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The Shape of M&A in 2018

By Daniel Hood
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Over the course of more than a decade, mergers and acquisitions have gone from being unusual events in the accounting profession to being just another tool in the kit of firms looking to grow and owners looking to retire. But while these combinations are so common these days as to be almost unremarkable, how and why they're getting done changes frequently.

To get a sense of the state of play in the accounting landscape for the coming year, we gathered to some of the busiest M&A advisors -- experts who work with firms on everything from finding appropriate merger partners to handling negotiations to structuring deals -- for a virtual roundtable that included Allan Koltin, CEO of Koltin Consulting Group; Terrence Putney, CEO of Transition Advisors; Russell Shapiro, a partner at Levenfeld Pearlstein; and Joel Sinkin, president of Transition Advisors.

Do you think the M&A landscape will be different this year from last? How?

Joel Sinkin: I envision the activity remaining very high and the trend of it becoming more and more a buyer's marketplace to continue, especially for larger firms. A large part of the reason for this is the increase in the supply of firms seeking to merge up or sell, and the weak marketplace for partner-ready talent. That combination will result in fewer buyers. I think we'll also see values remain depressed as compared to just a few years ago in external sales, and perhaps even more so for internal valuations relating to partner buyouts.

Russell Shapiro: I see current trends continuing. The current of robust M&A activity is continuing, with many smaller deals getting done.

Allan Koltin: I think the biggest landscape change to M&A this year versus last year is the continual movement of larger CPA firms acquiring non-CPA firms. Whether it be wealth management, cyber security, outsourced accounting or an industry niche practice, larger firms seem to be trending away from general compliance practices. I actually had one CEO of a Top 15 CPA firm say to me this year that they are done purchasing local and regional CPA firms, essentially stating that all of their investment capital will be going to acquiring consulting, advisory and outsourced-type practices.

Terrence Putney: Rather than different, I see a greater emphasis on current trends in today's M&A market. We see buyers (successor firms in mergers) continuing to push down valuations. Many buyers may be considering several seller opportunities at the same time, and as a result are often not motivated or focused enough to do what it takes to get a specific deal done. We also see buyers putting much more emphasis on strategic fits and staffing, as opposed to simply acquiring a good client mix. The level of M&A activity is going to remain at historical highs due to the need for external succession solutions for so many firms.

Koltin: I also think that many of the acquirers are getting more sophisticated (and experienced) in terms of what they're looking for, as well as what they're willing to walk away from. The last thing they want is a bad merger, and I think they are much more savvy in their approach to evaluating potential merger candidates.

Is succession/exit planning still the main driver of the current M&A mania? What other factors are involved?

Putney: The majority of seller firms seeking upstream mergers are still doing so in order to provide a succession solution for their partners. This will continue unabated for some time. However, we are also seeing an increase in firms seeking upstream mergers stemming from concerns about their ability to effectively compete with larger firms that may have recently entered their markets via a merger or organic expansion. Meanwhile, emerging technologies such as blockchain, artificial intelligence and robotics have also caused firm owners and partners some sleepless nights as experts have predicted that those will fundamentally revolutionize such CPA workload staples as auditing.

Sinkin: Succession remains a strong factor in M&A, but not the only one. More and more firms are open to satellite offices creating more opportunities for mergers; other firms are seeking to merge up, yes for succession of senior partners, but also for growth for younger partners seeking a larger platform of services to offer and deeper bench.

Shapiro: I would say largely yes as to succession/exit planning being a primary driver for many firms. But there are clearly other drivers for some firms. Other drivers include the ability to invest in technology, the ability to recruit talent and the ability to service growing clients which continue to have more and more complex needs.

Koltin: I think the No. 1 change I've observed over the past couple of years is the number of Top 500 CPA firms that have merged up, but had essentially no succession or exit planning issues within their firm. These types of mergers I refer to as strategic (versus succession) and I expect this trend to continue. Given all of the changes taking place in the accounting profession today (ranging from artificial intelligence to the profit squeeze on compliance services), firms are making a cost/benefit calculation of what it would take to build up the additional product and service line of value-added services within their firm. For some, my guess is they would rather hedge their bets and merge with a firm that has built out all of the consulting and advisory services and not have to put their own capital at risk. Having said that, some of these mergers are driven as much by client wants and needs, and firms know that as they get larger they need to have a broad array of products and services available for their larger clients.

What new trends are you seeing in M&A?

Shapiro: I would say that the main thing that I have experienced in the last two years is that deals have been getting smaller. There are probably more of them, but the average size is not as big as it was four or five years ago. I think that a lot of the larger deals, deals involving a top five independent firm in a metro area, were largely done a few years ago, except for those firms that decided to remain independent. Firms continue to look to expand geographically, expertise-wise and revenue-wise.

