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# FINANCIAL ADVISOR

Knowledge for the Sophisticated Advisor
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# The Transformer

United Capital's Joe Duran is building a different kind of holding company.

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# STRATEGIC MOVES

## UNITED CAPITAL'S JOE DURAN MUST SEE WAYS TO IMPROVE AN ADVISORY FIRM'S BUSINESS BEFORE HE OFFERS TO BUY IT.

BY JEFF SCHLEGEL

Photographs by Mark Robert Halper

## MERGERS AND ACQUISITIONS ACTIVITY IN THE FINANCIAL ADVISORY INDUSTRY HAS ACCELERATED DURING THE PAST THREE YEARS, AND UNITED CAPITAL FINANCIAL ADVISERS HAS DONE ITS SHARE OF DEAL MAKING.

Since it began in 2005, the Newport Beach, Calif.-based company has bought 12 advisory practices and a large financial consulting company, and now has $8 billion in assets and operates in eight states. Its strategy is to expand aggressively, build a larger national network of affiliated advisors and have a big liquidity event in 2011 that will make everyone wealthy.

On the surface, United Capital's game plan sounds little different from those of some of the 30 or so other holding companies (or roll-ups or consolidators, depending on the nomenclature) who are building a portfolio of advisory firms under one umbrella to gain a strategic foothold, prepare for a big payday, or both.

But United Capital doesn't like to be called a roll-up company. "We're a transformational acquirer," says CEO Joe Duran. Sounds jargony, yet Duran passionately believes that United Capital possesses a different business model built on a foundation of standardized practices and holistic financial advice.

"Holding companies buy a portion of a firm's cash flow, and say please deliver me this amount of cash flow and have a nice day," says Duran, 40. "When we acquire a firm, we're going to be your partner." United Capital's central office takes over all of the compliance, bill paying, reporting, personnel and payroll duties at each new affiliate so that advisors can devote most of their time to client service. In addition, the company devised a practice management system diagrammed on a color-coded chart that organizes—if not standardizes—an advisor's typical workweek, and it monitors all of its affiliates' portfolios on an ongoing basis to make sure that desired allocations don't get out of whack.

"We don't acquire a firm if we can't bring something to the table for it," Duran says. The firm's strategy includes changing the revenue mix to minimize commission-based products and maximize recurring fee-based income, and fostering a holistic planning approach that attracts more outside assets from existing clients.

Duran says that United Capital-affiliated firms on average have generated 40% more cash flow within 12 months after they were acquired, and all have had at least double-digit growth during that period.

The people running United Capital have been here before. At the age of 24, Zimbabwe native Duran joined a small investment firm in Los Angeles called FundMinder. During the next nine years, he and his two older partners grew the company both internally and through acquisitions of fee-based firms, which they retooled to make more profitable. Assets grew from less than $100 million to north of $2 billion, and revenue leaped from roughly $1 million to tens of millions of dollars. The firm later became Centurion Capital Management and in 2001 was sold to General Electric's GE Financial unit for a large, undisclosed amount.

Some board members of Centurion, as well as the venture capitalist involved with the firm, are again participating at United Capital, and Duran is tweaking his previous business model in hopes of even bigger things.

Duran seems more idealistic than hyperbolic, yet he's not shy about blowing United Capital's horn. "I don't know anyone doing what we do," he says. "We're creating one company, one vision and one culture. That doesn't exist anywhere else today."

### Many Choices

Last year was the busiest ever for M&A activity among RIAs, according to Schwab Institutional. The 81 transactions beat the prior record of 57 from 2006, which in turn topped the previous best total of 52 in 2005. The graying of the marketplace—the average principal is about 55 years old, and 30% of them are 60 years or older—means a lot of advisors are looking for an exit strategy.

David DeVoe, director of M&A at Schwab Institutional's strategic-client group, believes that succession planning will help propel M&A activity, as will the proliferation of holding companies funded by private equity investors looking for a piece of the action in a fast-growing business. Holding companies accounted for roughly 35% of acquisitions in 2007, reports DeVoe, up from 20% in 2003.

Holding companies come in many different flavors. Perhaps the granddaddy of them all is National Financial Partners, a broad-based roll-up of roughly 175 financial services operations ranging from insurance companies to benefit firms. The company's stock price has nearly doubled since its IPO in September 2003 though it has suffered recently with virtually all financial services equities.

