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# EDITED TRANSCRIPT

FOCS.OQ - Q1 2020 Focus Financial Partners Inc Earnings Call

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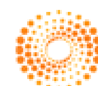

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## PRESENTATION

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

Good morning, everyone. Before we begin, 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' 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 lists some of the factors that may cause its results to differ materially from these statements, including without limitation uncertainties surrounding the current COVID-19 pandemic. Finally, Focus assumes no duty and does not undertake to update any such forward-looking statements.

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

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

Thanks, Rusty. Good morning, everyone and thank you for joining us. On behalf of the entire focus team, we hope that you and your families are staying healthy and safe. This morning we announced strong first quarter results with $337.1 million in revenues and $0.74 in ANI per share. Year-over-year, our revenues increased 29.7% and ANI per share was up 57.4% and our organic growth rate was 21.2%, 2 percentage points above our 19% target.

Our business performed well but the real story of the quarter was how our partner firms and the Focus team responded to the impact of the COVID-19 pandemic. They collectively demonstrated and continue to demonstrate incredible commitment and results in supporting their clients, the partner firms they serve, their communities and each other. Our team has been working with our partners on a daily basis. Our partner firms are doing an excellent job helping the clients navigate their pandemic related volatility. These are the times when prudent fiduciary advice is of utmost importance to our partners' clients and we are confident that our partners are well equipped to face the challenges posed by the disruption.

In fact, I have heard from a number of them so far, the current crisis has been easier to work through than 2008 and 2009. That the loyalty of their clients has been remarkable and that their clients have overall stayed calm. From our partners' perspective, navigating successfully in this environment is not about just staying the course, but in many cases playing offense and positioning themselves to take advantage of market opportunities arising out of the crisis. But this should not be surprising. Our partners have deep long-standing relationships with their clients and have carefully prepared them for periods of market stress. As a result and consistent with our 2008 and 2009 experience, our partners have not seen any tangible client attrition.



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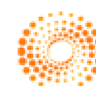

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A number have gained new referrals, which we see as a testament to the quality of work they are doing. We posted a new video to the Investors Relations section of our website this morning, in which a group of our partners share their perspectives on the current crisis. We encourage you to watch this discussion, which is intended to provide a snapshot of what they are seeing and how do are feeling. Concurrent with serving clients, firms moved approximately 4,000 employees and partners across 200 -- over 200 offices in the U.S., Australia, Canada and the U.K. through remote working arrangements. This transition has gone remarkably smoothly. Much of our technology is cloud-based and our partners have had comprehensive contingency plans in place for several years of which working remotely was a central element.

Focus has played a prominent role in helping them accomplish this. We quickly shifted our focus to helping then navigate the complexities presented by the rapidly evolving COVID-19 situation. Areas we have addressed include optimizing communications with clients, cybersecurity and addressing business development. We launched an online COVID-19 Resource Center and have brought our partners together through regular video calls to share best practices on a range of topics.

Additionally, our cash credit program is helping partners with clients seeking FDIC-insured cash investment alternatives as well as credit solutions. Helping our partner firms maximize the value that they deliver to the clients is at the core of what we do especially in highly uncertain times like these. Although it is too early to tell what the full impact of COVID-19 will be, we have successfully and navigated market dislocations throughout our 16-year history, including the 2008-2009 financial crisis and subsequent recession. The learnings from these experiences are embedded in our current business model and we believe it prepares us well for what lies ahead.

Importantly, our model has five sources of protection which safeguard our business during periods of market stress. First, more than 95% of our revenues are fee-based. Additionally, our revenues are not dependent on interest income, which can disappear overnight with bad decisions.

Second, approximately 73.3% of our revenues are market correlated. Our clients generally tend to be conservative investment with portfolios typically balance between equities and other asset classes, and about 50% allocated to equities. Our market correlated revenues are further diversified among asset classes because as over 60 partner firms each has their own fiduciary based client investment philosophies.

Third, approximately 26.7% of our revenues are primarily generated from family office type services that are non-market correlated, creating a further source of diversification. Although these type of revenues were not affected in Q1 as a result of the pandemic, we anticipate that they may be modestly impacted in Q2 and future quarters. Jim will provide our thinking on this in his remarks.

Fourth, we have a preference on the earnings of our partner firms, which preserve our adjusted EBITDA and in turn, our cash flows available for capital allocation, if revenues decline. While the press is an important source of protection, our firms are stable and adjusting their cost where needed. As a result, maintaining our preference is not a concern.

Fifth, management fees, which are our second-largest operating expense are directly tied to the profitability of our partner firms. This means that the major portion of our expense base adjust real-time based on the profitability. It is important to note that while our partners' businesses are stable and many of them are taking a wait and see approach to reducing expenses, there is the ability to take action and manage their costs should profitability remain under pressure for a long period of time. Incentives are closely aligned with us on managing the profitability of their businesses, weathering the storm but also positioning for the upside. These elements are central to the resiliency of our model. Although our growth may be lower for a period of time, our business is weathering this crisis well, enabling us to position ourselves for future growth as markets stabilize and recover.

