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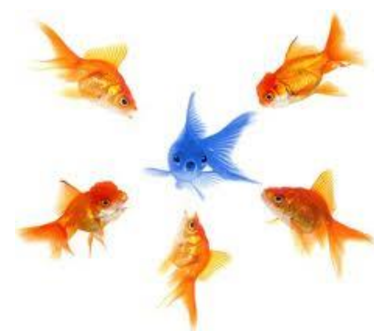
2018 In M&A: Trends Converge To Create A Changed Landscape



Mergers and acquisitions have transformed the accounting profession for at least a decade, and the frenzy is expected to continue. What differed in 2018 was the number of trends that came together to fuel the M&A activity and change the professional landscape, consultants say.

Consider the following:

- ✓ Firms can no longer expect quick growth without making huge technology investments.
- ✓ Firms are moving from compliance activities to advisory services due to shrinking margins and increasing client demand.
- ✓ Traditional tax and audit firms in lukewarm markets are less attractive to potential buyers.
- ✓ Firms are starting to acquire technology firms, HR shops or consulting businesses.
- ✓ Firms in the revenue range of roughly $10 million to $40 million are in more merger discussions now than ever before because the cost of growth is so high.

In addition to the factors highlighted on the left, layer on the usual reasons for M&A: the desire to expand geographically, the need to fill positions of retiring baby boomer leaders or the intention to add specialized services and experts. “Succession is the driving factor most of the time,” says consultant **Joel Sinkin**, of **Transition Accounting Advisors**.

The convergence of all these trends has **Allan Koltin** comparing 2018 to 2002 – the year of the corporate accounting scandal. Think Enron, Arthur Andersen, Global Crossing, WorldCom and Halliburton, and the impact of those bankruptcies and wrongdoing on the accounting profession. Last year was pivotal as well, but in a different way. Koltin, of **Koltin Consulting Group**, says that 2018 will impact 2019 and beyond.

Koltin says firms are lowering their internal valuations for the first time. Retiring partners are starting to get smaller payouts and deferred compensation packages are less generous. Average partner compensation is going through the roof, but don’t look to get rich on the payout at retirement, Koltin says. Sinkin agrees. “Younger people don’t want to pay for retirement buyouts and make less.”

The emphasis is now on specialization versus the “be everything to everyone” approach to services. “I think advisory will continue to increase at a larger rate than compliance in the near future. Therefore, you have a couple of options when you want to go into advisory work,” says **Carl George**, the former MP of Clifton Gunderson who now consults. “You can build it out, by starting fresh, which is very expensive and has a very steep learning curve. You can buy the expertise in a single individual or a team from another firm, or the third option is to look at advisory firms and try to negotiate terms with that firm to lead that particular niche."

The migration from compliance to advisory services is making "plain Jane" compliance shops look less attractive than they once were, Sinkin says.

Clients are telling Sinkin that if the firm had a strong cybersecurity, HR consulting or wealth management practice, they'd be much more interested in acquiring it. Firms of around $20 million are getting involved in mergers with IT businesses as a way to keep up with technological tools and add services. Firms with wealth management practices are selling for three times the value of a typical firm, Koltin says.

Allan Koltin

Koltin observes that obtaining talent and expertise is a huge M&A motivator, estimating that the topic occupies two-thirds of C-suite executives' time.

Talent acquisition can come from a tradition merger or through what Koltin calls a "liftout," or the acquisition of a specialized practice area from another firm. Another method is a "surgical strike," where a firm will target specific individuals from other firms. Even though partners are typically required to pay their home firm if they leave with a book of business, which has traditionally discouraged lateral movement, firms are so desperate for talent that they're negotiating deals.

Both Sinkin and Koltin say the market is favoring buyers, but there are exceptions. A high-performing firm in a densely populated area with an energized, successful partner group can be selective in courting potential buyers. George believes firms with robust tax consulting practices should do well in 2019.

The so-called vanilla firms may not be in trouble yet, but the consultants all say that they'll need to re-engineer their practices to remain competitive in the future. Margins are shrinking, competition is fierce and payroll costs are rising. "Something has to give so we have to do it a different way," George says. Koltin adds, "The beauty of public accounting is as long as you don't do a bad audit or tax return, you can stay around forever. You just won't make as much money."

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In the end, change is inevitable, and the transfer of leadership is as natural as life and death. With baby boomers retiring in droves, succession will be a major driver in M&A for years to come.

George views this positively. "For the young people who want to progress and advance in public accounting, there's more opportunity today than maybe ever. To me, there's no limit and there's no timeline. If you're ready, go for it! If you're close to ready, get readier." He says he has no doubt that they'll bring new energy and ideas to public accounting. "I'm very, very bullish on the next generations."■**IPA**

In **2017** 19% of firms reported a merger and 166 mergers were reported

In **2018** 22% of firms reported a merger with 179 mergers reported

30% of firms reported at least one partner retired last year 2017-18

275 partners retired in 2017-18 with another **271** expected to retire in 2018-19

70% of firms reported having mandatory retirement, with the majority kicking in at age **65**

Retirement obligations increased in 2017-18 to **2.2%**, up from **1.9%** in 2014

30% of newly admitted equity partners were lateral hires, and **28%** of newly admitted non-equity partners were lateral hires

Data Source: 2018 INSIDE Public Accounting National Benchmarking Report