

A photograph of three doors in a hallway. The two doors on the left are white with silver handles, and the door on the right is bright red with a silver handle. The floor is made of light-colored, polished wooden planks. The walls are white.

THE COMPLETE GUIDE TO  
**HIRING AN M&A ADVISOR**

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## **3 RED FLAGS YOU CHOSE THE WRONG M&A ADVISOR**

# Do I Need an M&A Advisor?

Thousands of business owners ask themselves this question every year when they begin to think about selling their companies. Wary of seemingly exorbitant fees and unsure of the true scope of the role, CEOs often underestimate the value a seasoned and qualified investment banker or advisor can bring to a transaction.

While it's certainly possible for business owners to handle sales on their own, those that opt to do so will likely make very costly mistakes throughout the transaction process. Even if things go smoothly, the opportunity cost may be high. In the study **Does Hiring M&A Advisors Matter for Private Sellers?** several academics analyzed a sample of 4,469 acquisitions of private sellers from 1980-2012 to “examine the decision and consequences of hiring sell-side M&A advisors.” The study showed that “private sellers receive significantly higher acquisition premiums when they retain M&A advisors” and this held true across all deal sizes. In other words, advisors generally lead to better deals than CEOs and business owners can get on their own. Read on to understand why advisors are so valuable, how to choose the right one, and how to structure and negotiate the best deal for you.

# Evaluating an Advisor's Value

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The right advisor will more than earn their fees (and lead to a better deal) before, during and after your transaction. Advisors add value at several key stages of the deal process:

## EVALUATING YOUR GOALS

Though you might think you have a pretty good idea of what a successful exit outcome looks like, experienced advisors can (and should!) make you realize that there may be more considerations than price when selling your company.

### Valuation

*Valuation is a careful equation of the buyer, the timing of the transaction, the state of the business, industry-specific trends, and macro trends.* Advisors have a sense of all of these factors and can help direct the process to align with your valuation goal.

### Timing

Many business owners often pursue a sale for reasons that have nothing to do with the business. An experienced advisor can help balance the urgency created by personal timing issues with an outcome that still gets you a fair price for your business.

### The Ideal Process

A good M&A advisor can help a business owner identify the best process for exiting the business. Since many closely-held businesses often experience intense family or shareholder dynamics, which may complicate the transaction, having a full understanding of the available options is essential. If you choose to pursue an external buyer, an advisor can then help you tackle the question of whether [a financial buyer or strategic buyer](#) is more appropriate.

### Personal Goals

Business owners often have other goals in a transaction that may even be more important than money. Each of these personal goals — including a desire to stay after the transaction, earn-outs, concern for company legacy, concern for management team, etc. — can change the nature of the process. An advisor knows the different strategies of [each buyer type](#) and can help align your interests align.

## TRANSACTION PREPARATION

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When it's finally time to move forward with a transaction, your advisor is instrumental in the preparation of key materials and the actual logistics of the transaction.

### Preparation of Marketing Materials

One of the most important M&A documents your advisor will prepare is the executive summary of your business, also known as the **teaser**. The teaser is how your advisor will pitch your business to prospective buyers. It will summarize your transaction goals as well as high-level highlights about your business' financial and operational performance, industry and market position, management team, competitive advantages, and any other differentiators. Private equity buyers and experienced corporate acquirers typically review hundreds if not thousands of teasers every year, so *the teaser is a critical opportunity to make a strong first impression*.

Your advisor will also prepare a more comprehensive **confidential information memorandum (CIM)** and detailed financial statements for buyers who express initial interest in learning more about your company. These later documents will help the buyer evaluate if they want to move on in the process and meet you and your management team. Lacking these necessary documents may cause many potential buyers to not even consider your business.

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### Building a Buyer List

During this stage of the process, many advisors will also begin compiling a prospective buyer list. Your advisor's transaction experience and industry expertise will play a large role in their ability to **build a diverse buyer list** that not only helps maximize your potential valuation, but also enables you to achieve your non-valuation transactional goals.

Advisors will rely on their existing network of financial and strategic buyers, **tools like Axial**, and your own knowledge of potential acquirers to compile the list. **Building the ultimate buyer list** is part art and part science, and a qualified advisor can help you identify the most likely buyers for your business from among the thousands that may potentially be interested.

## THE TRANSACTION

### Going to Market

The actual transaction process kicks off with your advisor “taking your company to market.” This simply means that they begin the process of reaching out to potential buyers, and gauging their level of interest in your business. The initial outreach typically maintains your confidentiality, as the teaser is usually blind and does not disclose the identity of your business. This stage of the process is often broken down into multiple waves, as your advisor might first reach out to strategics (who typically take longer to respond with interest) and other buyers in the top tier of your buyer list. Buyers interested in learning more about your business will sign a [non-disclosure agreement](#) (NDA) and request the CIM.