As we turn to Q2, there are a couple of factors that will impact our results. The first is that the effect of the Q1 equity market decline will primarily be reflected in our Q2 market correlated revenues. Approximately 70% of these revenues are built in advance primarily based on financial market values during Q1. The second is a slowdown in M&A activity. Given the market volatility, industry deal activity has standardly slowed. Except for the closing of the MEDIQ transaction and one merger for Buckingham we just announced, our Q2 M&A signings have been pushed out as client service has become the overarching priority.

In addition, COVID-19 related travel restrictions, lockdowns and social distancing have limited the amount of business development and due diligence we can do. For these reasons, we currently anticipate that M&A activity will be muted in Q2 and most likely in Q3 as well. However, we





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believe that a large percentage of these transactions in our pipeline will ultimately sign and close as the rationale for the transaction has not changed. In fact, in many cases, has been reinforced by the crisis. However, we believe that most important takeaway is not a couple of quarters of slower activity, but rather the size of the opportunity in the 12 to 36 months following this crisis. Many of our partner firms are viewing it as a larger and more compelling opportunity post-2008 and 2009.

We believe succession planning, the cost of building and maintaining business infrastructure and the need for scale will drive this wave. We're convinced that the value proposition we offer to perspective new partner firms will be reinforced by the experience of our current partners throughout the COVID-19 disruption. In fact, we continue to manage a highly attractive pipeline with excellent opportunities to deploy capital once markets stabilize. While we will not likely accomplish our 20% growth targets for revenues and ANI per share for 2020 if market conditions stay at current level so decline further, we remain confident that these continue to be the right long-term growth targets for our business.

Although our results will be impacted in the short term, our business is resilient and will only be strengthened by the way we are navigating the storm, which we believe will lead to outperformance over the long term. We are larger, more stable and will prove with greater financial resources in the long-standing track record of success, which should position us for continued success post-crisis. As we think about the remainder of 2020, our current macro assumptions are that Q2 and Q3 will reflect the biggest economic market impact with the path to normalization starting in Q4 as recovery begins. Obviously, this outlook depends on how effective the U.S. and other countries contain the Coronavirus and manage economic reentry. If the crisis evolves, our top priority will be to continue supporting our partner firms and their clients. However, we will also continue to focus on expanding our relationships within the industry and further enhancing our value-added services. Clearly this crisis is testing societies, businesses and life in ways none of us ever expected. However, I have to say that this is the finest hour for our industry and fiduciary advice for our partners and undoubtedly our business overall.

In a crisis of this magnitude, we are proud to say that we have reinforced our core value proposition, moved our entire employee and part of the base of approximately 4,000 people to remote working in a matter of days, experienced no tension for client attrition, benefited from the sharp decline in interest rates and maintained a strong balance sheet and reaffirm our previously established net leverage ratio targets of 3.5 to 4.5.

I have no question that Focus will continue on its path of success supported by one of the most resilient business models in the industry. We expect that just like in 2008-2009 this crisis is going to accelerate the trend towards quality and unconflicted advice, the advice that fiduciary RIAs are providing in the wealth management industry. As such, this crisis is not about weathering the storm but rather coming out strong on the other side. As Andy Grove said bad companies are destroyed by a crisis good companies survive them, great companies are improved by that.

One final note before I turn the call over to Jim. We recently enhanced many of the ESG initiatives. The details of which can be found on our website and in our recently filed proxy statement. We are committed to taking ESG considerations into account for all the aspects of our business and are also encouraging and supporting our partner firms in their development of ESG investing and other strategies to support increasing interest of their clients.

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

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

Good morning, everybody. And I hope you and your families are keeping safe during these unusual times. We had an extremely strong first quarter generating $337.1 million in revenues, up 29.7% from the prior year quarter. When compared to our exceptionally and seasonally strong Q4 2019, our Q1 revenues were essentially unchanged. ANI per share was $0.74, up 57.4% from the prior year quarter and essentially unchanged versus Q4 2019 as well.

This quarter presented extraordinary challenges and our partners demonstrated their nimbleness by quickly adapting their businesses to working remotely while maintaining consistent high standards of client service. This is not a business that naturally lends itself to social distancing but our partners are well prepared and have adjusted well. We believe that this response reinforces the value of our unique model, which maintains our partners' independence and entrepreneurship. It also demonstrates their business leadership, which is essential to successfully build in their businesses into platforms of the future. The resiliency of our business is a significant positive in this environment.





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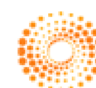

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Now turning to the details of our P&L. Our fee-based and recurring revenues continued to be more than 95% of our total revenues in Q1, which is an important contributor to the stability of our revenue model, particularly in crisis situations like the current one. Fee-based revenues are based on delivering holistic wealth management services to high and ultra-high net worth clients rather than being transaction-based or purely a function of investment performance relative to a benchmark.

Approximately $247 million or 73.3% of our Q1 revenues were correlated to the financial markets. Of this amount, 70% related to advance billings primarily based on Q4 2019 market levels and 30% related to arrears billings based on Q1 2020 market levels. The remaining $91.1 million or 26.7% of revenues were from sources not correlated to the markets, $7.1 million lower than Q4 2019 due to the seasonal factors we discussed on our last earnings call. These revenues are primarily generated by partner firms that provide family office type services, are an important source of diversification for us because they are independent of the financial markets.