Others include Focus Financial Partners, a private holding company funded by Summit Partners that has 14 affiliates and $26 billion in assets. Focus targets wealth managers with assets of at least $350 million. Boston Private Financial Holdings, a publicly traded company that owns a network of 14 financial services firms with total assets of $37 billion, provides capital, marketing and back-office help but lets its firms handle their own daily operations. As does Wealth Trust, a network of 11 wealth management firms with a combined $8.6 billion in assets that provides affiliates with accounting, compliance, human resources and other support while letting them make their own investment management and client service decisions.

United Capital is carving out its own niche. The firm "is unique in two ways," says Mark Tibergien, CEO of Pershing's advisor solutions group. "It tends to acquire smaller advisory firms, and it takes a more integrative approach."

United Capital's sweet spot is firms with $100 million to $500 million, and

it's definitely a hands-on consolidator.

"Most successful holding companies celebrate the independence of the RIAs and firms they acquire," says DeVoe, adding that he plots holding companies on a continuum to gauge how much independence they provide their affiliates. "I'd put United Capital at one extreme in that they get their fingernails dirty," he says.

DeVoe believes the growing number of diversified holding companies in the advisory space is good for the industry because that means more options for advisors looking to sell their practices.

### Doing Chores

As a boy growing up in Harare, Zimbabwe, Duran's family gathered around their black-and-white television every Sunday night to watch that American tale about greed and lust, "Dallas." After one particular episode in 1982, the inspired young teenager told his mother he would one day make his fortune in America. Duran left home at 18 and knocked around Europe for a year. He eventually earned a finance and marketing degree from St. Louis University, moved to Los Angeles to be with his future wife and began making his fortune in the financial services industry.

But he seems to lack the bloodthirsty instincts of his erstwhile inspiration, J.R. Ewing. He performs yoga three times a week, and United Capital-affiliated advisors quoted in this story all say that his is a management style that actively seeks their input and fosters a sense of collegiality.

After GE bought Centurion in 2001 and renamed it GE Private Asset Management, Duran remained as president during the transition and then pondered his next move when his two-year noncompete agreement ended.

Two things struck him regarding the industry. First, advisors were too focused on client portfolio quarterly performance and not focused enough on answering the question of what mattered most to their clients. Second, smaller advisory firms in the $100 million to $500 million range often get bogged down with the minutiae of running a practice at the expense of client service. "We saw that when we were building Centurion," he says.

Duran cites a Moss Adams study covering the period from 2000 through 2005 that shows average revenue at advisory firms zoomed 74%, to $1.35 million, while the pretax income per owner nudged up only 8%, to $273,000. He attributes this margin compression to the ever-rising costs of running an advisory practice. "Local advisors have all of the complexities of the big guys," he says, "but not the ability to leverage themselves."

He saw a market opportunity for a company like United Capital to ratchet up profits by bringing various firms under one roof and consolidating costly and time-consuming housekeeping chores. The company put up the first $5 million to get started, and the private-equity firm Grail Partners subsequently invested another $10 million. Grail's managing partner, Don Putnam, who helped fund Centurion and represented the firm in its sale to GE, says he's willing to invest up to $50 million before United Capital's anticipated liquidity

event in three years, which could be either an IPO or some type of buyout.

United Capital's target advisory market is what Pershing's Tibergien calls "tweeners." "They find it difficult to both manage their practice and serve clients," he says, adding that they often have to choose between trimming their client base, neglecting the business side of their practice, or merging with somebody else to deal with everything.

### Transformation

United Capital requires three key criteria in potential acquisitions: an asset base of between $100 million to $500 million; a philosophical desire to improve their practice; and the need and desire for a transaction.

United Capital buys all of the firm's assets and typically pays three to five times cash flow—sometimes less, depending on the amount of its recurring cash flow—in exchange for a combination of cash, stock and notes.

The firm also carefully vets the ADVs of possible purchases to avoid bad eggs that might cause regulatory snafus down the road. "We put them through a rigorous test because we truly are integrating these firms," Duran says. He adds that one of the lessons learned from his Centurion days is that buying firms that aren't a good cultural match is toxic. "It's incredibly destructive when you take on an advisor who's not willing to cooperate and work in a partnership mindset."

