Focus Financial Partners Inc.
Second Quarter 2022 Earnings
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<u>Presenters</u>
Ruediger Adolf, Founder and CEO
Jim Shanahan, CFO
Rusty McGranahan, General Counsel
Tina Madon, Head of Investor Relations

<u>Q&A Participants</u>
Craig Siegenthaler – Bank of America
Matt Moon – KBW
Brandon King – Truist Securities
Owen Lau – Oppenheimer

Operator
Good morning. I would like to welcome everyone to the Focus Financial Partners 2022 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. At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star and then zero on your telephone keypad. As a reminder, this conference is being recorded.

Mr. McGranahan, please go ahead.

Rusty McGranahan
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. And 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?

Ruediger Adolf

Thanks, Rusty. Good morning, everyone, and thank you for joining our call today. The second quarter results we announced this morning were outstanding. Our performance was again above the top end of our guidance, and our business is weathering the volatile market environment well. The benefits of our diverse revenue stream, the variable nature of our cost structure, and the scale of our global partnership are evident.

We generated Q2 revenues of $539.2 million, reflecting year-over-year growth of 26.8% and our organic revenue growth rate was 15%. Our adjusted net income, excluding tax adjustments per share was $0.99, and tax adjustments per share was $0.19, increasing 17.9% and 35.7%, respectively. Year-to-date, we have closed or announced three new partner firms and 11 mergers, bringing our year-to-date transaction total to 14 deals. We closed on Octogone, our first partner firm in Switzerland on July 1. We also closed on Icon Wealth Management as our newest partner firm on August 1. Icon, which manages approximately $1.6 billion in client assets is a premier firm with a prudent management team that will help us expand our presence in the fast-growing Texas wealth management market.

Despite the macro backdrop, industry M&A deal volume in the second quarter and first half of this year hit new records according to Echelon Partners. We continue to have an excellent pipeline with a good mix of new partner firms and mergers on behalf of our partners and connectors.

Our momentum going into the second half is strong, and we continue to believe that 2022 will be one of our best years for M&A. Our partner firms remain active in seeking mergers to strengthen their client service capabilities and enhance the growth of their business, and we expect deal volume momentum to only increase once current market volatility subsides. As an example, according to Echelon Partners, deal activity in 2021 was nearly 50% higher than in 2020, which was impacted by COVID. We capitalized on this dynamic in 2021, closing on a record number of transactions with our year-over-year deal volume increasing by over 50%.

Our partners are again demonstrating the ability to handle the challenges of difficult market conditions. Central to the stability of their businesses and to our financial results is high client retention. Our partners are trusted advisers in every aspect of their clients' financial lives beyond simply managing investments and have deep multifaceted relationships that frequently span decades. The clients are high and ultra-high net worth individuals and families who seek to preserve their capital across cycles through sophisticated multi-asset class portfolio construction. These clients are less concerned with the impact of market declines in the near term, focusing more on multi-generation of wealth creation and efficient tax planning in the long term. Collectively, these attributes drive strong client retention and are important sources of diversification and stability in our business. We believe that the flights to comprehensive high-quality advice will accelerate the growth in client assets managed by the RIA industry in the first few years after this correction, the way it has in prior cycles.

In my many recent conversations with our partners, they are taking the current macro environment in strides and have said that their clients feel well prepared to weather the storm. Our partners have navigated multiple market cycles during their careers, including inflationary environments. This experience substantially enhances their ability to be trusted advisers, in turn reinforcing the value they provide.

Clients, especially those who have benefited from the last decade of rising markets, have on balance been calmer over the last six months than they have been in prior periods of volatility. What client portfolios have been impacted, our partners highlight that they spend a significant amount of time helping their clients structure their asset allocation to mitigate downside risk. The investment management objectives are not about hitting home runs, but instead are tied to a holistic financial planning process and clients are not relying on their portfolios to meet short-term liquidity needs. But the current volatility may persist for some time. Our partners are confident that they will weather this period as well as they did in the '08-'09 financial crisis and subsequent recessions and most recently in 2020. In fact, as we have demonstrated again and again, these times of disruption creates excellent opportunities for client retention and referrals. Anecdotally, we are hearing that many of our partner firms are again experiencing strong referrals.

