The experiment is back: why accounting firms are considering life on public markets

Listing by MHA prompts shift in thinking as firms consider alternatives to selling to private equity

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MHA floated on London's Aim in April as it decided against selling out to private equity © Layton Thompson/LSE

When RSM Tenon, the UK's first publicly listed accounting firm, collapsed in 2013, it marked the failure of the profession's decade-long experiment with the public markets.

A number of acquisitions left the UK's then top-10 auditor saddled with debt it couldn't service and accounting errors that regulators put down to "extensive misconduct". RSM Tenon was put into administration and investors moved on.

But the experiment is suddenly back on. In a profession that historically operated as private partnerships, advisers and executives are predicting a wave of initial public offerings in the next few years.

Advocates say firms' interest in the public markets is likely to have more success this time. Private equity has emerged as an alternative to the partnership model, snapping up accounting firms across the US, UK and continental Europe, and businesses are in need of capital for technology investment.

MHA made the first move. The UK and Ireland arm of the Baker Tilly International network floated on London's Aim in April, having decided against selling out to private equity as rivals Grant Thornton UK and Evelyn Partners have done.

Accountancy firms courting private equity were falling prey to "Fomo", MHA chief executive Rakesh Shaunak told the Financial Times. "Everybody wants to be part of that feeding frenzy . . . I think IPO is the right option."

MHA's partners sold only a minority of the firm, raising $98mn for a 36 per cent stake. The price was lower than anticipated but the stock is up 24 per cent since its flotation and MHA has already used its shares to acquire its network firm in Cyprus and Greece.

Shaunak said that public accounting firms had more strategic freedom than those owned by private equity, where options might be constrained by a high debt load and a focus on boosting profit so investors can exit after a few years.

MHA "didn't want to be totally motivated by [earnings before interest, taxes, depreciation and amortisation]", he said. "With the IPO, with the range of investors you have, you don't have that singular pressure."

Julian Morse, co-chief executive of Cavendish, the investment bank that advised MHA on its IPO, said the flotation had prompted a shift in industry thinking. Other firms were "actively considering the possibility of an IPO as a credible alternative to PE investment", he said.

Allan Koltin, a veteran adviser to American accounting firms, said that some executives cannot see past private equity's reputation for cost-cutting and could steer their firms to the US public markets instead.

"There are firms out there that are anti private equity, and they are just not going to budge. I don't see that same sentiment against being a public company."

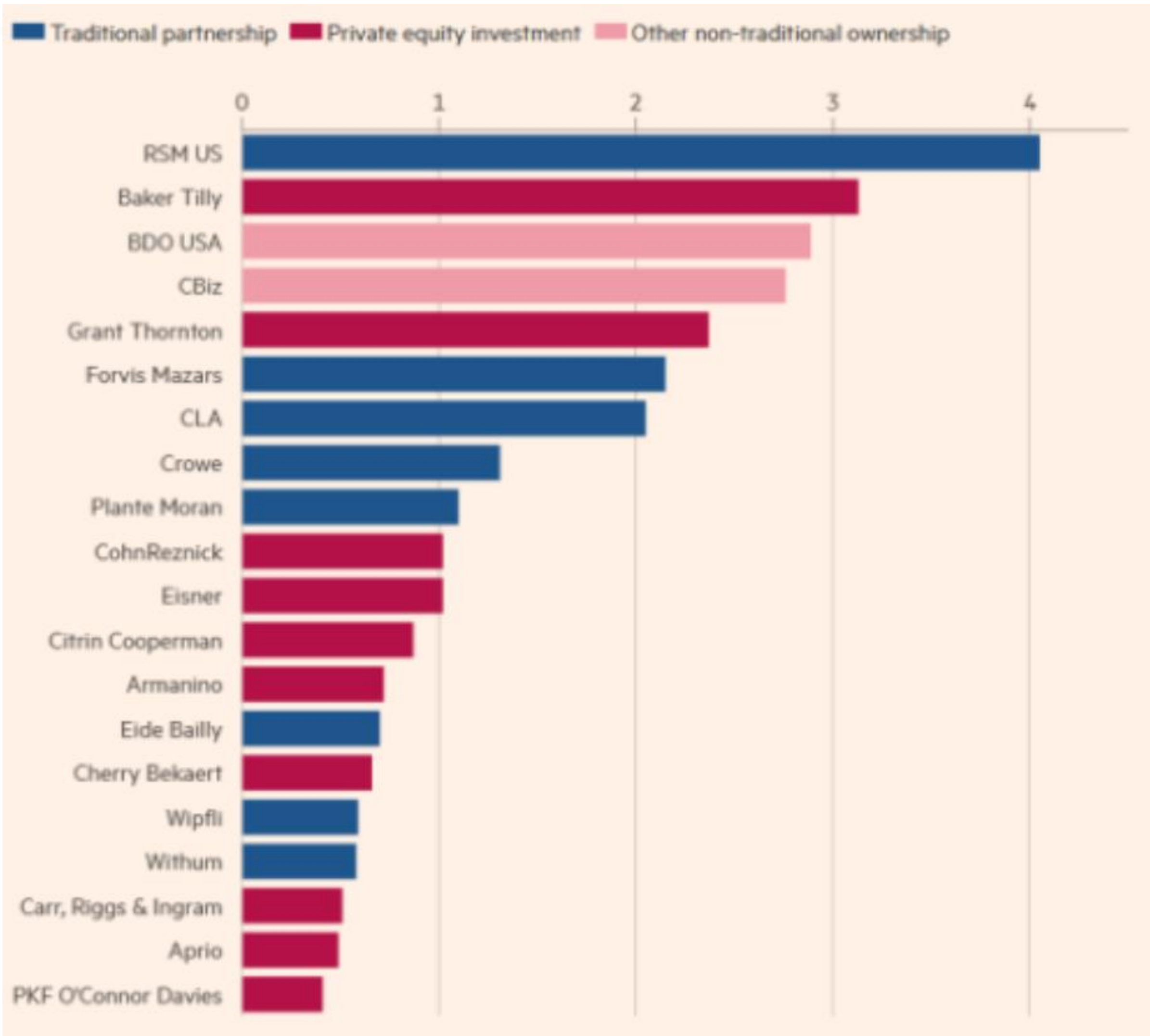
Koltin predicted a half-dozen or more mid-size firms could be public within five years, in addition to CBiz, which has been the lone listed accounting firm in the US since 1998.

