The 1991 Silber Study of Restricted Stock Discounts
What We Should Have Known Then

Why Your Family Business Has More Than One Value

The Top 10 Things Estate Planners Should Know About Business Valuation

Gin, Business Valuation, and Ryan Reynolds
Earn-Outs in RIA M&A
The 1991 Silber Study ofRestricted Stock Discounts
We Should Have Known Then


By the time I came into the business valuation profession, appraisers recited a small number of restricted stock studies to conclude that typical discounts were in the range of 25% to 45%, and therefore, that marketability discounts for illiquid minority interests of private companies should be in that range, as well.

But Professor William L. Silber wrote an article in the respected Financial Analysts Journal that told a different story. However, business appraisers ignored wisdom found in the Silber Study and only took its conclusion that the average discount in the study was 34% as confirming of the existing lore.

Summary statistics from the Silber Study are provided in Exhibit 8.4 of our forthcoming book, Business Valuation: An Integrated Theory, Third Edition (Mercer & Harms, Wiley 2020), which is available for purchase on Amazon.com. Exhibit 8.4 is reproduced on page 3 of this newsletter.

But wait, there's more. Professor Silber looked at his sample of 69 restricted stock discounts and noticed a distinct difference between the companies that had lower discounts (less than 35%) and higher discounts (greater than 35%). The study provided additional color as found in Exhibit 8.5 (on page 3 of this newsletter).

What a difference a more informed look makes. The average for transactions with discounts exceeding 35% was 54%, while the average for transactions with discounts less than 35% was 14%. What could have caused this difference? Professor Silber provided summary statistics for the two subgroups. Simply put, the companies with lower discounts were just more attractive in terms of cash flow, perceived risk, and likely expected growth than the companies in the larger discount sample.

A picture is helpful. I wrote about the Silber Study in Quantifying Marketability Discounts (which introduced the QMDM) in 1997 and provided a chart similar to Exhibit 8.6 from the new book (on page 3 of this newsletter).

Exhibit 8.4 :: Summary Statistics from the Silber Study (data from 1981 through 1988)

<table>
<thead>
<tr>
<th>Sample Characteristics</th>
<th>Means</th>
<th>Standard Deviations</th>
<th>Ranges</th>
<th>Mean Excl</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Restricted Stock Discounts</td>
<td>34%</td>
<td>24%</td>
<td>-13%</td>
<td>84%</td>
</tr>
<tr>
<td>Dollar Size of Issue ($mm)</td>
<td>$4.3</td>
<td>$6.6</td>
<td>$0.2</td>
<td>$40.0</td>
</tr>
<tr>
<td>Block Size (Issued/Total Shares)</td>
<td>13.6%</td>
<td>10.3%</td>
<td>1.0%</td>
<td>56.0%</td>
</tr>
<tr>
<td>Prior Year Earnings ($mm)</td>
<td>$0.9</td>
<td>$11.7</td>
<td>-$0.9</td>
<td>$65.0</td>
</tr>
<tr>
<td>Revenues ($mm)</td>
<td>$40.0</td>
<td>$106.0</td>
<td>$0.0</td>
<td>$595.0</td>
</tr>
<tr>
<td>Market Value of Equity ($mm)</td>
<td>$54.0</td>
<td>$88.4</td>
<td>$4.4</td>
<td>$532.0</td>
</tr>
</tbody>
</table>

Sample Size: 69 Observations

Exhibit 8.5 :: Summary Statistics from the Silber Study with Divided Sample (data from 1981 through 1988)

<table>
<thead>
<tr>
<th>Sample Characteristics</th>
<th>Discounts &gt; 35%</th>
<th>Discounts &lt; 35%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Means</td>
<td>St Dev</td>
</tr>
<tr>
<td>Restricted Stock Discounts</td>
<td>54%</td>
<td>13%</td>
</tr>
<tr>
<td>Dollar Size of Issue ($mm)</td>
<td>$2.7</td>
<td>$3.9</td>
</tr>
<tr>
<td>Block Size (Issued/Total Shares)</td>
<td>16.3%</td>
<td>12.4%</td>
</tr>
<tr>
<td>Prior Year Earnings ($mm)</td>
<td>-$1.4</td>
<td>$2.7</td>
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<tr>
<td>Revenues ($mm)</td>
<td>$13.9</td>
<td>$22.2</td>
</tr>
<tr>
<td>Market Value of Equity ($mm)</td>
<td>$33.8</td>
<td>$27.8</td>
</tr>
</tbody>
</table>

