From Mother Ship Deals to ESOPs

Top 10 Accounting Firm Structures Shaping the Future of the Profession

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Every firm is looking to grow, and today the capital it takes to achieve growth is coming from a widening range of sources. The capital markets are offering an array of methods to help firms invest in technology, people, offshoring and other needs. But while an increasing number of firms are accepting PE investments, others are getting creative to remain independent.

IPA spoke with **Allan Koltin**, CEO of **Koltin Consulting Group** and a top advisor on CPA M&A, about the Top 10 accounting firm structures, the players and the implications for what has been a little-changed profession over the last 130 years.

Among his predictions: More than half the Top 25 firms will be PE-owned in the next six months, six to 10 PE rollup firms will enter the market, and as soon as next year, a major firm could go public.

NO. 1 – THE MOTHER SHIP

The most common arrangement, and the most headline-grabbing structure over the last few years, is what Koltin refers to as the mother ship deal: A Top 25 CPA firm sells 50% to 70% of its firm to private equity, raising capital for acquisitions and other investments to support growth.

Examples: **Aprio** and **Charlesbank Capital Partners**; **Baker Tilly** and **Hellman & Friedman/ Valeas Capital Partners**; **Cherry Bekaert** and **Parthenon Capital**; **Citrin Cooperman** and **New Mountain Capital**; **EisnerAmper** and **TowerBrook Capital**; **Grant Thornton** and **New Mountain Capital**; among several others.

Smaller IPA 100 firms have also opted for mother ship deals, including **Smith+Howard**, which joined with **Broad Sky Partners**, and **Schellman & Company's** arrangement with **Lightyear Capital**. Even smaller is **Prosperity Partners** (formerly NDH) of Chicago, which took an investment from **Unity Partners**.

"If we're looking into the crystal ball, I would say that there will be another half-dozen Top 25 CPA firm deals that will take place over the next six months," said Koltin, "meaning more than half the Top 25 will be PE-owned."

NO. 2 – PRIVATE CAPITAL DEALS

To date, just one firm – Chicago-based **Sikich** – has taken a different approach. The firm sold a minority stake, at $250 million, not to private equity, but to private capital – in this case **Bain Capital**. In this arrangement, Sikich gained the money for needed investments while maintaining control of decision-making. In turn, private capital firms expect returns of 11% or more, but that rate could increase by as much as five to six points if the target firm exceeds growth and profit goals.

"If, unfortunately, the company should go the wrong way, they will have the ability to take a 20% to 30% control of the business from an ownership standpoint, but actually take over the running of the business," said Koltin. "If you're a confident CPA firm, you know that's never going to happen because you believe you can achieve what you say you're going to do. It sort of becomes a non-issue."

Alan Koltin

Koltin predicts one other Top 25 firm will announce a similar deal by the end of the year.

NO. 3 – THE ESOP OPTION

Offering an ESOP, in which the entire staff owns a stake in the firm, involves a major restructuring. In the last several months, IPA 100 firms **BDO** and **Grassi & Co.** implemented ESOPs and created alternative practice structures, with one group handling all tax and advisory work and the other heading up audit and attest work.

Examples: **Global Tax Management**, **Katz Sapper Miller**, **Redpath & Company**, **SC&H**, and a handful of smaller firms, such as **Bland**.

NO. 4 – NON-PE BUYERS

This type of arrangement involves wealth management firms, family office and sovereign wealth funds buying firms. Why the interest? Wealth management firms are popular with their clients when the market is good, but not so much when the market goes down. Offering complementary tax planning and wealth enhancement services, such as estate and trust planning and charitable giving, gives clients a more holistic approach.

The only example thus far is **Creative Planning's** acquisition of **Bergan KDV**.

"Will this be a trend? Will there be many more wealth management companies coming in? I don't think so, but there'll be some," Koltin said. "But for Creative Planning, it made all the sense in the world because they're all about the total solution."

NO. 5 – THE ROLLUP

Rollups yield advantages for both the PE firms that create them and the smaller firms that are brought into the fold. Often, the PE firms provide resources in technology, HR, marketing and infrastructure that help smaller firms – typically between $10 million and $75 million in revenues – achieve efficiencies and growth. Some PE funds will acquire even smaller firms with revenues between $1 million to $10 million, with the firms keeping their brands, culture, software and processes – for a time.

But there are marked differences in the approaches PE firms take, and small-firm partners should understand that, while their firms may function as part of a collaborative group of independent firms for a while, eventually the plan will be to fold them into a single entity. After a few years, the PE firm will consolidate the assets, Koltin said, and then sell to another PE firm or a PE-backed mother ship.

"In other words, you'll join the PE rollup and belong to the country club, but make no mistake about it, ultimately you will become part of the country," he said. "An integrated firm is worth a lot more than a loose confederation."

"Candidly," Koltin added, "I underestimated how well received the rollup approach would be. These groups are hitting it out of the park in terms of the number of firms they are acquiring. They are competing head on with mother ship firms and winning their share of the deals. At the end of the day there's not a right or wrong, it's a simple question of what's the best strategic and cultural fit for the firm being acquiring by PE."

Examples: **Aistra**; **Archer Lewis/StoicLane Partners**; **Ascend/Alpine Investors**; **Count Technologies**; **Crete Professional Alliance**; **DFW Capital Partners/ Harris**; **F3 Partners**; **Platform Accounting Group**; **TPG Growth**; **Trinity Hunt Partners/Springline**; and **Seneca Financial Partners**.