Discussions about eventual IPOs have picked up in recent months, after New Mountain Capital sold Citrin Cooperman to Blackstone in the first example of a private equity-owned accounting firm being sold to another financial buyer.

"If you play things out over a five-year period and firms double in size at a minimum, at some point they get too big for private equity," Koltin said.

Traditional partnerships now account for fewer than half of mid-market accounting firms in the US

Top 20 firms by annual revenue ($bn), excluding Big Four



BDO converted from a partnership to an employee share ownership plan. CBiz is publicly traded.
Sources: Accounting Today; FT research

Hellman & Friedman, the private equity owner of Baker Tilly US, has already signalled that an IPO is its most likely exit after the firm acquired Moss Adams this month to create the sixth-biggest accounting firm in the country.

Jeff Ferro, Baker Tilly's chief executive, said he tells partners "we would be only so lucky to be in a position to do a public offering" in a few years, but there are ways to relieve the pressure for an early decision.

"We'll continue to pay down the debt and then probably use debt to do some recap distributions along the way," he told the FT. "I think our partners will get a taste of monetisation every couple of years, and I think that's a vehicle that H&F uses so that they can stay in the investment longer."

Shaunak agreed that firms could not be flipped between private equity owners forever. "The only exit is a public market flotation, because otherwise it's smoke and mirrors."

Private equity ownership of accounting firms has raised concern among regulators in multiple countries. Stock market flotations are likely to find the same level of scrutiny — especially if firms have a large audit practice. Auditors are meant to offer an independent check on their clients' financial statements.

The Institute of Chartered Accountants of Scotland earlier this month called for an urgent review of the rules governing who can own audit firms, saying "difficult ethical decisions might face undue influence as a result of commercial pressures".

The UK accountancy regulator has maintained a more neutral tone, but included all forms of capital restructuring when it warned in March of the "risks" of changes in ownership.

Private equity executives counter that much of the value of an accounting firm lies in its reputation and they are no more likely to risk it than partners or public company executives.

While Citrin Cooperman's sale to Blackstone suggests that early private equity investors will make a sizeable return, the jury is still out on how more recent buyers will fare — let alone shareholders in newly-public accounting firms. CBiz shareholders have enjoyed a halo effect from the activity in private markets, as the stock was revalued higher, but two sets of underwhelming financial results followed.

CBiz shares soared as accounting sector attracted new investors

Share price, $

Source: LSEG via markets.ft.com

Will firms veering towards IPOs learn the lessons of the previous disastrous flotations?

“It’s different from the last time round,” said Rob Donaldson, chief executive of RSM UK, the accounting firm that scooped up the assets of the bankrupt RSM Tenon and adopted its name. He cited private equity as “perhaps an interim step” to help prepare smaller firms for the public markets.

RSM UK is happy to watch from the sidelines, however. It is a traditional partnership and will remain so even after merging into its larger sister firm, RSM US, as it plans to do later this year.

Donaldson rejected the idea that raising capital from private equity or public investors was necessary. “I’m under no pressure from our partners to restrain investment in order to preserve incomes. Quite the opposite. We are investing with five or 10 or 15 year horizons,” he said.

“In the long term, it might be that the partnership model wins out. It’s been here for hundreds of years — and you know, the previous experiment with the public markets didn’t quite go so well.”