In terms of M&A activity in Q1, we completed four mergers and added one new partner firm which was Nexus Investment Management, on February 1. Based on the mid-quarter close, Nexus contributed $1.2 million of revenues and $0.5 million of adjusted EBITDA in Q1. For the full quarter in Q2 Nexus is expected to contribute approximately $1.9 million of revenues and $0.8 million of adjusted EBITDA. (inaudible) which closed on May 1, is expected to contribute approximately $0.5 million in revenue and $0.2 million in adjusted EBITDA in Q2 or $0.7 million in revenue and $0.25 million in adjusted EBITDA growth for the full quarter.

As Rudy noted, we estimate low levels of M&A activity in Q2 and most likely Q3 as well, but anticipate that activity will begin to increase in Q4 assuming the pandemic is largely contained by that point. Management fees, which are tied to the profitability of our partner firms were $83.7 million in Q1 or 24.8% of revenues, essentially unchanged from Q4.

Our Q1 adjusted EBITDA was $78 million, up $23.5 million or 43.1% year-over-year, but $5 million lower than Q4 2019 due to the seasonal factors I previously mentioned. Our Q1 adjusted EBITDA margin was 23.1% in line with our guidance of 23%. Our non-cash equity-based compensation was approximately 1.5% of Q1 revenues and we expect this expense to be around 1.5% to 2% of revenues in future quarters this year.

Our LTM cash flow available for capital allocation as of March 31, 2020, was a $144.8 million, 24.6% higher than the prior year period, reflecting the growth of our partner group and the addition of high-quality new partner firms last year. In Q1, we paid out earn-out obligations of $30.2 million in line with our guidance of approximately $30 million and we anticipate that we will pay earn-outs of approximately $30 million in Q2. We plan to retain any excess cash flow in anticipation of increased M&A activity later this year and early 2021.

The first quarter of 2020 was impacted by $31.4 million of non-cash earnings reflecting changes in the fair value of estimated earn-outs pursuant to our Monte Carlo simulations under GAAP. As a reminder partner firm earn outs generally occur over six-year period. Weaker market conditions drove a reduction in the estimated these liabilities as of March 31. As markets recover these estimates typically increase.

Let me now turn to our current expectations for Q2. Given the high level of uncertainty related to the pandemic, the pace of M&A activity and market conditions, we are providing revenue guidance for Q2 to help alleviate near term investor concerns. However, we will evaluate this guidance on a quarter-by-quarter basis as we believe annual guidance is more appropriate for our business model. We estimate that our Q2 revenues will be in the range of $290 million to $300 million. This incorporates an estimated negative organic growth rate of minus 5% to minus 7% in revenues from year-over-year same-store organic sources, primarily due to lower levels of merger activity by our partners, the equity market decline and some modest decline in non-market correlated revenues. Some of our non-market correlated revenues are driven by family office type services for clients in the entertainment industry and relate to live events, movie productions and the like. It is inherently difficult to predict these revenues in the current environment.

If conditions do not change, we believe up to $25 million in total could potentially be at risk for the next three quarters. However, we estimate that this decline would result in an immaterial impact to adjusted EBITDA given additional cost savings across the partnership and our preference protection. Our partners are entrepreneurs and accordingly are swift in adjusting their business models, prudently managing expenses without impacting client service and future growth opportunities. They do not currently envision the need for any substance of staff reductions to support their profitability, but they are reviewing their discretionary expenses including variable compensation, travel and entertainment and business



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development events. Because our partners to take this approach to managing their businesses, maintaining our earnings preference is not a concern.

As a reminder since January 2018, we have added approximately $77 million in acquired base earnings for the 16 new partner firms added through today. During the same time period, we deployed over $1 billion in consideration of closing for over 50 business acquisitions we completed including mergers. We estimate that our Q2 EBITDA margin will be approximately 22%. Based on current market levels remain unchanged we do not anticipate adjusted EBITDA margin levels will go below this 22% level for the remainder of the year. The positive results in operating leverage, we are achieving reflects tight expense management and the automatic adjustments to management fees as partner firm profitability changes.

Now turning to the balance sheet. We ended the quarter with approximately $1.5 billion in debt outstanding under our credit facilities and a net leverage ratio of 4x unchanged from the 4x ratio at the end of 2019. Importantly, we remain committed to maintaining our net leverage ratio in a range of 3.5 to 4.5 times. We continue to believe this range is appropriate for our business. Based on our Q2 expectations, we anticipate our Q2 period end net leverage ratio will remain at approximately 4x.

We know a number of you have questions about the sensitivity of our net leverage ratio, so more severe and sustained downturn. We are continuing to provide the leverage sensitivity analysis in our earning supplement to show hypothetical changes in equity markets. In case of further market decline, we and our partners have the ability to make additional expense adjustments as necessary.

