The Leading Source for Trademark Values

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White Paper

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WHAT ARE PROFESSIONAL SERVICE FIRMS WORTH?

Valuing the brands of those doing the valuing

Accounting and law firms are frequently engaged as advisors in selling and acquiring businesses on behalf of their clients, and on finding and auditing the value related to such acquisition. For their own firms, however, many accounting and law professionals have no precise conception of value and price.

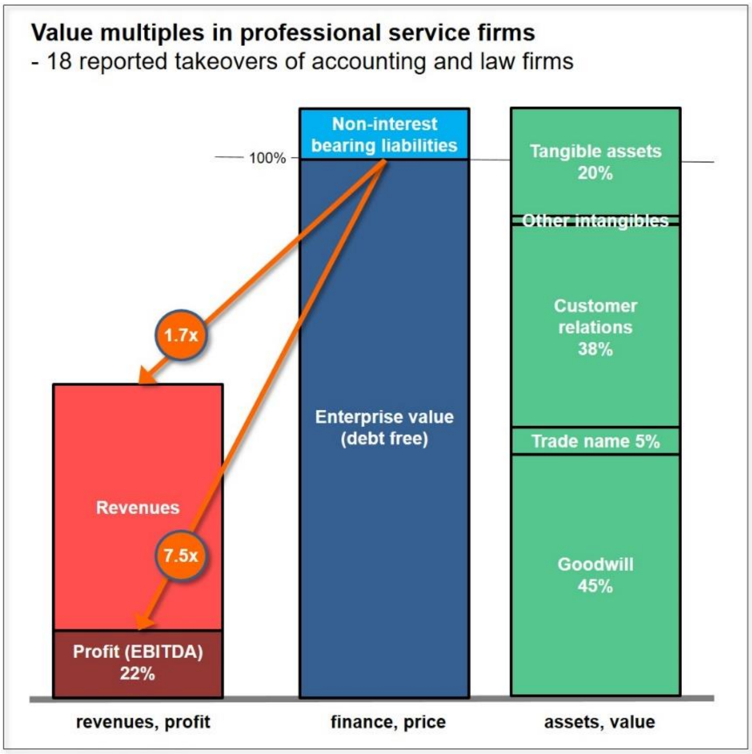
Mergers in the professional services sector remain a popular strategy among firms looking to boost revenue and acquire new clients, and among those professionals who seek to exit. As most players are private companies, and some sectors have specific requirements which do not permit external equity investments, the financial terms of takeovers are rarely disclosed. Therefore, the objective is to understand more about valuation multiples, and about the levers driving valuation, with a particular focus on the audit/accounting and law sectors.

A sample of takeovers of such firms by public companies which were subsequently reported in the financial statements of the acquirers (purchase price allocations) provides the basis for a deeper analysis. Beyond the purchase considerations paid, the structure of the acquired assets was analyzed. The sample covers 18 acquisitions of accounting and law firms between 2006 and 2016 in US, UK and Australia. The targets range from US$ 7 to US$ 129 million in revenues.[1]

Earnings multiples typically range from 6x to 8x EBITDA, or 11x to 14x net income after tax. These are rather moderate multiples, reflecting the limited scalability and growth potential of people based services where capacity is always a limiting factor. Sales multiples typically range from 1.3x to 2.2x revenues, depending on profitability. Professional service businesses are highly profitable; typical profit margins range from 15% to 30% on revenues (EBITDA).

Accounting and law firms are primarily acquired for the value of their existing customers. Customer relations account for 38% of enterprise value on average. Customer value is influenced by the stability of customer relations, (repeat business like i.e. IP lawyers and auditors, or project business like litigation or corporate finance advisory),

[1] The sample is taken from the MARKABLES database and published in the Feb 2017 snapshot.



Source: MARKABLES

excess margin (higher on projects, lower on ongoing repeat business), and by the independence of customer relations from key individuals. Over the total sample, the customer asset has a relatively short remaining life of 10 years. Eventually, customer value must be secured through non-compete and/or ESOP arrangements to prevent key individuals from leaving and taking customers along.

