MERCER CAPITAL

BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

Quality of Earnings Analysis

What Buyers and Sellers Need to Know About Quality of Earnings Reports

www.mercercapital.com

MERCER CAPITAL'S

QUALITY OF EARNINGS SERVICES

Mercer Capital assists clients by developing and performing customized due diligence procedures for potential transactions. Our focused approach to quality of earnings analysis generates *Insights That Matter* to potential buyers and sellers.

ANALYSES PERFORMED

Profitability Analysis – Investigating historical reported financial performance to identify the target's sustainable, and transferable, earning power. We measure pro forma run rate EBITDA (or other relevant measures) for acquisition targets.

Revenue Analysis – Investigating revenue data at the product, segment, and customer levels to reveal underlying trends in growth and customer retention. Procedures include: (1) identifying critical customer concentrations; (2) analyzing gross margin by product, segment, and customer; and (3) customer churn and retention analysis.

Working Capital Analysis – Investigating the components of net working capital required to operating the business. Procedures includes: (1) examining collections history, bad debts, and turnover; (2) analyzing inventory components and turnover; (3) reviewing prepaid expenses and operating expense accruals; and (4) assessing impact of seasonality on required working capital levels.

Our QofE engagements are led by senior professionals with deep transactional experience. We leverage that experience to customize procedures to generate *Insights That Matter* for the specific transaction under consideration.

SENIOR PROFESSIONALS

Travis W. Harms, CFA, CPA/ABV | 901.322.9760 | harmst@mercercapital.com

Travis is the President of Mercer Capital and leads Mercer Capital's Family Business Advisory Services Group which helps family shareholders, boards, and management teams align their perspectives to make more informed long-term strategic dividend policy, capital structure, investment, and M&A decisions.

Nicholas J. Heinz, ASA | 901.322.9788 | heinzn@mercercapital.com

Nick leads Mercer Capital's Transaction Advisory Group and has extensive experience in working with both buyers and sellers in merger and acquisition advisory engagements and assists clients through all phases of the selling or buying process.

Timothy R. Lee, ASA | 901.322.9740 | leet@mercercapital.com

Tim is the firm's Managing Director of Corporate Valuation services and has extensive experience in working with both sellers and buyers in M&A advisory engagements. Tim assists clients through all phases of the sales process, from conducting strategic alternatives analysis to determine if selling is indeed the best option, to structuring, negotiating, and closing transactions.

Bryce Erickson, ASA, MRICS | 214.468.8411 | ericksonb@mercercapital.com

Bryce, Senior Vice President, has been involved with hundreds of valuation and transaction-related engagements during his 25+ year career. These engagements have been conducted for the purposes of mergers and acquisitions, buyouts, and corporate planning purposes.

Mercer Capital's staff consists of CPAs, CFFs (Certified in Financial Forensics), CFAs, industry experts, big four alums, and other valuation and finance experts. Each quality of earnings engagement is staffed appropriately to ensure that our analysis generates *Insights That Matter* to potential buyers and sellers.

Copyright © 2024 Mercer Capital Management, Inc. All rights reserved. It is illegal under Federal law to reproduce this publication or any portion of its contents without the publisher's permission. Media quotations with source attribution are encouraged. Reporters requesting additional information or editorial comment should contact Barbara Walters Price at 901.685.2120. Mercer Capital's article does not constitute legal or financial consulting advice. It is offered as an information service to our clients and friends. Those interested in specific guidance for legal or accounting matters should seek competent professional advice. Inquiries to discuss specific valuation matters are welcomed. To add your name to our mailing list to receive additional complimentary publications, visit our web site at www.mercercapital.com.

Quality of Earnings

For buyers and sellers, the stakes in a transaction are high. You only get one chance to do it right. Commissioning a quality of earnings report is an essential step in getting the transaction right.

In this whitepaper, we illustrate how buyers and sellers benefit from a quality of earnings report that extracts a company's sustainable earning power from the thicket of historical GAAP earnings. We review the most common earnings adjustments applied in QofE analyses and review the role of working capital and capital expenditures as the links between EBITDA and cash flow available to buyers.

Leverage the experience of our QofE team to generate ***Insights That Matter*** in support of your next transaction.