Now turning to liquidity. In mid-March, we drew down $200 million of our revolver to enhance our liquidity position in light of the stress in the financial markets and the ongoing pandemic related uncertainties. We have no immediate need for the cash. We anticipate either paying this amount back once the crisis eases and markets normalize or use it to fund future M&A transactions. This drawdown had no impact to our net leverage ratio. Also, our revolver matures in July 2023 and our term loan in July 2024 so we have no short-term refinancing risk.

As a reminder, in January we reduced the spread on our term loan from LIBOR plus 250 to LIBOR plus 200 to reduce our borrowing costs. In March and April across three separate interest rate swap transactions, we successfully converted the effective interest rate on $850 million of our term loan borrowings from floating to a fixed rate resulting in a weighted average interest rate of approximately 2.6%, inclusive of the 200 basis point spread to LIBOR on our borrowings. With the repricing and swaps, with the fact they'll have investment-grade price on $850 million or 74.8% of our outstanding term loan borrowings for the next four years. We estimate approximately $14 million in annualized interest savings on this $850 million as compared to the rate in effect at the end of 2019. All other borrowings remain floating in the current low-interest-rate environment, of which we are a significant beneficiary.

To conclude, we are pleased with the strength of our financial performance. Our model is working as it should. To recap, we are estimating Q2 revenues of $290 million to $300 million and adjusted EBITDA margin at 22% and a net leverage ratio of 4x. We have reconfirmed our target net leverage ratio of 3.5 to 4.5 times. We believe these anticipated results demonstrate the resiliency of our business on a challenging time for the markets and our global community.

While the COVID-19 pandemic is unprecedented and creates a high degree of uncertainty on numerous fronts, our partner firms businesses remain solid and they are doing an excellent job servicing their clients. They have had no tangible client attrition, which speaks to the quality of their work and the importance of deep longstanding client relationships. Everyone in the Focus family has managed in the remote work arrangements seamlessly demonstrating the value of comprehensive contingency planning.

While our primary focus will continue to be helping our partners navigate the near-term challenges of the current crisis, we and our partner firms are also actively planning for the post-crisis environment which we believe will offer substantial growth opportunities. As one of our partners recently said, it is not about weathering the storm, it is about coming out strong on the other side.

Now, I'll turn the call over to the operator for Q&A. Operator.



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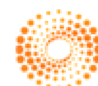

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## QUESTIONS AND ANSWERS

**Operator**

Our first question comes from the line of Owen Lau with Oppenheimer.

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

Good morning, and thank you for taking my question. So Buckingham was able to acquire RNP Advisory and it looks like the two firms have a long history of relationship. You also mentioned that your pipeline will ultimately sign and close. So my question is how many such kind of relationship Focus has that can contribute to the M&A in the near term? Over the long term, what indicators you're looking at? Which makes you confident that the consolidation opportunity in this industry will be higher than post-2008 and 2009 period and how Focus can achieve the 2020 target longer term? Thank you.

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

Good morning, Owen, and thank you for your question. RNP is actually a very good transaction because it is a firm if you rightly state that has been working with Loring Ward for a very long time. In fact, the principal (inaudible) was one of the co-founders of Loring Ward. It was of course, the thesis that we have behind the Loring Ward transaction that over time we can convert this pipeline. This is just another step in this conversion. As such really proves out the investment theory that we had behind this transaction. From an overall perspective, Owen, Q2, Q3 is probably going to be slower as we indicated, but the overall opportunity is just very, very attractive. Keep in mind after 2008-2009, your focus today is 10x. You're 10x the size of what we were in 2008-2009. It can be another 10x but clearly there is a tremendous opportunity. In fact, if anything we believe in the way we support our current partner firms through this crisis. I mentioned a number of the things we are doing there and the overall market dynamics will reinforce move to quality meaning to fiduciary advice out of the traditional brokers and banks and it will also accelerate industry consolidation.

We remain about 1,000 firms north of $1 billion, which would be a good direction in terms of the overall holding company targets well over 5,000 firms here that are below that. That still would very much be our strike zone. That's just in the U.S. You have heard we have announced a number of transactions, MEDIQ most recently in Australia. We have excellent momentum in Canada with the Nexus transaction. When we look at the overall universe, we believe it continues to be highly attractive and we are going to get our fair share. Now we have between the balance sheet cash and the revolver, we have almost $500 million in firepower, $233 million in cash, $250 million in the revolver within the 3.5 to 4.5 guidance we have tremendous flexibility but we are going to be very careful and thoughtful as we always have in the way we are deploying this capital, in what we believe are the most attractive opportunities.

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

Okay, that's great. My follow-up, could you please talk about some other value-added surfaces. I think you mentioned the cash and credit program and the activity level of these products during COVID compared to before. Do you see a much higher like increased activity in these products? Any more color would be helpful. Thank you.

