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The New Consolidators?

Observations on accountancy structures, capital and consolidation.

AGN Global Business Voice
Practice Management
June 2022

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Business Alert: The New Consolidators? Observations on accountancy structures, capital and consolidation.

Is consolidation different this time around?

The one thing that pretty much all senior partners of accountancy firms can agree on–across the world – is that they are facing a recruitment challenge, that there is a dearth of high-quality accountancy professionals, and the impacts of technology are ever increasing. Talent and technology challenges are key issues but not the only factors that have been driving the current trends of accountancy sector consolidation. In this article, AGN GBV digs deeper into factors driving market consolidation and 'external' equity injections.

In the US, a new top 10 firm has emerged; the FORVIS brand has been launched as a result of the merger of BKD and Dixon Hughes Goodman. In addition, New York-based IPA 100 firm Marcum LLP ($689.1 million) is merging with Friedman LLP ($144.7 million) - the combined business operating under the Marcum brand.

In the UK, we've witnessed Azets (formerly Cogital), expand through the acquisition of a range of medium-sized firms cross-border to become a GBP500m ($650m) top 10 player. Internationally, we've seen the accountancy networks hoover up key firms in a range of major markets. Nexia International have entered the list of top 10 global networks with its bold ambition to be 'top 10' in all major commercial centres.

There are many others active around the world; for example ETL in Germany, The Kelly Group in Australia etc.

Haven't we seen it all before?

In the 1980's globalisation of major public companies drove international players to consolidate in order to match the scale of their clients. In 1989 the "Big 8" became the "Big 6", then 5 with the merger of Price Waterhouse and Coopers & Lybrand in 1998, and latterly 4 on the demise of Arthur Anderson in 2002. A consolidation largely driven by market forces.

However, in the UK in 1999, a different funding model for accountancy firm consolidation emerged. Tenon was born with a listing on the Alternative Investment Market – raising £50m. Tenon quickly acquired some 16 firms around the UK. It was followed by Numerica in 2001, and Vantis in 2002, both AIM listed and both acquired a range of regional firms.

But unexpectedly, in December 2000, Tenon issued what was effectively a profit warning and from this point on, the dream of scale to match the Big 6 began to fade for both firms. They staggered on – with Tenon merging with RSM in 2009 – eventually collapsing in 2013, Numerica being bought by Vantis (another consolidator) which in 2010 ceased trading.

The primary reasons for failure were said to be; difficulties in accessing capital to fund acquisitions, poor share price performance and poor transparency to the market about how such businesses operated and were run effectively.

What's driving the consolidation this time?

Noticeable consolidation in the accounting sector has been back since 2017 – but the main protagonists are keen to distance their approach from what went before. There are a range of 'drivers' for their strategies – some new:

Functionality and price of technology

a) Developments in technology mean that it has become easier than ever for multiple firms to operate common and remote client service systems (audit, book keeping, tax reporting etc), and accounting and practice management systems – thereby lowering costs and improving efficiencies. This is of particular relevance to compliance-focused firms, where processes lend themselves to automation. A straight efficiency play.

b) The price point and accessibility of the tech has opened up a new market opportunity: e.g., it's now economical and practical to aggregate smaller regional firms into a larger group. The acquired firms often keeping their local physical presence, sometimes their brand – but with other operational back-office systems centralised in one location.

GBV has interviewed a privately-owned Australian consolidator, who tangentially to their own accounting practice, has developed an accountancy software business. Their strategy is to accumulate and integrate small, one or two partner rural accountancy practices using their own technology. It specifically offers a route out to retiring partners - but is accumulating some larger than expected agricultural clients. This integrator is not even fussed about brand. Sometimes local loyalty is very strong and business names and legacy are important. Ironically it is in itself an exit strategy for the original business....ie short to medium term accumulation of revenue and value in order to sell.

Talent and demographics

Talent is in short supply in the accounting profession; therefore, firms are increasingly using mergers to add talent for growth and creating an internal succession team for the long-term security of both the successor and the acquired firm. Some 'consolidators' are prepared to offer an exit route for retiring baby boomer partners.

Niche services

Connectivity and analysis of client data across multiple firms present an opportunity to develop new 'value add' consulting services. For example, practitioners can use the data a system presents to advise clients on business strategy, and data around seasonal fluctuations might help with providing business planning services. In addition, accountants can use this 'big data' to benchmark clients' financial performance against their other client groups, pinpointing important variations to the norm within a specific sector.