### Narrowing Down Candidates

As various buyers confirm their interest or withdraw from the transaction, your advisor will help you navigate the process of narrowing down buyer candidates. At this point you should expect to meet potential buyers in-person (known as “management meetings”). As the process progresses you should also begin receiving [IOIs \(indications of interest\)](#) and [LOIs \(letters of intent\)](#). IOIs are informal letters confirming a buyer’s intent to purchase a company and usually include valuation guidelines, transaction structure and other terms, due diligence expectations, and a timeframe for closing. LOIs are more formal, legally-binding agreements that serve as a precursor to the purchase agreement and describes the proposed transaction in more detail.

### Negotiation and Final Due Diligence

If you’ve managed to generate interest from multiple buyers, your advisor has done a great job so far. However, their job is far from complete — they will continue to negotiate the final agreement. Remember that [price isn’t the only important consideration](#), and your advisor can help you evaluate the other important considerations in the LOI. Your advisor’s ability to negotiate on your behalf can not only come in handy because of their experience in leveraging buyers against one another for the best terms, but also because they serve as a buffer to prevent any hard feelings in the negotiation process from affecting your relationship with the buyer post-sale.

Once you sign an LOI, your advisor will also be responsible for ensuring [a seamless due diligence process](#). Depending on whether you have an existing relationship with an M&A lawyer, they may also help you round out your “deal team” as you [finalize the purchase agreement](#) and close the transaction.

## BEYOND THE TRANSACTION

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Besides helping you plan, prepare and execute a transaction, a trusted partner also increases premiums by driving competition and allowing you to focus on your business. This dedicated effort and sense of competition are particularly important for private companies looking to sell because they do not have the public records, SEC filings, visibility or media attention that typically help drive interest in purchasing public companies. Beyond the transaction, advisors offer these extra-valuation benefits:

- **Economies of Scale** Financial intermediaries (advisors) are able to drive better deals for their clients because they have greater economies of specialization and information acquisition, and lower search costs. In other words, they often run smoother, faster processes with better buyer lists.
- **Laser Focus on Sale** Concurrent interest from several interested parties is critical to obtaining the best sale price. Advisors are particularly adept at keeping multiple, relevant bidders engaged simultaneously. Where you need to be focused on running your business during this critical time, they are focused solely on the sale.
- **Marketplace Perception** A seller has more negotiating leverage when a prospective buyer believes that it is competing with other bidders. *Simply having an advisor gives the impression that there are competing strategic buyers against which it must compete to acquire the seller.*
- **Peace of Mind** With the right advisor, you can rest assured that you are being represented by someone you can trust with one of your most prized assets. They will also be able to serve as objective, third-party counsel to help you make decisions that maximize successful outcomes for all stakeholders.

Ultimately, the right M&A advisor can have tremendous tangible and intangible benefits for you and your business. It's important to [begin developing formal relationships with advisors](#) at least 2-3 years before you think you might sell – it takes time to build trusted relationships with someone who understands your personal goals, and can help you undertake the strategic planning efforts that will help you achieve them.

# Finding the Right Advisor

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Once you've decided to work with an advisor to help define your goals, find the right buyer and close a deal, you want to be sure you find the right partner for you. Choosing a qualified, experienced investment banker with relevant transaction experience to represent your company might be the most important decision you make to ensure a successful sale of your business. If you choose poorly, the downside is serious, as even well-meaning bankers can derail a deal with bad advice, poor judgment, or a misrepresentation of their skill-sets. Each business and business owner is different so you'll need to first find the right kind of intermediary for you, and then ask the right questions to make sure the individual or firm is a fit.

**Here are the key questions to ask yourself, and your prospective banker, as you make this important decision:**

## **SHOULD I CHOOSE A GENERALIST OR SPECIALIST INVESTMENT BANK?**

Investment Banks usually self identify as either generalists (cover a wide range of industries and sectors) or specialists in one given area. Choosing between a generalist or a specialist firm is not a clear-cut decision for many.

The fact of the matter is that there is no right answer, and each business opportunity presents unique considerations that drive that decision. Timing, sector knowledge, relationships, and financials are just a few factors entrepreneurs should consider. Ultimately, there is no across-the-board answer to the generalist/specialist dilemma. As with many business issues, the best course of action depends largely on the specifics of your business.

