Case Study Number 4: A Large Local/Regional CPA Firm Seeking to Merge Upstream for Professional and Financial Growth

We started the process by requesting information from the merger candidate that described the practice and the firm's background in sufficient detail for prospective larger regional and national firms to make a preliminary evaluation of interest. We also helped the merger candidate define the firm and partners' personal, professional and financial goals. 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 merger candidate was that their firm was not seeking retirement but growth. They felt they "had hit the wall" and could not grow anymore and be as competitive in their marketplace without being in a larger practice environment.

The Merged-in Firm

This firm was generating $16,000,000, 13 partners, 4 of which were non-equity, a separate valuation division that generated $1 M of fees. They felt the need to have deeper expertise in order to retain and expand services for some of their specialized clients, more back up and support and long term transition for some of the senior partners. They had several significant prospective clients they believed were ready to engage them but were competing with national firms who clearly had more services to offer these prospects. They were somewhat concerned about their ability to continue to attract and retain quality clients without a higher profile.

The Successor Firm

The successor firm is a large regional firm which at the time was generating over $100,000,000 in annual revenues. The firm is diversified and offers a variety of high value consulting services. The firm had additional space capacity and would have no trouble providing the necessary staff to support the combined firm and future growth. Although the firm had a presence in the merged-in firm's market, they felt the merger would strengthen their position in the market through adding the merged-in firms' volume and substantial referral network. In addition, their local valuation team would be substantially strengthened allowing them to expand their litigation support practice locally.

Negotiation Process

After initially meeting several firms of varying sizes ranging from $27,000,000 to $300,000,000 +, the merging firm narrowed the field to the above firm we introduced them to. We assisted in drafting a proposal laying out the parameters for a merger. Several additional meetings were held and a verbal agreement was reached. We then assisted in the preparation of a letter of intent, and with our guidance, due diligence lists were exchanged and field reviews were performed by the parties. The successor firm drafted merger contracts and we worked with both firms to develop an integration and transition plan to retain the clients and staff. The time from introduction to closing was approximately 4 months.

Deal Terms

Under the merger agreement, the merged-in partners were initially kept whole in earnings compared to what they were making in the recent past. This was based on them keeping their existing client list intact and maintaining their time commitment to the practice. This removed one of the firm's primary concerns, the risk that their contributions would not be adequately recognized in their compensation by the successor firm. It was an easy commitment for the successor firm to make because the deal resulted in some cost savings and much larger presence in a market they had targeted for substantial growth potential. The merging firm's partners were provided equity in the firm based on a formula that combined the realization rates, billing rates, profitability, volume and some subjective terms. In addition to their normal compensation, the merged firm's partners were entitled to participate in firm profits. The allocation of profits would be determined based on the compensation methodology of the successor firm which considered level of client-managed billings, partner productivity, local office profits, new business development, and a subjective performance evaluation.

Benefits to Both Parties

The successor firm added partners, staff and additional clients (with the attendant revenues) and a stronger foothold in a growing marketplace. The transition was very smooth. This created many synergies that provided additional profit margin from the outset. The successor firm's larger platform of services has created many cross selling opportunities for the merged in firm and assisted them in attracting many new clients. The merged-in firm now has the resources to grow their portion of the practice and earnings. They have protection for the value of the firm in the event of a health issue or worse of key partners. The younger partners became part of the succeeding firm's long-term succession team which provides them a better professional future and financial opportunity.

Results Thus Far

This deal is in its third year. Because of the detailed transition plan that we worked out prior to closing, over 95% of the original clients and staff have been retained while the merged in firms revenues have actually gone up by almost 15%. The volume from the merged-in practitioner's original clients is expected to continue to increase based on additional services being rendered. Every partner is anticipating increased earnings compared to before the merger.

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