Ownership structure

In part due to the expectations and requirements of GenZ and millennial talent, some feel that traditional partnership structures are falling away. This has freed up the opportunity for third parties to take part in the market. It also means that its now much easier for firms to offer their future talent the incentive of some sort of ownership and equity. A private equity house (PE) investor might reserve 50% of the shares in exchange for its investment, but the business is at liberty to incentivise future talent with any of the remaining 50% - Options? Share allocation? Dividends?

The involvement of Private Equity is a popular innovation

Turning back to the UK market, Azets (formerly Cogital) backed by HG Capital (a Private Equity house) was launched at the end of 2016 by the merger of Nordic-based Azets and UK-based Baldwins and Blick Rothenberg. The accountancy group now has a turnover of £500m and employs over 6,500 people across eight countries and has corporate clients in 60 countries. It has partly grown through the acquisition of smaller rivals such as AGN member Hazlem Fenton in London, and former top 20 accountancy firm Wilkins Kennedy. Azets have offered a route out to numerous partners in the twilight of their careers.

Azets meanwhile is now the 8th largest firm in the UK. Market intelligence suggests that it attempted to come back to the market (for 1st round capital providers to exit) having "aggregated" but not "integrated", but was unable to achieve a sufficient valuation. Thus, it is now upping its integration strategy, using artificial intelligence and "smart technology" to service its clients and uses self-service tools to help its clients process invoices and reports. A classic PE/technology play.

And it's not just the larger firms - London technology driven firm Jeffreys Henry, turning over some £10m took external investment from private equity house Tenzing, and now backed by Tenzing, has itself acquired smaller firm ABG – cementing its own consolidation strategy.

But not all PE involvement in professional services is the same. In 2021 AGN member in the UK Leonard Curtis (insolvency and restructuring specialists) welcomed a £15m private investment deal from family investment office Arete Capital Partners, in conjunction with Svella PLC. The deal is aimed at driving growth, builds on existing capabilities and will help Leonard Curtis add new specialist services aimed at its professional and SME client base.

Leonard Curtis Director, Alex Cadwallader: *"Arete are a great fit for us. Their involvement has given us the liquidity we need to invest in critical future services but also leave us with the flexibility to incentivise key staff into ownership".*

The Leonard Curtis (LC) story is markedly different to the likes of Azets - Leonard Curtis are not an easily systemised business but rather a high value consulting operation and one that is surely well positioned for the predicted economic turbulence of the future. There are other similar examples; CVC, via Teneo buying Deloittes restructuring business, HIG capital buying KPMG restructuring.

However, Arete Capital Partner Simon Lord offered a word of caution for ageing stakeholders looking for an easy exit…"*There will always be caution when investing in a people business due to the fear that it's a retirement sale. The truth is it can be anything but. If you have a good distribution of partners, a decent spread of equity, a strong culture and growth story then the provision of liquidity can help these businesses unlock their vast potential which may have previously been constrained"*.

The rise of PE involvement in accountancy firms is also prevalent in the US. In the last few years, Tower Brook Capital Partners have taken an ownership interest in Eisner Amper LLP. Lightyear Capital have bought into Schellman & Co ($77.36m revenue) ranked No. 65 in the Accounting Today 2021 list of the 100 largest US firms. Earlier this year CBIZ, a firm based in Cleveland, and its affiliated accounting firm

Mayer Hoffman McCann acquired Marks Paneth LLP, a Top 50 firm based in New York, in a megadeal that's adding an expected $138 million to CBIZ's annual revenue. There are plenty examples of others. Most observers agree that PE investors are attracted to accountancy firms because the profession is seen as low risk and largely recession proof, with high rates of profitability and great cashflow because of recurring work and clients, and the partners are generally trustworthy. On top of this, PE houses can cross-sell services to their own portfolio. On the other hand the accountancy firms know that they need human talent in an increasingly difficult environment, and (particularly due to the inexorable march of technology) they need to transition into 'advisory' from traditional compliance. The PE investment provides the capital to assist with that journey.

The return of Publicly Listed Firms

Leaving PE to one side for a moment, the Kelly Partners Group in Australia listed on the Australian Stock Exchange in 2017. The Kelly Group are true full on consolidators and have grown to 18 locations, very recently acquiring their 7th firm. The approach is driven by their 'Partner-Owner-Driver model', which they use to advertise their strategy of consolidation backed by technology and the offer of an exit route to retiring partners.

More evidence of the importance of technology is witnessed by UK based K3 Capital Group PLC, listed on the London Stock Exchange in 2017. It describes itself as a publicly funded professional service-based business, consisting of KBS Corporate, KBS Corporate Finance, Knightsbridge, Knight Corporate Finance, K3 Debt Advisory, Quantuma, randd, inTax, Knight R&D and K3 Tax Advisory. All are offering M&A, Tax and Recovery services, again underpinned by proprietary software systems.

