NAB Professional Services

# The Accounting M&A Report 2022

Planning a Successful Merger and Acquisition for your Accounting Firm

# Contents

# Introduction

As we deal with the ongoing disruption of the past few years, accountants, like everyone else, are looking to the future. Opportunity abounds for those firms that get their strategy right, as businesses continue to rely on their accountants as trusted advisers. At the same time, the democratisation of technology means that smaller firms increasingly punch above their weight.

Against this backdrop, low interest rates make financing possible on relatively attractive terms. So it's hardly surprising that, as our survey outlined here uncovers, nearly one third of accounting firms are planning to grow by acquisition. The benefits of a well-considered merger and acquisition program are many – from helping to grow a business and capturing new markets to closing portfolio gaps and facilitating digital transformation. However, it's vital to align any M&A strategy with an organisation's broader business goals.

Sometimes, a successful acquisition is not just about offering the highest price, but about being the party that is easiest to deal with and most prepared. With the best selling firms likely to have multiple interested parties, it's imperative that buying firms have a strong strategy, internal buy-in and confirmed financing before entering a sale process.

**1 in 3**

Firms planning to grow by acquisition

Source: NAB Accounting Survey 2022

For accounting firms looking to get a head start, familiarity with the core elements of a successful merger, acquisition or sale is essential – from setting strategy and finding a target buyer through to conducting due diligence and negotiating terms.

To help with this process, NAB surveyed 86 Australian accounting firms with revenues of between $500,000 and $20 million in February 2022. The survey included 18 questions designed to gauge whether they were intending to buy or sell another company, and what they looked for in an acquisition.

The survey results have been combined with NAB's own knowledge and market observations to produce this paper – an informative and useful resource for accounting firms around Australia.

# NAB Accounting Survey 2022: Overview

**Survey type:**
18 questions, quantitative and qualitative

**Survey sample:**
86 accounting firms around Australia

**Revenue:**
From $500,000 to $20 million

**Survey date:**
February 2022

# 01

# A seller's market

The high-level survey results show that we can expect a very active M&A market in accounting over the next two years, in which buyers looking to build scale compete for a smaller number of sellers.

Nearly half (44 per cent) of the firms surveyed were looking to either buy or sell in the next two years. However, buyers far outnumbered sellers, with 29 per cent looking to buy compared to just 15 per cent looking to sell (and only six per cent having a strategy to both buy and sell). This means there are almost twice (1.9 times) as many buyers as sellers.

## Twice as many buyers as sellers


Source: NAB Accounting Survey 2022

This shortfall of sellers will lead to a highly competitive market for buyers. Planning is therefore critical – not just in ensuring that a firm does not overpay, but so that it can move quickly, confidently and competitively when the right opportunity presents itself.

“In this market, you may find yourself in a situation where there are, say, 40 bidders asked to make an initial inquiry and, of those, only five are invited into the due diligence stage,” says Adam Holster, NAB Professional Services Banking Executive. “Before you pick up the phone, it really is important to make sure you have a strong case for what you can bring to the table.

“As a firm, having a clear strategy around growth, either acquisitive or organic, is an important step in achieving the desired outcomes.”

If a firm is not solid enough on its direction and growth plans to be sure whether it is interested in buying or selling, this indicates a lack of strategy and also a potential opportunity cost for the business.

“Guiding principles are important,” Holster says. “You want to have a vision for where you want to be in five years, and then know the steps you need to take to get there.”

He adds that having those guiding principles in place will help steer direction when the right time is to buy, or even sell.

“While it’s true that accountants are working longer in their careers, there will come a point where the owners want to exit,” he says.

Further on, we’ll look at how to put together a strategy around making an acquisition, and a plan for execution of pricing, timing and terms.

**A boost for valuations**

This uptick in buyer activity is likely to sustain strong valuations of accounting fees into the future. However, potentially paying more is not necessarily something that should concern firms looking at an M&A, especially if they have a solid strategy and therefore understand what they value in a target.