*“A trusted partner also increases premiums by driving competition and allowing you to focus on your business.”*

## SPECIALIST INVESTMENT BANK

- 1. Intimate industry/sector knowledge.** Specialists are intimately familiar with challenges, players and needs in your industry. These firms are best able to recognize and articulate your distinct advantages that are not easily replicable, especially during down economic times.
- 2. Understanding of the fundamentals.** Specialist are often the best fit for businesses that face financial challenges.
- 3. Deep relationships.** Pascal Niedermann, founding partner at **The Maestro Group**, emphasizes the strong relationships specialists maintain with institutional investors in their sector, “creating and cultivating relationships with key strategic and financial buyers.”

VS.

## GENERALIST INVESTMENT BANKS

- 1. Better able to handle complex transactions.** The clear advantage that a generalist investment bank possess is that these firms tend to have larger teams and are better able to handle several larger and more complex financial transactions simultaneously.
- 2. Able to engage multiple buyers simultaneously.** Smaller, nichely-focused teams may be unable to handle many sales processes at once and cannot quickly accommodate multiple requests for information like generalists can.
- 3. Small team expertise.** Many “generalist” investment banks actually consist of multiple teams that possess a similar quality of sector experience as specialist firms. In this case you get the best of both worlds of industry speciality with the resources of a larger, broadly focused firm.

## DO THEY HAVE THE RIGHT EXPERIENCE?

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Perhaps the most important question you want answered when talking to an M&A advisor is: “*Can they actually get a deal done?*” With the plethora of potential pitfalls that can derail or prolong a transaction (which can take 6-12 months to get done as it is), you’ll want a high degree of confidence that your banker has the credentials and experience to close the deal. Here are two important questions to ask any investment banker you might be thinking of hiring:

### **Ask Your Banker...**

- 1. What comparable transactions have you completed in the past 4-5 years?** Make sure the advisor provides examples of companies in both your industry and of a comparable company size. Recent industry experience will ensure that they have up-to-date insight into who is actively making acquisitions in your space, and an existing foundation of knowledge for [preparing your marketing materials](#). The size of past transactions is also important since the size of your company dictates which financial and strategic buyers are the right partner for you.
- 2. How many M&A assignments have you worked on in the last three years that didn’t close and why?** This is critical due diligence. While a fair number of deals fall apart for reasons beyond either the banker or seller’s control, you’ll want to tease out which of these reasons are legitimate and which seem like excuses by the banker. Ask to speak with several of the business owners they have worked with. When you connect with the business owner, ask how hard the advisor worked, how long they stayed focused, and who were the individuals that really completed the work. Be wary of any advisor who will not provide such referrals.

## WHAT DOES THE DEAL TEAM LOOK LIKE?

Depending on your company's size, you'll meet with firms of various team sizes and organizational structures, ranging from solo advisors and boutique firms to mid-sized regional banks with a pyramid structure of partners, senior/mid-level professionals, and junior associates/analysts. Much of the value an M&A firm brings to the table comes from the experience and network of its senior bankers. Ask these two questions during the process to ensure you'll be comfortable with the involvement and level of attention you get from the senior banker on your deal team.

### *Ask Your Banker...*

- 1. Walk me through the role of each deal professional at each stage of the transaction process.** There are almost a dozen steps in the process of selling a company. You may be okay with junior bankers handling the early stages of preparing materials for your company (and maybe even the initial outreach to potential buyers if that pool is large), but you'll want the senior banker to bring his years of experience when it's time to begin more serious conversations with potential investors or acquirers.
- 2. How many clients do you typically take on in a given year, and how many do you expect to take on this year?** Bankers get busy, too. If a banker takes a meeting with you despite already having a full pipeline of upcoming engagements, you should feel free to ask them how they plan to allocate their time and attention among their clients to ensure you're not being sidelined for other projects.

## WHAT IS THE VALUATION AND FEE STRUCTURE?

As tempting as it is to simply choose whichever M&A advisor will charge the lowest fees, you should treat this decision as an investment in your business — and your goal should be to maximize the ROI from hiring the right bank to get you the highest purchase price for your company:

### *Ask Your Banker...*

- 1. What valuation range should I expect for my business and why?** A good banker should know enough about industry trends, current market activity, average multiples, and other valuation factors to give you a ballpark figure of what your company is worth.
- 2. Tell me about your fee structure.** Some combination of a retainer and a success fee is the most common way that an M&A advisory firm will charge for its services. The exact mix will vary from firm to firm, but be wary of structures that veer too far one way or the other. See page 14 for more on fee structures.

## CAN THEY ADD VALUE BEYOND THE TRANSACTION?

Bankers should have a great understanding of the competitor, supplier/vendor, or customer landscape in your space. Even if you're still in the exploratory stage of a sale process, top-tier advisory firms will look for ways to add value to your business regardless of how far you are from an exit.

