TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

The following information is only of a general nature and should not be taken as professional advice.

203 | More About Buying Parcels of Fees

Buying parcels of fees gets easier with time – the more often you do it, the easier it gets.

More About Buying Parcels of Fees

In the last episode we already discussed how to buy a parcel of fees. In this episode we will delve deeper and ask some tricky questions.

Here is what we learned from Ed Chan, co-founder of WIZE Mentoring and founder and non-executive chairman of Chan & Naylor, but please listen in as Ed explains all this much better than we ever could.

To listen while you drive, walk or work, just access the episode through a free podcast app on your mobile phone.

Business Brokers

The vendor decides whether to involve a broker or not. When the vendor is determined to sell, they often involve a broker. If the seller hadn't anticipated to sell this quickly but the buyer contacted them through a personal contact or an email or letter drop campaign, then the sale might go through without a broker.

If a broker is involved, it is usually the seller who engages and pays the broker. In most cases, the brokerage is a percentage of the sales price – the higher the price, the higher the brokerage.

The broker is like a referee that negates the middle ground and talks sense to both parties. Buyers and sellers often have very different ideas about what is fair. We all tend to live in our own bubbles. We don't know what is out there. You might want this and that and don't realise how unreasonable that is. The broker tends to keep the peace and navigate the transactions through. If they are any good, it is not about the price. It is about getting the deal through. And that is where there value is.

Sales Price

The sales price for buying parcels of fees is determined by one of two methods. Either on an EBIT basis or a dollar per dollar basis.

For practices with revenue under $1m, the sales price is usually determined dollar-per-dollar on turnover. If it is over a $1m, it is done on EBIT. Banks will only lend based on EBIT. They will not lend on a dollar-per-dollar basis.

To use an example, let's say EBIT is 25% after partner's salary and you get 4x EBIT. So this comes back to a 1:1 on a dollar-per-dollar basis. And if you are doing 20% EBIT 4x, you get 0.8 on dollar-to-dollar basis. So the two concepts link.

Dollar-per-Dollar

On a dollar-per-dollar basis a parcel of fees sells between 0.8 to 1.2 times of revenue. So if an accounting practice has $500k in revenue, you will probably pay $400k to $600k for the practice.

The real measure of what the business is worth is on EBIT. However, there is a strong good demand for practices under $1m. And the valuation of these practices is usually on a dollar-per-dollar basis.

EBIT

The EBIT has to include the partner's salary. Partner's salary is generally set at market rates and not necessarily based on what was actually paid. The sales price is then set at 3x or 4x of EBIT after partner's salary.

Due Diligence

As a buyer you have to do your due diligence. You have to go through the client list with a fine comb and look at the clients' age, succession plans, outstanding debts, payment history, compliance history, type of work and so on.

If the practice has clients with a poor payment history, exclude those clients.

Assess whether you can get at least four or five years out of them if the practice has older clients. Four or five years would give you the capital back and make some money on top of it. But it all depends. You might still buy those older clients if the vendor is happy to drop the price on those.

When you make an offer, the vendor may accept it or the vendor may not accept it. The vendor may put the practice back on the market and if there is someone who wants it he may sell it. That is just the way it goes.

The price is usually not a sticking point for most buyers. The sticking point is mainly around the terms – the earn-out percentage as well as the period the buyers has to stay.

Negotiations

The first round of negotiation is about getting the big rocks in place. Does the practice fit your current firm? Is the price right and agreed on? Is the buyer happy to move to the seller's location? Happy to stay on? These are the big rocks.

Once you got those big rocks in place, you might enter into a Heads of Agreement where you sign a confidentiality agreement etc. After that you can start your diligence and really have a look under the bonnet. That is when you will realise how good or not so good the practice really is and then you re-negotiate based on those finding. Most practices have some dead bodies in the boot, so make sure you find them.

To hear more of Ed's business growth strategies for accounting firm owners, please visit www.wizementoring.com/taxtalks where you can download a copy of WIZE Mentoring's free eBook – The Accountants 20 Hour Workweek.

MORE

SMSF Corporate Trustees

Taxable Importations

Tax Effective Structuring

***Disclaimer**: Tax Talks does not provide financial or tax advice. All information on Tax Talks is of a general nature only and might no longer be up to date or correct. You should seek professional accredited tax and financial advice when considering whether the information is suitable to your or your client's circumstances.*

The information above is for general information only and should not be taken as constituting professional advice from Tax Talks. We are not a financial, legal or tax adviser. You should consider seeking independent legal, financial, taxation or other advice to check how the above information relates to your unique circumstances.