A Closer Look at CPA Practice Valuation

Financing for CPA professionals

a complimentary whitepaper for certified public accountants

Each CPA practice is unique, so it's crucial to take the time to correctly value a firm. CPAs often devote decades of work to their business, then offer the practice for sale for much less than its worth. Since the accounting practice is probably their largest asset, retiring CPAs can impair their financial future if they leave money on the table when selling their business. Here are some points to consider when determining the valuation of your CPA practice:

Seller's Discretionary Earnings vs. Revenue Multiples

Never sell a CPA practice for merely 100% of billings without speaking with an expert first. Many industries base the market value of businesses for sale on multiples of earnings before interest, taxes, depreciation and amortization (EBITDA). Many small businesses are valued utilizing a multiple of Seller's Discretionary Earnings (SDE), defined as EBITDA plus owner's compensation and benefits and other discretionary expenses or "add-backs."

Assuming all other variables are equal, buyers prefer firms with high SDE over low SDE. For example: Two single-owner firms in the same city might both have $500,000 in annual collected billings. One is managed well, producing an annual cash-basis SDE to the owner of $250,000, while the other is poorly managed and only produces $50,000 SDE. Which practice would you rather buy assuming all other aspects of both firms were essentially equal? There is very high demand from buyers for profitable CPA practices. Higher demand means higher prices for highly profitable firms compared to practices with a lower profit margin.

As a result, a well-managed accounting practice for sale with a high SDE should often be valued at more than 100% of annual billings. Based on the SDE approach, most profitable CPA practices will sell in the range of 125% to 150% of billings. In addition, some exceptionally profitable practices are acquired for 150% to 200% of billings. CPA practice owners with high SDE should consider using SDE as the primary valuation methodology to achieve the highest possible asking price.

Raising Your SDE

But what about CPA practices with low SDE? If possible, raise your SDE before you start the process of selling your practice. Owners with low SDE accounting firms should consider raising fees, cutting costs and enhancing the bottom line, which could take a few years. But it is worth the wait. Implementing changes to improve profitability can result in a higher sales price and cash amount at closing.

Avoid Large Contingency Earn-Out Deals

Under an earn-out deal structure, the buyer pays a small down payment and the remainder is paid to the seller on a contingency basis, based on collections from existing clients over a set period of time. Keep in mind, sellers bear the majority of the risk under this structure. The buyer acquires the business and pays the seller a certain percentage of fees collected over a negotiated payout period, usually three to five years. If the buyer does well, so does the seller. But if the desired results are not achieved, the seller can lose a large amount of the initial purchase price.

The buyer is considered to have "less skin in the game" when he or she does not pay the seller most of the purchase price in cash at closing – especially if the deal contains a large contingency. Buyers with less skin in the game may often perform poorly with respect to client retention. In fact, the earn-out deal structure is a favorite of buyers who wish to intentionally cherry-pick a seller's client list. Such buyers are responsive to a small percentage of clients they wish to keep, and unresponsive to a larger percentage of clients they are not interested in. Thus, the earn-out deal structure containing a small down payment and large contingency often drives excessively poor buyer performance with respect to client retention.

A seller can avoid an earn-out deal by marketing his or her firm to a larger pool of qualified buyers with the goal of receiving multiple offers for the practice.

Alternatives to Large Contingency Earn-Out Deals

Many buyers do not blindly adhere to the concept of a large contingency earn-out deal. A seller can avoid an earn-out deal by marketing his or her firm to a larger pool of qualified buyers with the goal of receiving multiple offers for the practice. Consulting with an expert in the field of accounting mergers and acquisitions is highly recommended.

Getting Help

It is important to note that marketing, pre-qualifying candidates and negotiating the sale of a CPA practice in the proper manner requires massive effort beyond the scope of what most sellers have available in terms of time and resources. The typical seller does not have access to a database of qualified buyers willing to avoid the earn-out structure and pay significant cash at closing. In addition, most sellers do not have the expertise or techniques needed to negotiate a maximum value sale. A good business broker will typically minimize the seller's effort and maximize the price and terms of the sale.

If you're serious about maximizing the sale of your accounting practice, consult with a firm such as Accounting Broker Acquisition Group. Accounting Broker has a successful track record of bringing exceptional buyers to the table while maximizing the price and terms of the deal.

Exceptional financing sources such as Oak Street Funding can provide the cash needed to pay sellers a higher percentage at closing. Your future is too important to leave to chance. You need highly effective professionals in your corner.

About the Author

Harry L. Olson, CPA is the founder of Accounting Broker Acquisition Group, the only national business brokerage of its type comprised of 100-percent of brokers who are CPAs with significant "Big Four" merger and acquisition experience. Harry and his partners have developed unique deal-making strategies and negotiating techniques with proven results of sales price maximization. Harry may be reached directly at 800-419-1223, extension 101 or via email at harry@accountingbroker.com. To learn more, visit accountingbroker.com.

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