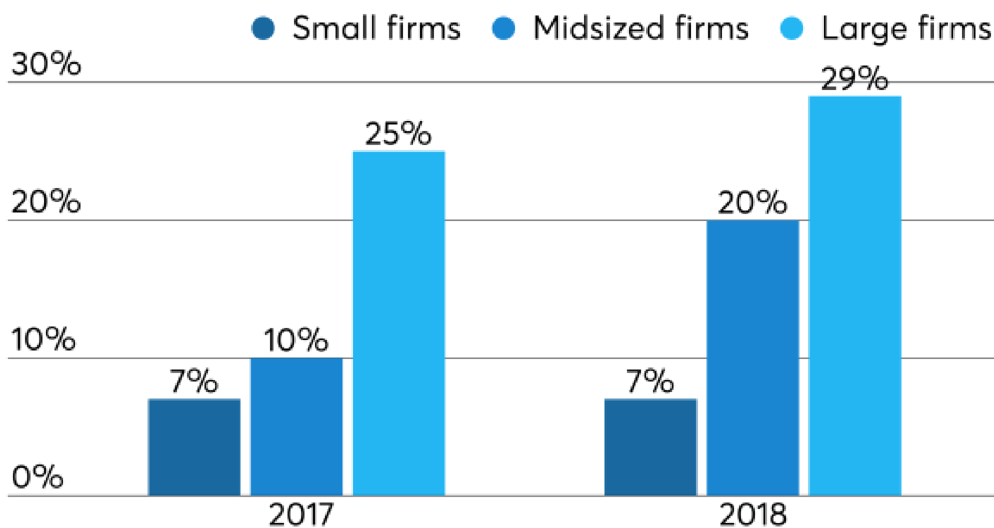
Koltin: I don't know that it's a new trend, but I clearly saw it this year and it seems to be happening more. That is the willingness of the acquirer to bring in older partners and provide them with a retirement date

that is greater than what they use internally for their existing partners. I think many of the firms have come to realize that today's 70 is 60 and if you don't provide some of these entrepreneurial partners the ability to continue working, they simply won't consider you as a viable merger candidate.

Putney: We are seeing buyers become more creative with deal structures in order to facilitate the proverbial win-win outcome. An example of this would be the use of tax treatments more favorable to the seller in exchange for longer payout periods. We also see buyers altering their buyout offers toward terms more consistent with their internal owner agreements, which may vary substantially from traditional purchase terms. Firms needing an external solution for succession are now going to market much sooner, rather than procrastinating to a point where they are faced with either accepting any offer that comes along or closing their doors for good.

Sinkin: Many firms -- some based on their concern that future technology will continue to reduce revenues from traditional accounting and tax functions, and others just because it makes strategic sense -- are looking toward nontraditional niches such as cyber security, HR consulting and payroll, all of which have huge cross-selling potential to both existing and future clients.

Koltin: The other trend I see, and again it's not new to this last year, but it seems to be happening more, is acquirers taking a much harder line on problem partners or partners that simply don't fit strategically prior to the merger. They basically are telling the acquirees, "You need to do your surgery upfront before joining us, because if we let that partner (or partners) go after the merger it only reflects poorly in the marketplace in terms of the success of the merger." Years ago, I think the mentality was to bring the whole group in and we'll figure it out afterwards. I think the wisdom today is that rarely works and it's better for everyone (both the acquirer, acquire and the "problem partner") to deal with these issues up front.



After a deal has been signed, what are the most important steps that firms can take to ensure a successful combination?

Koltin: The first important step is a sensitivity to the announcement itself, as it relates to internal staff, clients, referral sources and the greater community. These groups need to understand that, for the most part, the service providers will remain the same and the fees won't increase. They also need to understand the benefits of the combination and why this is good for all.

The second most important step is to have a successful integration. I have observed some acquirers that draw a hard line and try to do too much too fast, whereas others don't want to upset the apple cart and do very little integration. I think the conventional wisdom is to draw the line in the middle and be committed to truly integrating into one firm, but understanding that not everything has to happen on Day 1. Obviously, the time of year when the firm is merging in (December 31 versus May 1) will also impact how quickly the integration process can and should take place.

The other item that I think is enormous is to do whatever can be done to take away the "we and they" and create a culture of "we and us," whether it's as basic as mixing and matching people from both firms from an office standpoint or the larger firm helping the new firm. To integrate successfully, all of these things are critical to the successful onboarding process.

Sinkin: Firms need to make a maximum effort toward sending the "right" messages regarding client and staff retention post-closing. The truest measure of success in any merger is client and staff retention, yet many spend so much time making their deals happen that they don't invest enough time to ensure they work. The key is to always make the merger the addition of the successor firm, not the loss of the original firm. Emphasizing the continuity of services, personnel, fees and similar cultures while also focusing on the value-added items that the combined successor firm will bring is a critical part of that message.

Putney: The first step is to articulate a business plan for both the buyer and the seller firms. Determine what will change Day One and what will not. What are the upsides for both parties? Post-merger, the now-combined practice must focus on building a cohesive team comprised of members of both firms. And above all, communicate, communicate, communicate!

Be sensitive to the consequences of changes that are being introduced when considering the timing. Remember to provide strong support and the necessary resources to the team responsible for executing those changes.

Daniel Hood is editor-in-chief of Accounting Today and Tax Pro Today, and has covered the tax and accounting field for over 20 years.