



transitionadvisors LLC



Leading CPAs Through Transition With Succession and M & A Strategies

Valuating CPA Firms in 2021

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Transition Advisors

National Consulting Firm working exclusively with accounting firms on issues related to ownership transition



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If there are 50 things you need to think about in a transaction.....



.....the smartest of us will think of only 35



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How the Coronavirus Impacted Activity

- Economy: Attrition and loss of most organic growth
- Lack of comfort level with safety of face to face meetings
- Video conferencing will help but not cure
- Likely low activity 2020, boom in 2021 (like post 9/11)



Post Pandemic



Pent up demand

According to Michael Cohn, editor and chief of *Accounting Today*:

“While deal activity slowed in the first half of 2020 due to the pandemic, M&A transactions bounced back strongly in the second half of 2020 and now in early 2021. The deal activity has been strong in the U.S...”



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Aging of the Profession

Age of the Partners

	Average Age of Partners				% of Partners Over Age 50			
	2019	2018	2017	2009	2019	2018	2017	2009
Over \$20M	52.9	52.7	52.7	50.7	59.9%	58.9%	60.9%	52.6%
\$10-20M	53.1	53.6	52.9	50.7	61.6%	62.2%	60.8%	54.0%
\$5-10M	53.1	52.6	52.9	51.1	61.4%	60.4%	63.7%	60.9%
\$2-5M	53.4	53.1	53.5	51.7	62.2%	66.1%	61.8%	58.1%
Under \$2M	55.3	56.4	55.3	52.7	72.3%	70.6%	63.1%	58.5%
All firms > \$2 million	53.3	53.0	53.2	51.2	61.0%	61.2%	61.7%	56.3%

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Is it a buyers or seller's marketplace?

- Location, location, location
- Density of population
- Size in revenues
- IT disrupting
- IT adding
- Niches



Who is in trouble re: valuations? **Firms with major issues.**

Is it a buyers or seller's marketplace?

Coronavirus impact

- > Organic growth slows M & A Growth goes up
 - Tuck ins have higher value
 - Desperate firms' weak value
 - Niche's seller's marketplace
 - Strong firms see rise
 - Likely staffing issues somewhat dissipate
 - Leases and satellite offices



Five Main Variables for Valuing a Practice

1. Cash up front, if any
 - Dependent on time of year
 - The deal's cash flow
 - Treatment of accounts receivable
 - Time to recover investment
 - Less cash available due to virus impact



Five Main Variables for Valuing a Practice

2. Retention clause/guarantee

- Collection deals, deals by percentage
- Fixed deals
- Limited guarantees
- Economy clause
- What deal worked best for who?
- Likely emphasis on retention due to sting of pandemic



Five Main Variables for Valuing a Practice

3. Profitability

- Seller's current profitability / billing rates
- Buyer's anticipated profitability / billing rates
- Leverage
- Tax ramifications of deal structures
(goodwill vs current deduction)

How it could change due to attrition

4. Length of the payout period likely extends



Five Main Variables for Valuing a Practice

5. Multiple

- Cause vs effect
 - Multiple = effect
 - Balance = cause
- Basic rule:
 - Lower down payment, longer payout period
 - Higher profitability, longer guarantees = higher multiple



Additional Aspects of Valuing a Practice

Miscellaneous items that impact value

- Annual Tax clients vs Traditional Accounting clients?
- Future IT impact
- Staff coming along
- Advisory services
- Too many partners seeking succession
- Cross selling opportunities
 - Both ways



Hot Trends

*Premiums and strong markets
covet these niches*

Great demand exists for

- Client Accounting Services (CAS)
- Outsourcing CFO, HR and other services
- Cyber Security
- Cloud consulting



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Cold Trends

Market weakening for

- 1040s
- All or most partners seeking succession
- Lease issues





Percentage of Firms Making Partner Buyouts

Here are the percentage of firms actively making payments to retired partners:

	2019	2018	2017	2016	2015
Over \$20M	95%	97%	91%	90%	85%
\$10–20M	76%	75%	77%	75%	82%
\$5–10M	62%	66%	63%	54%	54%
\$2–5M	50%	50%	46%	38%	41%
Under \$2M	21%	30%	14%	26%	25%