United Capital finds potential acquisition targets through its industry network of custodial houses, investment bankers and consulting firms. "We've networked and spent a lot of time articulating our story," says Matt Brinker, the company's vice president of acquisitions. If an initial phone call or meeting with a referred advisory firm indicates a potential fit, Brinker and his team dig deeper into the staff, investments and corporate structure of a potential acquisition. In turn, the advisory firms are encouraged to do their homework on United Capital.

If both sides want to go forward, United Capital executives make an on-site visit to an advisor's office to fill in the gaps and create a fuller picture of what their world would look like as part of the company. After that, United Capital's staff of CFPs and MBAs generates a report to assess a firm's efficiencies and deficiencies, its potential growth drivers and bottlenecks. "A lot of advisors who go through that process, even those who ultimately don't do deals with us, appreciate that output," Brinker says.

The first step after an advisory firm joins United Capital is to integrate its administration and operations. The next step is centralizing its asset management process. "We're agnostic about which investment methodology they apply," Duran says. "We care about the way they apply it and that it's done in an institutional way."

United Capital's team of certified financial analysts review every client portfolio and closely track each mutual fund and separate account manager used by their affiliates to alert advisors about fund manager changes or fund style shifts that can alter a portfolio's intended allocation. They also provide research from various firms about allocation recommendations. When one advisor wanted to create an income-generating plan using ETFs, mutual funds and individual securities, he worked with the company's CFAs to create and implement the investment plan.

The final integration step entails a practice management system that's diagrammed on a color-coded chart. The ideal workweek goes like this: Monday is devoted to case management work and prepping for upcoming meetings on Tuesday through Thursday. After lunch on Thursday, the afternoon is spent reviewing the current week and prepping for next week's meetings. Friday is dedicated to case management work and housekeeping duties, and the advisor has the option to take the day off.

**UNITED CAPITAL FINDS POTENTIAL ACQUISITION TARGETS THROUGH ITS INDUSTRY NETWORK OF CUSTODIAL HOUSES, INVESTMENT BANKERS AND CONSULTING FIRMS.**

The business plan was put together by Duran; by company president Pat Bommarito, a CFP who previously ran his own advisory firm affiliated with American Express; and by chief operating officer Gary Roth, who co-founded an Internet application company serving the financial industry.

### Learning Curve

Mark Chmielewski ran his own shop in Port Richey, Fla., with AIG-affiliated Royal Alliance Associates and wanted to transition from a heavy commission-based bent to more of a fee-based practice but wasn't sure how. An industry contact put him in touch with United Capital, and the two sides saw a possible fit.

Chmielewski sold his practice in September 2005 and took his payment 30% in cash and 70% in United Capital stock. He maintained his company name, Successful Retirement Planning, and like all affiliates added the tagline, "A Division of United Capital Financial Advisers Inc." United Capital set a revenue growth target 50% greater than the office's average gross revenue of roughly $1 million.

United Capital senior personnel worked with Chmielewski for two weeks to help explain to clients the firm's new approach. Various support staff from HQ periodically flew in during a two-month period to train the staff.

Chmielewski started charging advice fees and wondered if clients would pay. He asked his clients to give the new approach a shot, and if they didn't like it, they were free to walk after a year. He says his renewal rate is 90%, and that United Capital's practice management system has organized his practice to the extent that he's booked a year in advance with client meetings and reviews. An alert system from United Capital's investment oversight program notifies Chmielewski when his clients' portfolio allocations become misaligned.

The practice went from 75% commission and 25% fee-based compensation before the acquisition to 65% fees and 35% commissions by the end of 2006. Currently, he says, fee-based business contributes about 75%. United Capital wants advisors to be roughly 80% fee-based; however, it sees commission-based

products—such as insurance—as necessary in providing holistic planning.

For his part, Chmielewski says he's developed closer relationships with his clients, resulting in an influx of $25 million in outside assets they previously parked elsewhere. "Advice fees replaced commissions lost," Chmielewski explains, "and the lift came from new AUM."

His revenue jumped 40% by the end of 2006, but has since plateaued at about 47%, or just short of the 50% target. To get over the hump, Chmielewski is asking for referrals and is seeking tuck-in acquisitions with smaller local firms.