Every potential acquisition will mean something different to each firm; what might be considered overpaying for one will represent a good price for another – for example, if the target firm operates in a sector or offers a service that is a key growth area for the buyer.

“In a market where there are double the number of buyers than sellers, there is likely to be upward pressure on valuation, meaning buyers may need to pay more for their purchase,” Holster says.

**Regional firms benefit from tech**

Another factor to keep in mind when planning for M&A is the increasing demand for regional firms. The current ratio of buyers to sellers is 2.5 in regional areas, compared to 1.8 buyers for every seller in metro areas. This reflects the impacts of technology becoming increasingly inexpensive and widely adopted, allowing regional firms to compete with bigger firms, but with lower occupancy (rent) costs and salaries.

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## Regions a hotbed for buyers

**Ratio of buyers to sellers**


Source: NAB Accounting Survey 2022

With the availability of technologies like sophisticated customer interfaces, regional firms are no longer limited by geography when it comes to attracting clients. A CPA Australia report titled ‘My Firm, My Future’ also found that offshoring and technological trends such as AI have made lower-level services easier and more efficient to deliver, so that instead of large numbers of staff carrying out low-value tasks like data entry, smaller numbers of staff can deliver higher-value advisory work.

This makes an accountant’s work more interesting and, in turn, makes it easier for firms that have the latest technology to attract staff – especially with many city-dwellers seeking a sea or tree change. Regional firms can also leverage remote working to attract staff, with a Business Fitness survey of 186 practices finding that 63 per cent of firms are already combining at-home and in-office working.

“Regional firms are definitely attractive acquisitions in their own right,” Holster says.

**Smaller firms are ripe for M&A**

For acquisitive firms looking for the perfect target, the smaller end of the market is fertile hunting ground given the fragmentation of the industry. An IBIS World report titled ‘Accounting Services in Australia’ found that the Big 4 accounting firms have just 20 per cent market share.

This was reflected in the NAB survey, which found that most respondents looking to sell had revenue of less than $1.5 million (38 per cent of respondents) or revenue of between $1.5 million and $4 million (46 per cent), while just seven per cent of firms with revenue of more than $10 million were looking to sell. These smaller firms looking to sell tended to be those that had grown organically and had not made an acquisition in the past two years.

“The market is very weighted towards smaller players, and from what we see many do not have a succession plan in place. It’s clear why so many sellers are at that end of the market,” Holster says.

On the other hand, the biggest group of firms looking to buy are those that are the largest – the ones that have revenue over $4 million. And of those firms looking to buy, many are experienced in M&A – 50 per cent have made a transaction in the past two years.

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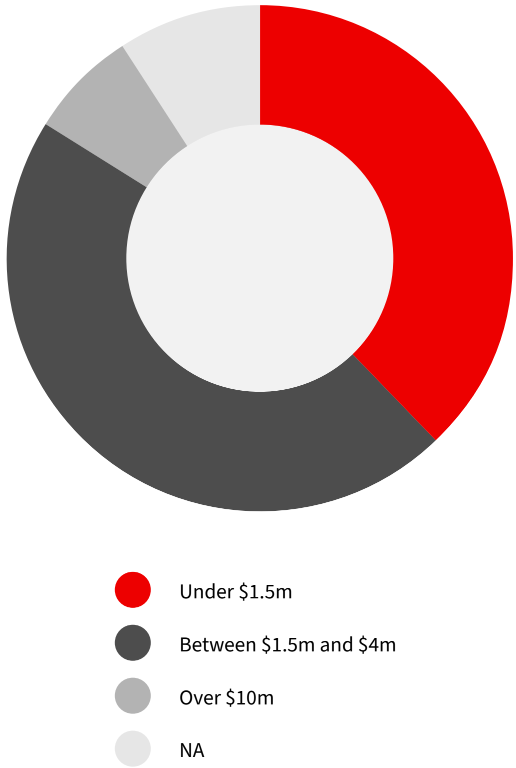
## Smaller firms hungriest to sell

