the SEC, which list some of the factors that may cause its results to differ materially from these statements. And finally, Focus assumes no duty and does not undertake to update any such forward-looking statements.

With that, I'll turn it over to our Founder and CEO, Rudy Adolf. Rudy?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Thanks, Rusty. Good morning, everyone, and thank you for joining our call. We appreciate your interest in Focus. This past month, we marked the first anniversary of our IPO. We've been very pleased with the level of investor interest in Focus, as we continue our evolution as a public company. As part of that development today, I will discuss some expanded disclosures related to the growth of our partner firms. I'll also discuss our financial leverage and our current views on the growth of our business, which we hope will be helpful to your understanding of our unique model.

Now turning to our results. We had an excellent second quarter and first half of 2019 characterized by the strong performance of our partner firms and access to highly attractive opportunities to deploy our capital. For both periods, our business generated year-over-year growth in excess of

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30% for revenues and adjusted net income per share, well above our stated annual targets of 20% for each. This was our fifth quarter reporting as a public company, and in each of these quarters, we achieved revenue and adjusted net income per share year-over-year growth in excess of 30%. Our value proposition continues to resonate with wealth managers and our momentum is excellent. We are a company with a rare combination of high growth, high operating cash flow generation and substantial downside protection of our earnings. We participate in a multi-trillion-dollar industry that is experiencing rapid secular growth in consolidation. We're a significant beneficiary and driver of this evolution because we have the advantage of a longstanding track record and access to inexpensive debt capital, as well as industry-leading M&A expertise and the benefits of scale. We believe we have established a unique position in this market with an enviable partnership of firms.

I can't emphasize enough the power of our differentiated model. Our business creates sustainable shareholder value in 2 ways. The first is the accelerated growth and time-to-scale that our firms achieved through our M&A expertise and by enhancing their businesses through our value-added services. The second is the growth we obtained through the acquisition of new firms taking advantage of the large and fragmented market to execute attractive deals. We estimated that our year-to-date aggregate transactions are accretive in the low double digits on a pro forma adjusted earnings per share basis.

On the acquisition side, we are capitalizing on the most attractive parts of the industry. We focus on buying larger, high-quality wealth management firms, primarily RIAs, as these firms are the best positioned to become platforms for growth well above industry averages. We focus on those serving ultra-high and high-net-worth clients because of our ability to add value to their businesses, their attractive client retention dynamics and the potential for future growth.

Our pipeline is robust but not at the expense of being selective in the firms we acquire. We only pursue transactions that are accretive to deal-specific return hurdles or that meet a strategic need. We're not simply aggregating a collection of assets or solving succession planning issues. We are acquiring and partnering with firms who we believe will win the consolidation race and become national and super regional leaders with revenue platforms of $50 million or more. These are the firms that will create enduring value well into the future.

We typically pay mid to high single-digit multiples for both new partners and mergers. This is in exchange for allowing our firms to operate independently post-acquisition and to take advantage of our intellectual capital, M&A expertise and industry network. That continued operational independence ‑ never turning entrepreneurs into employees ‑ and the ongoing freedom to grow in their own vision are exceptionally important to the firms we acquire. Once we acquire a partner firm, we create value by enhancing its business and positioning it for accelerated growth. Speed-to-scale is a critical element of that. Through our value-added services, we position our firms with the infrastructure and scale to grow through M&A. We make sure they have the appropriate technology infrastructure, depth of talent, incentive structures and other elements to build the scale needed to support high growth. We then help with sourcing and structuring merger opportunities and ensuring that those mergers are integrated effectively.

On average and over time, growth via mergers has more than doubled our partners' revenue growth rates compared to what they could achieve without mergers. Our firms don't stop growing organically once they start to engage in M&A, but if the pipeline for merger prospects were to slow, our firms have the ability to expand their businesses through more traditional means. However, partner firms who rely on M&A versus traditional asset gathering have transformed their businesses by accelerating their growth. Growth via mergers enables our firms to efficiently monetize large pools of client assets and client leads as well as add exceptional advisor talent on an accelerated basis rather than building their businesses a client or advisor at a time. This is a powerful value proposition.

Let me put some numbers to this statement, which you will find recapped in our earnings supplement on Page 8. We have outlined the aggregate revenue CAGRs of the 46 partner firms that have been with us for 2 years or more as of June 30, so that we have a minimum of 1 full year of growth with Focus for each firm. We then divided the firms between those that have completed mergers and those that have not since joining us. We believe that this approach represents an accurate picture of growth because it includes the largest number of firms over the longest period and thus is less subject to business or market-driven distortion.