Our family office firms who provide services to artist entertainers and other ultra-high net worth clients have been an important source of revenue diversification year-to-date. They are the primary component of our non-market correlated revenues, which represent approximately 23.3% of our Q2 revenues. Unlike 2020, when a portion of our non-market correlated revenues were adversely impacted by COVID, we are getting the full benefit of this diversification in our 2022 results.

As we turn to the second half of the year, it is difficult to know how the macro environment will evolve, although we anticipate that markets will remain volatile. Given the potential recessionary outlook, we remain prudent in our capital deployment.

With 14 transactions closed or announced year-to-date, we continue to execute on converting our strong pipeline. Despite deal signings and closing getting somewhat delayed in the current environment, we anticipate that 2022 will be one of our strongest M&A years. As a result, while we continue to expect our revenue growth for 2022 to be approximately 20%, we are resetting our adjusted EBITDA growth guidance for this year from 20% to a range of 16% to 18%. Similar to prior patterns, when markets normalize, we expect an attractive catch-up phase, similar to what occurred in 2021. And subsequently, a normalization to the 20%-plus growth rate we have demonstrated in the past.

Looking ahead, we see several important takeaways. The first is that our business is resilient despite the market backdrop. The second is that we continue to be highly disciplined capital allocators and even more so today given heightened risks in this environment. The third is that although markets may remain depressed for a while, they will eventually recover. Until that time comes, our diversified revenue stream and the structural protection in our business model, we continue to mitigate our market sensitivity. We believe that the growth opportunities ahead, and particularly after significant market volatility, combined with the operating leverage on our business will lead to our sustained outperformance once conditions stabilize.

The first of these is opportunities in accelerated industry consolidation. We believe that the secular tailwinds of succession and scale will accelerate once the recovery takes hold and lead to substantial incremental growth opportunities in our business. The second is the large international opportunity we have. We plan to continue expanding our presence outside the U.S., particularly in the ultra-high net worth segment, which will further increase the growth and diversification of our partnership. The U.S. independent wealth management industry, which stands at approximately $7 trillion in client assets will remain our largest market and primary focus. That said, the international markets represent an incremental multitrillion dollar opportunity and one that lends itself well to our decentralized partnership structure and the type of resources we make available to our partner firms.

And finally, our value-add capabilities, which are a substantial differentiator today, particularly in these markets and which we believe will become increasingly important to our partners' ability to provide the highest level of services to the clients. As with previous cycles, our client demands will continue to become more complex, driving the need for scale in order for independent wealth managers to remain competitive.

My co-founders and I have every confidence that Focus will successfully continue its growth path and deliver superior value to its shareholders. While we are very attuned to the dynamics influencing our partner firms, our decentralized structure enables us to manage our business with maximum flexibility in both down and up markets. Because our partners have autonomy, they are nimble in how they manage their businesses. These attributes allow us to adapt quickly as conditions evolve and positions us to weather environments, like the current one, particularly well.

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

James Shanahan
Good morning, everyone. We delivered excellent results this quarter, reinforcing the resiliency of our business model and the quality of the firms in our partnership globally. As Rudy mentioned, our business is weathering the challenging environment well. The diversity and recurring nature of our revenues, our earnings preference, the structure of our management fees, and the strong

economic alignment we have with our partners have withstood the recent volatility. Our partners have done an excellent job of focusing on their clients, while at the same time, positioning themselves for the growth opportunity that will emerge when markets begin to recover.

Now turning to the key elements of our P&L. We reported Q2 revenues of $539.2 million at 26.8% year-over-year increase and above the top end of our $535 million guidance. Our organic revenue growth rate was 15%, also above the top end of our 11% to 14% guidance. To help investors better understand the composition of our organic growth rate, we have added the rate excluding mergers to our earnings supplement on page five and 10.