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

Cash and credit, I guess, sometimes you need to be lucky relaunched literally in the perfect time because there is tremendous interest in FDIC-insured deposits. We have a program that can provide up to $50 million and more of FDIC-insured highly attractive deposits. Demand for lending has been very, very high. We probably have let's say 25 or 30 of our partner firms participating in these programs. This really enhances the value proposition to their clients. Quite frankly, even for some clients, we were able to help them in the PPP program. These are relatively small loans, of course, but still very, very helpful. Just, think about the power of helping an entrepreneurial client weather the storm and survive this crisis because of the access to these programs, so they are a terrific way to reinforce our value proposition. We never thought of this program as a big source of profitability





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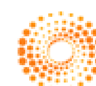

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or at least direct profitability. Obviously, we want to cover our expenses and hopefully see some more returns on top of it but what it really is about giving our partners access to capabilities that quite frankly are unique in the industry and only an organization of our scale can really create to provide these solutions to these clients.

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

So would you be able to like quantify for us the financial impact for now or is it still too early?

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

So we are covering our expenses and probably a little more, but it's too early. The real power of this program is that we are helping our partners. If you want to increase their share of wallet, increase the advisory capabilities, help them attract new clients. In fact, we have seen a number of referrals that came out of these programs. Here we have one very satisfied referred others. So it's really helping our partners retain and get new clients and therefore then of course we get our split of the incremental economics and that's the number one reason for this program.

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**Operator**

Our next question comes from the line of Gerry O'Hara with Jefferies.

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**Gerald Edward O'Hara** - *Jefferies LLC, Research Division - Equity Analyst*

Great, thanks. Good morning and I appreciate the enhanced disclosure this morning. Perhaps just one on the 20% growth target. It's understandable that the backdrop isn't conducive for that sort of forward growth guidance, but can you perhaps help us frame what we might expect if it's sort of an all else equal environment going forward and M&A fails to accelerate towards the latter half of this year?

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

We, of course, provided precise guidance for the second quarter and we're not providing full-year guidance because just given the volatility it is kind of a very difficult to provide Q3, Q4 guidance. Having said that, and this is most important. Remember, this business was compounding revenue since 2014. It's 30% EBITDA, 32% adjusted net income per share of 29.6%. This goes all back to 2014. So we have a tremendous track record of growing this business at very, very attractive rates. We know that once markets are normalizing that these continue to be the right targets given the power of our business model and you're quite frankly the overall economic dynamics with industry consolidation and quite frankly to move towards high-quality advice. The one thing I want to stress, however, and of course this is a significant and we need to be very conscious about the human toll of this crisis, but the number of partners-- I just got another tax from a partner today. They are telling us their pipelines are significantly larger. The referral momentum from centers of influence, from other clients, is very attractive. Most interesting and something I wouldn't have expected. We are actually seeing client closings without actually these partners ever meeting these clients in person. These are ultra-high net worth and high net worth clients. Quite frankly we feel very good about the overall dynamics here. We reaffirm that in the -- once this has settled out 2020 is a very good target for Focus and our track record certainly speaks for itself.

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

Gerry, as we saw the guide towards the later part of the year with the M&A hopefully we'll pick up. As Rudy had mentioned, we have the firepower in terms of the cash and the revolver. We'll continue to operate in our leverage range and we continue to generate sufficient LTM cash flow available for capital allocation to deploy. Obviously, we've become a recent beneficiary of the drops in interest rates where LIBOR is about 25 basis points today. We'll have the firepower to accelerate on that M&A. We obviously also have equity as a currency to use. When the market starts normalizing in a post-COVID environment, we have the capacity to execute on the M&A towards our long-term targets.





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**Gerald Edward O'Hara** - *Jefferies LLC, Research Division - Equity Analyst*

Okay. That's reasonable and fair. Rudy, staying with you. You mentioned some recently enhanced ESG initiatives and we all promised to take a look at the video, but perhaps you could give us a few of the highlights just to give us a sense of how you're focused on building out that initiative.

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

You were cutting off in the very beginning. Which initiative?

**Gerald Edward O'Hara** - *Jefferies LLC, Research Division - Equity Analyst*

I'm sorry. The ESG initiative. If you could give us a couple of highlights on how that is moving forward.

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

We are very committed to our ESG enhancements that we just launched. Quite frankly, particularly when you're operating in the ultra-high net worth space if your clients really care about this criteria for who they want to do business with, for the way they invest their money. As such here we just launched this. There are a number of key components and of course, they're in the proxy. We have enhanced our governance, very important. We have now a Lead Independent Director. We have imposed stock ownership guidelines and we have just published our first sustainability highlights report. We have adopted a policy towards ethical and sustainable investing which we are committed to encouraging and working with our partners to develop these strategies, which by the way was really not a strong push but rather it was also a demand from our -- from our partners here. There's just a lot of momentum around the ESG. So it's very collaborative in the way we are. We rolled them out. And then of course we are having regular webinars with outside experts and really marshaling the collective ESG knowledge of the Group to ultimately really make this is an important emphasis in our overall business model.

**Operator**

And your next question comes from the line of Chris Shutler with William Blair.

**Christopher Charles Shutler** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Hope you're well. Maybe just to start Rudy with on the M&A discussion. What do you think are the main kind of gating factors for M&A across the industry to get restarted? And I guess, when do you think of doing more M&A coming out of this environment. How do you determine what's the right EBPC number really is?