SECTION 1 - INTRODUCTION

Corporate earnings are an important guidepost to transaction prices negotiated by buyers and sellers. However, reported earnings – even when audited and presented in accordance with generally accepted accounting principles ("GAAP") – have limitations. GAAP earnings are backward-looking: they report how a business has performed in the past under specific rules. GAAP earnings certainly have their uses, but buyers and sellers care about the view through the windshield, not the rearview mirror.

Credible perspectives on the future must be grounded in a reliable base of historical information. However, not every dollar of GAAP earnings is equally relevant to establishing that base. A quality of earnings ("QofE") report helps buyers and sellers discern that base of ongoing earning power relevant to establishing the transaction price. As shown in Exhibit 1, a QofE report is neither an audit, nor a projection of future results for the subject company but instead serves as a pivot between the two.

Exhibit 1 :: Audit, QofE Report, and Projections

Audit	QofE Report	Projections
Present historical results according to generally accepted accounting principles (GAAP)	"Translate" GAAP earnings into reliable base for projections / valuation	Expected future financial performance built off of reliable base earnings, reflecting forecasts for economy, industry, market share, etc.

The objective of a quality of earnings report is to "translate" historical financial information into a relevant picture of earnings and cash flow that is useful in developing a credible view through the windshield.

What needs to be translated from historical performance to create a relevant picture of earnings and cash flow? As summarized in Exhibit 2, there are five broad categories of adjustments used in QoE analyses to translate historical GAAP earnings to pro forma run rate earnings.

In Section 2 of this whitepaper, we illustrate each of these adjustment categories. Section 3 addresses the relationship between EBITDA and cash flow, illustrating working capital and capital expenditure analyses that are a critical element of QofE reports.

Exhibit 2 :: QofE Adjustment Categories

1. **Discretionary expenses**
2. **Unusual and nonrecurring items of revenue and expense**
3. **Timing / accounting policy adjustments**
4. **Major customer wins and losses**
5. **M&A run rate adjustments**

SECTION 2 – QofE EARNINGS ADJUSTMENTS

In this section, we illustrate how earnings adjustments in QofE analyses translate historical GAAP earnings to a measure of pro forma run rate earnings that is relevant to buyers and sellers.

1. Discretionary Expenses

Private business owners occasionally commingle business and personal expenses. For example, some family businesses have employees-in-name-only that could be terminated with no effect on operations. Other businesses incur expenses that have more to do with owner lifestyle than business operations (automobiles, aircraft, vacation properties, event tickets, etc.). Such discretionary expenses depress historical earnings of the business and should be identified and documented in a quality of earnings report.

For example, Exhibit 3 summarizes reported and adjusted earnings for a family business. Three second generation family members, while titular sales managers of the business with handsome compensation packages, do not actually work in the company and would not be retained by any buyer following a transaction. Eliminating compensation, benefits, and associated payroll taxes for these individuals from reported historical earnings yields a more accurate measure of the true earning power of the business.

Exhibit 3 :: Adjusting for Discretionary Expenses

	As Reported	Discretionary Expenses	Adjusted for Discretionary Expenses
Net revenue	$249,253	$0	$249,253
Cost of goods sold	129,972	0	129,972
Gross profit	$119,281	$0	$119,281
Selling expenses	34,222	(1,500)	32,722
Research & development expenses	2,733	0	2,733
General & administrative expenses	62,582	0	62,582
Operating expenses	99,538	(1,500)	98,038
Operating income / EBIT	$19,744	$1,500	$21,244
Depreciation	5,132	0	5,132
Amortization	1,094	0	1,094
EBITDA	**$25,970**	**$1,500**	**$27,470**
EBITDA margin	*10.4%*	*nm*	*11.0%*

2. Unusual and Nonrecurring Items of Revenue and Expense

As the maxim goes, "time and chance happens to them all." No business is immune to exogenous forces that can distort the company's reported financial performance. Business interruptions, revenue windfalls, casualty losses and the like influence historical earnings but do not affect the company's core ongoing earning power. Unusual and nonrecurring items can be either favorable or unfavorable from the perspective of historical results. A thorough QofE analysis should seek to identify such adjustments regardless of whether they increase or decrease adjusted EBITDA.