Against the backdrop of an exceptionally difficult market environment, the resiliency of our revenue performance is notable. While our revenues are not immune to market movements, they have four important sources of diversification, which we continue to believe are not fully appreciated by the investment community.

First, approximately 23.3% of our Q2 revenues were not correlated to the financial markets, meaning that they are typically derived from family office type services, tax fees, and fixed fees for investment advice. Second, our partners' clients are sophisticated high and ultra-high net worth investors whose portfolios are invested in multiple asset classes and are highly diversified as a result.

Third, we don't manage the client investment process at the Focus level. Each partner firm has its own investment committee and follows its own asset allocation strategy, which creates substantial diversification within the 76.7% of our revenues that are market correlated. And fourth, our partner firms use a variety of billing methodology, which mitigates the impact of quarterly market movements. Approximately 67.2% of our Q2 market correlated revenues were built in advance, meaning they were built typically based on prior quarter movements. Approximately 32.8% are billed in arrears, meaning they are billed typically based on Q2 quarterly movements.

Our earnings preference is another important structural protection of our model. The cumulative acquired base earnings for the 30 firms we have added as new partners since the beginning of 2019 totals $148 million. As a reminder, acquired base earnings represents our annualized preferred position in our partner firms' earnings and typically must be met prior to the respective management companies earning any management fees. The acquired base earnings is typically between 40% and 60% of the partner firms EBPC.

Our management fees adjust real time as our partner firms' earnings fluctuate. For firms that are above their target EBPC earnings, we share in the amount above that level. For example, for a partner firm with a 50-50 split, this means for every dollar of decline in its earnings, there is a $0.50 reduction in Focus earnings and a $0.50 reduction in the firm's management fees. This is an important structural aspect of our financial model as management fees are our second largest operating expense and create an economic alignment of interest.

Our adjusted EBITDA for Q2 was $137 million, a 27.1% increase year-over-year, and our adjusted EBITDA margin was 25.4%, above our guidance of approximately 24.5% to 25%, reflecting lower compensation expense as a percentage of revenue due to variable compensation.

So far in Q3, we have closed on two new partner firms, Octogone and Icon, which based on mid-quarter closings, we expect will add estimated revenues of approximately $7 million and adjusted EBITDA of approximately $1.7 million in the third quarter and over $30 million in annualized revenue and $7.8 million in annualized adjusted EBITDA. As Rudy noted, our pipeline for the second half of 2022 remains strong. We continue to be a highly sought-after partner by leading firms and merger targets, seeking to enhance and grow their businesses.

Now let me turn to our Q2 expenses and cash flow. Our management fees were $136.8 million or 25.4% of revenues, sequentially consistent with Q1. Our noncash equity compensation expense was approximately 1.4% of Q2 revenues, and we expect this expense to be approximately 1.5% of revenues in Q3.

The second quarter was impacted by $42.8 million of noncash earnings, reflecting reductions in the fair value of estimated earn-outs pursuant to our Monte Carlo simulations under GAAP. As a reminder, our partner firm earn-outs generally occur over a six-year period. Weaker market conditions drove a reduction in the estimate of these liabilities as of June 30. As markets recover, these estimates typically increase.

Our LTM cash flow available for capital allocation was $323.2 million as of June 30, increasing 21.5% for the comparable prior year period, reflecting the earnings growth of our partner firms and the addition of new partner firms.

Our gross unamortized tax shield was more than $2.7 billion as of June 30 or approximately $5.82 per share, demonstrating the substantial incremental value that our tax-efficient structure creates for our shareholders. In Q2, we paid cash earn-out obligations of $33.3 million, which was in line with our estimate, and we estimate that we'll pay earnouts of approximately $50 million in Q3.
Now turning to our Q3 P&L expectations. We estimate that our Q3 revenues will be in the range of $505 million to $515 million, a sequential decline of approximately 4% to 6% from Q2. These estimates reflect the impact of the 2022 market declines on our market correlated revenues. We estimate that our Q3 organic revenue growth rate will be between 0% and 2%.

