Valuing your Accounting Practice When Selling to a Partner or External Buyer

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Transition Advisors
Transition Advisors

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
Why is Activity So High?

Economy:
2006 through 2008
versus
2014 ???????
Niche Development
The Boomers
IT
Whose in trouble re valuations?
Why is Activity So High?

Is it a buyers or sellers Marketplace

Trends

Who may be in trouble
Impact of Demographics

In 1993, over 40% of AICPA members were over 40 years old......
Impact of Demographics

In 2012, that number rose to 70%......
Succession Challenges

In 2012 AICPA survey
67% of the firms stated they expected at least 1 partner to retire within 5 years, with more then half saying more then one partner will retire

Well up from just 2008!

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5. Do you expect succession planning to be a significant issue for your firm in the next 10 years?

<table>
<thead>
<tr>
<th></th>
<th>&lt; $500,000</th>
<th>$500,001 - $1,000,000</th>
<th>$1,000,001 - $2,000,000</th>
<th>$2,000,001 - $3,500,000</th>
<th>$3,500,001 - $5,000,000</th>
<th>$5,000,001 - $8,000,000</th>
<th>$8,000,001 - $15,000,000</th>
<th>$15,000,001 - $20,000,000</th>
<th>$25,000,001 - $50,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>61%</td>
<td>77%</td>
<td>82%</td>
<td>86%</td>
<td>78%</td>
<td>79%</td>
<td>82%</td>
<td>76%</td>
<td>89%</td>
</tr>
<tr>
<td>No</td>
<td>39%</td>
<td>23%</td>
<td>18%</td>
<td>14%</td>
<td>22%</td>
<td>21%</td>
<td>18%</td>
<td>24%</td>
<td>11%</td>
</tr>
</tbody>
</table>

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Three Ways to Grow

- One Client at a time
- Develop marketable niches
- Merge or acquire another firm
Purchase Price Structuring

Multiple of billings

Fixed purchase price

Fixed based on past compensation
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

1. Cash up front, if any
   • Dependent on time of year
   • The deal’s cash flow
   • Treatment of accounts receivable
   • Time to recover investment
Five Main Variables for Valuing a Practice

2. Retention clause/guarantee
   • Collection deals, deals by percentage
   • Fixed deals
   • Limited guarantees
   • Economy clause
   • Minimum grantees
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
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?
Other Items to Consider

Other assets, either acquired or required

• Furniture, fixtures, equipment
• Leases and location
• Staff joining the new firm or not joining

Participation in Future Growth

• Fee increases from prior services
• Fee increases for new services
• Fee increases for referrals
• New business incentive clause
Sales - Internal v. External

Internal Sales
- Almost always go for less
- Often no retention period
- Brand versus partner loyal
- Death, disability, and penalty buyouts
- Remaining partners making more
- Non-multiple formulas on gross are more common
- Accounts Receivable & WIP

External sales are more of a “business” deal and go for high dollars
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
19. Which of the following does your firm use to calculate the retirement benefit (just the deferred compensation, guaranteed payment, etc. portion of the benefit)? (Select the best answer.)

<table>
<thead>
<tr>
<th>Method</th>
<th>&lt; $500,000</th>
<th>$500,001 - $1,000,000</th>
<th>$1,000,001 - $2,000,000</th>
<th>$2,000,001 - $3,500,000</th>
<th>$3,500,001 - $5,000,000</th>
<th>$5,000,001 - $8,000,000</th>
<th>$8,000,001 - $15,000,000</th>
<th>$15,000,001 - $20,000,000</th>
<th>$25,000,001 - $50,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>We have no agreement at this time to pay a retirement benefit</td>
<td>76%</td>
<td>59%</td>
<td>48%</td>
<td>33%</td>
<td>22%</td>
<td>0%</td>
<td>3%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Multiple of salary</td>
<td>0%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>12%</td>
<td>36%</td>
<td>61%</td>
<td>29%</td>
<td>33%</td>
</tr>
<tr>
<td>Ownership percentage times annual net revenues</td>
<td>14%</td>
<td>22%</td>
<td>26%</td>
<td>25%</td>
<td>25%</td>
<td>28%</td>
<td>24%</td>
<td>18%</td>
<td>33%</td>
</tr>
<tr>
<td>Client book of business</td>
<td>6%</td>
<td>9%</td>
<td>12%</td>
<td>15%</td>
<td>14%</td>
<td>15%</td>
<td>0%</td>
<td>6%</td>
<td>0%</td>
</tr>
<tr>
<td>Other</td>
<td>4%</td>
<td>5%</td>
<td>10%</td>
<td>22%</td>
<td>27%</td>
<td>21%</td>
<td>13%</td>
<td>47%</td>
<td>33%</td>
</tr>
</tbody>
</table>