A word of caution is in order here. Identifying a business event as "unusual" or "nonrecurring" is inherently subjective. A regular or predictable pattern of unusual or nonrecurring events in the same direction can undermine the credibility of a QofE analysis. The QofE report should carefully describe the nature of the events identified as unusual or nonrecurring and offer a compelling rationale as to why the associated items of revenue and expense are not representative of the ongoing earnings of the subject company.

Continuing our previous example, the subject company wrote off $10 million of stale inventory to cost of goods sold during the fourth quarter. The written-off inventory was acquired as part of a failed product diversification bid that has since been abandoned. As shown in Exhibit 4, removing the inventory write off as a nonrecurring event increases gross profit and EBITDA for the company.

Exhibit 4 :: Adjusting for Unusual or Nonrecurring Events

	Adjusted for Discretionary Expenses	Unusual or Nonrecurring Items	Adjusted for Unusual or Nonrecurring
Net revenue	$249,253	$0	$249,253
Cost of goods sold	129,972	(10,000)	119,972
Gross profit	$119,281	$10,000	$129,281
Selling expenses	32,722	0	32,722
Research & development expenses	2,733	0	2,733
General & administrative expenses	62,582	0	62,582
Operating expenses	98,038	0	98,038
Operating income / EBIT	$21,244	$10,000	$31,244
Depreciation	5,132	0	5,132
Amortization	1,094	0	1,094
EBITDA	**$27,470**	**$10,000**	**$37,470**
EBITDA margin	*11.0%*	*nm*	*15.0%*

3. Timing / Accounting Policy Adjustments

There is more than one way to comply with generally accepted accounting principles. Companies make a host of accounting elections (inventory accounting methods, capitalization thresholds, etc.) that do not represent deviations from GAAP, but may nonetheless warrant adjustment to enhance comparability with the accounting policies of potential acquirers.

Furthermore, despite the best intentions of GAAP, sometimes revenue and associated expenses are recognized in accounting periods that do not conform to the economic substance of a transaction. For example, if a company incurs operating expenses in one period which are reimbursed by customers in a subsequent period, it may be appropriate to adjust recognition of the events across time to represent more faithfully the economic substance of significant transactions. Such timing adjustments will, over time, net to zero.

Exhibit 5 illustrates the impact of an accounting policy adjustment. The subject company uses the LIFO (last-in first-out) method of accounting for inventory, while FIFO (first-in first-out) is the standard method in the company's industry. During the period under question, use of the LIFO method understated cost of goods sold (through liquidation of "old" LIFO layers) relative to the FIFO method favored by industry peers.

This example underscores the need for QofE analyses to consider interactions between the income statement and the balance sheet. In this case, use of the LIFO method has understated cost of goods sold on the income statement and the QofE analysis should evaluate whether a corresponding adjustment to the balance sheet is warranted.

Exhibit 5 :: Adjusting for Timing/Accounting Policy Adjustments

	Adjusted for Unusual or Nonrecurring	Accounting Policy / Timing	Adjusted for Acctg Policy / Timing
Net revenue	$249,253	$0	$249,253
Cost of goods sold	119,972	1,236	121,208
Gross profit	$129,281	($1,236)	$128,045
Selling expenses	32,722	0	32,722
Research & development expenses	2,733	0	2,733
General & administrative expenses	62,582	0	62,582
Operating expenses	98,038	0	98,038
Operating income / EBIT	$31,244	($1,236)	$30,008
Depreciation	5,132	0	5,132
Amortization	1,094	0	1,094
EBITDA	**$37,470**	**($1,236)**	**$36,234**
EBITDA margin	*15.0%*	*nm*	*14.5%*

4. Major Customer Wins and Losses

While nearly every business experiences some degree of "churn" in its customer base, for businesses with significant customer concentrations, adding or losing a major customer during the year may merit adjustment in a QofE analysis. To help unearth and support such adjustments, a QofE report should include a robust analysis of historical customer churn. The results of detailed customer analysis can be summarized in the form of customer count and revenue rollforwards, as illustrated in Exhibit 6.