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Retirement

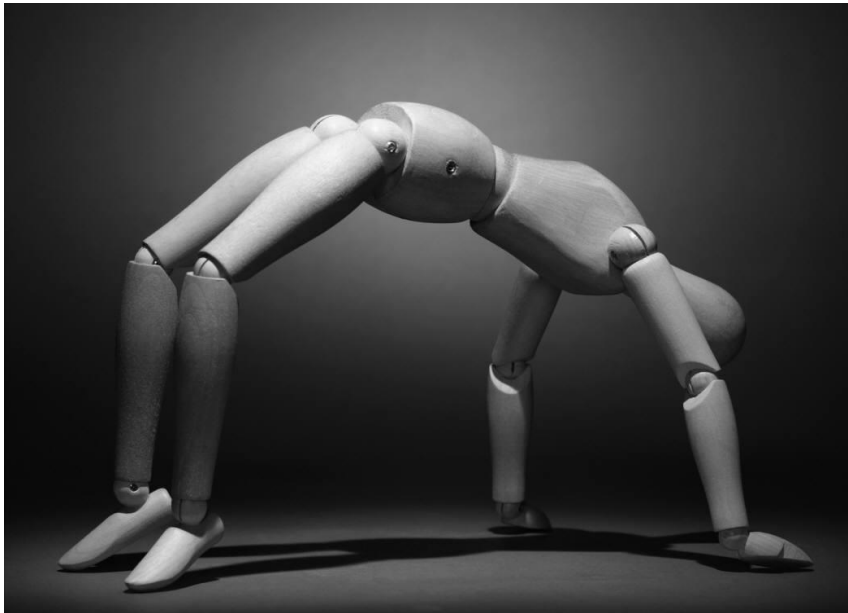
Methods for Valuing Equity:

- Book of business
- Equity
- Compensation
 - Formula sample
- Hybrids
- Mandatory retirements



Right Financial Arrangement

Backwards Valuation



Reward your retiring partners fairly for their years of sweat equity

BUT

Don't expect your remaining partners to borrow or take a step back in compensation to do it.

Right Financial Arrangement

Available capital is the retired partner's foregone compensation.

Three uses for that capital:

- Pay the retiring partner off.
- Cost of replacing that partner.
- Some upside for the remaining partners for assuming the obligation and the extra work.
- . Litmus test
- . Critical need for caps just in case



Rosenberg Survey 2020

Partner Retirement/Buyout

	2-4 Ptrs	5-7 Ptrs	8-12 Ptrs	13+ Ptrs	2019 Total	2018 Total	2017 Total
Multiple of compensation	34.1%	49.4%	58.2%	60.7%	47.3%	47.6%	46.4%
Book of business	8.0%	14.6%	7.3%	0.0%	9.2%	10.4%	9.3%
Ownership percentage	25.0%	15.7%	3.6%	3.6%	15.0%	14.8%	17.9%
AAV	18.2%	11.2%	21.8%	25.0%	17.3%	16.4%	15.4%
Fixed	12.5%	9.0%	7.3%	7.1%	9.6%	8.8%	8.6%
Equal	2.3%	0.0%	1.8%	3.6%	1.5%	2.0%	2.5%
Firms with no retirement provision	23.8%	7.2%	5.1%	9.4%	13.5%	12.0%	13.0%

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Rosenberg Survey

Here is a summary of the average multiple used to value partner retirement benefits, broken down by various firm sizes:

	>\$20M	\$10–20M	\$2–10M		< \$2M	All Firms > \$2M
2015	73%	77%	79%		88%	79%
2016	77%	77%	80%		89%	80%
2017	67%	77%	79%		89%	78%
			\$5-10M	\$2-5M		
2018	69%	75%	77%	82%	81%	77%
2019	67%	75%	79%	83%	83%	77%

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Rosenberg Survey

Partner Retirement Plans

The chart below shows the percentage of firms that pay capital AND goodwill to retired partners. The balance of firms do not have a documented retirement plan.