We look at revenues rather than assets under management, because our non-correlated revenues, which represent nearly 1/3 of our overall revenues are not asset-based. So, revenues are the most relevant measure. Using this framework, nearly 60% of the 46 firms have completed mergers. As of June 30, this group delivered a weighted average revenue CAGR of over 15% including market since joining Focus and have been with us for a

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weighted average period of 7 years. We're using weighted averages to adjust for the size of our firms. The remaining 40% of the 46 firms have not yet completed a merger. They've delivered a weighted average revenue CAGR of 7%, including markets, since joining Focus and have been with us for a weighted average period of 4 years. The entire portfolio of 46 firms have delivered a weighted average revenue CAGR of over 13% since joining Focus.

The other important dynamic at play that influences these growth rates is scale. As our firms scale their businesses, their revenue growth rates accelerate. We have an excellent portfolio of firms relative to the industry and we continue to build on that by being highly selective in the additional firms that we acquire. Our most recent new partner firm, Williams Jones, is a good example. Year-to-date through August 8, we have closed 30 transactions, including 6 direct acquisitions and 24 mergers. In aggregate, we have already exceeded our 2018 full-year deal volume, and our second half transactional momentum remains strong. We are the largest acquirer in the market and believe we have a competitive advantage because of our unique model. We have significant runway ahead of us for further expanding our business, and we are well positioned to pursue the opportunities that we see.

Before turning to call over to Jim, I want to take a moment to address our acquisition strategy and its impact on leverage, as we appreciate that our comments on issuing equity together with our recent term loan upsizing may have resulted in some questions. Our IPO further raised our visibility and credibility within the wealth management industry, leading to a far greater number of opportunities than we initially anticipated. This includes some of the larger deals in our history, including Escala and Williams Jones. We are capitalizing on these transactions because we believe they are important additions to our business. They represent substantial future growth potential and diversification benefits for our portfolio of partner firms, in turn creating attractive incremental value for our shareholders.

Given these unprecedented opportunities, we believe that the benefits of pursuing them outweigh the drawbacks of increasing our leverage above 4x. We're comfortable with this higher leverage because of the structure of our model, including the preference we take on the earnings of each firm we acquire, our high level of fee-based and recurring revenues and the fact that one of our largest expenses is management fees, which are variable and tied to the performance of our firms.

However, we are not acquiring simply for the sake of accelerated growth. We invest the operating cash flow that we generate into the growth of our business, but to the extent there are less attractive opportunities in the market, we will use that cash flow to delever. We have always operated our business this way. We recently raised debt capital under our term loan to give us the flexibility to continue to capitalize on compelling acquisitions, but we remain highly opportunistic and selective. As such, we don't plan to issue equity in the near term unless it is in connection with specific transactions that would be accretive to our adjusted net income per share. We will continue to pursue an acquisition strategy that is based on generating growth and value over the long term.

With that, let me now turn the call over to Jim. Jim?

James Shanahan - Focus Financial Partners Inc. - CFO

Thanks, Rudy, and good morning, everyone. First a quick reminder on the format of our financial presentation. The financial statements and other GAAP disclosures contained in our press release include the results of Focus Financial Partners Inc., which is the public company, and those of Focus Financial Partners LLC, of which Focus Financial Partners Inc. became the managing member and owner of the majority of the outstanding membership interest on July 30, 2018, in connection with our IPO.

We had an excellent second quarter and first half of 2019. Our business is generating growth well above our stated annual targets of 20% for revenues and adjusted net income, or ANI per share, supported in the quarter by 18% year-over-year organic revenue growth. Our revenues increased 30.3% year-over-year and our ANI per share grew 37.5%. This is our fifth quarter reporting as a public company, and in each of these quarters, we have achieved year-over-year revenue and ANI per share growth in excess of 30%.

Now a quick recap of the quarter, which highlighted our strong growth and momentum. Total revenues for Q2 2019 were $301.5 million, an increase of $70.1 million or 30.3% over the prior year quarter. Approximately $28.6 million of this growth resulted from 8 new partner firm acquisitions that closed during the 12 months ended June 30. Wealth management fees were the primary driver of that revenue growth. Our fee-based and recurring

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revenues remained in excess of 95% of our total revenues. As such, an important differentiator of our business is that we earn virtually all of our revenues from fee-based and recurring sources.

Our firms serve ultra-high and high-net-worth clients with holistic wealth management service-driven rather than benchmark-driven models. They use a full suite of services that go well beyond just investment advice. Because of the complexity of these interactions, they present much securer client relationships than is typical for the wealth management industry as a whole. Approximately 70% of our revenues for Q2 were correlated to the financial markets, both equity and fixed income, of which 70% were generated from advanced billings. The remaining 30% of our revenues came from sources not correlated with the markets. These allocations highlight a second important differentiator of our business, which are the embedded hedges in our revenue stream that limit our exposure to the markets. Our non-correlated revenues serve as a hedge against market volatility as do the varied methodologies and timing of the billing practices used by our firms. Additionally, ultra-high-net-worth and high-net-worth clients tend to be conservative investors for whom capital preservation is more important than beating a benchmark, which serves as a further hedge particularly against equity market volatility.