Sample Size: 34 Observations

Exhibit 8.6 :: The Overall Sample and Two Sub-Samples from Silber Study

69 Observations
Standard Deviation = 24%

35 Observations
Standard Deviation = 13%

34 Observations
Standard Deviation = 13%
As a young business appraisal profession, we should have known, within a reasonable time after the Silber Study was published, that restricted stock discounts, in and of themselves, provide no valuation information. Assume that a restricted stock transaction occurred at $7.50 per share while the freely traded price was $10.00 per share. What do we know from this observation?

- The public price was $10.00 per share.
- The restricted stock transaction price was $7.50 per share.
- The discount to the public price was $2.50 per share or 25%.
- The public price reflected a 33.3% premium to the restricted share price.

That's it. There is no economic or valuation information in one restricted stock observation that can be used to apply to the pricing of private companies. If there's no economic information in one observation, we do not gain information by looking at many discounts, or averages of many discounts.

What is the root cause of restricted stock discounts? Why did/do they exist? We tackle this and other questions on the blog www.ChrisMercer.net. Visit the blog and/or subscribe for future content.

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NEW BOOK

Business Valuation: An Integrated Theory, 3rd Edition

The revised and updated third edition of Business Valuation: An Integrated Theory explores the core concepts of the integrated theory of business valuation and adapts the theory to reflect how the market for private business actually works.

In this third edition of their book, the authors, two experts on the topic of business valuation, help readers translate valuation theory into everyday valuation practice. This important updated book:

- Includes an extended review of the core concepts of the integrated theory of business valuation and applies the theory on a total capital basis
- Explains “typical” valuation discounts (marketability and minority interest) and premiums (control premiums) in the context of financial theory, institutional reality, and the behavior of market participants
- Explores evolving valuation perspectives in the context of the integrated theory

The third edition is the only book available regarding an integrated theory of business valuation, offering an essential, unprecedented resource for business professionals.
Why Your Family Business Has More Than One Value

Excerpted from Mercer Capital’s Family Business Director Blog

It is understandably frustrating for family business directors when the simple question – what is our family business worth? – elicits a complicated answer. While we would certainly prefer to give a simple answer, the reality a valuation is attempting to describe is not simple.

The answer depends on why the question is being asked. We know that sounds suspect, but in this post, we will demonstrate why it’s not. Let’s consider three potential scenarios that require three different answers.

What Is Our Family Business Worth to Our Family?

This is the most basic question about value, and the answer revolves around the expected cash flows, growth prospects, and risk of the family business on a stand-alone basis. This does not mean that the status quo is assumed to prevail indefinitely, only that a combination with a strategic buyer’s business is not anticipated. The family business may have plans for significant changes to operations or strategy, and if it does, the value should reflect such changes.

This perspective on value is especially important to family business directors weighing long-term decisions regarding dividend policy, capital structure, and capital budgeting. The value of the family business to the family depends on three principal factors:

Expected Cash Flows

Identifying the expected cash flows of the business requires careful consideration of historical financial results, anticipated economic and industry conditions, and the capital needs of the business. Revenue and earnings are important, but future cash flows also depend on how much the business will need to spend on capital expenditures and working capital to execute on the business plan.

Growth Prospects

All else equal, the faster a business is expected to grow, the more valuable it is. Cash flows can grow because of increasing market share, a growing market, or improving profitability. The assessment of growth prospects should take into account each of these potential factors and the sustainability of each.
Risk

The value of a business is inversely related to the risk. Investors crave certainty, and risk is just another word for not knowing what the future holds. The wider the range of potential outcomes for your family business, the riskier it is, and the less enthusiastic investors will be about committing capital to the business. When investing in riskier businesses, investors pay less. Risk is evaluated relative to comparable investments or businesses.

