The Deal Room Podcast

Episode 160 – Tips and traps in Selling (or Buying) an Accounting Practice Part 1

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Transcript

Joanna: Hi, it's Joanna Oakey here and welcome back to The Deal Room Podcast, a podcast proudly brought to you by our commercial legal practice, Aspect Legal. Now today, we have on the show Mark Attard from Xcllusive Business Sales, who is talking with me all about buying and selling accounting practices. This will be a two-part series where we really dive into a lot of discussion about how selling an accounting practice or buying an accounting practice can be different to buying and selling other types of businesses, we look at the current market conditions, we look at inquiry levels at the moment, we look at who the buyers are of accounting practices, we talk about why it's not just always about the price, and we discuss why the terms of the sale for an accounting practice can be so much more important than in any other industry. We look at business clients versus individual returns, we look at pricing, we look at the sale of the accounting practice and so much more. In fact, Mark and I had so much to talk about in this topic that this has ended up as a two-part series. So in part one, which is the episode that you're listening to right now, we're talking about filtering prospects, we're talking about due diligence, we're talking about classic mistakes that sellers make, we're talking about the benefits of using a broker and we're talking about what makes selling an accounting practice different from selling another type of business. And then in part two of the series, which will be released next week, we'll go through current market conditions before and during COVID and we'll talk about business clients versus individual returns in an accounting practice and the impact on valuation. We look at the quality of accounting clients that can impact valuation, we talk about committing to the process, and we give some final tips and takeaways. So buckle in here we go with part one of our two part series all about buying and selling accounting practices.

Joanna: Hi, Mark, and welcome to The Deal Room podcast.

Mark: Good to be here.

Joanna: Fabulous. It's so good to have you Mark and I'm really excited to have this discussion today about buying and selling accounting practices because number one, we have a lot of accountants who are listeners. At number two, I deal with a lot of accountants who are acquiring or who are selling. And so I think like we're going to have loads of things that we find interesting to delve into together today. And number three, because you're just a really nice guy and I love to chat to you.

Mark: Oh thank you Joanna, you're too kind.

Joanna: So why don't we kick it off? I guess the right thing to do right here is maybe for you to just begin by telling us how is it that you work with accountants? What's your background? And why do you work in accounting practice acquisitions and sales?

Mark: My start with accounting practices started quite a few years ago, when I worked in corporate banking and at the time, they developed a accounting package for accountants other professionals where they would lend money for them to acquire other practices. Though I used to work closely with accounts for many years, I found accountants it does take a while to to build that right relationship with accountants and..

Joanna: Like lawyers. I guess we're all sort of conservative industries, aren't we? It takes us a little while to build that bond and that, you know, that trusting relationship.

Mark: Yes, so my time at ANZ was probably over 25 years and so my relationships from the ANZ days of sort of carry through to my days in business sales. I've been doing business sales for about 12 years now. And I'd I just sell accounting practices, but I do have a bit of a speciality in working with accountants. I know a lot of accountants around Sydney. And yeah, I know the intricacies of selling in accounting practice.

Joanna: Brilliant. And it's an interesting I guess, accounting practices are an interesting industry within our M&A business sale and acquisition industry. Because it often is the case that there's lots of sellers and not many buyers. But in the accounting industry, it's that's almost flipped on its head, right?

Mark: Exactly. We've got a database, I can't tell you how many people we've got on our database wanting to buy accounting practices, but I get calls regularly. Every week, I get calls from people looking for accounting practices. And I get the opportunity several times a year, three, four times a year to sell accounting practices. And, you know, invariably, when we advertise accounting practices, I'll have 100 enquiries to work with. So...

Joanna: So a hundred to one?

Mark: So generally, I need a shortlist to make, you know, the the prospects, because you can't talk to 100 accountants like your bank to get a shortlist of about five or six accountants to talk to you. And look from talking to the prospective buyers, I can tell whether there's a fit or not.

Joanna: So how do you do that? So how do you come up with your shortlist?

Mark: Well, I suppose number one on the list is delving a little bit into the financial side to work out what someone situations like a financial position to actually be able to acquire accounting practices.