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

Well, so clearly the co-gating factors right now across the industry is the partners, senior advisors, they are really focused on their clients and one reason why we are weathering the storm very, very well. And quite frankly one why the industry is going to weather this storm very well is this real determination to provide best possible advice. This takes time.

Yeah, I mean I talk to our partners on a daily basis, and my colleagues too. They're all busy on the phones providing advice, which by the way very often has relatively little to do with investment advice, but they are just really more broadly, what's going on out there and I would very much encourage everybody to listen to this video that we posted to bring it to life here what our partners are saying and hearing what they are doing.





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Second, of course, there is some market impact based on really the equity markets as we disclosed, and this, we were guiding to in the second quarter. So probably your second question, looks to right EBPC is, you need to adjust. We usually invest based on the run rate and obviously having done probably 200 deals or so since the beginning of this business, we have tremendous expertise to ultimately get to the right revenue and EBITDA and EBPC and of course (inaudible) projections. Now remember, over 50% of our deals have created returns north of 30% average return 25%. Yeah, our track record of deploying capital in a very professional way of course speaks for itself. So we are very confident that once things normalize, once these, some of these gates have disappeared. This industry, consolidation is probably going to accelerate for some period of time versus what we've seen in the past.

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**Christopher Charles Shutler** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay, thanks. And then a few follow-ups for Jim, on the family office types of revenues, just a couple of questions. So I guess, first would -- would you confirm that you mentioned $25 million in total could be at risk there? Is that $25 million in aggregate over the next 3 quarters or $25 million per quarter?

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

It's aggregate in total over Q2, Q3 and Q4 of this year. It's an estimate based on where we are today.

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**Christopher Charles Shutler** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay. So, go ahead.

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

It's a de minimis. We don't expect any real EBITDA impact, because the other expenses to adjust in these areas and yeah, for some key our preference would be kicking in. So it's a de minimis impact. This is related to really life events in the entertainment space, and obviously there is consensus that this will come back. It's very state specific. It is unclear when they really will come back. So $25 million aggregate impact on the roughly $400 million total base is obviously a very, very small impact given the circumstances.

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**Christopher Charles Shutler** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Yeah, okay. And so, just to confirm, then, for Q2, what's baked into the, into the guidance there. Is it just divide 20 or 25 divided by 3 or is it higher in Q2, given that's (inaudible).

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

Yeah, we don't have a specific guidance by quarter. But I would expect more of it would be in our Q2 and Q3, I guess, I'll follow up later in the year.

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**Christopher Charles Shutler** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Got it. Yeah. And then lastly on that topic. Jim, just, in Q1 just confirm, I think that going back a quarter you had expected the family office revenue to be down like $20 million quarter-over-quarter, and it sounds like it was down $10 million, is that right? I just want to make sure I have the numbers correct.

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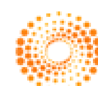

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

Yes, that's right. At the last earnings call, we had an estimate of $20 million and it came in more favorable around $10 million.

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**Christopher Charles Shutler** - *William Blair & Company L.L.C., Research Division - Research Analyst*

Got it. And then lastly, of the, I think there is roughly 22% of your revenue that is correlated to markets but and not build in advance, so I'm just trying to understand, of that revenue that's not build in advance. what equity market assumptions did you make in your second quarter guidance range?

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

Generally what the market is today that's our assumption for the year.

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**Operator**

Our next question comes from the line of Alex Blostein with Goldman Sachs.

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**Ryan Peter Bailey** - *Goldman Sachs Group Inc., Research Division - Associate*

Good morning. This is actually Ryan Bailey on behalf of Alex. Thank you for taking our questions. Rudy, I was wondering if we could come back to the opportunity advice of 8 or 9. It's been a little bit of time that -- I was wondering if we could, if you could talk about, I guess. A, what gives you confidence about the opportunity being better? B, kind of what's different now advice of 8 that you could -- you could see an even better opportunity?

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

Yeah. So again on the challenging side here. This is of course much more for human crisis than the health crisis than 2008, and that makes it of course very, very different. But at the same time, this is another time of very high volatility, and what I'm hearing from our partners is, it is easier to manage than 2008, quite frankly because of 2008. Our clients went through this crisis, have the experience and quite frankly staying the course, being prudent about the way to make the financial decisions and quite frankly really working and listening to the advices have served them extremely well.

Yeah. In this period, in this learning. Yeah. Ultimately was a major kind of very, very helpful as we are working with clients today. What we believe and that's partially, it's the aging of the advisor population, partially it is simply the challenges of having to go to remote which again overall for the industry is not that hard to do, because it is an industry that is set up to work remotely. But at the same time and we experienced as with our partners, having the resources. Having the capabilities that we have on our scale and helping our partners address cyber security issues, address communications issues, address how to market with new clients.

Our firms are going to go do very, very well through this and other prospects are going to notice. And there's nothing more powerful than a satisfied group of existing partners who ultimately become referral sources for our business model.

Third, of course financially, we did very well through 2008 and 2009. You may remember in 2009, basically our revenues were small, very small impact on the revenue base and really our EBITA was basically flat in 2009 versus 2008. And what we did very well in this period and we are going to do again is we kept significant dry powder. We were very careful and prudent not employing the capital too fast. And when the markets turned, basically we could deploy and quite frankly, there weren't many around who could deploy capital at that point.