Whether using a discounted cash flow method or using methods under the income approach, the value of the family business to the family is a function of these three attributes of the business itself. This measure of value is often likened to the perspective of stock market investors or private equity buyers that look to the operations of the business to drive return apart from a strategic combination with another business.

If this first question deals with the value of the family business assuming it continues being a family business, the second question addresses the value of the business once it stops being a family business. In other words, what is the value of the family business to a strategic buyer?

What Is Our Family Business Worth to a Strategic Buyer?

Families occasionally decide they don’t want to own the family business anymore. Families can reach this decision for different reasons. Sometimes, the family friction associated with managing the family business has reached an unsustainable level. In other cases, the family may be approached by a buyer of capacity with what appears to be a very enticing offer. Or, perhaps, an enterprising family decides that a “fresh start” with proceeds from the sale of the legacy business could unlock new opportunities for the family. In any event, when the decision to sell, or at least consider selling, has been made, directors naturally turn their attention to maximizing the sales price.

A strategic buyer is one that will combine the operations of the target company with their existing operations in a bid to increase the earnings and cash flow of the target and/or the newly combined entity as a whole. Strategic buyers are most commonly competitors of the target, but they could also be suppliers or customers. The essential attribute is that a strategic buyer has the ability to change how the target operates, resulting in either higher earnings, better growth prospects, or reduced risk (or some combination thereof).

Exhibit 1 illustrates potential earnings enhancements available to a strategic buyer (in this case a competitor).

By combining the target with their existing operations, the larger strategic buyer will be able to achieve purchasing efficiencies, which will contribute to a higher gross margin. In addition, there are redundant general and administrative expenses, which can be eliminated by the buyer. As a result, the strategic buyer anticipates generating an EBITDA margin of 22%, compared to the 16% EBITDA margin available to the target company on a stand-alone basis. Stated alternatively, the strategic buyer anticipates EBITDA that is 38% higher.

Does that mean that the target company is worth 38% more to the strategic buyer? Not necessarily. The amount that a strategic buyer will, in fact, pay for the target company depends on how many other strategic buyers they are likely bidding against and how unique the target company opportunity is.

<table>
<thead>
<tr>
<th>Exhibit 1: Illustration of Strategic Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Revenue</strong></td>
</tr>
<tr>
<td>Stand-Alone</td>
</tr>
<tr>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Cost of Goods Sold</strong></td>
</tr>
<tr>
<td>$(20,000)</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
</tr>
<tr>
<td>$30,000</td>
</tr>
<tr>
<td><strong>Selling &amp; Marketing</strong></td>
</tr>
<tr>
<td>$(15,000)</td>
</tr>
<tr>
<td><strong>General &amp; Administrative</strong></td>
</tr>
<tr>
<td>$(7,000)</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
</tr>
<tr>
<td>$8,000</td>
</tr>
</tbody>
</table>

| **Gross Margin**                            |
| Stand-Alone | Strategic |
| 60%        | 62%       |

| **EBITDA Margin**                           |
| Stand-Alone | Strategic |
| 16%        | 22%       |
of reasons. As a minority shareholder, one has no direct influence or control over business strategy or other long-term business and financial decisions: one is simply along for the ride and subject to decisions made by others. Furthermore, since it is a family business, there is likely no ready market for the shares. As a result, one is effectively stuck, and, potentially, for a long time.

So, from this perspective we need to think about all the things that influence what the family business is worth to the family plus some additional considerations that relate to the unique position of being a minority shareholder in a private company. This perspective is critical for gift and estate tax planning.

**Are There Any Dividends?**

Regular cash flow dulls the pain of illiquidity. If there is a reasonable expectation that investors will receive dividends while owning the shares, that helps to mitigate the burden of being unable to sell the shares. Since many family businesses are set up as S corporations, it is important to clarify that the dividends that matter are those in excess of any tax liabilities that are passed through to shareholders.

**What Are the Prospects for Liquidity?**

Even though there is no ready market in which to sell minority shares in a family business, there are still opportunities to sell the shares from time to time. For example, the family business could be sold, the company may repurchase shares from select shareholders, or other family members may be willing to acquire the shares at a favorable price. While future liquidity opportunities cannot be predicted with precision, it is possible to establish a range of likely holding periods by analyzing relevant factors. The longer the period until a liquidity event can be anticipated, the less attractive the investment.