Joanna: Like have they worked out where the finances? Have they got themselves finance ready, is that what you mean by that? Yeah,

Mark: I mean, you can only do so much inquiry in that area, but you can get a good feel if someone is ready to buy an accounting practices and accounting practice, to what their situations like so their current situation, so we've got buyers coming from different areas. So, I mean, typically, a buyer might already have an accounting practice, and looking to acquire a bunch of fees to grow their accounting practice, it might be a partner in one of the bigger firms that's looking to go on on their own. And everyone knows, it takes time to build the client base. And, you know, if you leave a bigger firm, and go on your own, it's going to take a couple of years to get to a critical mass where where it can support the principle.

Joanna: Such a good point. And so you know, this is the avenue of getting a running start on an all by the client base.

Mark: The other the other thing is, generally accounting practices to be viable, there's got to be getting pushing up to three, four or 500,000, in fees, any less than that, and you just don't get the economies of scale, you know, to barely employ people. And generally, you know, from what I can see accountants, at that level, really get worn out with all the compliance stuff, get bogged down with the compliance, whereas if you've got a firm with 800,000 to a million in fee, you can employ people a practice manager, you know, you don't have to be all things to everyone.

Joanna: And, you know, they're more likely to have systems and processes in place that make the operation potentially easier. Okay, so that's your shortlist but are there any other things that contribute to the shortlist? So number one, you identify whether or not they are financially ready. And what what else is in that, like I presume, and I could just be guessing here, I presume that, particularly with accountants, it must be relevant to understand how much they know about the process, how educated they are, and how long they've been thinking about it. Because I think this is an example of the type of industry and certainly based on my experience of working with clients. We're making broad generalizations here. But just from a broad generalization perspective, accountants tend to take a bit longer in my experience, to go from that idea of I want to buy a practice to actually finding the right practice and then having the confidence to complete, you know, because one of the things that I see can be a bit of an issue for accountants purchasing, is if they're on their first run through so they've gone through their first target their first sort of, it's almost they need a first dry run. They can often get bogged down in the due diligence stage because they just suddenly then get a bit nervous about it all because they haven't done the learning. They haven't taken themselves through the process. Do you see that to?

Mark: A couple of good points. There is talking about that due diligence piece, due diligence doesn't need to take a long time. I've seen due diligence done in, you know, two hours. Wow, you know, on a smaller practice where someone picks up five or six files at random, just checks through the file notes, you know, worked out, you know, the quality of the files. And I've seen that done even, you know, on larger firms as well, where, you know, due diligence doesn't take a long time at all. On your point about having a dry run. Yeah, the ideal buyer for us is someone that's bought other accounting practices.

Joanna: Yeah.

Mark: They've been through it all. They know what to look for. They know what they prepared to pay. And it's funny, you know, even though there's a lot of competition for accounting practices, accountants will generally won't overpay for an accounting practice. So yeah, they know exactly what the market is. And they just won't visit parameters in which they'll pay up to. And beyond that, you know, you're just stretching it too far. So, and we know what those parameters are, we when we do a valuation on the business, we generally, this is all all types of businesses, but generally, we like to be, you know, 5% to 10% range of where we pitcher pitcher. So, you know, sometimes we stretch it a little bit, but you know, it generally settles around the price that that we have in mind. In the first instance,

Joanna: I do find that an interesting thing about this particular industry segment, that there is so much competition for accounting practices. And yet, that doesn't move the dial in terms of the price. It's not like, you know, in a large way, like it's interesting, isn't it? Fascinating. But yeah..

Mark: I mean, I've been selling practices, probably around 10 years. And, yeah, the price doesn't seem to go up. But I think if you went back 20 years, the price would have been vastly different to what they are. Because the same happened with the mortgage broking industry. Financial Planning is another annual because of all the legislation that's come in. It's changed in another way?

Joanna: Yep. Okay. All right. So so that's good. So I guess we've given some tips about the buy side. But let's talk about the sell side. At the moment. You know, let's talk about the sell side generally. And then let's have a bit of a chat about market conditions, because I'd love to do that as well. And everyone loves current up to date trend. So we've got to give a bit of that as well, Mark, let's do that. But let's start with what is it? What do you think of the classic mistakes, that sellers, make or things maybe that accounting practices, who are looking to sell, maybe don't quite realize from the beginning?

