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A Talent For Finding Pearls In Stone

Gary Furukawa's imagination for novel, undiscovered investments continues to get his clients excited.

Freestone Capital Management senior partner Erik Morgan with founder Gary Furukawa

A Talent For Finding Pearls In Stone

Gary Furukawa launched Freestone Capital as a holistic planning firm, but it's still his imagination for novel, undiscovered investments that gets clients excited. **BY ERIC RASMUSSEN**

IT'S NOT EVERY ADVISOR WHO STARTS HIS OWN FIRM saying, "I have no wish to grow."

But Gary Furukawa was a different kind of advisor. Trained as an accountant, he had already lost interest in that subject 18 months into a career at Deloitte & Touche. A small businessman since his early teens, he was still running a fireworks stand after he'd launched his accounting career. In college, he started buying foreclosed homes at auction to rent to low-income tenants. By the time he started his own advisory firm, Seattle's Freestone Capital, he had already become wealthy after years of making savvy investments in real estate and venture capital—including a ground floor stake in a small internet bookstore that would go on to take over the world.

Yet Furukawa founded Freestone in 1999, he says, not because he wanted to build a giant RIA firm. He said that after years working in the brokerage world—doing stints at E.F. Hutton and Smith Barney—he started to get an itchy feeling that he'd never measured the impact of the securities he sold on the lives of the people he sold them to. He wanted to run off with a few of his favorite wealthy clients and do holistic planning for them, as well as to serve his fecund imagination for value opportunities in strange places, things he could do writ large with high-net-worth investors.

Despite his plans to stay small, the firm has grown into a major RIA firm with $3.8 billion in assets, 1,800 or so client relationships and 63 employees, some of whom are now working out of the firm's offices in Portland, Ore., and Santa Barbara, Calif., which Furukawa now calls home.

Like other Seattle firms, Freestone's success is very much tied to the rapidly building tech wealth of the Pacific Northwest. These are not conspicuous consumers but more modest folk, says Furukawa's partner, Erik Morgan. "You may find people in Seattle with tens if not hundreds of millions of dollars and if you look at the car they're driving or the clothes they're wearing or even sometimes the house they are living in, there will be a massive disconnect."

Microsoft helped ignite a Seattle renaissance in the late 1990s, but add to that the success of Boeing, Costco, Amazon, Starbucks, etc., you put Freestone in the right place at the right time to cater to the ultra-wealthy and offer them the kinds of deals even savvy investors never think of.

Furukawa has moved beyond HUD homes to buying national distressed housing plays, locked up hedge fund assets and even mobile home parks—wherever he sees things selling at a discount. He puts it simply: He doesn't like overpaying for things, and that goes for other RIA firms, which he has no interest in acquiring.

HUMBLE BEGINNINGS

Furukawa's father died when he was 7, and he was working by age 10 at the dry cleaning business his father had started. He then started up the fireworks stand at age 16. In another business, he was selling pearls at the state fair and mounting them on rings (boyfriends were buying for girlfriends). While still in high school, he was making $1,000 a month and earned enough to buy his own BMW, he says.

He was still working at the fireworks stand after starting his accounting career; one of the Deloitte partners even caught him moonlighting.

When he was 18 at the University of Washington in the late 1970s, Furukawa started working in real estate. Seattle suffered an economic lull related to Boeing layoffs in that decade; Furukawa bought auctioned distressed homes for around $18,000, then rented them to participants in a low-income housing program in Seattle that subsidized 90% of the rent.

"You never had to worry about collecting," he says.

Lyle Bjork, an associate of Furukawa's back then (now a client) says most people would call dealing with government housing something less than fun for your average investor. But Furukawa "was a workaholic, working on the computer after hours dealing with beaten up properties. ... It can consume time."

Furukawa joined Deloitte & Touche for 14 months after college, and realized quickly that accounting wasn't for him. "If you used an accounting mentality to make investments, you wouldn't make any investments," he quips.

