The Art of the Deal

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National consulting firm working exclusively with accounting firms on issues related to ownership transition
If there are 50 things you need to think about in a transaction....... 

......the smartest of us will think of only 35
Reasons Why Firms Merge

Firms fall into 2 categories:

1. Firms seeking growth by combining with another firm
2. Firms seeking to solve a problem

Know your reasons...
Know the other firm’s reasons...
The 7 Steps in a Deal

1. Author a generic practice information including your goals
2. Organize your must haves
3. Identify what your merger partner should look like
4. Have your initial meetings
5. Narrow the field and share non binding offers
6. Perform due diligence
7. Close the deal
Author a generic practice information including your goals

- Metrics: revenues, services rendered, rates, staff, profitability, etc...
- Add lease info, timing for partners who may be seeking role reductions
- Technology
- What the goals are for the deal
- Individual goals for some partners if different
- Aging of the partners/staff
- What success looks like
Author a generic practice information including your goals

• List the deal structure you are seeking:
  • Sale
  • Merger (What type)
  • Two Stage Deal
  • Combination
  ➢ List the value you seek
    ➢ In compensation
    ➢ Valuing your equity
Organize your must haves

Items that are absolute breakers such as:
- Location
- Partner retention
- Compensation

Items you strongly prefer such as:
- Technology
- Staff retention
- Name

Items you are more flexible about such as:
- Software
- Perks
Identify what your merger partner should look like

Start with the Big Four (C’s that is)

A) Culture
B) Chemistry
C) Continuity
D) Capacity

- Specialties
- Technical skills
- Size
- Location
- Technology
Have your initial meetings

1) Share your firm information, goals and must haves upfront
2) Focus on Four C’s
3) Discuss what success looks like
4) Narrow the playing field into top choice (s), bridesmaids and forgetaboutit
Ask for a Non Binding Offer

• You have already told them what you have and what you want
• Require a non binding offer that shares with you what the deal looks like philosophically and financially, pending due diligence
• Make sure the terms are complete as to must haves, deal structure and terms
Methods to Structuring the Transition of a Practice through an External Sale

1. Straight sale
2. Buy in to a Buy-Out
   • Buyer opts in an interest into the firm
   • Buyer may or may not bring clients into the newly combined entity
3. Merger or Buy-Out
4. Carving or culling out clients
5. Two stage deals
   • Sell equity but stay on
   • Less exposure for Seller than #2 and #3
Five Main Variables for Valuing a Practice for External Sales

1. Cash up front, if any
   • Dependent on time of year
   • The deal’s cash flow
   • Accounts receivable
   • Time to recover investment

2. Retention clause/guarantee
   • Collection deals
   • Fixed deals
   • Limited guarantees
   • Economy clause
Five Main Variables for Valuing a Practice

3. Profitability
   • Seller’s current profitability billing rates
   • Buyer’s anticipated profitability billing rates
   • Tax ramifications of deal structures (goodwill vs current deduction)

4. Length of the payout period
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
   - Tax clients vs Traditional Accounting clients?
Larger Firms External Sales

• Traditionally go for lower multiple and longer payout period

• Retention periods
  • Brand Versus Partner Loyal

• Traditionally never a total sale but a combination of sale, merger and two stage deal

• Do frequently consider hard assets for additional value
Perform Due Diligence

For the mergee/seller

* Prior track record of successor firm in M & A
* Background checks: professional, financial, legal, malpractice, licenses, peer review
* Metrics
* Their own retention rates
* Technical skills
* In a merger a key document is the partnership agreement of the successor firm
* Your practice special needs i.e. language, licenses, niches...
Perform Due Diligence

For the successor firm or buyer:

- Metrics
- The great mystery of billing rates
- Differences in Profitability ... not always important
- Continuity = retention
- Culture
  - Partner Billable Hours
  - Size of Book managed
  - Marketing
  - Dress Codes
  - Billing ... hourly vs value
  - Compensation ... proxy for culture
  - Technology i.e. the cloud
Close the Deal