**What Is a Share of Stock in Our Family Business Worth to an Investor?**

The magnitude of strategic benefits available and the likely negotiating dynamics for a family business tend to be very fact-specific. So, assessing the value of your family business to a strategic buyer will require that you and your fellow directors consider the following questions:

- Who are the competitors, suppliers, or customers with whom our family business would provide the most compelling strategic “fit”?
- What opportunities would such buyers have for increasing earnings and cash flow, improving growth prospects, or reducing the risk of the family business?
- How unique is our family business? Are there other similarly situated businesses that can provide comparable strategic benefits to buyers?

A potential strategic sale is not the only context in which family business directors need to think about the value of the family business. We’ll consider the final variation on the question of value in the next section.

**What Are the Growth Prospects for the Investment?**

When liquidity does come, what proceeds can be reasonably expected? In other words, at what rate would one anticipate the value of the business to the family to grow from the cur-
rent level? If the family business has a track record of reinvesting earnings in attractive capital projects, investors will view the growth prospects more favorably than if management has a propensity to accumulate large unproductive stockpiles of cash or other assets in the business.

What Are the Relevant Risks?

As with the business itself, the value of a minority share is inversely related to the attendant risks. The risks of a minority share include all the risks associated with the family business plus those associated with the illiquidity of a minority interest. In other words, the focus is on identifying those risks (including, potentially, lack of access to financial statements, uncertainty as to the ultimate duration of illiquidity, uncertainty regarding future distribution decisions, and the like) that are incremental to the risks of the family business itself.

The combination of expected dividends, holding period, expected growth, and risk factors determine the value of a share in the family business relative to the corresponding pro rata portion of the value of the business as a whole to the family.

Conclusion

There is no simple answer to “What’s our family business worth?” because the question is never quite as simple as that. The answer depends on exactly how and why the question is being asked. From transaction advisory services to gift and estate tax compliance to corporate finance decisions, our valuation professionals have the experience and expertise to help you ask the right questions about the value of your family business and get the right answers. Call us today.
The Top 10 Things Estate Planners Should Know About Business Valuation

Estate planners work with business appraisers every day. Experience suggests that there are numerous aspects of business valuation that when known to estate planners greatly benefit the proposal and execution processes. We have compiled a “top 10” list of things every estate planner should know about business valuation. While a few of the items might seem obvious, to many they are not.

1. Define the Project

In order for the appraiser to plan the assignment, estimate the fee, and understand the client’s specific needs, the estate planner needs to provide some basic benchmark information, such as: a description of the specific ownership interest to be appraised (number of shares, units, bonds); a clearly stated understanding of the “level of value” for the interest being appraised; a specific valuation date; which may just be current, or may be a specific historical date, and a description of the purpose of the appraisal (inform the appraiser why your client needs an appraisal and how the report will be used).

2. Understand the Standard and Premise of Value

There are different standards of value for appraisals under certain circumstances and in different jurisdictions. Corporate and owner-level tax compliance appraisals are based on “fair market value,” certain jurisdictions require “fair value” in dissenters’ rights cases; and “liquidation value” may be appropriate in certain cases. Most appraisals are developed using a premise that the subject entity of the appraisal is a “going concern” in which business assets are used to conduct business versus being liquidated in a piece meal sale of assets.

3. Involve the Appraiser Early On

Even in straightforward buy-sell agreements, family limited partnerships, or corporate reorganizations, it is usually helpful to seek the advice of the appraiser before the deal is finalized to see if there are key elements of the contract document that could be modified to provide a more meaningful appraisal to your client.
4. Distinguish Between a Business Appraisal and a Real Estate Appraisal

Many of the corporate entities appraised either own or rent the real estate where the business is operated. For a successful operating business, the most meaningful valuation is typically based on some measure of income, rather than the value of the underlying real estate. However, one should recognize that the value of some businesses, due to the nature of the subject business model, is better characterized by the value of underlying assets, and less so by the ongoing income. This is true for asset holding entities, and for some older family businesses with marginal earnings but with appreciated real estate on the books. Many business appraisers are not asset appraisers, and therefore, may need to consider a qualified real estate appraisal in the business valuation process.

