WEALTH MANAGER-Advisers should approach roll-ups with eyes open

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* Roll-ups give cash, shares for stake in adviser firms

* Value of shares unclear until roll-up goes public

* Advisers should consider number of deals needed to float

* Firms added later may not be of same quality-consultant

By Helen Kearney

NEW YORK, Dec 14 (Reuters) - Wealth management consolidators offer independent financial advisers a chance to realize some value from their businesses, but analysts warn of big pitfalls to avoid.

A number of consolidator firms backed by private equity, such as Focus Financial Partners and United Capital Partners, have emerged in recent years to compete with the big Wall Street banks and take advantage of the wave of brokers forming independent firms.

Consolidators, or "roll-up" firms, buy an equity stake in an adviser's business in exchange for a portion of the firm's cash flow. Advisers receive some upfront cash and shares in the consolidator that they hope will prove valuable when the consolidator goes public.

So far, no wealth management consolidator firm has achieved that goal, and that should give independent wealth managers pause, said Elizabeth Nesvold, whose investment bank, Silver Lane Advisors, specializes in wealth management deals.

"With a few exceptions, I'm generally skeptical of the model on behalf of my clients," said Nesvold. "Why would I want to swap the valuable currency I've built and control in my own firm for a lottery ticket?"

Several consolidator firms were established earlier this decade and managed to complete an impressive number of deals quickly. During the financial crisis, however, deal-making practically ground to a halt, leaving many questioning whether the model would recover.

Roll-ups are found in every industry -- firms launched by investors in hopes of consolidating lots of small practices to create one company more valuable than the sum of its parts.

Affiliated Managers Group (AMG.N: Quote, Profile, Research, Stock Buzz) acquired a series of asset management firms, such as Tweedy, Browne Co. It went public on the New York Stock Exchange in 1997 at $23.50 a share and now trades at around $94.

But asset management firms have a number of advantages over their wealth management counterparts, said Nesvold. Margins in asset management tend to be much higher and the firms are generally bigger, which means AMG did not have to do as many deals to reach sufficient scale to go public.

A consolidator needs about $30 million of free cash flow to attract stock market investors, said Mark Hurley, chief executive of Fiduciary Network, a Dallas company that invests in wealth managers.

Hurley noted his firm is owned by Emigrant Savings Bank, a closely held New York bank, and has no plans to go public.

If the average independent firm has $1 million in cash flow, and the consolidator firm gets half, then the consolidator needs to do 60 to 70 deals in order to go public, he said.

Critics of roll-ups also warn that consolidator firms can end up lowering their standards in order to achieve the scale they need.

"The value of the public offering depends on the quality of the advisers in the group," said Dan Inveen, director of research at FA Insight. He produces an annual report tracking trends in adviser consolidation and consults with advisers on building their businesses.

"The problem is, you don't get to control who gets to come to the party after you," he said.

The other big risk advisers face as the consolidator adds more firms or seeks more private equity funding is the dilution of the shares the advisers hold.

Private equity firms are often able to demand preferential shares, which means they are able to sell their shares in an IPO before the wealth manager firms. Management of the consolidator firm can also have such agreements.

Advisers should ask any potential acquirer whether there are preferential shares in place and what the effect of additional firms would be on the advisers' shares, said Inveen.

Advisers should also ask if they can buy back their business if things do not work out, said Chip Roame, managing principal at consultants Tiburon Strategic Advisors.

"Too often the courting process is filled with promises and theories," said Roame. "Instead, it should be used to discuss the worst-case scenarios."

(Reporting by Helen Kearney; editing by John Wallace)