### *Ask Your Banker...*

- 1. What growth opportunities in my industry can I pursue leading up to a sale?** Since a banker's fee is ultimately tied to the price they help you get for your business, they shouldn't be shy about offering advice and insights to help you maximize your company's growth and value in the 1-3 years preceding a sale.
- 2. What else can I do to prepare my company for a sale?** Whether it's ensuring that a strong management team is in place, that your customer base is sufficiently diversified, or that your financial statements and accounting practices are in proper order, good advisors can help you with a quick "diagnostic" to understand (and begin addressing) the issues that prospective buyers may find with your business.

## IS THERE CHEMISTRY?

Think of your banker as someone who ultimately serves as an extension of you. You should be confident that this is someone who understands you, your business, and your goals.

### *Ask Yourself...*

- 1. Does this banker understand my personal goals and what motivates me?** Though you certainly want to sell your business for as much as possible, [the purchase price isn't everything](#) — ask yourself, does this banker understand everything else I want out of the sale, both personally and for my business post-transaction?
- 2. Do I trust this person?** It will probably take several conversations and meetings with the banker to answer this question confidently. This is one reason [building relationships with potential advisors well in advance](#) of actually initiating the sale process is important.

In the end, the right advisor must have unique a combination of transaction skills, relevant industry experience, trustworthiness, and commitment to your success. If you focus on the above questions, you have a better chance of choosing the right advisor to sell your company.

# Structuring the Relationship

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After you've made the decision to invest in an advisor, and identified the right one for you and your business, you need to seal the deal. To ensure you are setting up the most beneficial structure with your chosen banker, you need to understand some basics about how banks are incentivized.

Nearly every banker structures their fees as some combination of a retainer and success fees. The split between retainer and fee, along with how the success fee is structured, has the biggest impact on banker incentives.

## RETAINERS

The retainer is the fee paid just to have an investment bank work on your transaction. It is non-refundable and paid in monthly installments or upfront as a lump sum. They tend to be highly negotiable: Bankers might waive a retainer for a surefire deal, while riskier projects could carry a steeper charge. This ensures that the advisor isn't left empty-handed if the deal flatlines.

The good news, though, is that money spent on retainer is usually credited against the success fee when the deal closes.

Think hard about the riskiness of the company compared to the retainer being changed. Banks that charge a large upfront retainer but shrimpy success fees won't be strongly motivated to get a deal done, while those that tout a success-only model probably do not close a greater percentage of deals, just a greater number.

*“The right advisor will more than earn their fees (and lead to a better deal) before, during and after your transaction”*

## SUCCESS FEES

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The bulk of a banker's pay comes from a fee earned upon successfully completing the sale of your business. The success fee is calculated in a number of different ways. The terms vary depending on the size and complexity of the deal, the nature of the transaction (equity raises are a bigger lift) and final outcome, among other considerations.

Starting in the '70s and '80s, success fees were based on the Lehman Formula. Originally applied to financing engagements, the formula was made famous as a template for M&A transactions. In a nutshell, Lehman is a 5-4-3-2-1 structure: 5 percent of the first million dollars, 4 on the next million, and so on, scaling down to 1 percent.

Today the formula is still a popular way of structuring success fees, though inflation has made the traditional numbers unworkable. Instead the Double Lehman scale is more prevalent: 10 percent of the first million dollars, 8 percent of the second, 6 of the third, 4 of fourth and 2 of everything thereafter. Variations on the structure have also become more common, tailored to each deal. The Modified Lehman scale takes 2 percent of the first \$10 million and a lesser percentage of the balance.

Rather than reducing fees as a deal gets bigger, some firms actually increase their fees as they generate a higher sales price.

Escalating success fees above certain benchmarks is one way to incentivize bankers towards larger outcomes — i.e. 1.25 percent of first \$100 million of value, 1.5 percent on value between \$101 and \$125 million, 2 percent thereafter. Regardless of the scale, the logic behind compensation is to incentivize the banker to do his or her job. That means resisting the quick solution and driving towards superior terms.

## OTHER FEES AND EXPENSES

It may seem obvious, but it is worth noting that fees are determined by the value of the deal, not the proceeds to the seller. That is, bank debt or other liabilities may reduce the seller's payout but not the fee base.

And timing is another issue. Bankers often want to be paid at closing, which is reasonable in connection with a cash sale. It gets more complicated, however, and more negotiable, when deals involve different financing components, like deferred payments, capital adjustments and promissory notes.

Aside from retainer and success fees, targets will have to reimburse the banker for deal-related expenses, like travel, which on a large transaction can become significant.