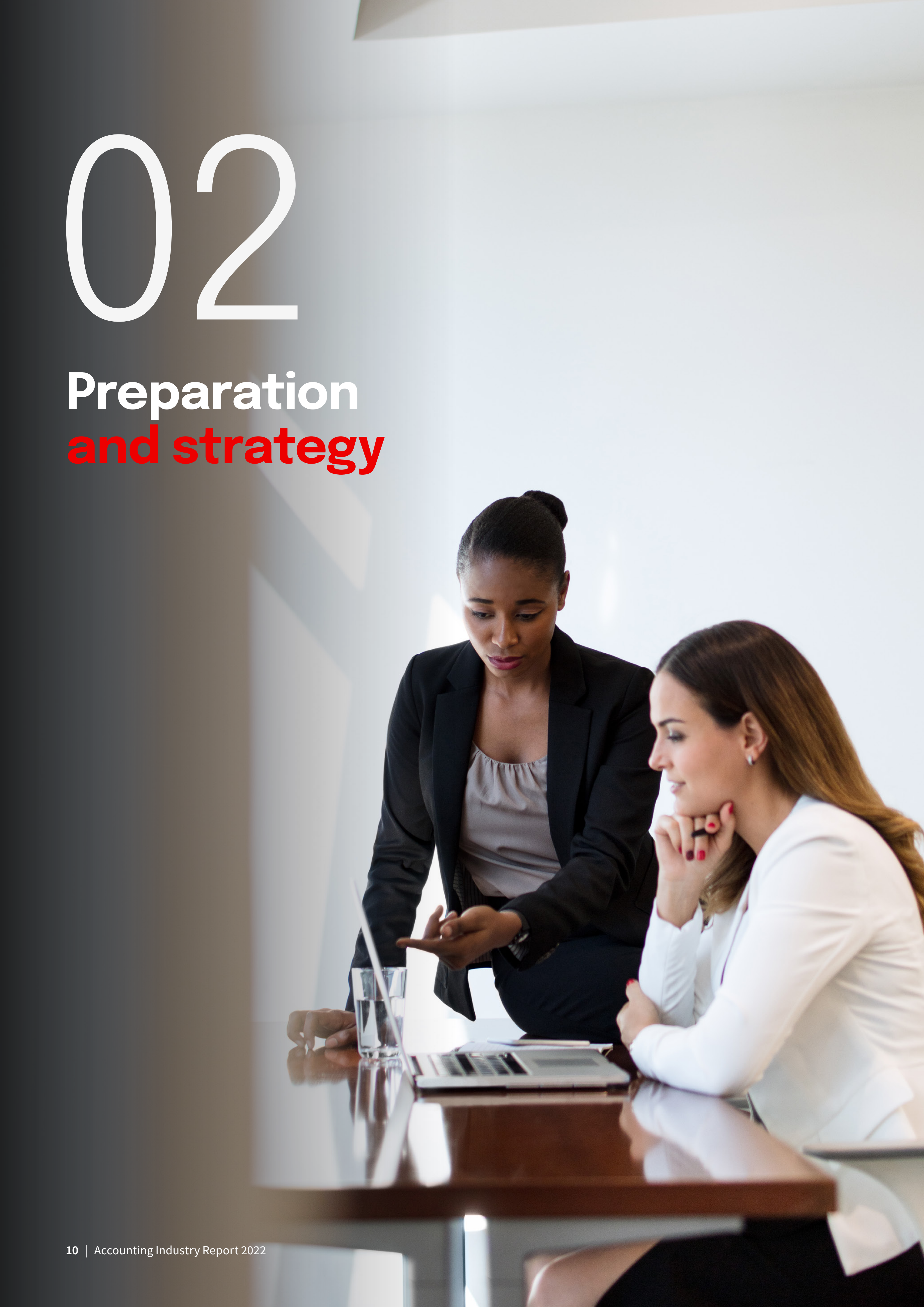
**Size of revenue of firms looking to sell**




Source: NAB Accounting Survey 2022

# 02

# Preparation and strategy



## With informed preparation an essential part of any M&A transaction, let's take a deeper look at tackling the core elements of this preparation.