We expect that our Q3 adjusted EBITDA margin will be approximately 24%, which would bring our first nine months margin to approximately 25% on a rounded basis. Our partner firms remain nimble in managing their clients and businesses while navigating the macro environment. While lower market levels are impacting their revenues, our partners are not immediately adjusting their operating expenses. They manage their cost conservatively to begin with and take a long-term view to invest in and consistently manage in their businesses. This approach ensures that they are delivering a superior client experience across cycles.

Unlike 2020, during which discretionary costs dropped sharply in response to the COVID shutdowns, our partners are taking a measured approach to reducing these type of expenses. Although this approach impacts the management fees and creates negative operating leverage for us in the near term, our partners are positioning themselves to take advantage of the substantial growth opportunities when a macro backdrop stabilizes. We anticipate that our adjusted EBITDA margins will recover as the markets recover. However, should unsettled markets persist for a longer period of time, our partners have levers that they can pull on expenses, including discretionary spending and variable compensation.

Now turning to our balance sheet. We had approximately $2.5 billion of debt outstanding as of June 30, and our net leverage ratio was 3.9x within our estimated range of 3.75x to 4x. We expect that our Q3 net leverage ratio will be approximately 4x. As Rudy highlighted, we are deploying our capital in a very disciplined, measured way, particularly given the heightened risk created by the broader macro environment.

Our Q2 interest expense was $19.9 million, $2.3 million higher than the $17.6 million in Q1 due to the rising rate environment and the increase in our borrowings. Similar to last quarter, we have included an interest rate sensitivity analysis on page 22 of our earnings supplement. The important takeaway is that if 30-day LIBOR or SOFR rates as applicable were, for example, 200 basis points higher than the actual rates in effect on our borrowing store in Q2, our pretax interest expense would have increased by approximately $7.9 million. On an annualized basis, this is a modest headwind on a business with over $2 billion in annualized revenues.

To conclude, we are pleased with the strength of our financial performance this past quarter, particularly given the challenging environment. Our business is benefiting from a diverse revenue stream that is 95-plus percent fee-based and recurring and an earnings stream which has substantial downside protection due to the variable nature of our management fees and the earnings preference we have on the cash flows of our partner firms.

Our pipeline continues to be strong, and we believe that 2022 will be an excellent year for M&A activity. While our estimated Q3 revenues and earnings will be impacted by the challenged conditions in recent months, the reduction is modest when compared to the broader decline across the financial markets.

Our partner firms' businesses are performing well, and they're doing an excellent job servicing their clients. They have no tangible attrition, which reflects the quality and depth of their client relationships. Time sight (ph) these position our partners well for strong growth in the future. We are confident that the resiliency of our business will again be evident in our performance, even if it takes a longer time period for markets to recover. We are executing well and navigating the storm. This is an extremely important because it means we expect to be well positioned to benefit from the growth opportunity once macro conditions improve and deliver incremental value to our shareholders.

I'll now turn the call over to the operator for Q&A. Operator?

Operator
Thank you. At this time, we will be conducting a question and answer session. If you would like to ask a question, please press star and then one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star and then two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we pull for questions.

Our first question is from Craig Siegenthaler of Bank of America. Please go ahead.

Craig Siegenthaler
Good morning, Rudy, Jim. Hope you're both doing well.

Ruediger Adolf
Hello, Craig, how are you?

James Shanahan
Good morning, Craig.

Craig Siegenthaler
My question is on the pace of new investment activity in the U.S. RIA industry. And it's great to see 14 deals year-to-date, and we heard your commentary that 2022 will be one of the strongest years. But do you think your prospects are generally a little less willing to transact right now? And could this impact activity levels in the second half, which tends to be very strong every year, especially considering you've had like three very strong second halves in a row?