Exhibit 6 :: Customer and Revenue Rollfowards

	Customer Count	Revenue	Customer Average
Prior Year Total	673	$225,634	$335
less: Lost customers	(72)	(7,436)	103
plus: Retained customers (increase)	*488*	15,992	33
less: Retained customers (decrease)	*113*	(3,167)	(28)
plus: New customers	180	18,230	101
Current Year Total	781	$249,253	$319
Lost customers / beginning total	-10.7%	-3.3%	
Revenue growth (increasing retained)		9.4%	
Revenue growth (decreasing retained)		-6.6%	
Y/Y change (excluding new customers)	-10.7%	2.4%	14.7%
Net Y/Y change	16.0%	10.5%	-4.8%

The year-over-year revenue growth of 10.5% that can be read off the face of the income statement masks the underlying narrative that is of most interest to potential acquirers.

- Nearly 11% of customers from the prior year did not return in the current year. These lost customers were – on average – smaller than average ($103k average annual revenue vs. overall average of $335k).
- Of the customer accounts that were retained from the prior year, approximately 81% of them purchased more in the current year (an aggregate increase of 9.4%). The balance of the retained customer accounts generated less revenue in the current year (a 6.6% decrease).
- On a net basis, excluding the impact of new customers, total revenue increased 2.4% year-over-year, with the average revenue per customer increasing by 14.7%.
- The company closed on an acquisition that extended its geographic footprint and added new customers at the end of the third quarter. That acquisition accounted for a significant portion of the total number of new customers gained during the year. Since sales for the current year reflect only fourth quarter sales from the acquired customers, the average revenue per new customer ($101k) is lower than the overall average ($319k).

The company does not have any significant customer concentrations, with no single customer accounting for more than 3% of annual revenue. Aside from the impact of the acquisition, the observed customer churn was judged to be typical, so no discrete adjustment was warranted in the QofE analysis.

5. M&A Run Rate Adjustments

When companies make acquisitions, the GAAP financial results for the year of acquisition will include results for the acquired entity only from the closing date of the acquisition. Similarly, the results of divested operations are included in the financial results for the year through the effective date of the divestiture. As a result, the reported financials for the year of acquisition (or divestiture) will not reflect the true "run rate" of the business as of the analysis date.

Exhibit 7 illustrates the adjustment for the company's acquisition that closed at the end of the third quarter. To establish an annualized run rate, the income statement for the acquired company during the period leading up to the acquisition date is added.

Exhibit 7 :: Adjusting for Mid-Year Acquisitions/Divestitures

	Adjusted for Acctg Policy / Timing	Pre-Closing Earnings of Acquiree	Pro Forma Run Rate Earnings
Net revenue	$249,253	$39,724	$288,977
Cost of goods sold	121,208	16,679	137,887
Gross profit	$128,045	$23,045	$151,090
Selling expenses	32,722	7,428	40,150
Research & development expenses	2,733	0	2,733
General & administrative expenses	62,582	8,964	71,546
Operating expenses	98,038	16,392	114,430
Operating income / EBIT	$30,008	$6,653	$36,661
Depreciation	5,132	622	5,754
Amortization	1,094	0	1,094
EBITDA	**$36,234**	**$7,275**	**$43,509**
EBITDA margin	*14.5%*	*18.3%*	*15.1%*

Middle Market Transaction Update

This newsletter analyzes deal volume, deal value, and other M&A indicators in the middle market in light of the current environment.

