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US accounting industry split on taking private equity cash

BDO, Grant Thornton and Marcum among firms to have explored deals as new capital fuels M&A boom

Stephen Foley in New York
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Several of America's largest accounting firms have explored the possibility of taking private equity cash in recent months, as money from buyout funds adds fuel to a mergers and acquisitions boom across the industry.

BDO and Grant Thornton are among those to have considered a deal with private equity, and while neither immediately decided to pursue an investment, bankers and executives expect a number of smaller firms will do so, and use the cash to swoop on rivals.

Private equity has been drawn to the fragmented US accounting industry for its relatively stable cash flows and consolidation prospects, but selling some or all of the business to the so-called barbarians at the gate has split a sector dominated by traditional partnerships.

"We've been partnerships for a long time. Part of those partners' desire to be here is they are business owners," said Eric Miles, chief executive of Moss Adams, an accounting firm based in Seattle, who has talked to private equity but decided to watch from the sidelines.

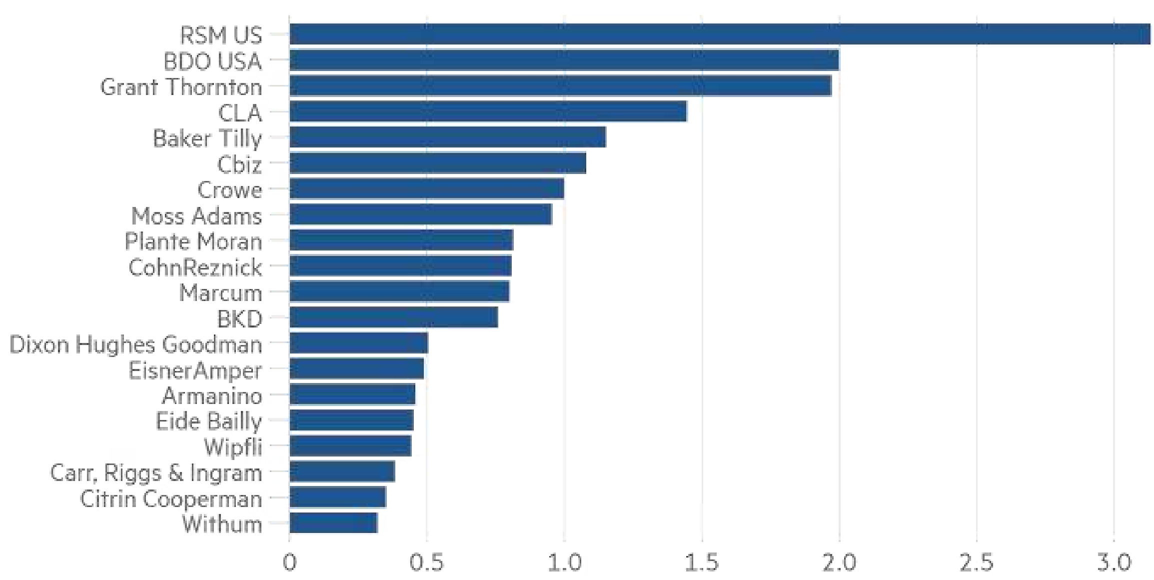
"If private equity is right for the industry, what do you lose by waiting to see if that's true?"

EisnerAmper, a top 20 accounting firm by revenue, electrified the sector by selling a majority stake to TowerBrook Capital last year and using cash from the deal for an acquisition spree. Three more firms, Citrin Cooperman, Schellman and Cherry Bekaert, have followed suit with stake sales to other private equity groups.

Marcum, the 15th largest by revenue, is also in talks about doing a deal, according to sources familiar with the situation, even as rising interest rates complicate private equity financing arrangements and price negotiations in the short term. Jeffrey Weiner, Marcum chief executive, declined to comment.