Deal-making discourages transparency, but it never hurts to simply ask the banker how fees were structured for comparable deals. It might reveal much, especially if the transactions involved private companies, but even general outlines make the process less inscrutable.

## WRITING THE ENGAGEMENT LETTER

**The engagement letter is without contest the most important agreement between your company and the investment banker.** Outlining the terms and scope of the advisory services provided, it rigorously details the quality and depth of the investment banker's duties to the client as well as the economic points that define the relationship.

When negotiated and structured properly, this contract can be remarkably powerful in aligning the investment banker's interests with yours. In order to successfully negotiate this agreement, it's imperative that executives understand the perspective of the investment banker and the specific motives that will encourage a top notch transaction outcome. Here are the key terms that need to be outlined in such a letter:

- **Fee structure.** As mentioned above, investment bankers will typically divide your advisory charges into a non-refundable deposit or retainer, and a success fee. The success fee — not the retainer — should always be the most significant component of the total compensation. This gives both parties the best motives for an optimal outcome.
- **Exclusivity.** Nearly all qualified investment bankers will require exclusivity, meaning they are the only banker allowed to shop the deal. Why? A good banker is going to be putting a significant amount of thought, time and effort into preparing your team and your offering materials to go to market. The sale process will span several months and result in a number of divergent outcomes. High quality and trusted investment bankers take each mandate seriously and dedicate themselves to closing a successful transaction.
- **Length.** The term length specifies how long the engagement — and therefore the accompanying exclusivity — lasts. A 6-12 month term is pretty standard. This allows time for your banker to position the company, send out **teasers** to potential buyers, prepare the **confidential information memorandum**, solicit interest, get disclosure agreements signed, coordinate with buyers during their due diligence processes, receive offers, and negotiate a deal. The engagement term you negotiate should be driven by two things:
  - how much time your advisor needs to close your specific deal and
  - how long you can be reasonably bound to an exclusive relationship with that advisory team.

- **Termination.** Your letter should explicitly outline the rights of termination after the term of mandate. Generally speaking, most agreements are drafted to automatically renew on a monthly basis until canceled, in writing, by either you or the banker.
- **Tail Period.** A tail is a length of time after the official term during which a transaction close would still result in advisor compensation. Typically, the tail period will be 24 months. It's in your best interest to seek a shorter rather than longer tail period. The fundamental purpose of the tail is to make sure that the advisory team is compensated for their work when a deal is started, but not consummated, within the mandate term. It also precludes a client from terminating an engagement immediately prior to deal close in order to dodge the majority of the advisory fee.
- **Expenses.** Your banker will incur reimbursable out-of-pocket expenses such as travel, research and material preparation during the sale process. Most engagement letters will explicitly dictate that the client will cover any expenses incurred by the advisor in the performance of its services. It's in your interest to draft the letter such that you maintain the ability to exercise some reasonable control over these expenses.
- **Coverage.** A sale process can result in a wide range of outcomes, from selling only a portion of the company for a minority equity position, to raising mezzanine debt, to launching a strategic joint venture. It's important that the scope of services provided and covered transactions are well defined. For example, ultimately raising mezzanine capital may be a great outcome for you. The fees due to a banker for raising mezzanine capital, though, are usually significantly lower than raising a comparable quantity of equity capital.

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*“The engagement letter is without contest the most important agreement between your company and the investment banker.”*

# 3 Red Flags You Chose The Wrong M&A Advisor

- 1. The M&A firm won't give you references to CEOs they've successfully served.** Do your reference checks. If they aren't willing to provide references, then you are not working with a banker or firm that has a history of success. When a CEO or business owner has a great experience working with an investment bank who successfully helps sell their company, they are almost always willing to serve as a reference. That's fine, but firms that resist providing references aren't worth considering.
- 2. They take on a lot of assignments each year but hardly close any of them.** These firms are likely trying to make a living based on volume. They tend not to be thorough and persistent on their client's behalf. Selling a business is complex and takes a lot of work and sustained focus to get a deal completed. You need to get a feel for whether the bank you're evaluating knows how to get a deal done and has a disciplined process that they use to maximize success for their clients.
- 3. Their pricing model charges large up front one-time fees for valuation and materials preparation.** If the bank charges a large one-time up front lump sum to do analysis, prepare marketing materials, and conduct business valuation, that's a red flag. It's likely a sign that they are trying to play the volume game, will throw the pasta at the wall once or twice, and move on. Compensation should be spread out over the course of the engagement and should be enough to cover their out of pocket and opportunity costs, but the windfall for them should come when the transaction is completed.