5. Establish a Reasonable Time Frame

Each client’s business appraisal is a custom piece of work. Clients rarely have available all the information requested at the outset of a business valuation assignment. Typically, a valuation project takes several weeks to complete once the engagement is authorized to proceed. Timing can be accelerated to meet special needs, but it is usually a good idea to avoid rushing the production of a complex appraisal project.

6. Insist on an Appraisal Firm with Experience and Credentials

Each business appraisal is unique and experience counts. Most business valuation firms are generalists rather than industry specialists. However, the experience gained in discussing operating results and industry constraints with a broad client base helps an appraisal firm understand each client’s special situation. While credentials are no guarantee of performance, they do indicate a level of professionalism for having achieved and maintained them.

7. Know the Primary Business Valuation Methods

Business valuation is an art as well as a science and appraisers utilize various valuation methods and treatments as required to appropriately address the unique considerations of each assignment. Key methods typically include: transactions method (focuses on actual transactions in the security being appraised); underlying net asset value method (considers estimates of fair market value of the entity’s net assets, on a tax-adjusted basis); capitalization of earnings method (based on estimates of underlying earning power times a derived capitalization factor); guideline company method (similar to the capitalized earnings method, but uses comparable, or guideline companies to derive the appropriate capitalization factor); or discounted cash flow (derives the present value of future cash flows, based on a combination of projected future cash flow and a derived discount rate appropriate to the situation). Other valuation methods may be appropriate to certain companies in specific industries where particular comparable transaction data may be available.

8. Consider the Appraisal as a First Line of Defense

A well-reasoned and documented appraisal report serves as an indication of the seriousness and professionalism with which you address a client’s needs. Having an independent valuation in a transaction situation provides a level playing field for negotiations in good faith on both sides. For tax-compliance cases, the appraisal serves notice to the other side that they need to be equally prepared to support a contrary opinion of value.

9. Litigation Support Issues

The business appraiser cannot serve as advocate for your client, but it is always helpful to have an experienced business appraiser available for expert opinion testimony. In addition to providing a well-reasoned and documented report, the ap-
praiser must be able to articulate the reasonableness of valuation and investment conclusions to the court and be able to deal with intensive cross examination.

10. Expect the Best

In most cases, the fee for appraisal services is nominal compared to the dollars at risk and the marginal cost of getting the best is negligible. You can help your appraiser do the best job possible by ensuring full disclosure and expecting an independent opinion of value. The best appraisers have the experience and credentials described above, but recognize the delicate balance between art and science that enables them to interpret the qualitative responses to due-diligence interviews and put them in a stylized format that quantifies the results.

Mercer Capital has been providing objective valuations for tax compliance since 1982. Our opinions of value are well-reasoned and well-documented, which provide critical support. Give one of our professionals a call today to discuss your needs in confidence.

WEBINAR REPLAY: Estate Planning Opportunities in the Current Environment

In this July 21, 2020 webinar, Travis W. Harms of Mercer Capital and Brook H. Lester of Diversified Trust share their insights with family business directors and their advisors.

As family business leaders tackle the many operating challenges thrust upon them by the COVID-19 pandemic, it is tempting to let tasks like estate planning fall to the bottom of the to-do list. While estate planning may appear to be less pressing than other issues, the positive impact of effective planning on the long-term health of both the family and the family business is hard to overstate.

If your or your client’s family business is overdue for ownership transition, you should not miss the current opportunity for tax-efficient estate planning transfers.
Gin, Business Valuation, and Ryan Reynolds

Earn-Outs in RIA M&A

Excerpted from Mercer Capital’s RIA Valuation Insights Blog

Typically, my love of business valuation and gin and tonics do not go hand-in-hand, and, unfortunately, Ryan Reynolds has never been thrown into this mix. But recently, three of my favorite things collided in Reynolds’ viral out of office reply.

On August 17, 2020, Diageo, a European beverage company, announced it would be acquiring Aviation American Gin, owned by Ryan Reynolds (among others), for total consideration of $610 million. The following day Reynolds had a stark realization...

Thanks for your email. I am currently out of the office but will still be very hard at work selling Aviation Gin. For quite a long time, it seems.