Mark: Often accountants, often accountants Don't think about the exit strategy. I mean, early enough, and I am generalizing, but I've seen quite a few cases where that's happened. They're so busy running their businesses, that it's taken a second, a second build, like, it's second priority to them. Yeah, the better firms, and I've got numerous examples of better firms, where they're have not needed me for their exit strategy. So typically, you know, they've had a junior accountant come on board, I've seen some times where they've been, you know, graduates that have joined with their senior principal, and overtime that Jr. has become part owner of the firm. And generally speaking, you know, once the older captain is ready to retire, the junior Captain will take over the practice.

Joanna: And I guess that's an example of good succession planning. But on the flip side, you know, I guess what accountants need to be careful of, is that the amount that they're limiting the value that the might get it sound number one, or limiting the, the structure of the sale, so maybe the amount of money they might get up front of whatever, by only looking at that strategy rather than going to market is that you're saying?

Mark: It depends on their motivation. So you know, if your motivation is to sell and get most of your money up front, you know, a succession planning strategy like that may not always work but it's gradual exit, and what I find is most accountants don't want to finish up on on the Friday and play golf on the Monday, they all want to, you know, be, you know, continue in some capacity helping with the firm. And it might be just being the face of the clients. That's an important point, actually, you know, for firms that do sell, you know, an orderly transition, where the outgoing owner, you know, is on, you know, a contract a couple of days a week for up to 12 months, even beyond that, if, you know, they both agree, it all helps. Because, you know, the face is still there. Yeah, you know, until you until the clients meet the new accountant once, possibly twice, and get some confidence in the the accountant that's required the firm. You know, you don't have a relationship until then. Having the the old accountant there invaluable for retention to clients.

Joanna: Yeah. And, you know, one of the things that I have seen scuttled deals in this space before is sellers, perhaps not being so tuned in to how important it is for them to ensure that their clients are going into trusted hands or hands that they trust. And in the beginning, it might seem about the dollars and how the deal is structured. But as we go along and get to that point of transition, or worst after completion, they suddenly start thinking this through, if they don't have confidence in the buyers, it can cause massive issues with the deal. So this is something that I think he's actually really important for sellers in this space to think about from the beginning, what is it that they are looking for in a buyer as well? What do you think about that, Mark?

Mark: I agree with that, Joanna. And it comes back to the original point of how we filter all these prospects. At the start, I take a position when I'm talking to people, as if I'm in the seller's shoes, and work out, can this person jump into the space of the seller, and transition their business without losing clients. And if it's not apparent, like this, there's probably some good examples would be, you know, an accountant that just simply works with I return type clients trying to buy a practice, it's got, you know, numerous clients that have turned over 15 $20 million, you know, it's not going to be easy for that accountant who hasn't had the experience in small to medium business to transition those clients, and it'll affect the the seller as well, because, you know, when you sell an accounting practices, invariably retention that's held, you know, to account for any loss of clients over one, possibly two years. And that could be up to 20. I've seen it, you know, up to 30%. So, you know, the selling the selling the seller of the accounting practice, he needs to be confident that those clients are going to transition and not leave, you know, as soon as, as soon as they they make the income of accountants.

Joanna: Yep, and it's interesting, I love like the different terminology in this space because I love how accountants in the accounting sphere, we tend to always call this a retention. Or sometimes people like to refer to it as a clawback. But ultimately, it's not a clawback it's more about a retention of the purchase price but in the rest of the world we call it an earn out because ultimately it is that so that is it's an earn out you know, if you make these metrics This is the amount that will pay into the future but I just love in the accounting world same thing but we just got retention instead love it. That's hilarious. I love in accounting terms the reference to tuck in as well like I think that's fabulous because you know, it's just once again It feels like a little bit of industry jargon where the same concepts happening in other industries but we just don't use it.

Mark: So true.