As I mentioned earlier, our Q2 organic revenue growth was 18% year-over-year on a substantially larger revenue base. This rate was positively impacted by the merger activity of our firms. We have completed 27 mergers since July 1, 2018, the largest of which was Loring Ward into Buckingham, which in and of itself contributed $12.8 million of revenue in Q2 2019. Over the last 10 quarters, our average quarterly organic revenue growth rate was 13.4%.

Based on our visibility due to the advanced billing by our firms, we expect another strong quarter of organic revenue growth in Q3 with a year-over-year growth rate in excess of 15%. While our organic growth rate can vary quarter to quarter based on the timing of when we complete transactions, the levels we are achieving, both quarterly and on a trailing basis demonstrates the sustainability of our business.

Our adjusted EBITDA was $63 million for the quarter, an increase of 21.3% year-over-year. Annual acquired base earnings for our 2 new partner firms, Escala and Sound View, which closed at the beginning of the quarter, was approximately $6.7 million. These firms contributed approximately $1.9 million of adjusted EBITDA and $7.3 million in revenue for Q2 2019.

Our M&A velocity continued to be strong in the second quarter in which we added the 2 new partner firms I just mentioned and closed 9 mergers. On August 1, we closed the acquisition of Williams Jones, which we estimate will contribute approximately $42 million in annual revenues and $16.5 million in acquired base earnings or approximately $7 million in revenue and $2.7 million in EBITDA in Q3. Year-to-date through August 8, acquired base earnings for the 6 partner firms we closed were $35.1 million. We also closed 24 mergers, of which 9 were in the second quarter and 6 to date in the third quarter. We don't anticipate any additional new partner firm closings in Q3. The 24 mergers we completed were done on behalf of 14 partner firms and half of these firms were executing their first merger.

Our adjusted EBITDA margin for the quarter was 20.9%, in line with our 21% EBITDA margin guidance. While we are in this period of rapid growth, our adjusted EBITDA margin will continue to be influenced by the percentage of EBITDA we acquire. Accordingly, we cannot provide full year guidance, but we estimate that our EBITDA margin will be approximately 21% in Q3.

Management fees, which is one of our largest operating expenses, increased sequentially by $22.2 million and also as a percentage of revenues due to the growth of the business and the associated impact on the contractual management fee calculations. Management fees can vary based on the percentage acquired, and the mix of new partner firm acquisitions and mergers, and by the number of people that are part of the management company of each partner firm.

Our non-cash equity compensation expense was 1.6% of revenue for the first half of 2019, which is a good proxy for the normalized expense. Our GAAP net income was $3.1 million in the quarter compared to a net loss of $7.7 million in the second quarter of 2018. Our adjusted net income was $41.2 million, 42.1% higher than the prior year quarter, reflecting the acquisition activity completed over the past year, as well as strong organic revenue growth and a net reduction in interest expense primarily related to the repayment of our $207 million second lien term loan in July 2018. ANI per share was $0.55, 37.5% higher year-over-year. As a reminder, the share count for our ANI per share calculations is impacted by our quarter-end share price, which is used to calculate common unit equivalents for incentive units outstanding at the Focus LLC level. We didn't issue any equity in connection with our Q2 acquisitions and we don't anticipate doing so for our Q3 acquisition activity.

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Lastly, while we operate in a CapEx-light business model, our capital expenditures were slightly elevated in Q2, primarily due to relocation of our New York headquarters in late July. We look forward to hosting our first ever Investor Day on November 20 in our new location.

Now turn into other balance sheet items. We ended the quarter with approximately $1.1 billion in debt outstanding under our credit facilities and a net leverage ratio of 4.05x. At the end of July, we closed on an incremental $350 million of borrowings under our existing term loan and paid down our revolver balance to reset our dry powder for M&A activity. The offer was oversubscribed, and we closed at 99.75, demonstrating the strong demand for our debt.

As we discussed, the visibility created by our IPO led to unprecedented opportunities we've seen over the last year. As a result, our top and bottom line growth have each been in excess of 30% for the last 5 quarters. To sustain growth at these levels requires a higher leverage level than what is required to meet our 2020 targets. While we carefully and prudently manage our use of leverage, we're comfortable with a higher level than we initially anticipated because of our high level of fee-based and recurring revenues, our variable expense base and our preference, which all provide meaningful downside protection in the event of market volatility.

In aggregate, these factors would limit the adverse effect of a market decline on our EBITDA and therefore our leverage. For example, had our Q2 market-correlated revenues declined by 10%, our Q2 reported net leverage would have only increased by 0.1x. Had our Q2 market-correlated revenues declined by 20%, our Q2 reported net leverage would have only increased by 0.2x. Except for management fees, which are tied to the profitability of our partner firms, these analyses hold all other revenues and expenses constant.