Ruediger Adolf
Yes. Thank you, Craig. So clearly, and we have enough visibility, this will be one of our best M&A years. And we don't really see any kind of tangible slowdown here based on the current market environment. When you look historically in our industry, a real slowdown comes if there was kind

of '08 type of scenarios. Yes, '08 and then really '09, there was very little activity in the industry. But yes, we are clearly not in the situation. We see maybe some deals take a little bit longer, but I don't see any material difference. And keep in mind, the fundamental drivers of M&A, which is ultimately clients needing better and deeper advice, and you need scale to do that, it's easier to grow a business when you have a division of labor and again, this drives scale. And then, of course, the aging of founders and succession planning, these fundamental drivers are not affected. And so yes, no, we don't just believe that '22 is going to be a good year, but even what we see going into '23 is there's no abatement of M&A opportunities whatsoever.

James Shanahan
Right. And we certainly are focused on continuing to be prudent capital allocators as we've spoken about in the past. And as you can see in our June financials, we have over $200 million of cash. We generated over $320 million of LTM cash flow available for capital allocation, and we have over $500 million available on our revolver. So the opportunities are there in the second half, as Rudy mentioned, and we have the currency to execute on that as well.

Craig Siegenthaler
Thank you, Jim. And just as my fault, and I'm not going to mention any names, but we wanted to see how the competitive landscape is evolving in 2022. Our focus is competitors generally pulling back. I know several of them are funded with private equity capital and many of them run with quite high leverage, which may be putting a strain in their financials.

Ruediger Adolf
Yes. Absolutely. Obviously, I never speak specifically to any particular names. But what we have seen last year, I may have used the word drunken sailors, they are gone. We don't see any activity from some of the players who just dramatically overpaid for assets that clearly were not worth it in our estimation. So overall industry activity is going to remain high. Competition is kind of, I would say, normal. Last year, it was not normal. And quite frankly, we do see a stabilization. Actually, I would say, in a softening of multiples. But as you know, Craig, we have always been very disciplined. Yes, we did 38 deals last year, 14 we announced year-to-date, and it's ultimately the power of our value proposition. You want to be an entrepreneur, you want to have access to value-added services and you want to have permanent capital, Focus is the only game in town. There's nobody else who can have this type of a powerful value proposition. This is highly differentiating. And this basically enables us to sustain our M&A proposition for years to come, both domestically and internationally.

Craig Siegenthaler
Rudy, Jim, thank you.

Ruediger Adolf
Thank you, Craig.

Operator
Our next question is from Kyle Voigt of KBW. Please go ahead.

Matt Moon
Hi. This is actually Matt Moon on for Kyle. Just one for me on the adjusted EBITDA margin. Obviously, it was a strong performance (inaudible) in the quarter, one of the best in your company's history I believe. So just wondering when comparing that to the notably lower 3Q guidance, just the factors that are driving the variance between the two figures, I think you had outlined some lower variable comp for the second quarter. Is that not expected to occur going forward? And -- or is this maybe more related to kind of the acquisitions that are coming on board in 3Q and potentially a lower associated management fee?

Ruediger Adolf
Yes. Thanks, Matt, and Jim will provide some more detail. But basically, of course, it's -- this is because of our advanced billing. This is where the market simply impacts us in the third quarter. But very important and strategically, the markets, of course, have some impact, but they go down, they go up. We have not seen, and we are not encouraging our partners at this point to, quite frankly, cut any costs or do anything that kind of would improve the margins because client advice is critical in times like this. And most importantly, and we have really demonstrated this in 2020, and of course, we have seen it in '09 and '10, you need to be prepared for the upswing. And we had our industry, and we, of course, had just a terrific year in 2021. And if you cut too close, you won’t be able to take advantage of the upside, which in variable will come, it's just a question of when.

James Shanahan
Yes. If you kind of put things in perspective, Matt, you look a little bit of a longer time horizon, in 2020, our margins were 23.6%, and we grew them to 25.1% last year. And even in the first half of this year, they grew to 25.3%, right? So we have a very resilient model. And from an M&A perspective, as you indicated, sometimes that can impact it. We've disclosed the revenue and the adjusted EBITDA contribution for the new firms that joined, Octogone and Icon, and they're about a 24% margin. And certainly, the majority of our market correlated revenues are built in advance and with the sharp market correction that has an impact, and our partners haven't adjusted all their cost structures in the short-term duration due to the opportunities ahead, as Rudy just mentioned. So if you look at a nine-month year-to-date, it will be plus or minus 25% on the adjusted EBITDA margin. I would say that's a very attractive margin in the financial service industry based on the volatility that we've all experienced in the first part of this year so far.