Koltin sees another six to 10 PE rollup firms entering the market by the end of the year.

NO. 6 – MERGERS OF EQUALS

Ownership transformation can certainly occur without private equity or capital. The joining of two similar-sized firms is one way. In these deals, firms can solve their capital problems by doubling their size overnight, providing enough capital so that selling all or part of the firm isn't necessary.

Examples: The 2022 merger of **BKD** and **Dixon Hughes** to create **FORVIS**, which has since partnered with **Mazars** to create **Forvis Mazars**.

Mergers of smaller, similar-sized firms can result in huge firms down the road. "We can't discount the smaller ones because they become lightning rods to get to the next step," said Koltin. "For example, in 2003 the $40-million **Dixon Odom** combined with the **Crisp Hughes Evans** to form **Dixon Hughes**, and today that firm trades as **Forvis Mazars** with revenues of $1.7 billion."

NO. 7 – THE PUBLIC COMPANY SOLUTION

Only one example of a public company exists today in the accounting profession – publicly-traded **CBIZ**, the 11th largest firm in the nation. When CBIZ completes its planned combination with **Marcum**, ranked No. 13 in the nation, the combined entity will rank No. 7 with 10,000 employees, 135,000 clients and $2.8 billion in combined annual revenue. The deal is expected to close in the fourth quarter.

Koltin believes public companies will re-enter the accounting profession over the next five years, possibly including PE taking a firm public on the flip. As soon as next year, he said, a Top 25 firm could become the first to do an IPO and use the capital to create a global firm.

"When the private equity group wants to sell their investment in year five to seven, everybody's asking the question, 'Who will they sell it to?' One of those answers is you're going to do an IPO. You're going to take the company public. You're not going to sell to another private equity group. I think we're going to see that within the next three to five years," Koltin said.

NO. 8 – TRULY GLOBAL FIRMS

Koltin said the Big 4 and other Top 10 firms may say they're global, but they're insulated by their partnership agreements for legal liability for acts within their country. Additionally, these firms retain all their profits, and decision-making is done within that country. He believes these mega-firms will begin to "break down the walls" and become truly global firms over the next couple of years.

"If you were asking me to predict who the first one will be, I would offer up Grant Thornton," he said. "Grant Thornton will go outside the U.S. and use New Mountain Capital's money to acquire other Grant Thornton firms throughout the world." (Publications such as *The Financial Times* and *The Wall Street Journal* have suggested that GT Ireland and GT UK are in active discussions with GT U.S.)

He added, "I believe once the U.S. Big 4 accounting firms do their private equity and/or IPO deals, they will most likely do exactly what Grant will have already done, but on a much larger scale."

NO. 9 – CPA WEALTH MANAGEMENT SALES

This arrangement involves CPA firms selling their own wealth management businesses to private equity to remain independent while raising capital. A sale monetizes what the partners have built, and it gives retiring partners a big payout.

"It's a 2-for-1 deal," Koltin said. "Number one, it's a way to create capital and not do a private equity deal. Number two, it's the single biggest asset that the legacy partners have created, and they're entitled to share in the wealth of that business they've built."

Examples: **BDO Wealth Management**, **Cherry Bekaert Wealth Management** and **RSM Wealth Management** to **Choreo**; **Maxwell Locke & Ritter Wealth Management** and **Wipfli Wealth Management** to **Creative Planning**; **Warren Averett Wealth Management & Wealth Partners Capital** to **HGGC**.

NO. 10 – CPA FIRM DIVISION/SUBSIDIARY SALES

Similar to wealth management sales, some firms are selling a division or subsidiary to PE. Partners have been "clipping coupons" for years to build the business and, typically, the profits get re-invested. "The good news is business keeps growing," Koltin said. "The bad news is if we retire and we don't have a way to unlock the value of what we've invested in, we walk away with either nothing or the book value of the business."

A sale can accomplish three things: reward the original shareholders, reduce risk and gain capital to grow and expand.

Examples: **Crowe Healthcare Consulting** to **TPG** (renamed Kodiak Solutions), and **KSM Consulting** to **Renovus Capital Partners & Investcorp**.

THE FUTURE

What does all this mean? Many firm leaders are "living in the moment," working hard and enjoying multiple years of high profits. But Koltin offered a warning to firms that aren't planning now to become firms of the future. "Nothing in business is forever, but more precisely, the worst place to be in business is to be in a position of strength and think that it will last forever."

He also noted that firms don't have to jump on the PE bandwagon to be successful.

"My professional opinion is it's not about whether to do private equity or not. It's about having a strategy of sustainability and growth, and what we've observed is in today's world, you can no longer do it on the cheap. You need capital." Firms have taken different approaches to raise capital, and many of the Top 25 firms will likely remain independent, best of class firms, such as **CLA**, **Crowe**, **Eide Bailly**, **Forvis Mazars**, **Moss Adams**, **Wipfli** and **Withum**, he said.

"Just because the bells and whistles are all suggesting the trend is private equity, let's not in any way assume that that's a one-size-fits all for everyone," Koltin said. "Nothing could be further from the truth."

This is the second of a three-part series that will cover various angles of the private equity's growing influence in the accounting profession. Watch for part three later this fall.