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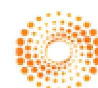

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And we again believe that it will be very prudent in the deployment of capital. Therefore you're less M&A momentum in Q2, Q3 maybe Q4, and then basically, we will have just all the resources, the track record, the reputation to ultimately take advantage of the consolidation. So yeah, we remain very optimistic in the medium term, how we can capture this opportunity.

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**Ryan Peter Bailey** - *Goldman Sachs Group Inc., Research Division - Associate*

Got it. Thank you. And then maybe just a question on referrals. You focused of a couple of times on the call and I think maybe specifically on kind of same-store sales. I was wondering if you could talk about whether maybe since there is a slowdown in M&A over the next couple of quarters as expected whether you would expect your partner firms to have a pickup in same-store sales. And I think anecdotally, we're seeing some news articles that it's more for the mass market or the lower end of the market, but we are seeing more demand and more interest and advice. Is there any way that same-store sales can bridge the gap over the next four to six months?

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

We are in the ultra-high net with a high net worth space and the sales cycles are of course longer. We don't see that quite frankly the mass affluent market is doing better in the situation. Actually, we think it's exactly opposite. It is highly sophisticated advice for highly sophisticated clients that really is the differentiator.

Our strategic decision here about three years or so ago to massively emphasize this ultra-high net worth space with firms like SCS and Brownlie & Braden and many other end -- of course some of our high-end Multifamily offices and so on. This is our world. And yes, we have seen significant increase in this referral volume. It's not a short-term. So I wouldn't say that it's going to have an impact on Q1 or Q2, but structurally, yes, we believe for a good period of time, we are going to see very attractive additional activity here for our, for our partner firms.

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**Operator**

Our next question comes from the line of Mike Carrier with Bank of America.

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**Dean M Stephan** - *BofA Merrill Lynch, Research Division - Analyst*

This is Dean Stephan on for Mike Carrier. Good to hear the favorable client retention trends at partner firms. As we look ahead, what we need to see in terms of may be a market rebound or economic recovery in order for these firms to shift their focus from the client retention back to kind of growth and expansion. And have you guys seen any reversal in this focus given the recent market rally and some positive sentiment?

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

Yeah, so just on the retention side. Retention in this industry, the retention for our partner firms has always been basically rounding error of 100%. This industry is known and that's the power of holistic deep advice for ultra high net worth and high net worth families. So retention is never the issue, however. And you're correct on why you asked a question. The focus on fulfilling the promise to these clients. You're helping them weather the storm is what's happening right now and that is of course the essence of what our partners do.

Again do look at the video, because it really comes to life to here from these partners. Retention and growth in this world is almost synonymous because most of the growth in the ultra-high net worth space comes from referrals, referrals either from existing clients or referrals from centers of influence. And so the better we serve our current partners, sorry clients, the better -- more of these referrals are coming in. That's the dynamics that I'm hearing from so many of these partners.

That ultimately, these are clients who were underserved, poorly served, misadvised by the traditional brokers who were just selling them some product. And obviously didn't work out. They didn't take a holistic perspective to the overall advisory situation. Quite frankly, many brokers right





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now are hiding from their clients. Because that's under, that's not what -- holistic advice is not what they can do in the way we are. And this is where the referrals are coming from. And that's quite frankly -- we are very comfortable that the phenomenon that we experienced in 2009 and thereafter, accelerating the market share shift the RIA space, even more so, being the place to be, is going to repeat itself and hopefully even in a more pronounced way than what we experienced last time.

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**Dean M Stephan** - *BofA Merrill Lynch, Research Division - Analyst*

Okay, thanks, that's helpful and then just a quick follow-up, given the tougher expected M&A backdrop for the next couple of quarters. What are the near-term cash priorities in terms of cash retention or maybe possibly paying down debt?

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

First on the debt side, so I mentioned before you're almost $500 million in fire power between the cash on the balance sheet plus just a revolver. What is so important to understand is we are basically funding the balance sheet at investment grade. It's not just based on the current interest rate environment, but Jim can go into the details, we swapped $850 million into fixed now. So for almost 4 years, we are assured basically investment grade funding. This gives us a tremendous cost of capital advantage. Many of the other kind of bios out there are usually private equity or similar sponsor-based very high level of leverage.

Quite frankly we know of deals that were happening at 6.5 times leverage. Recently, so pre-crisis, and quite frankly this deal is all in trouble. Because it's not just much, much higher leverage than what we have, but nowhere close to the cost of capital that we are having. So for many of these deals, quite frankly capital sources have dried out. This leverage deals can be financed anymore.

So either they need to deploy much more expensive equity or this deal simply can't happen. We maintained our firepower and we locked in for a long period of time. So clearly paying down debt is not a priority for us, but rather we are committed to the 3.5 to 4.5 leverage target that we committed last year too, and we believe that within this, we have tremendous flexibility we are keeping this cash on the balance sheet, not because we need it, but just. Yeah, it's an additional kind of flexibility and we will just steadily deploy it whenever we see opportunities that we believe are attractive.