Joanna: I love it. But you can have within these m&a statements like like, you know, this little subsection of jargon that relates to only the one area but anyway, that's cool. We debunking, the jargon here today Mark are explaining what it really is. Love it. So we've talked a little bit about I think essentially, we've sort of talked about some of those benefits of using a broker, maybe you can just talk a little bit more about it. So you talked about, well, here's one way of exiting the succession planning approach. And we said, brilliant, if you can make it work, there are a few reasons why it may or may not work. And it's a really long term strategy that may or may not work. If the, you know, the staff that you're bringing on board with that succession planning mind, ultimately, don't want to, you know, it doesn't work for them, they're not the right people, the clients done like, I didn't know it, stuff like that, you know, stuff can go wrong with that approach. And it's a really long term approach. So if, if we looking at a shorter term approach for someone who's selling a practice just wants to sell,you know, 1-3 year timespan, and we saying, well, there's heaps of buyers around, why is it that they should use a broker?

Mark: So by using a broker, I suppose they're going to have exposure to, to various types of buyers, their business, yeah, like I said, before, you've got the young accountant that's coming out of a big firm, you've got the suburban practice that's got two offices wanting to expand their fee base, sometimes you'll have a city firm that, you know, once a presence out in the suburbs, or regional setup, as well. And sometimes they're not solely business reasons, there might be personal reasons for, for wanting, wanting exposure to those, those areas. So you know, having having a, having a broker also has added benefits of taking away that the emotional side, the emotional side is really important. And, look, we do have accountants coming to us that just may not be ready at the time to sell, and you can tell because they'll be pushed back. And it'll be difficult to find the right buyer for their business. And it does happen, like, you know, if someone's not ready, it will sometimes it just, it'll just mean, you know, them running it another couple years. Because it's a big decision, most of these accountants have been working in their firms for 20-30 years. And that's why I think a long transition helps not only the buyer, but it helps helps the seller emotionally as well.

Joanna: I totally agree. And, and I think just jumping in here, like I think, you know, it's probably useful for our listeners to hear that whilst as accountants, you may have dealt with clients who are buying and selling businesses. It's different when you are the client when you are the business that is selling or acquiring as well. And it can be hard to keep that emotional disconnect, you know, that the distance that's required to make good decisions and fast decisions, I think, if you don't have someone guiding you through the process, so the first thing that I would say, is, often when I deal with accountants, I feel like they think they should know everything about the process. And they should, you know, it's almost like they feel that because they have this role of trusted advisor or have dealt with their clients in sales or acquisitions before that they should, that they that it's expected that they understand the whole process, and they understand the legal side, and that they understand the process of selling. And yet it's not like, it's so different sitting on the client side, there's so many other things that are going on, than what you as an accountant have had to deal with an advise on in your accounting capacity. What's your thoughts on that mark?

Mark: Excellent point, Joanna. Look, in addition to to qualifying buyers, it's important for us to also find a match of matching personalities and matching personality between the outgoing owner and the purchaser. But not only that, then a match between the staff because they're gonna be really important in the transition. If you've got if you've got a situation where the staff are not on the same page as the incoming owner, issues will will arise at some point during the sale process.

Joanna: That's such a good point. I just have to throw in there. Like I totally agree with you. We just like it a agreeing bundle here. I feel like we need to disagree on something to prove that we ...I just totally agree with you. Um, do you know what we've seen? We've seen a number of transactions where this whole buyer selection thing probably wasn't done well enough? And do you know what I really think in both of those instances, it was because the seller didn't use a broker. And I think it's, I think it's a bit of a risk that this understanding that there's a lot of buyers out in the market. So therefore, you can go and find the buyers yourself. And you know, accountants are really tuned into the dollars, can they save some money doing it themselves. But at the end of the day, if you end up with a deal that falls through, it takes a lot of time, money in it, and your attention pulled away from the business if you get it wrong. So that's the first thing. And so for to choose the wrong buyer for it to fall over in due diligence for just to be a slow, painful process is damaging to your practice in the list. But then the second component is where I've seen issues is after completion, where a buyer has got such a different approach to running the practice to the seller, and the seller. And as we've talked about, we've often got this retention. So the seller is like really invested in making sure this works, because they've got money on the line. But they've got...it's not just ego, it's like this, this relationship with a clients and they feel that they clients are looked after, and that their staff is looked after. And if the buyer and the seller haven't either A, you know, aren't on the same page about that, because they've not had that discussion, or no one sort of match made them which I guess what a broker is like a matchmaker, buyer and seller,

Mark: You're absolutely right, by the way, our skills in matching buyer and seller. Yeah, to make sure that it works. And I think my skill is being able to identify early, even from a phone call whether this is gonna work or not. Just because someone's got access to capital, doesn't mean they're the ideal buyer. Yeah. Because you know, you could spin the wheels for six months, sometimes accounting deals, drag after 12 months before, and I've seen it before where, you know, the seller realizes it's not going to work. Hmm. So you know, my skills in finding the ideal buyer at the outset, or a capital, like, four to five is ideal. And then, you know, if they don't panic if you go to the next four or five, but you...

