Empirical Evidence Confirming the Importance of a Transaction Advisor

A recent study conducted by Mercer Capital found empirical evidence supporting the retention of a financial advisor when selling your business. In this study, the pricing multiples received by those sellers who retained a transaction advisor were compared to those who did not. Our analysis revealed that the pricing multiples received by those sellers who retained a transaction advisor were significantly higher than those who took the For Sale By Owner (FSBO) approach, selling their business without hiring a transaction advisor.

In conducting this analysis, we reviewed transaction data in the banking industry, which is one of the few industries where this type of analysis is possible, particularly for smaller private companies. Factors in the banking industry conducive to this type of analysis include:

- **Readily Available Financial Information.** The banking industry is highly regulated and generally has a large amount of financial information made publicly available. Comparative financial information is difficult to derive for most other industries, particularly for smaller private companies, as most private companies do not make a comparable level of financial disclosure available to the public.

- **Readily Available Transaction Pricing Information.** Pricing multiples are generally readily available and easily accessible to market participants in the banking industry. Transaction information (including whether or not the buyer or seller retained an advisor) was available for over 1,200 deals occurring since 2001. It would be difficult to find this level of detailed pricing information, particularly those involving smaller private companies, in any other industry.

If you own a company in another industry, you may be thinking that our findings do not apply to you. Yet, this analysis is critically important to business owners considering selling their business in any industry. The availability of information in the banking industry allows business owners to have a reasonable idea of the value of a particular banking franchise, and one would suppose that the need for a professional M&A intermediary would be mitigated by the increased knowledge of the parties involved in the transaction. The transaction data analyzed clearly indicates that transaction advisors play a very significant role in helping owners maximize the value received for their banks, despite the increased level of information available. Thus, one can assume that the importance of a transaction advisor would be magnified in transactions in other industries, particularly those industries where both parties have less access to information.
THE STUDY IN DETAIL

Our analysis began with an examination of all bank transactions occurring since 2001. Those sellers who retained a financial advisor were compared to those who did not. In order to control for the difference in size among the acquired banks, our analysis focused on similarly sized financial institutions (with assets between $100 and $500 million). It was found that those sellers who utilized a transaction advisor received substantially higher pricing multiples and were more likely to maximize the value received for their investment. As shown in Figure 1, those banks sold with the assistance of a transaction advisor received a 20% higher price to earnings multiple and a 15% higher price to tangible book multiple.

It is interesting to note that those banks sold without retaining a transaction advisor were generally more profitable with a higher median return on average assets (ROA) and return on average equity (ROE). Typically, a bank’s return on equity is directly related to the price to book value measure, but the data indicates that the more profitable banks that elected not to retain a transaction advisor received lower price/tangible book value multiples relative to their less profitable counterparts who sold with the help of a transaction advisor.

One explanation for this trend is that business owners and managers do not often seriously consider selling their business until they are approached by an acquirer. Highly profitable, well-run institutions are more likely to be approached by an acquirer. Yet, the first offer is generally not the best offer available, but rather a starting point for negotiations. The retention of a seasoned professional can serve to attract multiple potential acquirers and develop a competitive bidding situation, which will result in a higher price and allow the seller to determine the true market value of their businesses.

The importance of a transaction advisor is even more pronounced when the seller enters into negotiations without a transaction advisor and the buyer has engaged an advisor or has in-house M&A staff. As shown in the Figure 2, the retention of a transaction advisor in these situations improved the pricing received by the seller and even put the seller at a distinct advantage over the buyer when the seller engaged a transaction advisor and the buyer did not.

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1 In order to conduct this analysis, we utilized transaction data for financial institutions as reported by SNL Financial. SNL Financial defines the seller advisor field as follows: “Indicates whether the Seller hired a third-party financial advisor. This may include advisory firms engaged from within a deal participant’s corporate structure.”

2 The analysis presented in the remainder of this article focuses on 443 similarly sized institutions with assets between $100 and $500 million in an attempt to derive more meaningful conclusions by controlling for other factors that might explain pricing differentials such as asset size of the target institution. While we focused on this particular asset size group, our overall analysis of over 1,200 bank transactions across all asset sizes occurring since 2001 had similar results.
REAL-WORLD EXAMPLE

To better illustrate the benefits of hiring a transaction advisor, consider the following real-world example in Figure Three. XYZ Bank is considering selling and has the following financial information: total assets of $250 million, earnings of $2 million, and equity of $20 million. XYZ Bank must choose between two different scenarios: one in which they hire a transaction advisor, and another in which they elect not to hire a transaction advisor. Based on the median pricing multiples derived from our study, the bank’s net proceeds would be $7 to $8 million higher (after deducting the estimated costs of hiring the transaction advisor) if they retain a transaction advisor.