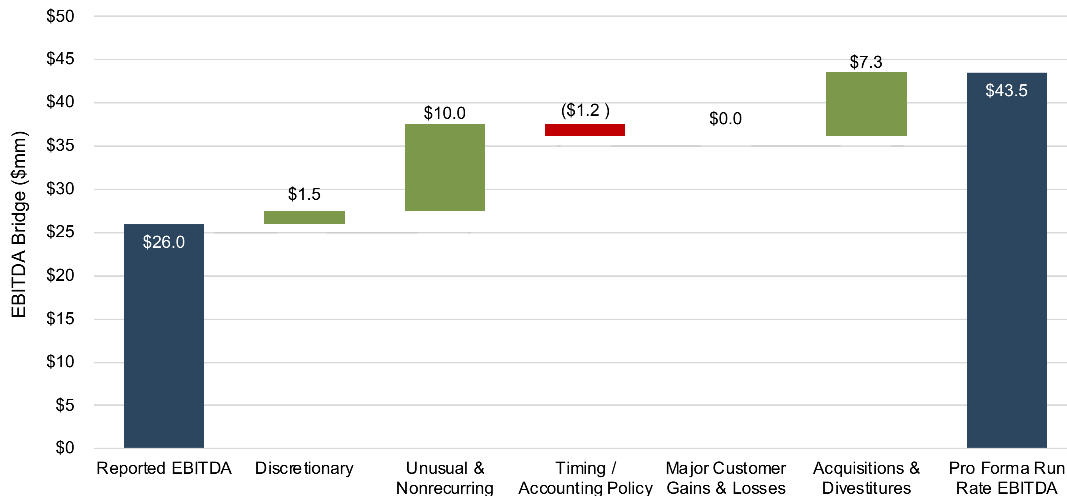
SUBSCRIBE

Click here to read previous issues

Net Effect of QofE Adjustments

Having identified relevant (and material) adjustments of each type, it is instructive to step back and assess the overall direction and magnitude of the adjustments made. A "bridge" chart like that shown in Exhibit 8 summarizes the adjustments made in deriving pro forma run rate EBITDA.

Exhibit 8 :: Net Effect of QofE Adjustments



From reported EBITDA of $26.0 million, the QofE adjustments for discretionary expenses, unusual & nonrecurring events, and timing / accounting policy adjustments resulted in a net upward adjustment of $10.2 million to $36.2 million. Including full-year earnings for the company acquired at the end of the third quarter brings pro forma run rate EBITDA to $43.5 million.

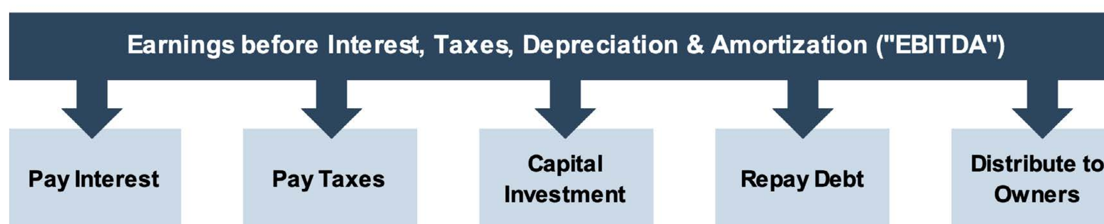
While in compliance with GAAP, the reported EBITDA of $26.0 million was not an appropriate base from which to derive valuation indications (using guideline or single-period capitalization methods) or build an earnings forecast. For sellers, QofE analysis is an essential step in achieving transaction outcomes that reflect the true earnings potential of the business they have built. Likewise, a proper QofE analysis helps buyers maintain discipline by identifying the truly durable components of earning power for the target company.

SECTION 3 - EBITDA AND CASH FLOW

The principal earnings measure analyzed in QofE reports is EBITDA. Why do buyers and sellers focus on EBITDA?

First, EBITDA is the broadest measure of earnings and cash flow for the firm. As depicted in Exhibit 9, EBITDA is a proxy for cash flow available for a variety of purposes.

Exhibit 9 :: Potential Uses of EBITDA



Second, referencing EBITDA promotes comparability across firms. Working up from the bottom of the income statement, EBITDA provides the most consistent measure of relative operating performance across companies by “normalizing” for how different companies are organized, financed, and assembled.

- **Income taxes.** Many private companies are organized as tax pass-through entities and therefore report no income tax expense on the income statement. Since EBITDA is calculated without regard to income taxes, C corporations and S corporations are on equal footing.
- **Interest expense**. The decision to finance operations with debt rather than equity does not directly affect the operating performance of the business. Since EBITDA is calculated without regard to interest expense, the operating performance of highly leveraged companies can be readily compared to that of companies with no debt.
- **Depreciation.** Depreciation is a non-cash charge that depends on various accounting estimates and fundamental business decisions, such as whether to own or lease productive assets. Nonetheless, while it is true that depreciation does not represent a cash flow in the current period, it does arise from a real cash outflow in a prior period, and one that will need to be repeated as the asset wears out.
- **Amortization.** Acquisitive companies recognize acquired intangible assets on their balance sheets that are subsequently written off through amortization charges on the income statement. Companies that grow organically do not incur amortization charges. EBITDA is unaffected by amortization charges, thereby putting companies that grow organically and those growing by acquisition on an equal footing. Unlike depreciable fixed assets, amortizable intangible asset generally do not need to be replaced through subsequent cash outflows.