He joined ultra-competitive E.F. Hutton in 1982 and went on to Smith Barney, hustling and pulling 12 hour days, not letting himself go home until he had made at least 20 presentations using note cards and a Rolodex in the days before they had a computer.

A NOSE FOR OPPORTUNITY

But at the same time he was always pursuing other novel investments on his own. Mark Britton, the former general counsel at Expedia and the founder of lawyer referral network AVVO, was still an attorney at Preston Gates & Ellis when he met Furukawa and two business associates in 1997. The three had a plan to do mini-tender offers at companies where the shareholders had illiquid, concentrated stock positions they couldn't move.

"One was a gaming company; one was a cement company," Britton says. "They were so diverse. All of the truly unique opportunities he was uncovering just blew me away." When Expedia went public and was acquired, Britton found himself able to meet Freestone's minimums and joined as a client.

One particular investment, however, would change Furukawa's fortunes immensely. In 1995, he tagged along with a friend for a meeting in a warehouse to meet a man who was starting up an internet book business. The man was Jeff Bezos, the company Amazon. They were there about seven hours.

"I met with him; he was in his first grungy warehouse in a place called Pioneer Square," says Furukawa. The only two people working with Bezos were his wife MacKenzie and Shel Kaphan. Furukawa says that Bezos, who was trying to raise $1 million at the time, was more than just an impressive guy touting a Princeton pedigree and a 4.4 GPA. He not only understood the technology, but seemed to understand human nature. He had stacks of books lying around where he was assembling orders, and could tell you what the book said about the people who ordered them. He was like a baseball player who is good at batting, pitching, catching and fielding. Furukawa admits this investment was a bet on Bezos himself, and he helped seed the start-up with $50,000. By the time Furukawa started cashing out a few years after the firm's IPO, his stake was a great deal more. He won't say how much he made, but the Motley Fool calculates that people who invested $10,000 with Amazon at its 1997 IPO would have $6.7 million if they had held on to it 20 years.

The Amazon play is a double-edged sword. Furukawa himself admits there is a fluky aspect to venture capital. Morgan says, "The view in town is that the reason Gary has been successful is because of Amazon. [But] he has been a successful investor since he was 16 years old."

FOR GROWTH'S SAKE

When he struck out on his own from Smith Barney to found an RIA firm, Furukawa said early on that growth for growth's sake wasn't an ambition. He just wanted to work with his favorite clients. But a group of employees came to him after six months, and said that if he didn't want to grow for himself, he needed to grow for them.

That's when he hired Morgan, who led the growth initiative and helped the firm focus on what wealthy clients would need. Morgan's background was at Arthur Andersen (he learned business as a teenage go-fer in Canada to an entrepreneur).

"If we wanted to work with larger clients, we had to broaden out what it is we were doing. We couldn't be simply a money manager," Morgan says. "And helping build those out for affluent individuals is something I brought. If you were stereotypical about it, I would be the emotional part of the quotient, Gary would be the intelligence part of the quotient."

"We have unashamedly plagiarized a bit," he adds, "from what the large family offices in the country have done and what the endowments have done, and said trying to generate consistent returns without big drawdowns is much better for the wealthy than to ride the roller-coaster [of the S&P or Nasdaq]." That has allowed the firm to avoid the worst aspects of things like the telecom bust, says Furukawa.

Another thing that helped the firm grow, Furukawa says, is a change in Washington state's accounting rules around the year 2000 allowing CPAs to share fees with registered investment advisors. "We got a couple of pretty large CPA firms to send us their clients, and they would get part of the management fee. We raised probably a billion dollars from that over a three- or four-year period."

Freestone's sweet spot is clients with $4 million to $20 million to invest, though the firm does keep $1 million minimums to work with clients on Charles Schwab's referral platform.

Mutual funds and ETFs are ancillary, here. For traditional investment management, Furukawa in 2006 switched from a value stock selection process to a quantitative system.

"Our numbers are so much better than they were when we were actually doing individual stock picking ourselves," Furukawa says. "And it's also much less brain damage. We have so many flaws as humans, the way we are wired. This idea of getting a bunch of smart people together and picking stocks. We know across the board it doesn't work."