Having an overarching plan that is underpinned by clear objectives, strategy and tactics is fundamental to successful M&As – because it helps take the grey out of decision-making.

"We say have a one-, a three- and a five-year plan so you all know what your strategy is, such as what lines of the business you want to grow," Holster says. "As well as basics like having a clear ownership structure and an idea of how you value the firm.

"Acquisition just to grow for the sake of it without really understanding the purpose is not likely to result in a successful outcome."

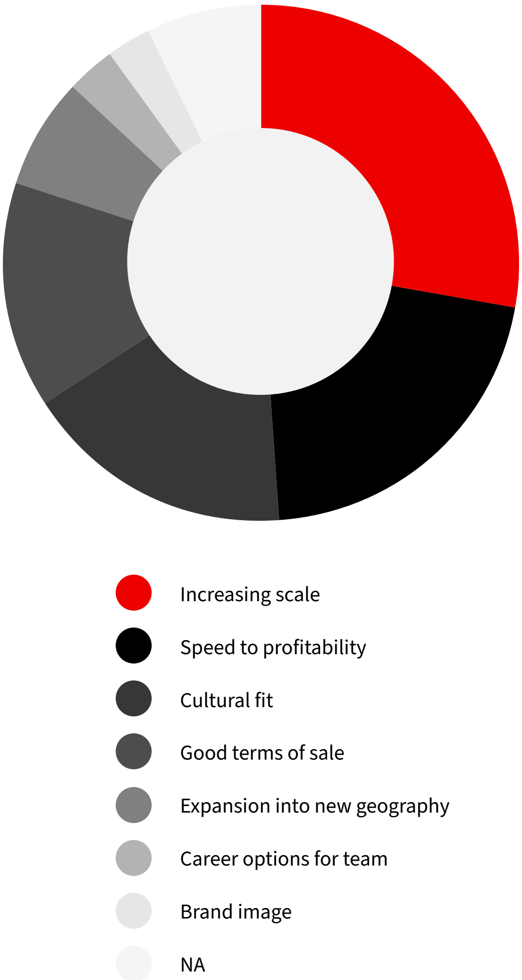
At this stage, it's worth bringing in external support and seeking help from someone like a business coach or adviser. They can help you work out whether the cost-benefits of a merger or acquisition will work for your firm. And if selling is a possibility, this helps to guide the process of completing a valuation.

When we look at the survey results to dig deeper into the drivers and methods of value when assessing a transaction, we can see a variety of strategic reasons for undertaking M&A, topped by increasing scale, speed to profitability and cultural fit.

Notice that many of these motivations stem back to the core intentions of the business. As such, it's imperative to make sure any M&A plans link back to core questions on the firm's operations and plans, such as:

- How big do we want to grow?
- Do we want to expand our geographic reach?
- What kinds of clients do we want to target with our growth – a specific sector, service or industry?
- What complementary products and services could we offer?
- Could we benefit from additional expertise?
- When do the existing partners want to retire? What is our succession plan?
- How can we motivate our best senior people?

## Key M&A drivers




Source: NAB Accounting Survey 2022

**Stakeholder buy-in**
Once your strategy is decided, it's important to get internal buy-in from all stakeholders, especially partners. Of course, the stronger the mutually agreed strategy, the more likely it is that all partners will stand behind a transaction.

Factors to consider here include what kind of partner approval is needed for a transaction to go ahead, as well as making sure everyone is happy and comfortable.

"While we technically only need a simple majority of the partners to vote yes, we like to have agreement from everyone – because it's important for our working relationship that we are all aligned," says Eugene Smarrelli from Banks Group, a firm of accountants, auditors and advisers.

At Banks Group, each division presents an annual business plan, and part of that is how and where they intend to grow. At that point, they make it clear and communicate what type of M&A they might be interested in pursuing.