Our Q2 2019 compensation costs were approximately $106 million, and SG&A expenses was approximately $60 million. In the event of a prolonged downturn, our partner firms would adjust their cost basis accordingly. Equally important is that, if we see less attractive M&A opportunities, we would instead use our operating cash flow to repay debt and delever. This is integral to why we say that our 2020 growth targets are averages over time. The growth of our business is not solely dependent on acquisitions. The performance of our portfolio is a key driver of our long-term growth: The multiplier effect to the growth of our firms is evident in the revenue CAGRs Rudy shared with you earlier, especially for those firms who accelerate their growth through M&A.

We remain focused on allocating our capital efficiently. While we routinely evaluate our sources of capital as our business and market conditions evolve, we continue to carefully evaluate the deals we do to ensure that we have the right balance between leverage and growth.

Now, I'll turn the call back to Rudy for his concluding remarks. Rudy?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Thanks, Jim. In closing, we are proud of the growth and value our business is generating. Our success is driven by the fact that, at its core, Focus's role in this industry, first, benefits our partners' clients by ensuring continuity of high quality advice; second, benefits our partners and next generation advisors by protecting and enhancing their business models and culture; and third, is highly attractive from a shareholder perspective.

As such, we are excited about the future of our business and believe that we are well positioned to deliver superior shareholder value over the long term. I would like to thank our employees and partners for their hard work and dedication this quarter. Our business would not be where it is today without you.

With that, we'll now open the call for questions. Operator?

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from the line of Mike Carrier with Bank of America.

Michael Roger Carrier - BofA Merrill Lynch, Research Division - Director

Good morning, and thanks for taking the questions. Maybe first question, Jim, just on the balance sheet and leverage, just given the level of activity that you guys have seen on the M&A front, given that you're slightly over that 4x level, first, is there any like timing items that will - that may have impacted that – meaning deals that have been announced – you expect the EBITDA you need to flow through going forward. And then, if we continue to be in an environment where the M&A opportunities remain as attractive as they have been this year, is there any level that you guys are uncomfortable in terms of running at?

James Shanahan - Focus Financial Partners Inc. - CFO

Yeah, so thanks for the question, Mike. So, yes, we – in Q3, we closed some mergers there in the supplement that we've provided. We also closed in August the Williams Jones transaction, which was $16.5 million of acquired base earnings. Just touching on a couple of points, our guidance was growing 20% revenue in ANI per share based on the profitability of the business and the excellent opportunities that we've seen. Since the IPO, we've been growing 30% revenue and 30% ANI and certainly over the last 5 quarters based on public reporting. Yes, we're over 4x, you know, we're very prudent in how we look at our transactions to ensure that they are accretive.

We look at great deals like Williams Jones, which has just closed on August 1. We continue to evaluate the leverage; we may stretch a little on the leverage to include these accretive deals, which are in the best interests of our shareholders in the long term. And obviously, we generate a lot of operating cash flow. As you can see in the financials, we included a slide, in 2018, it was over $105 million; on an LTM basis, $124 million, and those cash flows help us support the M&A pipeline, as well as if they're not accretive deals in the pipeline then we would use the cash flow to help us delever.

Michael Roger Carrier - BofA Merrill Lynch, Research Division - Director

Ok, that’s helpful. And then maybe just on – given the level of deal activity both on the acquisition side and the merger side, you guys mentioned the number of deals being up I think about 20% year-over-year. But any other color in terms of like the types of deals, like earnings contribution – any, even mix in terms of the ownership, just so we have some context on the types of deals that you guys are seeing in the market.

James Shanahan - Focus Financial Partners Inc. - CFO

So we – just in terms of new partner firms, I just went through Escala, a great firm, probably and Sound View that we closed in Q2. These firms had $6.7 million in acquired base earnings; they contribute about $7.3 million in revenue in Q2 and $1.9 million in EBITDA. Williams Jones is a large transaction we just closed this current quarter – we gave guidance on that. It will contribute about $7 million of revenue and $2.7 million of EBITDA this quarter, and on an estimated full basis, $42 million of revenue and $16.5 million of acquired base earnings. Year-to-date, the 6 new partners that we closed contributed $35.1 million in base earnings.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Mike, more from a qualitative perspective, we basically are executing on the very strategy that we started with and we – quite frankly, we ourselves, we're surprised by our ability to grow way above guidance since the IPO and you've seen the numbers, and these are absolutely the quality firms that fit into our portfolio. And it all comes down to, and I mentioned it in my remarks, to the essence of our value proposition. There is a certain type of firms that get attracted by the independence and entrepreneurship, that get attracted by our ability to add value to them over time,

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and of course, the ongoing access to capital. And we couldn't be more pleased with how the pipeline has been unfolding so far this year, and quite frankly, we feel very good about the rest of the year, early days, but how we will be entering next year.