• Now is the time to bring in lawyers
• What is the goal of a contract
• Lawyer that makes deal versus breaks deal
Roadblocks

- Time
  - Adversarial nature
  - Messages you send
  - Leaking pending to merger to marketplace, clients, staff
  - The 13th time you read the agreement
  - Opening door to competition
Roadblocks

• Unity of Partners
• Capacity
• Impatience
• Transition Issues
  • Staff
  • Clients
• IT
Owner Accountability & Unity

SIX STEPS TO FOLLOW

1) Creating a governance system
2) Construction of goals specific to each partner's role
3) Understanding what success looks like
4) Creating a compensation system that ties into goals
5) Having regular debriefing meetings
6) Partner buy in
Governance: Owner Accountability & Unity

- Decision making
- Unanimous vs Super majority vs Simple majority
- Financial Commitments
Owner Accountability & Unity

By way of example ...

- Super majority
  - Admission of new partner
- Simply majority
  - Expenses in excess of certain amount
- Unanimous
  - Dissolution or sale
Owner Accountability & Unity

Pros and Cons of Unanimous Decision Requirements
Owner Accountability & Unity

Construction of Goals Specific to Each Partners Role

MAKE THEM AS MEASURABLE AS POSSIBLE

Financial: metrics
  > chargeable hours
  > realization
  > profitability…

Business development

Market penetration

People development (mentoring)
Owner Accountability & Unity

Does Success Look Like

Success for the audit partner different than success for a tax partner, etc…

Create yardsticks wherever possible

Be as specific as you can
Owner Accountability & Unity

Compensation Programs

Examples of Roadblocks to Avoid

• Buy outs based on a system that penalizes you for transitioning clients

• Comp systems tied into your personal book of business when the firm goal is to create a pone firm client approach

• Compensation programs not based on the goals that have been created for each partners role
Owner Accountability & Unity
De- Briefing sessions

Two Issues to Focus on

• Is the partner achieving the goals
• Is the firm holding up their side

Be honest and clear
Owner Accountability & Unity

Regular De-Briefing sessions

In the meeting

• Progress update
• Roadblocks encountered
• Identifying where falling short and create strategy to rectify
• Establish mini goals to be reviewed at next meeting
• Hold these meeting at least quarterly
Owner Accountability & Unity

Partner Buy In

No program will work if you don’t have partner buy in day one

- Buy in to firm goals
- Buy in to your role
- Buy in to how you will be measured
- Buy in to authority
- Buy in to the greater good
- Buy in to consequences of falling short
- Keep selling concepts year round
Roadblocks

- Equity
- Firm Name
- Communication
- Unneeded ‘must haves’
  - Staff
  - Leases
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
What is on the other firm’s mind in a merger? Should you care?

- Master of their own domain
- Clock punching employee
- WII-FM, not you
- I don’t want to be swallowed up
- I’ll lose my identity
- They are going to cherry pick my clients
- I can’t accept this much risk. I need certainty
- My name must be in the firm
- If I work a few more years, I will make even more
- It is more emotional than financial for most partners
Internal Buyout Issues

- Remaining partners must make more
- How many partners can leave at same time
- Notice
- Replace the role, not the body
- Brand versus Partner Loyal impact
- Vesting periods for buyout more important than age?
- Caps
Other Thoughts

• 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
• Staff merging
Transitioning Clients

◊ What are the Client’s fears?

- Is the Partner/Owner I trust still there?
- Is it going to cost me more money?
- Do I have to travel far to meet with my new accounting firm?
- Is the staff I am accustomed to working with part of the successor firm?

**ITS ALL PACKAGING!**

**CHANGE IS A DIRTY WORD.**

**THE EMPHASIS NEEDS TO BE ON CONTINUITY.**

**NOT THE LOSS OF, BUT THE GAIN OF ........**

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Leading CPAs Through Transition With Succession and M & A Strategies

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