As important as it is to have partner buy-in before any major transaction, it can also be useful to be open and able to move quickly, particularly on smaller, opportunistic acquisitions. For example, if one partner hears about a portfolio for sale that fits with the firm's strategy, then waiting for all partners to have a formal vote may risk them missing out on a seat at the table. In these cases, that base alignment on strategy comes into play – because if an acquisition is an obvious fit, it will be easier to get partners to agree further down the line.

# What if you receive an offer to sell?

For firms looking to sell, preparing for a potential sale is, of course, essential.

However, firms more focused on acquisition and not actively considering a sale may receive unsolicited offers in this competitive environment – even if it's just a friendly tap on the shoulder to enquire as to whether they are interested. This kind of situation can pose an issue if a firm is not fully prepared and hasn't reached internal agreement on important issues such as succession and exit planning.

"Sometimes, these kinds of situations can arise at a time when you haven't necessarily thought about where the business is going to be in five years' time," Holster explains. "You can therefore struggle to decide what is the right thing to do."

In any case, having in place those core elements – a solid succession plan, a defined growth strategy, a strong business valuation and partners in alliance – will make the process easier, as will having conversations about what the firm would do if approached to sell.

# 03

# Evaluation and negotiation

While valuation is, of course, an important consideration, it is also essential to get right cultural fit and good terms.

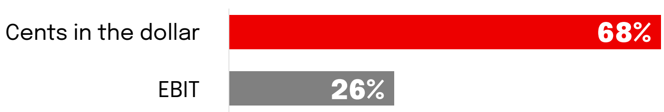
After setting a strategy and plan, the next stage is knowing how to evaluate potential targets and negotiate attractive terms. There's a lot to look at when deciding whether a merger or acquisition is the right fit – not just price, but cultural fit, distribution of client revenue and terms of sale.

**Unpacking valuation**

Our survey looked at the two main valuation methods being used in the market today: the longstanding method of cents in the dollar (a simple multiple of revenue) and earnings before interest and tax (EBIT).

The latter is growing in popularity among larger businesses, although our survey showed that the former method remains well ahead as the method for valuing fees, with 68 per cent of firms using cents in the dollar and 26 per cent using EBIT.

## Most common methods of valuation




Source: NAB Accounting Survey 2022

While cents in the dollar is easier to understand, it has limitations due to its sole focus on revenue. EBIT is more focused on how earnings are generated from operations, which can provide greater clarity on areas like quality of clients and how expensive they are to service, not just the overall revenue they bring in. However, the most important point is for firms to be aware of this limitation and ensure they are prepared to adjust their valuation if new information comes to light.

"Cents in the dollar can go up and go down," Holster says. "For example, concentration risk to a specific client will knock value down. Or if you're buying a portfolio and they've got clients all around the country, that's a pretty expensive operating model."

He believes valuation will eventually move towards a method based on customer lifetime value: the current value of the lifetime future revenue a client is expected to generate. There's also room to generate additional value from an acquisition here – for example, buying a company then taking a section of its client base that has only ever had tax returns done and offering them additional advisory services.

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**Assessing cultural fit**
When assessing a merger, it's important that firms looking to buy never underestimate the importance of a strong cultural fit – both for themselves and for the firm they are buying. In fact, in regional locations, survey respondents rated this as more important than a strong sale price (respondents in metro locations rated the two considerations equally).

## Regional firms value cultural fit over price

**How firms looking to buy rank consideration factors**

| | Cultural fit | Price |
|---|---|---|
| Regional | #1 | |
| Metro | #1 | #1 |

Source: NAB Accounting Survey 2022

The survey asked firms that had chosen 'good terms of sale' as a critical factor when assessing a transaction to break this down further. Of metro firms who chose good terms of sale, they frequently also ranked 'cultural fit' in the top three factors. For regional firms who chose good terms of sale, cultural fit was ranked first.