The Transaction News Advisor covers selected M&A, private equity, and credit and capital market transactions of note.

Also in each issue:

- Market Snapshot
- Recent Mercer Capital Transactions

Click the button below to subscribe to this monthly newsletter

SUBSCRIBE

Not all EBITDA dollars are equally valuable, however. That is why some prominent investors like Warren Buffett are dismissive of the measure. Transactions are ultimately built on cash flow, not EBITDA. Therefore, a useful QofE report will not stop at EBITDA, but will also analyze the capital investments that stand between EBITDA and cash flow.

Of the five potential uses of EBITDA noted on Exhibit 9, four are discretionary, meaning that the buyer of a business will choose how to allocate EBITDA to those purposes:

- Interest payments depend on how a buyer elects to finance the business. If the buyer elects to finance the purchase with all equity, there will be no interest expense.
- While you can't really opt out of paying taxes, tax elections made by buyers will influence the form and magnitude of those payments.
- Debt payments depend on past and future financing decisions which are ultimately at the discretion of the buyer.
- The amount and timing of owner distributions are also at the buyer's discretion.

Since these four uses are a function of choices made by the buyer, they do not affect what a given dollar of EBITDA is worth. Capital investment, on the other hand, does influence the value of EBITDA since capital-hungry businesses with significant capital investment obligations to sustain operations generate less cash flow per dollar of EBITDA than their capital-light peers.

Capital investment consists of two components: capital expenditures and incremental working capital. A comprehensive QofE report should analyze each.

Capital Expenditures

Capital expenditures are essential to supporting a company's productive capacity. Broadly speaking, capital expenditures are required either to maintain existing capacity (i.e., maintenance expenditures) or add new capacity (growth expenditures). For capital-intensive businesses, a comprehensive quality of earnings report should distinguish between the two categories. Often, depreciation expense can serve as a proxy for maintenance expenditures when a more precise breakdown is not possible.

Exhibit 10 (on the next page) illustrates potential analyses around capital expenditures.

- Since capital expenditures are often lumpy, it can prove helpful to consider cumulative measure over longer periods of time. For the subject company in this example, five year aggregate capital expenditures represented 2.9% of cumulative revenue.
- For the same period, depreciation charges were equal to approximately 74% of capital expenditures, suggesting material growth expenditures.
- The efficiency of capital expenditures made can be measured by comparing the net balance of fixed assets to revenue over time. Over the period analyzed, this ratio declined from 9.5% to 7.8%, indicating improving capital efficiency.

Exhibit 10 :: Fixed Asset Rollfoward

	2018	2019	2020	2021	2022	Cumulative
Beginning balance - gross	$101,706	$121,654	$153,653	$171,019	$236,959	$101,706
plus: Capital expenditures	20,860	32,077	15,566	56,121	45,929	170,553
plus/less: Other, net	(912)	(78)	1,800	9,819	(22,279)	(11,650)
Ending balance - gross	$121,654	$153,653	$171,019	$236,959	$260,609	$260,609
Beginning balance - A/D	$27,923	$47,557	$71,043	$92,944	$117,915	$27,923
plus: Depreciation	19,573	23,197	24,616	25,732	32,889	126,007
plus/less: Other, net	61	289	(2,715)	(761)	(14,782)	(17,908)
Ending balance - A/D	$47,557	$71,043	$92,944	$117,915	$136,022	$136,022
Beginning balance - net	$73,783	$74,097	$82,610	$78,075	$119,044	$73,783
plus: Capital expenditures	20,860	32,077	15,566	56,121	45,929	170,553
less: Depreciation	(19,573)	(23,197)	(24,616)	(25,732)	(32,889)	(126,007)
plus/less: Other, net	(973)	(367)	4,515	10,580	(7,497)	6,258
Ending balance - net	$74,097	$82,610	$78,075	$119,044	$124,587	$124,587
Revenue	$778,833	$913,734	$1,091,721	$1,410,989	$1,595,222	$5,790,499
Capex / Revenue	2.7%	3.5%	1.4%	4.0%	2.9%	2.9%
Depreciation / Revenue	2.5%	2.5%	2.3%	1.8%	2.1%	2.2%
Net book value / Revenue	9.5%	9.0%	7.2%	8.4%	7.8%	
Depreciation / Beg bal (gross)	19.2%	19.1%	16.0%	15.0%	13.9%	
Accum depr as % of gross	39%	46%	54%	50%	52%	

Working Capital – Components and Cyclicality

The second component of capital investment is the annual change in working capital. Since working capital investment is sensitive to cyclical and seasonal factors, it is often appropriate to analyze working capital balances on a monthly basis. For illustrative purposes, we present a quarterly analysis for our sample company in Exhibit 11.