Operator

Our next question is from Alex Blostein with Goldman Sachs.

Alexander Blostein - Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst

Great. Hey good morning, everybody. How are you – so back to the deal dynamics, Rudy clearly sounds like the pipeline is very strong; we've seen that from you guys over the last several quarters now. Leverage keeps coming up. I know, you're saying you're comfortable staying above 4 and you guys gave us some helpful stats in the slide deck with respect to market sensitivity but I guess: Is "4-plus" is kind of the new "3 to 4"? It just seems like, given the pipeline to execute on that, you guys are going to need to continue to remain a little more levered than what we've talked about in the past, and how are you guys thinking about alternative funding sources in case the deal momentum continues. So, you know, kind of maybe help us walk through that dynamic.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Alex, as Jim just mentioned, we're very comfortable where we are. And of course, the reason we disclosed in Page 12 of the supplement, our sensitivity to different market scenarios particularly as it relates to the 0.1x, 0.2x dynamics that we show on the page here. We feel that we are in a good spot and in a very much sustainable spot. Clearly, we generate a lot of cash flow and we have 2 ways to deploy it into the next level of transactions or into delevering, and what we are seeing now is basically the success of the business model. When we grow at 30% and more as we have demonstrated now since the IPO, what it is, is the momentum that gives us more opportunity to deploy capital, albeit staying in what we believe is still a prudent and well-managed leverage ratio that, yes, it is higher than the 3 to 4 that we originally anticipated assuming that we have a 20% growth rate only.

Alexander Blostein - Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst

And I guess just thoughts around any alternative funding sources to delever since it doesn't sound like you guys are willing to kind of slow down the pace of M&A.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

This will be – obviously, see, it's a function of the opportunity that we've seen in various transactions. Having said that, yes, we don't have current imminent plans to issue equity. As we explained last time, we only issue equity in the context of a specific set of transaction or transactions where we have a clear understanding that this is accretive, ultimately from a shareholder perspective. So unless we see this type of opportunities, we are going to stay where we are today, but of course, if we see some of these types of transactions, we would be willing to tap into the equity markets, assuring that this is still accretive from a shareholder perspective.

Alexander Blostein - Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst

Got it, thanks. And then, just another question around maybe an update on Buckingham and Loring Ward, kind of how that integration is going. Maybe give us a sense of kind of where they are with respect to synergies you outlined in prior calls and how do you expect the accretion from that transaction to evolve through the rest of the year, thanks.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

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So, Loring Ward is very much on target with the numbers that we disclosed, in terms of $50 million in revenues and they are working with over 300 RIAs. So we – it's tracking along as expected. We are not expecting to see any more charges because the level 1 synergies has been accomplished in terms of headcount changes and others here, which we have seen in earlier earnings announcements, but it's, of course, early days. There is much more opportunity in terms of migrating the portfolio over into the core of Buckingham business, and, yes, clearly more opportunities on the integration side. So we are pleased where it is today, but much more work ahead. But everything is consistent with our prior guidance here on this subject.

Operator

And our next question is from Chris Shutler with William Blair.

Andrew Nicholas - William Blair & Company, LLC

This is actually Andrew Nicholas on for Chris. To the first two quarters of the year, I think you completed 18 tuck-in deals, which is more than any full year prior. And then, I think you've already added another 6 through – halfway through the third quarter here. So I was just hoping if you could talk about the pacing of tuck-in deals, specifically what about the current environment is so conducive to those types of deals, and if that's something you expect to continue that type of pace through the remainder of this year and into next?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

It's obviously very difficult to predict the actual closing on a quarterly basis of deals; they can move around. And consistent with the past year Q4, we will probably see much less activity than throughout the year. Thirty (30) deals year-to-date versus 25 deals full year last year is, of course, a tremendous accomplishment. And we like the mix here because these mergers, as we explain, yes, they are a big part of our value-added to partners; these are very attractive deals typically and is very much at the core of what we are seeing. Why is the activity so high? Because first we have simply more platforms.

We have more firms that are now ready to do merger transactions and have the infrastructure and the capabilities and have been given throughout various value-added programs that are necessary to be really qualified to do mergers. Second, the market is very, very attractive and it comes back to, as I mentioned before, to the power of our value proposition where our model, we firmly believe and the results are demonstrating, it is simply superior to the monolithic one size fits all models that really seem to be dominating some parts of this industry. So we feel very good about the rest of the year, and we feel it's just every time we do a deal, it's a reaffirmation of our value proposition and that obviously is very powerful step in our evolution.