But if there's one thing we learned in 2008 or 2009 is don't rush deploying our capital. Steady and prudent is the way to play this and as I said before is we are 10 times the size of what we were in 2009. There is tremendous opportunity ahead.

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

On the earning supplement on page 25. We go through the priorities of the cash and we give guidance for Q2 in terms of our earn-outs and for the full year, which should be about $50 million. We go through the term loan amortization which is about 2.9 a quarter.

And then as Rudy said, we're generating cash flow. The LTM was $144 million for capital allocation. So with the cash in the revolver that sort of fungible and we can use that to deploy on accretive transactions at the appropriate time.

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**Operator**

Our next question comes from the line of Kyle Voigt with KBW.

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

I really just want to dig in a little bit to EBITDA margin guidance. So in the second quarter, do you expect to benefit at all from your preferred position in base earnings, the second quarter, or would you need to see kind of a bigger market or AUM drawdown to realize a more material benefit and



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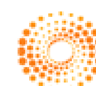

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if you are seeing a benefit or you expect to see a benefit, is it quantifiable at all? So just wondering what the EBITDA margin would be kind of without that preferred position and base earnings.

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

Hi, Kyle, good question. It's actually interesting. We are weathering the storm and our partners are weathering the storm extremely well. And quite frankly the benefit of the press is very small. So it would need a significantly higher market disruption really for the preference to kick in, which is very much what we expected.

It's, of course, you understand the stability of the revenue streams. You understand the variability of the expense base, and quite frankly the nimbleness of our partners. They of course have made adjustments and so as we know company on the discretionary expense side. And quite frankly are ready to do more if there was more necessary, but this is not about how we survive this crisis. That's not our issue, it is you are really been positioned to take advantage of the upswing and the upswing is going to come. It's just a question of when. And so it's very much of a balancing act, but now the preference is not an important feature, it is a level of market correction.

At this point, it's usually, as we explained in the past, in the first year or two, maybe the preference is important. Yeah, so for relatively recent transactions, because we didn't base on the run rate and therefore there may be a little bit, but of course, there was a huge liquidity event. And then for most firms after two years or so, this is in the rear view mirror. And quite frankly, most of our partners where we don't even remember this number because it's not relevant for them. Even in this level of market dynamics, so now it would need to take a significantly more bigger market correction for this to kick in.

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

That's really helpful. And then just a follow-up also related to the EBITDA margin guidance for 2Q. Is it just a bit better than we expected? So I'm just trying to understand. Are there expense offset built into that 2Q EBITDA margin guidance at the corporate kind of holding company level? Are you doing things at the holding company level to reduce expenses? And then also you mentioned that your partner firms really aren't looking to reduce head count at least at this point in time. So where are they pulling back? Is it on marketing, or other G&A, maybe you could just kind of provide some more details there? Thank you.

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**James Shanahan** - *Focus Financial Partners Inc. - CFO*

First just on the holding company. The holding company is a relatively small part of the overall expense base. You remember we have only like 80 people in the holding company. The overall cost base is very much, of course, watch the partner firms. You're correct. There is no need for absolutely anything except in some very, very isolated areas in the entertainment space, but so, one is the revenue side, of course, in the adjusted much. That's the stability of the revenue base, but then it's all the discretionary expenses.

And of course bonus pools as small are -- quite frankly we are rationalizing some of the healthcare expenses. Travel and entertainment quite frankly his self-adjusted, although quite frankly ultimately, it's not a good thing. We want to be out there. We will be out there whenever these things are opening up again, and it is important for of course, our partners to meet with their clients.

And so this will come back, but right now. This has obviously a very significant impact on this line item, which is a meaningful line item for us. And so it's all the areas that basically don't really impact head count. And on the headcount side, we need to be ready for the upswing. And this is an industry where there is a shortage of talent. This is an industry where quite frankly, we constantly are running behind on the recruiting side. So treating our staff fairly -- treating them well and retaining them is really the best recipe to capture this upside when it's coming.

So I think between our partners in the holding company, we are very comfortable that ultimately we are managing the expense base very prudently given the circumstances, and we will still be ready to capture the upside.





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

Thank you.

**Operator**

Thank you. We have reached the end of our question-and-answer session. I would like to turn the call back over to Mr. Adolf for any closing remarks.

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

Yes. So thank you all for your interest and in closing, we are incredibly proud of how well our partners have adopted in the face of these extraordinary times, superior time service, seasoned professionalism, consistency and stability are what the current clients will remember and what will attract new clients and merger candidates in the future. The current prices is reinforcing our core value proposition and demonstrating the resilience of our financial model. In turn, enabling us to position our business for the substantial opportunity we see developing post crisis.

We believe that these attributes will further enhance our competitive positioning as markets and economies recover. Importantly, I want to thank our partners and colleagues across our firms and our talented team of the holding company employees who have gone above and beyond in helping our partners navigate this crisis.

They have shown extraordinary commitment, dedication, and resolve, and our business would not be as strong as it is today without them.

On behalf of everyone at Focus, we hope that you all stay safe and healthy in the coming weeks and months. Thank you.

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