Exhibit 11 :: Working Capital Analysis

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Accounts receivable, net	10,221	10,477	12,796	13,010	17,114	12,968	14,727	14,672	12,413
Inventory	21,892	28,738	34,635	41,558	49,823	64,537	76,565	68,663	58,033
Prepaid expenses & other	2,763	3,824	3,724	3,694	4,623	6,185	6,370	5,244	5,206
Accounts payable	(19,316)	(18,757)	(22,763)	(25,950)	(29,894)	(26,158)	(31,889)	(19,190)	(22,003)
Accrued expenses & other	(13,917)	(11,349)	(13,564)	(15,134)	(20,673)	(19,032)	(20,300)	(16,719)	(33,031)
Taxes payable	(2,862)	(3,090)	(2,489)	(1,073)	(2,268)	(2,736)	(2,662)	(1,185)	(2,389)
Accrued payroll	(4,033)	(1,572)	(3,120)	(3,830)	(4,819)	(1,163)	(668)	(506)	(757)
Net working capital	**($5,250)**	**$8,271**	**$9,219**	**$12,275**	**$13,905**	**$34,601**	**$42,141**	**$50,979**	**$17,473**
NWC / net sales (annualized)	-2.2%	5.3%	4.1%	5.4%	5.0%	18.9%	16.1%	18.8%	6.2%
Days sales outstanding	16	25	21	21	23	25	20	20	16
Days inventory on hand	85	165	137	157	156	268	222	191	122
Days payables outstanding	75	88	79	85	89	95	81	52	63
Cash conversion cycle	27	102	79	94	89	198	161	159	75

The company's investment in working capital grew sharply over the two years analyzed, ballooning (as an annualized percentage of sales) from -2.2% at December 31, 2020 to 18.8% at September 30, 2022. The increase was primarily attributable to bloated inventory levels, which moderated during the fourth quarter of 2022, albeit at the expense of lower gross margin (37%, compared to 58% in 4Q21).

In addition to assessing the incremental working capital requirements over time, the working capital analysis in a QofE report is typically referenced when buyers and sellers are negotiating required working capital balances to be delivered at the closing of a transaction. These negotiations can lead to meaningful changes in the net proceeds received by sellers in transactions.

SECTION 4 - CONCLUSION

Corporate transactions are "measure twice, cut once" projects. An independent quality of earnings analysis plays an important role in the transaction process for both parties.

- For buyers, a thorough quality of earnings analysis is an essential component of the due diligence process. A quality of earnings report helps the buyer maintain pricing discipline by isolating the underlying ongoing earning power from the "noise" that often accompanies historical reported earnings.
- For sellers, a quality of earnings analysis can help position the company to increase the likelihood of achieving a premium price. Commissioning a quality of earnings analysis in anticipation of a sales process helps sellers present a compelling narrative regarding the true underlying earning power of the business for competing buyers.

Quality of earnings analysis is a multi-disciplinary task, requiring expertise in financial reporting and forensics combined with the judgment and expertise possessed by professionals with decades of experience in valuation and investment banking.

Looking to Enter the Acquisition Market?

IN THIS WHITEPAPER WE DISCUSS TOPICS LIKE:

- Identifying acquisition targets and assessing strategic fit
- Contingent consideration
- How to approach a target
- Fairness opnions
- and more!

DOWNLOAD PDF

Considering Selling Your Business?

IN THIS WHITEPAPER WE DISCUSS TOPICS LIKE:

- How long will it take?
- Benefits of hiring an advisor
- Understanding transaction fees
- and more!

DOWNLOAD PDF

Mercer Capital

1.800.769.0967

www.mercercapital.com