Andrew Nicholas - William Blair & Company, LLC

Great, thank you, that’s helpful. And then changing gears a little bit, last quarter you talked about the rollout of your Focus Client Solutions offering. Just hoping you could provide an update on how that's going and what kind of traction you're seeing amongst your partner firms.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Yes, absolutely. So when we announced FCS’s launch, we were very clear that it will not have meaningful financial impact on 2019. But in future years, it is going to be a contributor to our organic growth. We actually really like where we are. At this point, we are working – the team is working on literally 50 transactions involving 20 of our partner firms and very meaningful transactions. So clearly the initial uptick interest, most importantly simply value-added to our clients, to our partners' clients seems to be very well received.

We are signing up banks; the interest from the banking side is also very high, because here what we can offer these things when they join our FCS network, it's ultimately, they get access and very attractive economics to a quality and diversification of client base that quite frankly they just couldn't

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get any other way. So, it's great for our clients, it's good for our partners and it provides a very attractive channel with the banking institutions who are working with us on this program. So, so far so good.

Operator

Our next question comes from Kyle Voigt with KBW.

Kyle Kenneth Voigt - Keefe, Bruyette, & Woods, Inc., Research Division - Associate

Maybe couple of - a couple of follow-ups. The first is just on equity consideration, is that you said you'd use equity – you wouldn't use equity near term unless it was accretive to earnings. I guess just to clarify that, would the deal have to be immediately accretive to earnings or accretive year 1, year 2, is how you are thinking about that? And secondarily, at your current stock price, would the deals that you've executed over the past quarter or two, would those have been accretive if you used only equity consideration? Just trying to get a sense of using equity as kind of a viable option at your current share price.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

So first on the equity – our equity philosophy, as we said in the IPO, our deals will be primarily all cash and we have consistently applied this unless there is a very good reason for us to use equity. And we have used equity in the Loring Ward transaction, as an example. But, yes, I think it's the only example where we used equity recently. From an economics perspective, it all goes basically into the formula, and of course, we factor in the current multiples that we're trading at.

But keep in mind that we would run it against the pro forma of the first year to basically assess the accretion of the transaction. We usually pay mid to high single digits, which of course is an important source of our value added and then as we have explained in the past, when you look through what we acquire, the multiples that we pay, the tech shield and – of the overall economics of the transactions, these are very attractive still based on where we are trading today.

Kyle Kenneth Voigt - Keefe, Bruyette, & Woods, Inc., Research Division - Associate

And just a follow-up – I know there's been a couple of questions on this already, but I'm going to just try a different way. But just on your ability to delever quickly and you have strong recurring revenues, I think, investors understand that, but as going forward, how should investors think about kind of an absolute max on where you're willing to take leverage, before you'd want to hit the pause button on acquisition activity or switch to equity consideration for new acquisitions. I think: is it 5x, is it 4.5x? Is there any clarity you can provide there?

James Shanahan - Focus Financial Partners Inc. - CFO

So to your first point here, this business is extremely cash generative. You'll see it on Page 12 of the supplement, our cash flow generation in the last 12 months Q2 is $124 million. And so that's something we either deploy back into the next level of transactions or we use to delever. We announced in the last earnings here that we will be above the 4x. We are very comfortably above the 4x and given the quality of the revenue and the dynamics that we are explaining in the supplement on Page 12.

We don't have an absolute number that we are running the business against. As I said, we're comfortable where we are today. But we make these trade-off decisions between growth – this 30% plus that we have delivered since the IPO and leverage on – then given on the transaction by transaction basis, and I think we're in a very good spot where we are now.

Kyle Kenneth Voigt - Keefe, Bruyette, & Woods, Inc., Research Division - Associate

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And just in terms of 3Q – in terms of the deals that we have been announced or you expect to actually close in 3Q, any guidance as to where that leverage could go in the third quarter, specifically?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

We don't provide specific revenue guidance. We have – you see it on Page 9 of the supplement, we have done already 9 transactions for Q3, one of them the direct transaction, Williams Jones, a deal we are very proud of and we think is going to be a fantastic addition to the team. But no, we're not providing any specific guidance to the leverage will be at in Q3, but as I said, we're very comfortable with where we are today.

Kyle Kenneth Voigt - Keefe, Bruyette, & Woods, Inc., Research Division - Associate

And then last from me and I'll hop back in the queue, is just on the competitive dynamics in the industry. Are you finding more competition for these deals more recently or the acquisition prices moving higher and nudging higher at all? Just if you could kind of talk about the competitive dynamics for the deals that you're closing.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Kyle, the competitive environment for what we do quite frankly continues to be pretty much unchanged in any material way and this goes to our value proposition. We firmly believe if you're running a successful RIA and you want to keep your culture, you want to keep doing the "run the business the way you did" as an entrepreneur for many years, but you see true value in the value-added programs that Focus has a long track record now of deploying on behalf of our partners and you see access to our capital is a very attractive component. Quite frankly, we firmly believe we are the only game in town. Yes, there is nobody else that – who basically can offer this value proposition. You can get swallowed up by some mega institution, you can join in monolithic platform where basically the culture and the way of doing business disappears. You may get private equity involved, which really ultimately means significant loss of control, in particular, a private equity per definition is temporary capital versus Focus being permanent capital.