The trade name of the firm is of minor overall importance (see table below). However, its reputational value has an important role to “replenish” short-lived customer relations in project-based businesses. The reputational value of the trade name helps not only to create future customer relations, but also to attract new talent to join the firm. Still, the trade name accounts only for 5% of enterprise value on average. This translates into an implied royalty rate for the trade name of 1.5% on revenues under a royalty relief valuation. Depending on the background of the transaction (i.e. new territory or consolidation), the trade name of the acquired firm is assumed to be kept and maintained in 8 of the 18 cases. In 10 cases, the acquirer plans to replace the trade name of the target by his own name over time, on average within 4 years after the takeover

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Trademark Values - Peer Group Analysis 02/2017

Law and accounting firms
(including law firms, audit and accounting firms, tax advisory firms)

no. of observations: 18 period: 2006-2016 countries: 3	**Trademark royalty rate**	**Trademark profit split**	**Enterprise value**
	% of revenues	trademark value in % of enterprise value	revenue multiple
25% quartile	0.7%	2.3%	1.33x
median	1.5%	4.9%	1.66x
75% quartile	2.4%	8.9%	2.20x
mean	1.7%	5.3%	1.95x
Trademark life	- indefinite life: 44% - finite life: 56% with average useful live of 4 years		
Trademark revenues	from US$ 7 million to US$ 129 million		

Source: www.markables.net

Other intangible assets typically include software, non-compete agreements and eventually proprietary tools and methods; taken together, they are insignificant with less than 1% of enterprise value. Tangible assets account for 20% of enterprise value. They include a smaller percentage for fixed assets like office equipment and company cars, but consist largely of liquid financial assets and receivables. Typically, such businesses are fully self-financed. Therefore, tangible assets (book value) are financed free of debt and do not increase enterprise value.

Case Studies

Ernst & Young was valued in a marital dissolution case negotiated in 2002 by the Indiana Superior Court.[2] The valuation covered basically the accounting and tax business of EY, after its IT consulting division had been sold to CapGemini in 2000. Customer relations accounted for 38% of enterprise value, the E&Y trade name for 3% of enterprise value at a royalty rate of 1.5% on sales, and methods and tools for 7.5% of enterprise value, at a royalty rate 0f 3.5%. Fifteen years later, we still observe a very similar asset structure for accounting and law firms, in particular for their market intangibles.

The trade name of Duff & Phelps was valued in a purchase price allocation in 2004 when management together with Lovell Minnick Partners acquired the firm from Webster. The results of the PPA suggest that a royalty rate of 1% was applied (into perpetuity) to value the trade name. The revenue multiple of Duff & Phelps back then was rather low (0.4x revenues).

One important asset remains: goodwill with a share of 45% of enterprise value. This should however not be taken as a pure "residual". It includes a number of seizable components. One is cost savings expected from the combination. Another more important is the cross-selling potential in combining different territories, customer groups or service ranges. And lastly, goodwill includes the ability of the acquired firm to master the future beyond the current planning horizon, in particular to create enough new business to keep the firm running at its current profit level. For professional services firms, retaining key individuals is vital for this. A high price for a professional service firm must therefore include clear measures to retain key staff.

Brand value of the Big 4

AFRWEEKEND

Rapid growth of Deloitte, EY, KPMG and PwC puts brands at risk

A recent article in AFR (Australian Financial Review) discusses brand value of the Big4 (PwC, Deloitte, EY and KPMG), Accenture and McKinsey. It is based on the 2017 Brand Finance Global 500 brand ranking. Brand values reported range from US$ 18.5 billion for PwC to US$ 4.5 billion for McKinsey. The brands all have strong ratings from AAA+ to AA+.

Back solving the royalty rates applied by Brand Finance to arrive at these brands suggests royalty rates between 3.5% and 4.5% on revenues into perpetuity. While these are certainly great brands, Brand Finance's opinion on brand value seems to be - like in many other cases - too optimistic, at least considerably higher than what corporate finance experts conclude in real transactions (which are rather hypothetic for all of these firms).

[2] See *Bobrow v. Bobrow*, Hamilton County No. 29 DO1-0003-DR-166 (Indiana Superior Court)

M&A activity is expected to remain at a high level in the accounting and law sectors. For those who plan to sell it is important to prepare the deal with a clear focus on those assets that are important to acquirers and drive the value of the business.

About Trademark Comparables AG / MARKABLES

Trademark Comparables AG is a privately held, Swiss based company engaged in the valuation and capitalization of IP, notably brands and customer relations. Trademark Comparables AG develops valuation methods and provides input data for valuation algorithms to appraisers, accountants, auditors, tax advisers, brand owners, banks and investors all over the world. Trademark Comparables AG operates MARKABLES®, the leading and unique source for trademark values worldwide. MARKABLES® contains the results of over 8,900 reported and audited trademark valuations resulting from acquisitions and transactions. For more information regarding MARKABLES®, please visit www.markables.net