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<th>The Importance of a Transaction Advisor - Real World Example</th>
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<tbody>
<tr>
<td>Advisor Hired</td>
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<td>Bank’s Earnings</td>
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<td>x Median Multiple</td>
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<td>Deal Value</td>
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<td>x (1 - Investment Banking Fee)*</td>
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<td>Total Net Proceeds</td>
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<td>$ Difference</td>
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<td>% Difference</td>
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| Advisor Hired | No Advisor Hired |
| Bank’s Tangible Book Value | $20,000,000 | $20,000,000 |
| x Median Multiple | 2.45 | 2.04 |
| Deal Value | $49,018,000 | $40,722,000 |
| x (1 - Investment Banking Fee)* | 0.99 | na |
| Total Net Proceeds | $48,527,820 | $40,722,000 |
| $ Difference | $7,805,820 |
| % Difference | 19.2% |

*The investment banking fee is assumed to be 1% of the total deal value, which is the median transaction advisory fees (as a percentage of deal value) paid by sellers in a prior analysis of bank transactions conducted by Mercer Capital.

FIGURE TWO

FIGURE THREE
CONCLUSION

It is tempting to think that no one knows your business better than you and so no one can sell your business better than you. This thought is only half true. It is true that no one knows your business better than you, but transaction advisors know transactions like you know your business. A transaction advisor can be the difference between getting the price you were offered and the price you want.

Additionally, selling a business takes a great deal of time and energy, which can detract from your ability to effectively run your business. A transaction advisor will allow you to focus on running your business while they focus on getting the maximum value for your business.

Remember our “real-world” example, and pick the right scenario by hiring a transaction advisor to facilitate your transaction. Mercer Capital has been providing advisory services to businesses in a wide range of industries for over 25 years. We are regularly engaged to act as advisors to business owners that are considering a sale. If you are contemplating the sale of your company or financial institution, please call Mercer Capital first at 800.769.0967.

Jay D. Wilson, Jr.
wilsonj@mercercapital.com
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To summarize *Buy-Sell Agreements* in one word, that word would be "methodical." Mercer focuses like a laser beam on virtually all of the possible permutations of the pricing and valuation provisions of buy-sell agreements, together with the advantages and disadvantages of each... *Buy-Sell Agreements* offers a comprehensive buy-sell audit checklist that alone makes it worthy of purchase, serious use and study... If you are looking for a book that has a comprehensive discussion of the pricing and valuation aspects of buy-sell agreements (which I've really not ever seen before), this is it... *Buy-Sell Agreements* is a no-brainer addition to the library of every one who works with or who drafts buy-sell agreements.

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Mr. Mercer has done a great job of addressing the reasons business owners might want to have a buy-sell agreement and the business factors these business owners should consider in the agreement... Overall, Mr. Mercer provides valuation practitioners, business consultants, and business owners with a very useful handbook for preparing, reviewing and interpreting buy-sell agreements.

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**Rand M. Curtiss, FIBA, MCBA, ASA, ASA**
*President, Loveman-Curtiss, Inc. Chair of the American Business Appraisers National Network*

**David A. Ellner, CPA/ABV**
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In the teacher's manual to our *Business Associations* case book, my friend, colleague and coauthor Bill Klein posits that “any lawyer who advises people entering into a business venture and who fails to urge the adoption of a buy-sell agreement is guilty of malpractice.” Z. Christopher Mercer’s new book *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions* offers a tremendously useful guide to these remarkably important contracts. In it, he provides guidance for business people and their financial advisors to use in assessing the need for a buy-sell agreement and, if one is appropriate, deciding on key terms. It will also be very useful to counsel drafting buy-sell provisions, as it offers drafting checklists and samples of how various issues can be treated. I recommend it very highly.

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*Released in January 2007, “Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?” has quickly become a valuable tool for attorneys, business advisors and business owners who recognize the importance of buy-sell agreements. Don’t take our word for it. Below are just some of the published reviews.*
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