There are others – and on the whole they have a clear strategic focus or niche. Few are simply general practice, generic firms. Perhaps this is what is most different from what went before e.g., these firms are generally focused on the SME market, as opposed to pretending to be "Big 4 territory". But importantly they often have another unique offer; a strong regional identity or revolve around distinctive proprietary technology.

What lessons can AGN members learn from all this?

Accountancy industry consolidation is a big subject and this article is a brief canter through some selected aspects. But there are some critical observations that stand out and perhaps some lessons about strategy that would be worth taking careful note of...

1. None of this is generic. The nature of consolidation - whether publicly funded, privately funded, driven by PE or acquisitive accountancy firms, driven by technology or simply the desire to carve out a valuable niche – is different in different territories. And not all markets are moving at the same speed.
2. It is about serving the SME market. Generally speaking, activity is centred on businesses that serve the owner managed sector, but this isn't the only defining factor. Often a firm that is ripe to become a consolidator, or to be consolidated, has some other market or service strength or niche that makes it stand out.

3. Strong audit and tax-based businesses are attractive. Technology is increasingly the facilitator that makes consolidation a profitable proposition. At the moment easily 'systemizeable' (eg scaleable) businesses are attractive. In practice this means a strong and successful audit or tax business, but as artificial intelligence becomes more sophisticated, will advisory businesses come more into focus?

4. Partner mix and succession. While an audit dominated business with a great client base might be a desirable target for a consolidator, a general practice business with a cadre of aging partners is far less an attractive proposition. This also applies to a firm's client base. Often baby boomer partners and their clients have grown their businesses together resulting in a similar less than youthful age profile. Both of these factors are likely to have a dramatic impact on business value.

5. New structures emerging - Firms that are consolidated are seeing the old partnership legal structure fall away. They are generally replaced by more flexible and limited liability structures that allow for more imaginative ways to introduce new capital and control.

Conclusion

In summary, AGN Member Partners that view a boost of capital from a Private Equity deal as an attractive option to secure their own personal future and that of the next generation of practitioners in their firm, should in the first instance turn to the AGN Value Key for clarity of where to focus when building lasting enterprise value.

The following factors all play to elements of the AGN Value Key.

1. Evaluate your digitisation/tech position. Its important to understand where you are on the path to digitisation and the effect it's likely to have on your business. Map the key processes in your business – everything needs to be transparent not a mystery.

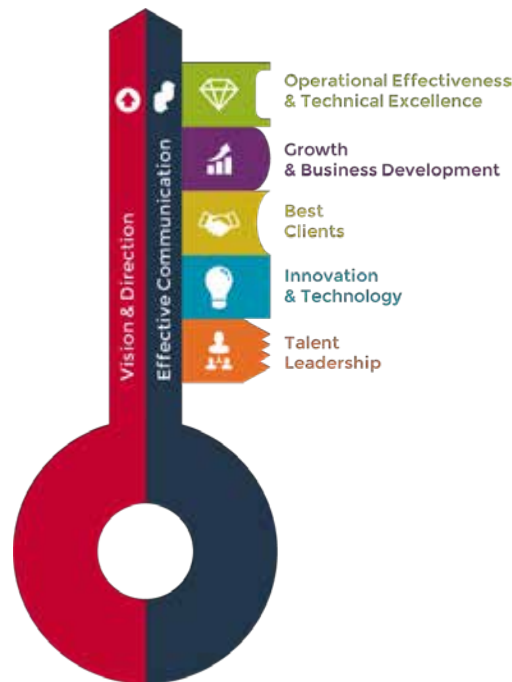
2. Identify and plan for niche or high margin advisory services. Any investor is buying the future story of your practice not the past. Undoubtedly your position will in some way reflect your progress with point 1.

3. Make sure your audit and tax processing operations are slick, efficient and of high quality. How can they be systemised?

4. Be clear about your NextGen and succession strategy. Your business is more investable if there is visible progress in aligning future talent and ownership. Again, the PE house is buying the future not the past.

5. Can you plan to reduce your long-term commitments such as property leases? In general, the profession is moving toward using less office space.

6. Get your client base in shape. Clear out the dead wood, understand which clients are key and build multiple relationships into them, broaden the service suite they buy from you – all of which secure them for longer.



Final thoughts - many firms won't relish the prospect of outside ownership, and maintaining control and steady growth are what's important to them, but the deals that are around seem less onerous than in the past and it could be that the injection of capital that they promise might just secure the long-term prospects of the firm.

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