Tuck-ins are part of United Capital's growth strategy. After its affiliates get up to speed and revenues rise, United Capital helps them identify, integrate and buy practices of retiring advisors with books of business of $50 million or so.

Chmielewski is pleased with United Capital. "Building systems and processes isn't my forte," he says. "They're good at building systems and automating them." That said, Chmielewski notes that United Capital's system wasn't flawless in the beginning. As part of the first batch of United Capital's acquisitions, he and other early joiners experienced operational snags as the company worked the kinks out of its processes.

Duran acknowledges that not all systems were perfect during the early stages. "We were very ambitious about what we wanted to get done," he says. "There was a lot more work to do than we realized, even though we had done this before."

Among other things, the company's initial accounting and bill-paying infrastructure didn't perform as planned. "We have a rule around here," Duran says. "Every Friday we'll be better than we were last Friday. We're constantly trying to improve."

### Seeking Pay Dirt

United Capital faces challenges—lack of name recognition, for one—as it strives to become a nationally branded player. Kelly Trevethan, managing director at the San Francisco-based Trevethan Group of Oppenheimer & Co., has had informal talks with United Capital. "Their system and platform is probably the best I've seen," he says. But Trevethan hesitates to join because he's concerned about how clients would react if he left a large, nationally recognized company for a relatively unknown independent outfit.

And United Capital's centralized, hands-on style isn't for everyone. Advisors who like calling their own shots need not apply. Even some of its affiliates need adjusting periods. Dwayne Grady at Cornerstone Wealth Strategies Group joined United Capital in October 2005. Although he bought into the system, the former independent planner found it hard to fully embrace all aspects of the practice management process.

"At United Capital, you go from being independent to being a partner," says Grady, the managing director at Cornerstone in Bethesda, Md. "But technically, you're an employee because you're getting a W-2. That can be an issue depending on the size of your ego and what you've done in the past."

Still, Grady says his firm's assets have grown to $155 million, or by 19%, since he joined. And revenue last year jumped roughly 45%, to $2.2 million. "United Capital is real responsive and they are what they told me they'd be," he says.

Grady and his partner at Cornerstone, Caroline Girgis, both took payment of 100% in stock in anticipation of a possible liquidity event. He's not alone. "We felt partnering with United Capital would provide a bigger end-of-the-day multiple," says Alan McClain, a managing director at Stabil Capital Management in Houston who took all stock when he joined the company in June 2005. "We saw not only the vision to do that, but also the track record and the people in place to do it again."

Duran envisions a big payday from an IPO, a buyout from a large, nationwide financial services firm, or a cash infusion from a large strategic investor such as a major insurance company, a European bank or a company like GE. He reckons that United Capital's envisioned model—a fully integrated financial services firm with standardized practices, offices around the country and fat margins from predominately fee-based income streams—will fetch a higher multiple than the standard holding company model comprising what he terms as "20 different practices not sharing anything in common."

To facilitate a successful liquidity event, Duran's goal for United Capital is to be valued at between $300 million and $800 million, meaning it must generate revenue of $100 million to $200 million with very good margins. That's a tall order given the company's current size. "We have plans to continue growing our revenues," he says.

Duran professes that he's building a company dedicated to providing life-relevant financial planning, and a company where the managing directors at the firms will want to remain working for the company after the big liquidity event.

But of course, that hoped-for event is also a big part of United Capital's reason for being, and Duran and his team are aggressively trying to make that happen. In October, the company took a big step forward when it bought PFE Group, a Massachusetts-based company with $6 billion in assets and a 401(k) consulting and pension advisory business for the likes of PepsiCo, GMAC and Nascar. Both Duran and PFE president Wayne Bogosian laud the deal's potential synergies, and United Capital's growth plans include future big acquisitions comparable to PFE Group.

Duran believes one of his company's biggest risks is the increasing consolidation within the industry that's boosting the selling prices for advisory firms. "We're seeing firms asking for prices that aren't logical or justifiable," he says. "There's no end value if you buy firms for those kinds of multiples."

He says another big risk is internal—namely, if the company fails to execute its game plan. "Everyone tells us you can't take a personality-based practice and turn it into a real business," Duran says. "We might be wrong, but so far we've been right."

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