Joanna: know, five, and the idea, like for perfect matches from a large pool that's been brought down to the right buyer for your practice.

Mark: Perfect. Yeah. And that's, that's in just asking the right questions. Yeah. Being able to, you know, what's your background? Yeah. What are the sort of clients you work with? Those sort of questions, like just delving a little bit into their, their background. And, you know, within minutes, you know, whether it's, you know, an ideal fit or, or, you know, it's just not gonna work.

Joanna: Yep. Brilliant, absolutely love it. And, and actually, I'd like to come back a little bit as well, just like, let's just really quickly touch on, what are the differences between selling an accounting practice versus selling, you know, other sorts of businesses? Where are the what are the main differences? Do you think so? So one, we've talked about the importance of matchmaking, the buyer and seller together? And, look, I think that's relevant across industries, but it's particularly so in accounting, because of this trusted advisor relationship between the accountants and their clients. So I think that's why it's whilst it's relevant across all industries, particularly relevant in this industry, but so whilst it's not different, it's just a little bit more intensified in this industry. But what other things do you think, you know, a different? I've got one actually, I know one, there's a high level of in accounting practices. ownership of the property as well, I don't know if that's something that you've seen. But we see that a lot that accountants quite often own the premises. And there are other industries where that similar as well, but accounting is one of those particularly industries where there'll be a high level of ownership of the actual premises.

Mark: True and I always tell I was told actually, not generally with accountants. Certainly not to off shelf in a situation where, you know, someone's got to take the property. Or someone's got to move their accounting practice to your property. Because then you're sort of, you're limiting the type of buyer that that is possibly out there, they could buy your practice. Yep. And generally, you know, the office space where an accountant operates from, can easily be sold or leased to another party. Yeah, so it shouldn't be the be all or end all.

Joanna: Perfect. That's critical. You know, don't assume you have to find, you know, maybe it's the accountants think this is a category of buy that they're looking for saying, Hey, you know, maybe you're looking at the wrong things in your buyers. So be careful.

Mark: When everyone comes with different circumstances. So, you know, you might have an accountant, it's got a big office, it's got surplus space, I'm in a bit of location. So, you know, you don't want to stop that person possibly buying your practice. It's similar to selling a business, where you own the factory, and you say, to a buyer, I'll only sell it to you, if you sign a five by five lease on the factory. You know, it might suit the buyer to move the business to another location might be more efficient for them, or they might already have a infrastructure in another building that cannot accommodate it is the sun, you know, by tying that, you know, the value of the property with the accounting practice? I just, I think it's limiting. And that's the case with most businesses, you know, keep them separate because it gives you more options.

Joanna: Yep. Okay, sowe've talked about premises being bit different with accounting practices from business sales in other industries, we've talked about, you know, the critical importance of matching the buyer and the seller. And so what else is different in this, in this sub industry?

Mark: In some ways, go in it, you know, selling it? Like the common question I get asked, Have you ever sold a business like this before? And, you know, there's 1000s of different types of businesses. And I've got a list of businesses that, only have sold once, you know, they are niche type businesses, and in some ways accounting practices are very much similar to any other business.

Joanna: Yeah, I look, I agree, but I think there's nuances that relate to that can cause roadblocks in accounting, practice acquisitions, that, you know, are a little bit more exacerbated than in other industries. And and I think it comes back to, you know, the conservative nature, often of accountants, firstly, and the importance of having a deal team that helping give them the confidence that, you know, they've found the right seller, and that the warranties and indemnities, for example, are okay, you know, and that they normal in this situation, and this is how they dealt with, you know, from a commercial perspective. I think that's one thing. I think that trusted relationship with their broker and our accountant, the deal team is particularly important in this space to help keep things moving. But you know, I also think, you know, because the main elements of value in an accounting practice are really generally two things. Generally, they're the client base, and they're the staff and they may not always be the staff, sometimes they are, sometimes they aren't, but they're generally the two sort of areas of value. And I feel like in this industry, that's where the focus, you know, often needs to be just to making sure that everyone's comfortable that that value is transferring.