	2019	2018	2017	2016
Over \$20M	97%	100%	97%	95%
\$10–20M	92%	89%	91%	92%
\$5–10M	90%	92%	90%	92%
\$2–5M	77%	81%	82%	79%
Under \$2M	56%	68%	60%	50%

Here are the percentage of firms actively making payments to retired partners:

	2019	2018	2017	2016	2015
Over \$20M	95%	97%	91%	90%	85%
\$10–20M	76%	75%	77%	75%	82%
\$5–10M	62%	66%	63%	54%	54%
\$2–5M	50%	50%	46%	38%	41%
Under \$2M	21%	30%	14%	26%	25%

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Niche Mergers

Barry Melancon said during a speech at the Accountants Club of America in New York:

“When you look at the top 400 firms, there are record numbers of mergers and acquisition activity of non-CPA firms,” he said.

“We are seeing those firms having to diversify skill sets and technology platforms and capabilities, and they have been doing that through acquisition of other types of business enterprises to diversify within their own environment. **About a third of the mergers and acquisitions that occurred in 2018 actually were non-CPA firm acquisitions by CPA firms.**”

Niche Mergers

- Who is right niche merger partners
 - Staying on
- Keeping niche owners whole
- Sharing Accounting firm cross selling niche
- Sharing niche firm cross selling accounting services
- Separate entity or division
- Buyout issue
- **Again IT can reduce your present and future value of your firm or increase it**



Niche Mergers

How to structure:

- Establish base compensation niche partners are currently making
- Guaranty their comp remains steady so long as their revenues and time commitment remain steady
- Key is how to share growth
- Are they partners in firm, separate entity?
- Buyout
- Cash upfront requests
- Likely more interesting to growth-oriented niches than short term sellers

Rosenberg Survey

Mandatory Partner Retirement

The percentage of firms that have mandatory retirement provisions:

	2019	2018	2017	2016	2015
Over \$20M	95%	94%	91%	87%	88%
\$10–20M	78%	81%	74%	77%	72%
\$5–10M	70%	69%	70%	70%	69%
\$2–5M	47%	53%	51%	49%	49%
Under \$2M	26%	25%	19%	17%	29%

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Mandatory Retirement Age

- Average age is 66¹
 - 54% use 65, 29% are 66 to 70²
 - How it impacts M & A
 - Surrendering equity
- doesn't always mean retiring
- Portfolio damage
- Redoing deals



¹Rosenberg ²PCPS

Other Thoughts: Choosing the “right” Successor

- General “chemistry” between the parties
- **Continuity/Culture** of relationships will help retain clients
- **Capacity** to take over the roles being diminished
- *A good deal is a fair deal*
- Remember, it’s the package, not the individual variables



Making Your Firm Beautiful for a Merger or Sale

- Technology:
 - Paperless
 - The Cloud
- Brand versus Partner loyal
- Trained clients
- Accurate understanding of your firm and its metrics
- Realistic terms
- No long term leases
- Having advisory services or clients that lend themselves to them



For More Information

Visit the AICPA Succession Planning Resource Center

<https://www.aicpa.org/interestareas/privatecompaniespractice/section/strategy-planning/center.html>

The screenshot shows the AICPA Succession Planning Resource Center page. At the top, there is a navigation bar with links for Sign In, My Account, About, Volunteer, Join, Press, For the Public, and Help. Below this is a search bar with the text "Enter a search term" and a "Search" button. A secondary navigation bar contains links for Membership, Become a CPA, CPE & Conferences, Career, Interest Areas, Research, Publications, Advocacy, and AICPA Store. The main content area is titled "Succession Planning Resource Center" and includes a brief introduction: "Strategic planning is the foundation for growth and sustainability. Achieve your short-term and long-term goals with these tools and join a community where you can easily network with peers and share creative strategies and solutions for practice management success." Below this are three featured articles: "Succession Planning Guide & Tools", "Succession Readiness Assessment", and "Succession Timing Calculator". A "Succession Corner" section features a video of Joel Sinkin and Terrence Putney, CPA, with a list of topics including pricing issues, mergers, and succession strategies. A left sidebar provides navigation options: "Browse" by Topic (Succession Planning (51), Small Firms (8), Practice Management (3)) and by Document Type (Tools (29), Overview (16), Article (5), Guidance (4), Survey (4), Click to view more). There is also a "Member Only Content" section.



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For More Information

Please visit our website for resources including FREE reports, whitepapers and case studies.

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