Meanwhile, in a market where there is a shortfall of sellers, it is also important that they are as comfortable as the buyer. For a buyer, this means they should make every effort to understand the seller's motivations – being mindful of slight variations in motivations between regional and metro firm owners.

The owner of a business will likely find the sale process an emotional one and want to make sure it's right for their staff and clients.

"In a lot of cases we are talking about selling their life's work," Holster says. "They're selling long-held relationships with clients as well, so they want to make sure they are providing a great experience for their clients.

"Also, in many cases they've recruited junior staff who have now become their senior staff and they want to make sure that they're really well looked after and engaged in their new workplace as well."

There's no set method to assessing cultural fit, but it can be as simple as walking around the building, meeting senior staff and getting a feel for how things are run.

"There's not anything especially technical about this – it's mostly a gut feeling," Holster says. "It needs to feel right for the buyer, and just as crucially for the seller as well."

Be aware also that culture is difficult to change, so no buyer should evaluate a transaction on the basis of what the firm could be if culture was improved.

**Due diligence is essential for both sides**
Firms must conduct thorough due diligence of the business to ensure that everything is in order. Firstly, this entails a close examination of the books to check that the company is doing what it says it is.

However, it goes much further than that, and should extend to any areas that could potentially make the transaction riskier or affect the valuation – for example, if the firm to be acquired has too much exposure to one or two clients, or the client base is overly weighted towards lower-value clients or newer clients that haven't yet established loyalty. Geographical exposure is another consideration – if the firm has a lot of clients around the country then that's going to be a more expensive model if they are used to being serviced in person.

Uncovering matters such as these might not be reason to walk away from a deal, but it might call for a re-examination of the initial valuation.

Red flags for buyers during due diligence checks include lack of preparedness or inability to produce information when requested.

"We say that the first 10 questions you ask should be answered easily," Holster says. "If information is not readily available and

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**Face-to-face still matters**
Our survey showed a preference for in-person due diligence, in particular meeting face-to-face with the seller and their senior staff. In fact, 80 per cent of survey respondents indicated that they would not proceed with a sale without this.

"That in-person meeting is still very important, despite all the technology we have available. That's how they assess those intangible qualities," Holster says.

For both buyers and sellers, it's also worth noting that this in-person preference will impact how due diligence runs, and ultimately shape the sale process. Firms should therefore note where the most willing buyers and sellers are located when identifying targets, as well as their ability to physically travel to the place where a firm they might buy is located.

Breaking down the survey result by state, respondents in Victoria were the most likely to buy, followed by Queensland and NSW across metro and regional areas. This means that buyers in Victoria are likely to face the most price pressure, and that those determined to sell are in a stronger position to have their terms of sale met.

# Sellers must be ready for due diligence too

For sellers, being thoroughly prepared for due diligence is vital to a successful outcome. This means anticipating what questions the buyer is likely to ask and having supporting information prepared and readily available. Also useful is outlining a process for buyers to follow, as this will give them certainty and improve trust. This includes timelines and set periods for opening and closing the books.

“Being prepared for due diligence not only leads to a faster sale, it allows the sellers to call the shots and put buyers more on their terms,” Holster explains.

**Terms: a complex equation**
Another key element of implementation is agreeing terms acceptable to both parties. When negotiating these, it's again important to remember that it is not just about price.

For example, from a seller's perspective, the highest offer may not always be the best if it comes with riskier terms, such as delayed payment. In that case, a slightly lower offer that will pay immediately might be worth evaluating.

For a buyer, it's particularly important to secure the right terms in areas like retention clauses for clients and, in some cases, key staff. Also, if a firm is looking to buy as part of a growth strategy, it can be beneficial to note that a full sale is not the only option. Increasingly, firms are looking at taking a 30 to 40 per cent stake in a business and becoming an external operational partner – the target firm keeps running with the existing partners but the buyers receive a share of profits.