Mark: I agree with that Joanna. Probably one of the things that strikes me is that typically, accountants , the owner of a firm would have a one on one relationship with most of their clients. And you know, you're trying to transfer that to another person. Yes, it's tough to have a relationship but generally secondary and more operational. You've got people in the back room doing the accounts. And that, you know, on the day to day stuff, they're talking to the clients, but anything of strategic value, it's always generally a one on one with the the owner of the firm and so you know, there's a there's a whole lot of trust built around, you know, transferring this knowledge from the The outgoing owner to the incoming owner. And then that's where it's, again, so important to find, to find a match and find a trusted level between buyer and seller. And you know that sometimes it takes more than one meeting for that to happen as well.

Joanna: Oh, absolutely. I completely agree. And because this whole retention element, which is another thing that I think is, it's not unique to the industry, it's just that it happens in a very large number of transactions in the accounting industry almost in the same way. Like, there's almost a formula isn't a, you know, that is not the same formula that supplied, you know, to other industries, generally the same sort of almost absolute way. But because, generally, there'll be some sort of deferred payment, you know, retention, whatever we're calling it. And there's, there's going to be an ongoing relationship for a period of time. And I think one of the important things, I think, right from the beginning, is to make sure that the buyer and seller are aligned in relation to what's going to happen on transition with the staff and with the clients, the communication, but also how long it's going to be before the buyer makes changes, because buyers come in wanting to make changes quickly, because they're enthusiastic, and they think they've got a better way of doing it. But I just think that's what can really trigger problems when you're in this post completion phase.

Mark: Look, it comes down to even the name of the practice, like in my suggestion to an incoming owners keep the same name, possibly six months after, incorporate the name somehow, and have, you know, ABC part of the CDA group, something to that effect. And then, you know, in 18 months, two years, when I think, you know, once there's a relationship with between the client and the accountant, and that I would give it 12 months, 18 months before you, you fully change your name and the signage and, and fully incorporate into the new firm. That's my suggestion. And I've seen that happen, it generally works really well that way. You know, having the having the selling accountant on the premises a couple of days a week, still being the front to the clients. Yeah. The friendly face of the firm, it helps, and you never know, sometimes they can, you know, can continue for years, you know, on a part time basis, or consultancy basis to, you know, because it suits both. I mean, that's the ideal scenario, because I think, generally accountants want want to continue in some capacity. And not just, you know, I mean, you can play golf, but, you know, five days a week, you know, it's hard before, but it's a bit of a void when you've been working so hard all your life.

Joanna: Be aware of that from the outset, I guess, was the point, yeah.

Mark: Yeah.

Joanna: Well, that's it for our first part of our two-part series, all about buying and selling accounting practices. Now, just a reminder, don't forget to tune in next week to the next episode, where we talk about current market conditions before and during COVID. And the impact and valuation of having business clients versus individual clients, or indeed the quality of the clients. We talk about committing to the process, and we give some tips and final takeaways, and that will be in part two of this two part series. But of course, you've just finished part one of the two-part series. So if you were interested in finding out more about this topic that we spoke about today, firstly, you can contact Mark Attard at Xcllusive Business Sales by heading over to our website at www.thedealroompodcast.com or check out the show notes will link straight through to Mark Attard and of course we also on our website, have a way for you to contact our lawyers at Aspect Legal if you are interested or your clients are interested in discussing any legal aspects of sales or acquisitions of accounting practices. We've got a number of great services to assist accounting practices and we deal with a lot of businesses in this area. And finally, if you enjoyed what you heard today, then please pop over to iTunes and leave us a review. Well that's it for today. Don't forget to tune in next week to part two of this two part series but for today, thanks again for listening in. You've been listening to Joanna Oakey and The Deal Room podcast, a podcast proudly brought to you by our commercial legal practice Aspect Legal See you next time.