For traditional investments, the firm charges a percentage of AUM, Furukawa says, but because "we have over a billion dollars in funds that we run, mostly real estate, for those we charge a management fee and then we get a percentage of profit above a hurdle."

After the housing crisis in 2008, Furukawa started buying distressed properties, first in Phoenix, then elsewhere. He says this business doesn't really scale unless you have widespread distress, which is what happened during the housing bust, "where properties were selling at a fraction of the replacement cost," he says. "And if it's an area that's growing, that relationship of selling low to replacement cost, it won't last. That was the opportunity."

Britton, no slouch when it comes to business savvy, says that he was shaken enough by the crisis to want to go to cash, near the bottom of the market, but Furukawa talked him out of it. What's more, Britton says that at the time Furukawa had found yet another intriguing opportunity.

Says Furukawa, "A large institutional investment firm had a client who needed to get out of a $75 million hedge fund position with a convertible bond arbitrage hedge fund and they needed to close just a few weeks after we were first contacted." After due diligence was done, he says, "We ended up purchasing the position for a 40% discount. In essence, we were purchasing a portfolio of convertible bonds that had already declined by 65% plus in price, at an additional 40% discount. Over the next two years, our clients earned a 350% return on the investment.

"I think we are one of the only firms, especially in the wealth management space, that could put something like this together, including fund formation paperwork and capital raising, with such a short time frame."

At the height of the bubble in 2006, Furukawa was rejecting offers to buy the firm, but in 2007, he sold a majority piece to the Sienna Group of private equity investors. He says he was doing six full-time jobs and he was tired—that he'd proved what he set out to prove. Also, he felt that firms like his were at peak value.

But then the crisis happened, and his firm's culture didn't mesh with the private equity group's growth plans. Some key employees asked Furukawa to buy the firm back, which he did in 2012 and then reorganized. Furukawa now owns 50% of Freestone and Morgan owns 20%, while partners own the rest.

THE VALUE INVESTOR IN AN OVERPRICED WORLD

Right now, of course, we live in an overvalued world again, he says, and the value investor is in a long winter. "There's no doubt right now that all assets are at some level being overpriced," he says. "Many, many examples of speculation, many examples of bad investor behavior."

"So much money is going into indexing and it's driving up all the underlying stock. ... That will end poorly. We know that. We are selling a lot of our real estate now. I don't know what's going to end this. Obviously, if we had a rise in interest rates ....

But the possibility of having good results over the next 10 years are low."

One area he's become enamored of in the last three years is mobile home parks, of all places—so enamored that a fund the firm has established, the Freestone Manufactured Home Communities fund, has become the 13th largest owner of mobile home parks in the nation, he claims—and what he calls the largest source of low-income housing in the country.

"This is an area where pricing hasn't changed that much," he says. "A lot of the parks that we buy are being poorly run, so there's lots of value we can add by running them better, and we've raised over $300 million, and then we've used leverage, so we own probably something around $600 million in mobile home parks." Supply has shrunk as old parks get converted and new ones haven't come online, he says. What's better, they pay high cash flow, which has made them a substitute for bonds, or even dividend-paying stocks, which he sees as vulnerable in bear markets.

"So we can buy mobile home parks and pay the clients 6% to 8% in cash flow and that's really hard to duplicate today. … If we have a crash again, our mobile home parks [won't see] much change in value."

Now that he's back in control of the firm, he plans to stay a long time, and there are no plans for succession currently. That could change 10 years from now. "Most of our key shareholders are in their late 40s and like what they are doing, but at some point they might want to monetize their interest.

"We want to grow, but it's not the number one goal. My view is that if we do a great job with client service and investing, then the growth will take care of itself, and so far that's worked. So we're not super focused on growing, growing, growing. … We think we'll grow because of referrals and word of mouth. We just have never been one of those growth-at-all-costs-kind of places. That's why we really don't want to acquire other firms. It's just not worth it to me. And especially now, you have to overpay anyway, and I'm not interested in overpaying for anything." FA