So in other words, this thing will be on the block again, which particularly in the ultra-high-net-worth base's market is very unattractive. So, if this is what you value as a prospect, Focus is unique and we don't really see much competition around this. So we continue to pay as we said in the IPO, mid to high single-digit digits for these firms that we acquire, almost independent of size and basically it's just a reaffirmation that this value proposition I described is very, very attractive in the marketplace.

Operator

Thank you and our next question is from Owen Lau with Oppenheimer.

Kwum Sum Lau - Oppenheimer & Co. Inc., Research Division - Associate

So on Slide 8, what are the things you can do or are doing to facilitate those 19 firms that have not made – that have not completed a merger to start making acquisitions to accelerate growth?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

So thanks for going to Page 8 because this is we believe a very important disclosure that we decided to make. And what of course it shows is that firms who join us and there is no sample bias, nothing in here, this basically the full universe of 46 firms who were with us for 2 years – for more than 2 years and is very attractive; 7% for firms without a merger; 15.4% with mergers – we believe this really speaks to the exceptional quality of our portfolio that ultimately enables us to create these very, very attractive growth rates.

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Firms when they join us, not for all of them, but for many broad, probably most of them, doing mergers is one reason to join Focus. That is where we are highly differentiated in the marketplace. And most firms when they join us do not have the ability to do mergers yet. Their infrastructure is not scalable enough, their process fees are not quite where they need to be, incentive systems need to get adjusted. So, there is a lot of work where our new partners and us roll up our sleeves and kind of get them in a position to be ready to do these transactions. And once firms are qualified, that's when we basically with our partners develop an M&A strategy for them and then create an outreach program to ultimately your help with the execution of the strategy.

Usually – probably, my guess is 2/3 or so of firms who join us here, we generated through the execution of this M&A program and 1/3 are just existing relationships that partners have and they are ready to consummate once they join us. So we expect, not all, but most of our partner firms ultimately will be in the M&A game and that is simply a function of this tremendous consolidating forces in this industry – 17,000 RIAs, managing $5 trillion in assets, and your founding owners 60 years plus. So there is just an enormous level of transition into generational transferring their ownership and control of these companies and our partners in Focus is just tremendously well positioned to take advantage of these forces.

James Shanahan - Focus Financial Partners Inc. - CFO

And just to supplement that, Owen. Obviously, it's the partners' decision to enter the M&A world. We can't force that decision, obviously. But many partners join us to accelerate their growth. As I mentioned earlier, we are very optimistic about 24 transaction mergers that we've done year-to-date by 14 firms of which 7 of them, it was their first time doing an M&A transaction. So they had built up the infrastructure, worked with us on all the value-add and now they're migrating from the no-merger world to the accelerated growth world with merger tuck-ins that are very accretive.

Kwun Sum Lau - Oppenheimer & Co. Inc., Research Division - Associate

Then, how about comp ratios? So your comp ratio was a little bit lower than the same quarter last year, and also last quarter, but management fees ratio was higher. What was the driver of that? Is it because you acquire less economics from the partner firms most recently, and how should we think about these 2 line items going forward?

James Shanahan - Focus Financial Partners Inc. - CFO

So compensation expense went from $97.2 million up to $100 million, so as a percentage, it went down 4%. Obviously, when you look from Q1 to Q2, going from approximately $260 million to $301 million, it was a 16% sequential increase in the revenue line. So that was a contributor as well as the 9 mergers. As I said before in the past, it's a function of where people reside – do they reside in the operating companies of our partners and are they joining the management company? So as an example in Q2, Escala joined us; they have over 20 partners and they're in the management company. So that's an item where we drive management fees going up, but we didn't necessarily drive compensation because they're not in the operating company.

Operator

Thank you. And our next question is from Dan Perlin with RBC.

Daniel Rock Perlin - RBC Capital Markets, LLC, Research Division - Analyst

Jim, can you help us - you've done a lot of transactions here. You did debt financing. Can you just help us where you stand today in terms of your debt capacity or what you refer is kind of your dry powder?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

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So our term offering was very well received, which is why we upsized it. When you look at the way that the transaction closed, it's just a tremendous reaffirmation that is very attractive and so we moved it up to $350 million. Yes, our total capacity now is roughly about close to $500 million with the new facility in place.

Daniel Rock Perlin - RBC Capital Markets, LLC, Research Division - Analyst

That's $500 million post all these transactions including the August 1?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Correct.

