

## Case study Number 1: A Two Stage Deal, Seller Transitions His Practice Over Time

We started the process by requesting information from the seller that described the practice in sufficient detail for prospective buyers to make a preliminary evaluation of interest. We also helped the seller establish personal goals for the succession of his practice. With our assistance, parameters were established for the type of successor firm to consider based on size, culture, location and various other important variables. The key thing we learned from the seller was that while he was interested in finding a solution to his long term succession needs now, he was not ready to quit working. He also was not interested in "going to work" for another firm as a clock punching employee.

### The Seller

The seller is a sole practitioner. He had two CPAs, one non CPA pro and a p/t clerical (staffing base resources) and was generating approximately \$750,000 in annual revenues. This practitioner felt he had a strong staff, but no one who could be his replacement. His goal was to work 2 to 3 more years full time, 2 more years thereafter part time but he did not desire to reduce his income or control of the practice for the initial 2 to 3 years. Over the next several years, he was interested in reducing his time commitment but remain in a "partner" role as it relates to his clients. His practice was predominantly compilation and tax oriented. This seller was netting 37% of his revenues including salary, perks and benefits. He was investing approximately 2,200 hours annually, of which 60% was billable. He worked 6 days a week during tax season, 4 days per week during the summer and 5 days per week the balance of the year while enjoying 4 week's vacation annually.

### The Buyer

The buyer is a 2-partner firm generating \$1,500,000 in annual revenues. It is a diversified firm that also provided various types of business and financial consulting. The firm had additional capacity both on a staff level and space. The partner's goal was to more fully utilize this capacity and create a growth situation that would enable them to make one or two current CPAs a partner down the road without having to reduce their earnings.

### Negotiation Process

After initial meetings, the seller narrowed the field to two firms we introduced him to. Once proposals were obtained and an additional meeting was held with each, the seller narrowed his choice to one firm. With our guidance,

due diligence lists were exchanged, field reviews were performed, contracts were drafted, a transitional plan was prepared, and the deal was closed. From introduction to closing took 11 weeks.

### Deal Terms

The buyers had the room thus the seller moved into the buyers' facility. The deal was structured as a Two Stage Deal. All of the professional staff were retained and hired by the buyer firm except the clerical staff. The seller retained control over client service matters, his day-to-day activities, and his earnings until Stage Two.

### Stage One

In a Two Stage Deal, Stage One is the time from the onset of the affiliation until the seller substantially reduces their role. The seller's practice was treated as a practice within the successor firm's practice. The seller continued to run his practice as he had run his firm before, coming and going as he saw fit. He billed his clients under the buyer's name. The seller continued to receive the same 37% of gross revenues he was earning prior providing he did not need any additional labor support over and above staffing base resources. The seller retained his old entity so he could manage certain expenses and perks (such as car leases, insurance, and retirement plans) on his own terms. The 37% agreed upon profit was paid to his old firm as consulting fees. If based on his sole discretion, the seller elected to reduce his time commitment to the practice and needed additional staff support, the seller would accept pro rata reductions in his income.

Under the deal, Stage One would terminate and Stage Two would commence based on the first of the following events:

*The death or permanent disability to the seller*

*The date the seller reduced his time commitment to the practice below 50% of his past efforts*

*The end of the fifth year*

### Stage Two

In a Two Stage Deal, Stage Two is the point that the sale is actually consummated. The purchase price, in this

case, was 100% deferred during Stage One. The seller was paid 1.1X based on 22% of gross collections for the subsequent 5 years paid monthly, including fee increases, special projects and the like. The seller received a \$50,000 advance upon the onset of Stage Two, which was credited back to the buyers at a rate of \$2,000 per month for the first 25 months.

The seller was to remain on in a reduced role for the firm for additional compensation based on 33% of what he was billed out for on each mutually agreed upon tasks. He also received a new business incentive program that rewarded him 20% for 2 years on any new business he personally developed and brought to the buyer. The price paid was structured in a manner that provided the buyer a current tax deduction.

### Benefits to Both Parties

During Stage One, the seller was able to remain "Master of his Domain", come and go as before while gradually getting his clients and successor acclimated to each other. The seller also received a free insurance policy that protected his family and clients in the event of his death or disability during Stage One. The insurance was the automatic back up and support from the firm that had a vested interest in his success. The seller also created a method of maximizing the value of his practice yet he greatly reduced his liability and exposure. In Stage Two he received strong compensation for his practice, his time and new business development skills.

The buyer received short term and long-term value. In the short run, since the firm had the space to absorb the practice and excess capacity on a clerical level, the partners immediately created an additional \$100,000 per year in overhead reductions by eliminating the seller's rent, labor costs on clerical, software and other expenses. The successor firm was also guaranteed by

the end of the fifth year to be in a position to take over a practice that had already been transitioned to them.

### Results Thus Far

This deal is in its third year. Based on the detailed transition plan we worked out prior to closing, every client has been retained other than clients who sold their business, relocated or died. The revenues have increased as the retained clients have grown. The buyer was able to provide some of their niche consulting services to the seller's clients, which has produced additional revenues benefiting both parties. The seller has seen the deal go so smoothly and the clients become so comfortable that in the second year following tax season he elected to reduce his role by 20%. During the third year he reduced his time another 20% during tax season and he reduced it 25% the rest of the year. Since the buyer was doing most of the administrative work for the seller, the seller was able to invest more time in new client development as well as billable work. This has proven to be another reason revenues are up as well. The seller is now contemplating retiring at the end of year 4 instead of year 5 but remaining on 1 day per week for several additional years thereafter.

We helped the firms to not only come to the agreement detailed above, including but not limited to creating the deal structure and valuing the practice, but also with ways to handle the liability issues, firm names, transition of clients and staff, treatment of accounts receivable, work in process, alternative deal structures, aspects of due diligence, the keys to having the proper documentation and many critical issues only professionals with hundreds of closings and over a decade of experience can bring to the process.