



## **The rise and fall of CPA firm multiples**

The three most common questions we get asked during the course of the year are in order: What's the multiple? What's the multiple? What's the Multiple?

All joking aside, had you asked that question 10 or 15 years ago, the answer would likely be very different than the one you'd get today.

At the turn of the century, it was not uncommon for CPA firms considering a sale to basically sit back and command multiples from several of the large accounting "consolidators" like American Express Tax & Business Services, Centerprise, H&R Block and Century Business Services, that ranged from 1.5 to sometimes approaching two times revenue.

Accounting firm consolidators were simply opening up their collective checkbooks and rolling up as many willing firms as they could conceivably digest.

But that was then and this is now.

According to the AICPA's PCPS unit, nearly 80 percent of multi-owner firms participating in their 2016 succession survey indicated they expect succession planning challenges within the next five years, while 70 percent revealed that one or more partners would be exiting within that five year span.

So, according to the often-intractable laws of supply and demand, that means there's likely to be a glut of firms looking toward M&A as their succession solution.

### **What our clients are telling us**

While firms were receiving multiples as high as one and one-half even as recently as seven years ago, today, depending on what part of the country the firms are located in, larger practices looking for upstream merger candidates are paying anywhere in the vicinity of .67 to 1.2 (depending on the other terms of the deal) – and that's predicated on the fact the acquired firm is sited in primary markets such as New York, Chicago or Los Angeles. Firms with a great client base and billings or those offering unique client niches that are in demand such as sophisticated IT consulting or international tax, are commanding higher multiples as well.

However, should the target firm be sited in a less densely populated area of the country such a rural area of the Midwest, our buyer clients have paid anywhere from .5 to .75.

The larger firms in the country face greater challenges in terms of logistics and multiples in the M&A arena due to the fact the available pool of successor firms is far more restrictive.

A larger firm or even a small regional practice looking to merge therefore may face the prospect of having just a handful of firms who are large enough and have sufficient resources to become their successor firm.



Unless you're a top 100 or super-regional entity, few firms could realistically absorb a practice generating roughly \$10-\$15 million in revenue without a substantial increase to their costs and infrastructure.

### **Internal Solutions**

And for those practices whose succession solution lies internally, partners are consistently being bought out at lower valuations.

For example just a few years ago many of the top 100 bought out partners based on 2.5X to 3.5X average annual compensation. Now most are between 2X and 3X and still moving downward.

And the reason is three-fold.

The millions of Baby Boomers exiting the workforce coupled with the stunning number of firms without a succession plan – formal or otherwise – and a drought of partner-level talent in the pipeline, has transformed the profession into a bona-fide buyer's market.

### **Multiples: Cause and Effect**

What we like tell our buyer clients is that the multiple is the effect, what they need to do is understand the cause when considering an acquisition or merger. The cause is predicated on a number of factors including: cash upfront if any; the length of the client retention period; the profitability of the transaction; and the duration of the payout period. Also don't forget the time of the year. For example, a basic tax practice will have collected most of its annual revenue by July. So if you merge that firm in say in August, the reality is that you may have to actually operate that practice at a loss for several months until the next tax season rolls around.

So think of it in these terms: the less money you pay upfront, the longer the payout and retention periods and the more profitable the deal is structured for you, the buyer the higher the multiple.

A successor firm should always mandate an upside to any deal. You've most likely never advised clients to buy a business that will lose money for the next several years and promoted it as a great deal.

You should follow that strategy when seeking potential merger partners.