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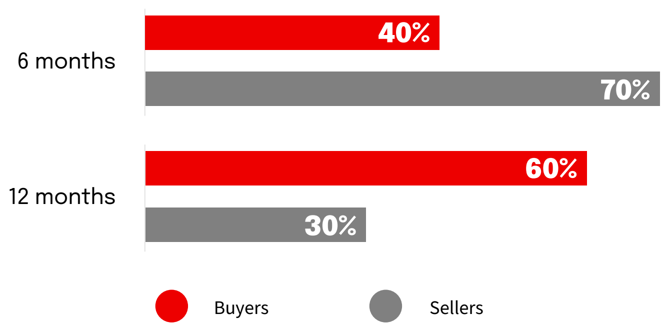
**Timing: a misalignment**
Our survey showed a significant mismatch between buyer and seller expectations around timing.

For example, 70 per cent of sellers expected a transaction would take six months, but only 40 per cent of buyers agreed. In comparison, 60 per cent of buyers expected it to take 12 months, compared to just 30 per cent of sellers.

## The great timing expectation mismatch

**Differences in how sellers and buyers see M&A timings**




Source: NAB Accounting Survey 2022

"Buyers and sellers are simply not on the same page," Holster says. "While the seller wants it wrapped up quickly, most buyers do not anticipate this happening."

Aligning on timeframes up front can be a great way to have a smooth sales process, but doing so takes effort from both sides. Firstly, the seller must be realistic about how much time a transaction will take. In turn, the buyer must be prepared, not only moving quickly on the assessment and evaluation stages, but having finance arranged and ready to go.

"There's nothing worse than a deal falling over because financing falls through," Holster says. "Often when it does happen, it happens after a firm has already spent time meeting with senior staff, doing the due diligence and all the rest. And then financing isn't approved in time, so it goes to someone else."

**Preparing for financing**
When organising financing, the sooner a buyer can talk to their bank, the better. And when they have that conversation, the more concrete information they can provide around the rationale for the transaction, the stronger their position.

"When talking about being ready to move on financing, I can't stress enough that the earlier we're engaged, the better," Holster says. "And the clearer that clients are on strategy – the ones that have a viable proposition for a merger and really know what they want – the better terms they can secure."

For example, Eugene Smarrelli from Banks Group finds that with financing relatively affordable due to historically low interest rates, it's useful to always have a financing facility ready and waiting to go.

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Keep in mind that there are many ways to finance a transaction other than just a straightforward loan. It's worth investigating that with a banker well in advance.

# Conclusion

For accounting firms, opportunities to buy and sell are there for the taking – for those that are prepared.

Despite a competitive sellers' market, the cost of debt financing still makes growth acquisitions attractive. And with the right rationale and terms, an acquisition can potentially become profitable to the buyer quite quickly.

In conditions where almost half of firms are interested in M&A, and buyers outnumber sellers almost two to one, firms serious about buying must look closely at all aspects of a sale – from strategy and planning to timing, terms and financing.

If they don't, those opportunities might drift on by, or result in merger terms not negotiated to their full advantage.

"Mergers and acquisitions are a method of growth that should at least be considered as part of strategy planning, while a sale is a key consideration for exit strategies and succession plans," Holster says. "Therefore, all firms should be at least looking at acquisitions as part of their business planning.

"We cannot stress enough how important it is to line everything up – from the paperwork through to the financing – because the most common reflections we hear from customers post-M&A are 'It took longer than I thought' and 'I wasn't as prepared as I could have been'.

"When people have taken the time, however, that's when the process goes most smoothly.

"When people have taken the time, however, that's when the process goes most smoothly. So regardless of whether you're thinking of buying or selling this year or in the future, reach out to your advisers now, for advice and guidance. Start the conversations."

## M&A preparation checklist

- ☑ Vision agreed
- ☑ Objectives mapped
- ☑ Strategy in place
- ☑ Stakeholders on board
- ☑ Legal and financial advisers engaged

To find out more, talk to your dedicated Professional Services Banker or visit **nab.com.au/accounting**

## Important Information