Ruediger Adolf
Yes. I think what you're really seeing is, yet again, the tremendous resiliency of our business model. We had double-digit drops in the equity markets. And the impact on revenues and EBITDA

is quite moderate and our ability to sustain the margins, it just speaks to the quality of the business model that we have here.

Matt Moon
Yes. Okay. Makes sense. And then I just had another one too, on capital. I know you guys announced a buyback authorization in the quarter. I don't think there was any mention of it in the release or presentation, I was just curious if you had utilized any of this at all during the quarter? And then maybe more to drill down to on kind of the framework of how you guys evaluate buybacks versus M&A and kind of just determining the preference between the two?

Ruediger Adolf
Yes. Yes, absolutely. So of course, this business is very cash generative, over $320 million, and we have a $200 million authorization. But when we announced it, we were very, very careful and precise in the choice of our words. This was never supposed to be a buyback program. We would execute a buyback here within the core framework financial objectives that we have, the 20% growth target and the 3.5% to 4.5% leverage. So it was really a program we designed to kick in if there was a way higher kind of disruption in the markets than what we have expected.

Quite frankly, I wish we had this program in Q2 2020, where the market is simply absolutely overreacted and it would have been very attractive for us to deploy this capital. We were nowhere close. We are not close to these levels. We, quite frankly, are very optimistic here. But yes, in the event of an event, it's a very good authorization to have -- and it's, of course, certain price levels, it would be highly accretive, but it's not a strategic buyback program that we have launched here.

Matt Moon
Okay. Thank you very much.

Ruediger Adolf
Thank you.

Operator
Our next question is from Brandon King (ph) of Truist Securities. Please go ahead.

Brandon King
Hey, good morning.

Ruediger Adolf
Good morning, Brandon.

Brandon King

Yes. So I wanted to get a sense of M&A for the back half of the year and where things currently stand. I'm aware you have a disciplined approach. But I'm wondering if compared to, let's say, last year or prior periods, are you passing up on more M&A opportunities nowadays compared to what you're seeing as far as potential? Just want to get a sense of how that's looking through your filter.

Ruediger Adolf
Yes. We have been always very selective and disciplined. Yes, that's how we built this business and really going all the way back to 2006. Yes, we see many opportunities. We are walking away from many opportunities where we don't like the pricing or we don't think there's a good fit for our business objectives here. When we execute the deals, like Octogone most recently, we very much look at these firms as platforms. It's platforms where we can help them grow, build on their traditional growth rates and then ultimately help them acquire other firms, acquire teams, and really expand beyond what they typically would have done similarly with Icon in Texas.

So I don't think there's a big change. It's really a continuation of the practice that we had. Last year, yes, we did 38 deals, but quite frankly, we walked away from many more deals which we did not see were attractive. And this discipline will continue forever as long as we are in the M&A business.

Brandon King
Okay. Thanks. And then you mentioned how, as of now, you're not encouraging your partner firms to adjust their expenses. But I'm curious what would it take for you to start nudging your partners to cut expenses? I know the markets have kind of rebounded a little bit lately, whether you get another downturn or what kind of duration of, I guess, a more deterioration in the markets, would it take you to actually encourage your partners to cut expenses?

Ruediger Adolf
Yes. Well, first and foremost, as you know, we have a very entrepreneurial model. So it's really our partners who are the nimble entrepreneurs who are very good at kind of managing their expenses and, of course, their revenues. But what's really important from our perspective is you need to prepare for the upside. And we saw it in '21, we saw it in prior years, when the markets come back, there is -- you need to have the capacity to really work with these clients, quite frankly, right now already and not dissimilar to other crisis, we have seen an increase in referral volume. We -- this is the period where our industry shines.