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Which of the following best approximates how you value the ownership interest in the firm to calculate the retirement benefit? (i.e., percent ownership equity times net annual revenues times 80 cents on the dollar, etc.)

<table>
<thead>
<tr>
<th>Ownership Interest</th>
<th>&lt; $500,000</th>
<th>$500,001-$1,000,000</th>
<th>$1,000,001-$2,000,000</th>
<th>$2,000,001-$3,500,000</th>
<th>$3,500,001-$5,000,000</th>
<th>$5,000,001-$8,000,000</th>
<th>$8,000,001-$15,000,000</th>
<th>$15,000,001-$25,000,000</th>
<th>$25,000,001-$50,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>less than 50 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>10%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>50 cents on the $1</td>
<td>17%</td>
<td>0%</td>
<td>11%</td>
<td>7%</td>
<td>4%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>55 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>60 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>11%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>65 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>70 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>75 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>80 cents on the $1</td>
<td>17%</td>
<td>0%</td>
<td>5%</td>
<td>14%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>85 cents on the $1</td>
<td>0%</td>
<td>11%</td>
<td>5%</td>
<td>10%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>90 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>95 cents on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>$1 on the $1</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
</tr>
<tr>
<td>$1.05 on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>$1.10 on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>$1.15 on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>$1.20 on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>$1.25 on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>More than $1.25 on the $1</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Not Applicable</td>
<td>0%</td>
<td>10%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>33%</td>
<td>0%</td>
</tr>
</tbody>
</table>
22. Which of the following best approximates the magnitude of the multiplier you use pertaining to average salary to calculate the retirement benefit (i.e., one year's salary times 2)?

<table>
<thead>
<tr>
<th>Salary Range</th>
<th>&lt; $500,000</th>
<th>$500,001-$1,000,000</th>
<th>$1,000,001-$2,000,000</th>
<th>$2,000,001-$3,500,000</th>
<th>$3,500,001-$5,000,000</th>
<th>$5,000,001-$8,000,000</th>
<th>$8,000,001-$15,000,000</th>
<th>$15,000,001-$20,000,000</th>
<th>$25,000,001-$50,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>than one year's salary</td>
<td>0%</td>
<td>25%</td>
<td>20%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>9%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>One year's salary</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
<td>20%</td>
<td>20%</td>
<td>7%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>One year's salary times 1.5</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>20%</td>
<td>7%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>One year's salary times 2.0</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>20%</td>
<td>20%</td>
<td>7%</td>
<td>4%</td>
<td>20%</td>
<td>33%</td>
</tr>
<tr>
<td>One year's salary times 2.5</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>40%</td>
<td>14%</td>
<td>22%</td>
<td>20%</td>
</tr>
<tr>
<td>One year's salary times 3.0</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>40%</td>
<td>14%</td>
<td>43%</td>
<td>35%</td>
</tr>
<tr>
<td>One year's salary times 3.5</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>4%</td>
<td>4%</td>
<td>33%</td>
</tr>
<tr>
<td>More than one year's salary</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Not Applicable</td>
<td>0%</td>
<td>25%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>
Sales - Internal v. External

Things to be wary of ..................

• Multiple partners, leaving simultaneously
• Partners reducing time commitment, but not income or control
• Replace the role, not the body
• Cannot replace the Administrator with a “Rainmaker”
• Must have excess capacity
• Partnership Agreements (check them annually)
  • Caps? Proper notice? Buyout terms that work?
Roadblocks

• Unity of Partners
• Impatience
• IT
• Equity
• Firm Name
• Unneeded ‘must haves’
  • Staff
  • Leases
Roadblocks

• WIIFM
• Leases
• Terms that don’t work
• Time
• Brand versus Partner loyal
• Poorly trained clients
• Accurate understanding of firm and its metrics
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 ........
For More Information

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

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