Below the Big Four: The largest US accounting firms by revenue

Annual revenue ($bn)



Fiscal year ending 2021
Source: Accounting Today

Until recently, accounting executives had largely assumed private equity would not make a foray into the sector, since US regulators say auditors cannot be owned by non-accountants. EisnerAmper kept a partnership structure for its audit work but sold TowerBrook a majority stake in a company made up of its tax and consulting services to overcome such challenges.

The structure is different to accounting giant EY's audacious plan to spin off its consulting division as an entirely separate company and list it on the stock market next year. Partners on the audit side of the business, which will retain a partnership structure, stand to receive cash payments of up to four times their annual earnings. The consulting division will not be able to use the EY brand.

In the mid-market deals, audit and consulting retain a tight relationship. Charly Weinstein, chief executive of EisnerAmper, said it took almost a decade of conversations with private equity to orchestrate a deal, but the new model means profits can be more easily reinvested into the business than in a partnership, where earnings are typically distributed to partners in full each year.

"We saw the opportunity to recapitalise the firm," he said, calling EisnerAmper a "platform company" for rolling up a fragmented industry.

"Prior to the TowerBrook transaction, we averaged one M&A transaction a year. In the last 13 months, we have done nine transactions and we have a pipeline of very good firms that are considering joining us," he said.

Wayne Berson, US chief executive of BDO, said he had given private equity bidders a hearing after years of turning down talks. Private equity-funded rivals had become more aggressive bidders on acquisitions that he wanted to do, he told the Financial Times.

"We need to know what the competition is doing, but it's not something we are entertaining today," he said. "We are a long way from being convinced it's the way to go for us. It's got to be good for our partners and the jury is still out on how regulators will react, given the need for auditor independence. Small firms may find it easier to do a deal."

BDO is one of only two accounting firms outside the Big Four of EY, PwC, KPMG and Deloitte that audits companies in the S&P 500. The other, Grant Thornton, also had talks with private equity earlier this year about selling a stake in its non-audit business to raise investment funds, according to sources familiar with the mooted deal. Ultimately, no agreement was reached.

A Grant Thornton spokesman declined to comment.

This year is shaping up to be the busiest in memory for M&A activity among mid-market US accounting firms. With surging labour and technology costs, businesses are seeking benefits of scale, and also bulking out their consulting arms to offer a wider range of services to clients.

“Accounting firms, starting with the Big Four, have gradually evolved to not only be your audit provider, your tax provider, but also to be your business expert,” said Andrew Nicholas, professional services analyst at William Blair. “Now smaller and midsize businesses also prefer to have a single vendor relationship.”

By the beginning of September, analysts at William Blair had counted 64 acquisitions in the accounting sector, putting this year on pace to eclipse the previous record in 2019 by about a fifth.

“Three words: off the chart,” said Allan Koltin, a Chicago-based consultant who is the most prolific deal adviser to mid-market accounting firms. “A couple of months ago it was the calm before the storm. And the storm has arrived.”

Even firms that have not taken private equity money are stepping up dealmaking.

“We have done 18 deals in the last four years without private equity money,” said Alan Whitman, chief executive of Baker Tilly.

“There are two things that scale brings you — intellectual capital, or great minds, and financial capital — and smaller organisations in the US and overseas are realising that to stay relevant and competitive takes significant investment.”

Baker Tilly was able to persuade its partners to fund a war chest for deals, Whitman said, after a 35 per cent surge in profits in the last financial year, when clients turned to accounting and consulting firms to help them through the pandemic.

Jerome Grisko, chief executive of CBIZ, the only listed US accounting services business, told investors last month that competition for deals meant prices for accounting firms had “ticked up a little” but continued to be good value.

CBIZ has spent $95.8mn on acquisitions so far this year, already eclipsing the full-year record of $88.8mn of 2020.

William Blair’s Nicholas predicted that the deal wave would continue, despite headwinds from rising interest rates and economic uncertainty.

“There’s a chicken and egg situation here where the industry is consolidating so then there’s a competitive dynamic to try to keep up,” he said. “And that leads to more consolidation.”