And we have proven this from a market perspective in Q2 last year, where we demonstrated that our industry gets hit much less than other parts of wealth management, whether it's wire houses or banks or traditional providers. But then the traditional industry growth rate, which is usually about 10%, almost doubles in year one and two after the crisis. And it has a lot to do with simply how well we serve these clients. We're doing tough times. This requires talent. This requires resources. And yes, our partners are kind of very good in the way how they are preparing for this. Yes, if there was a much more dramatic downturn, they are very good in managing their expenses, and we help them, but we are definitely not at anywhere close to these levels at this point.

Brandon King
All right. Thanks for taking my questions.

Ruediger Adolf
Thank you.

Operator
Our next question is from Owen Lau of Oppenheimer. Please go ahead.

Owen Lau
Good morning, and thanks for taking my questions. Could you please talk about your third quarter revenue outlook? I understand that 67% of the revenue is built in advance and the broader market in the second quarter was down a lot, but your revenue still hold quite well in the second quarter. I think M&A activities are pretty strong in the third quarter on page 17. And also the broader market has been quite strong so far in this quarter. I'm just wondering how much conservatism you have baked into your revenue outlook in the third quarter? Thank you.

Ruediger Adolf
Yes. I think we build the forecast from the bottoms up. We provided disclosures, you mentioned, Owen. The majority of our market correlated revenues, 67% are in advance. And obviously, markets were down at June 30 relative to March 31 as an example. So that's certainly one element of it. Then the residual of the market correlated is the arrears. We worked on our projections with our firms in July. As you just indicated, there seems to be a little recovery over the past week, but we'll see ultimately how the quarter unfolds for Q3. We're obviously very optimistic about the diversity of our non-correlated revenues, as you can see from Q1 to Q2, they grew from 1.17 to 1.25 . So we certainly like the stability and the diversification of that during the turbulent volatile market time period. So we put that all together, and that's how we provide the guidance, which is down sequentially 4% to 6% versus Q2.

Owen Lau
Okay. God it. Thank you very much. And then my follow up question is maybe a broader one. Could you please give us an update on your international expansion, where you are right now? Do you expect more -- like traveling more deal outside of the United States in the second half of this year? Thank you.

Ruediger Adolf

Yes. Owen, so from a geographic footprint, I think we got the markets that we are most interested in. There is maybe one more market that we will be announcing later this year. And then it's all about depth. We want to further -- you will hear about more activities in Canada and Australia, U.K. and most certainly in Switzerland. All of these markets, we have kind of, if you want established the beachhead or the beach heads and there's much more opportunity here.

But let's keep in mind here today only 5% of our revenues are from international. And ultimately, our target is somewhere above 20% because then we have the full benefit of the diversification of these international markets. Excellent opportunities out there. Our model is quite unique in the U.S. from a value proposition perspective. Quite frankly, this model is unheard of in many of these additional markets here. And so yes, you will hear more, but you will hear more in the existing markets than adding new markets to our portfolio here at this point.

Owen Lau
Got it. Thank you very much.

Ruediger Adolf
Thank you, Owen.

Operator
Ladies and gentlemen, we have reached the end of the question and answer session. And I would like to turn the call back to Rudy Adolf for closing remarks.

Ruediger Adolf
Thank you. And to close, we are very pleased with how our partners are once again navigating difficult conditions here so successfully and how this is translating into the quality and consistency of our financial results. Our business is, again, rising to the test of an extraordinary market correction. It is stable, resilient, and will emerge stronger, enabling us to take advantage of the substantial growth opportunity as the environment stabilizes.

We believe that we are uniquely positioned to capitalize on industry dynamics, reinforcing our competitive advantages globally. My co-founders, Rajini and Lenny, and I are excited about the path forward as we continue to execute on our long-term growth strategy and build a partnership that is second to none in this industry. Thank you all for your interest.

Operator
This concludes today's conference. Thank you for joining us. You may now disconnect your lines.