Daniel Rock Perlin - RBC Capital Markets, LLC, Research Division - Analyst

And then the other question I have around capacity, Rudy, is really, your management team's capacity. You've clearly run much faster on these deals year-to-date that clearly draws a lot of your team's attention to these partners. And so I'm just wondering how do you feel about your team's capacity in order to sustain running at 30% plus growth rate.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

So, of course, very important question. And Focus always has been a heavily recruiting organization and we are constantly bringing in new talent, particularly on the M&A and relationship management side. We have created a whole new layer of talent that joined us – started to join us in the last 12 months, which are - Vice Presidents who work for our managing directors who are running the regions. Yes, quite frankly, my two Co-Founders, Rajini and Lenny, they are very deeply involved with constant talent acquisition in bringing this, exceptional people into our organization and training them and bringing them up to the standards that we have at Focus.

In many ways, our regional structure is in pyramids – the pyramid org structures within these regions really make our model tremendously scalable. As long as we are constantly on this talent recruiting path and we constantly use the very high standards that we are applying, quite frankly this organization is extremely scalable. But then we – this is a core competence. Recruiting, onboarding talent is a core competence that we need to sustain in the 20% growth rates and most certainly 30% plus growth rates that we have demonstrated since the IPO.

Daniel Rock Perlin - RBC Capital Markets, LLC, Research Division - Analyst

The third quarter call out for organic growth greater than 15%, you know, you just posted 18%, which is an incredibly strong number. I'm just wondering is there any reason kind of, all else equal, when we look at the timing of these deals kind of all rolling in the mergers as opposed to partner firms that that's not sustainable to also carry into the fourth quarter or is there something else that would require that level of organic growth to be supported in the fourth quarter?

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

And let me point you to the supplement where we kind of showing the quarterly organic growth numbers. It's on Page 7. So intrinsically, these quarterly organic growth numbers of course are relatively volatile and 18% is of course not sustainable over a period – a long period of time. It wouldn't. I think more important is, I mean, you look at the trailing 10 quarters that we are showing here, it was low double digits, 13.4%. In the IPO process and subsequently, we always guided towards 20% overall growth and roughly half plus-minus would be coming from the same store.

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So as much as I thought the investor community totally overreacted when it was only 7.7% in the first quarter. We also are not saying that they should overreact to the 18%. Our guidance of plus-minus 10% holds; we are very comfortable with this and we thought by explaining or by providing a guidance into the third quarter, this 15%, we give you enough of the tools to kind of model it.

But overall, of course, we believe these are tremendous numbers. And we are very proud of the – in average and over time organic same-store growth that we're generating.

James Shanahan - Focus Financial Partners Inc. - CFO

The billing methodologies gives us a lot of visibility as well as this fee-based recurring revenue. So that's why we provided the guidance in excess of 15% for Q3, which is strong in relation to the 10-quarter average, so we disclosed on the side of 13.4 %, but we're not providing guidance into Q4 at this point.

Daniel Rock Perlin - RBC Capital Markets, LLC, Research Division - Analyst

Just one quick one and I'll jump. The EBITDA margin guidance here also roughly 21%. Can you just remind me the year-on-year kind of degradation in margin, what was that just kind of reconciling items to get me to that?

James Shanahan - Focus Financial Partners Inc. - CFO

So remember the primary driver of the EBITDA margin is a percentage acquired. We've done a lot of transaction activity and based on the current status of the firms, we have about 63 partner firms today. They have a very different range of economic splits, which is generally in the 40% to 60%, and based on the baseline of the business today, we're forecasting Q3 to be 21% as well.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

The 21% is very consistent with kind of what we see over the cycle. But again, we need to keep in mind this is an organization that's going 20%, 30% a year and during this excellent growth stage, basically, it's really the M&A activity that first and foremost influences this margin from an EBITDA perspective. So the 20% plus-minus 21%, a little higher or lower, is a very good way to think about this business for a good period of time.

James Shanahan - Focus Financial Partners Inc. - CFO

Yes, I think the focus should be on the revenue and adjusted net income per share; the current run rate of the business, which is based on the current portfolio of partner firms today as opposed to looking back in time.

Operator

Thank you. And I'm not showing any further questions in the queue. I would like to turn the call back to Rudy Adolf for his final remarks.

Ruediger Adolf - Focus Financial Partners Inc. - Founder, CEO & Chairman

Yes. So again, thank you everybody for listening in. Thank you for your interest in Focus. We firmly believe that we are again demonstrating the enormous growth and earnings power that this business has and I'm very much looking forward to seeing you all on our next quarterly call. Bye-bye.

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Operator

And with that, ladies and gentlemen, we thank you for joining us today. This concludes the program and you may now disconnect. Have a great day.

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