In related news, I just learned what an ‘earn out’ is... And I’d like to take this opportunity to apologize to everyone I told to go f**k themselves in the last 24 hours. My lawyers just explained how long it takes to achieve an ‘earn out’... so... turns out I’m not as George Clooney

as I thought. The point is, to those listed below, I’m sorry... and I’ll indeed be needing your help in the coming months and years. Thanks in advance!

Mom, Blake, Peter, Diageo CEO, The Rock, George Clooney, Southern Glazer’s, Betty White, TGI Friday’s, Baxter, Calisthenics, AMC Theaters, Total Wine, The Number 8, Don Saladino, Darden, The Head of Alfredo Garcia, Soothing Lavender Eye Pillows.

Ryan Reynolds
Owner

Aviation American Gin

Apparently, the $610 million advertised transaction price is made up of an initial payment of $335 million and contingent payments of $275 million, based on the performance of Aviation American Gin over a 10-year period.
Earn-outs are commonly used in RIA deals, and we expect contingent payments to make up an even larger percent of deal consideration for the next few months, quarters, or years depending on how long the current economic uncertainty lasts. And while we hope most of our clients would be thrilled by the prospect of $335 million in upfront cash payments, we don’t want you to end up feeling as Ryan Reynolds did last week. In this post, we explain what an earn-out is, why they are commonly used in RIA transactions, and how earn-outs may be used as a saving grace for deal activity in the current economic environment.

What Is an Earn-Out?

An earn-out is an agreement between a buyer and a seller to defer a portion of the purchase price. The amount of consideration ultimately paid is determined based on either some measure of post-closing financial performance such as AUM or EBITDA, or a specific milestone that occurs post-closing such as the renewal of a large contract.

Contingent consideration allows for risk-sharing between the buyer and the seller. Deferral of the purchase price functions as a hedge for the buyer against poor future performance, while sometimes simultaneously providing the prospect of additional upside for the seller if they outperform buyer expectations. Importantly, contingent consideration influences post-transaction behavior. When it is necessary for the seller to continue operating the business following the sale (for RIAs, this is almost always the case), the presence of contingent consideration can incentivize the freshly-endowed sellers not to “call in rich” (like Reynolds thought George Clooney did in his sale of Casamigos tequila for $1 billion – actually 30% of the total consideration was subject to a 10 year earn-out like in Reynolds’ case), but continue to promote the success of the business.

Why are Earn-Outs Commonly Used in RIA Transactions?

Earn-outs are commonly used in RIA transactions, as the purchase price is not based on the value of hard assets acquired but expected future cash flows. Future cash flows of an RIA can vary dramatically as they depend on a large number of variables, including:

- The performance of financial markets;
- The skill of the investment management staff;
- The sustainability of the acquired firm’s fee schedule;
- The retention of key staff at the acquired firm;
- The motivation of key staff; and
- The retention of client assets.

As an example, we consider just one of these variables – market performance – and how an earn-out can be used as insurance to the buyer in case of a market downturn. While the market has almost recovered back to February highs, thanks mostly to the FANG stocks, some still think that this V-shaped recovery could turn into a W.

Assume that RIA Capital buys ABC Investment Management, with $4.2 billion in assets, for a total price of $100 million. The transaction is structured such that two-thirds of the proceeds are paid up front and the remainder of the purchase price is paid over three years if ABC’s AUM grows by at least 5% per year.

In Scenario A (page 14), ABC Investment Management’s AUM grows by 7.5% per year, and given the operating leverage inherent in most RIAs, EBITDA increases from $12.5 million to $15.8 million over the earn-out period. In this scenario, the entire earn-out is paid. The total consideration paid by the buyer is $100 million, which represents 6.8x average EBITDA in years 1-3.

In Scenario B (page 14), ABC’s AUM falls by 15% in year one and slowly begins to recover, but, due to the operating leverage, EBITDA falls by almost 40% in the first year (a decline in revenue with little or no decline in expenses results in a larger drop in profitability). In Scenario B, the seller does not receive any contingent payments. The total consideration paid by the buyer is $67 million (the amount of the closing payment), which represents 6.6x average EBITDA in years 1-3.

While the financial results in Scenario A and Scenario B differ quite drastically, the deal economics (from the buyer’s perspective) are similar. In both scenarios outlined above, the buyer paid roughly the same multiple of forward average EBITDA despite the difference in ABC’s EBITDA trajectory.
Scenario A: Exceed AUM Threshold

<table>
<thead>
<tr>
<th>Runrate</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$4,200,000,000</td>
<td>$4,515,000,000</td>
<td>$4,853,625,000</td>
</tr>
<tr>
<td>x Effective Fees</td>
<td>0.85%</td>
<td>0.85%</td>
<td>0.85%</td>
</tr>
<tr>
<td>Revenue</td>
<td>$35,700,000</td>
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<td>$41,255,813</td>
</tr>
<tr>
<td>- Expenses</td>
<td>(23,200,000)</td>
<td>(25,000,000)</td>
<td>(26,500,000)</td>
</tr>
<tr>
<td>EBITDA</td>
<td>$12,500,000</td>
<td>$13,377,500</td>
<td>$14,755,813</td>
</tr>
</tbody>
</table>

Buyer Cash Flows: ($67,000,000) for years 1-3. Year 1-3 Average EBITDA: $14,661,104. Multiple of Average EBITDA: 6.8x

Scenario B: Miss AUM Threshold

<table>
<thead>
<tr>
<th>Runrate</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUM</td>
<td>$4,200,000,000</td>
<td>$3,570,000,000</td>
<td>$3,659,250,000</td>
</tr>
<tr>
<td>x Effective Fees</td>
<td>0.85%</td>
<td>0.85%</td>
<td>0.85%</td>
</tr>
<tr>
<td>Revenue</td>
<td>$35,700,000</td>
<td>$30,345,000</td>
<td>$31,103,625</td>
</tr>
<tr>
<td>- Expenses</td>
<td>(23,200,000)</td>
<td>(22,750,000)</td>
<td>(20,250,000)</td>
</tr>
<tr>
<td>EBITDA</td>
<td>$12,500,000</td>
<td>$7,595,000</td>
<td>$10,853,625</td>
</tr>
</tbody>
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Buyer Cash Flows: ($67,000,000) for year 1, $0 for years 2-3. Year 1-3 Average EBITDA: $10,109,947. Multiple of Average EBITDA: 6.6x

Expect a Larger Portion of RIA Deal Proceeds to be Paid as Contingent Consideration

RIA transaction activity has slowed during COVID-19. Most deals that were already in motion when COVID-19 hit, were finalized. However, new deal activity has been minimal. While a lot of due diligence can be performed virtually, buying an RIA in the middle of so much uncertainty is hard to swallow. However, the need for succession planning in the RIA space has not halted because of the pandemic. Rather, during COVID-19, many RIA principles have realized that succession planning is something that can no longer be delayed.

So, how do you get buyers and sellers to execute a transaction during COVID-19 when the economic environment is so uncertain and when buyers likely have never set foot in the office they are buying or met management face-to-face? Part of the answer may be to bridge the gap between seller and buyer expectations by structuring the deal in a way that defers payment of a substantial portion of the purchase price in the form of contingent consideration.

If you’re contemplating an offer for your firm that includes an earn-out, talk with an independent expert so you can better understand the value of the payments. And, Ryan Reynolds, if you are reading this, we would be happy to advise you on your next business deal.

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Mercer Capital’s ability to understand and determine the value of a company has been the cornerstone of the firm’s services and its core expertise since its founding.

Mercer Capital is a national business valuation and financial advisory firm founded in 1982. We offer a broad range of valuation services, including corporate valuation, gift, estate, and income tax valuation, buy-sell agreement valuation, financial reporting valuation, ESOP and ERISA valuation services, and litigation and expert testimony consulting. In addition, Mercer Capital assists with transaction-related needs, including M&A advisory, fairness opinions, solvency opinions, and strategic alternatives assessment.

We have provided thousands of valuation opinions for corporations of all sizes across virtually every industry vertical. Our valuation opinions are well-reasoned and thoroughly documented, providing critical support for any potential engagement. Our work has been reviewed and accepted by the major agencies of the federal government charged with regulating business transactions, as well as the largest accounting and law firms in the nation on behalf of their clients.