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The Investment Banker Alpha: Why RIAs Should Hire an Investment Banker when Selling Their Firm

The value proposition for investment bankers, much like wealth advisors, has been more straightforward to describe than to measure. Quantifying the advantages of hiring an investment banker is not easy for a seller, whereas fees can be measured and compared. In some cases, sellers may believe that the investment banker's fees are greater than the value of their advice. The worth of advice is a subjective evaluation that differs from one person/firm to the next. While some of the advice's additional worth can be quantified, it can only be estimated at best due to the distinct characteristics of each company that goes through a transaction. Based on a 20-year analysis of transactions, a recent study conducted by the University of Alabama and Portland State University estimated that sellers of privately owned businesses who engaged an investment banker received valuation premiums of approximately 25%[(1)]. We will walk through several areas where investment bankers add value to a seller throughout the process and conclude with an illustrative example that quantifies the Alpha of hiring an Investment Banker when selling your business.

Optimizing Adjusted EBITDA

A sell side advisor will have the expertise and resources to help business owners optimize their Adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) before they go to market. This involves identifying and eliminating non-essential expenses, making pro-forma revenue adjustments, and identifying areas for operational efficiency. EBITDA is the baseline for which most offers are based and if adjustments are not brought to the buyers' attention, they may overlook items that justify a higher valuation for the business. It is important to note that the investment banker will not only identify these adjustments but also explain and justify these adjustments to the buyer pool.

EBITDA
+ Revenue Adjustments
+ Expense Synergies
= Optimized EBITDA

(1) Agrawal, Anup and Cooper, Tommy and Lian, Qin and Wang, Qiming, Does Hiring M&A Advisers Matter for Private Sellers? (January 24, 2023). Quarterly Journal of Finance, Forthcoming, Available at SSRN: https://ssrn.com/abstract=2400531

Finding Buyers and the Competitive Bidding Process

An investment banker will be able to leverage their deep contacts within the business community to generate competitive bidding for the business. This will help business owners secure the highest possible sale price for their business in an organized and efficient process. Competition or the possibility of it leads to negotiating leverage that sellers can use to achieve higher offers and better deal terms. Sellers will sometimes assume they are in a good position just because they have a buyer in hand but that is not always the case. A buyer is always going to be looking to achieve a transaction at the lowest cost with the most favorable terms to them so if they know they are the sole competitor they are unlikely to negotiate.

Expertise in Deal Structuring and Contract Negotiation

The skills of an investment banker enable them to design and bargain the deal in a manner that benefits the business owner's interests. They possess a comprehension of market terms and will work alongside legal counsel to negotiate payment terms, restrictive covenants, and other elements to ensure that the terms are reasonable and in line with what was conveyed to the seller during the process. In most deals, a seller must choose which battles to fight and concede on terms that are unlikely to change or do not have a significant impact. It is essential to note that buyers require a few concessions to justify their investment. With the guidance of a competent investment banker, sellers can better identify and prioritize the issues that impact the deal.

Behavioral Coaching

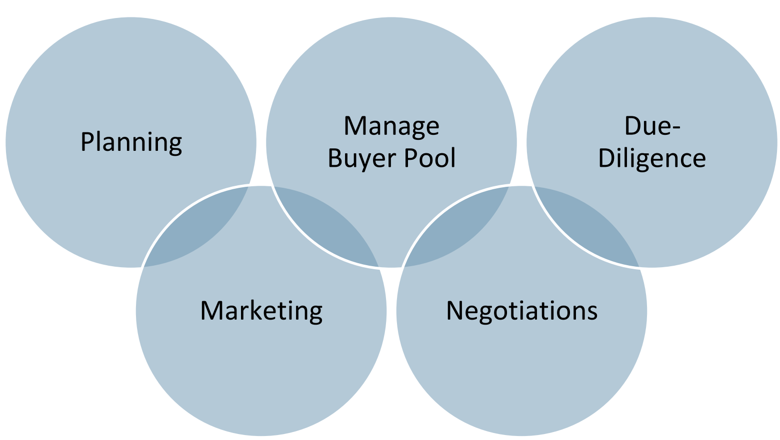
Much like how a wealth advisor assists clients in navigating investment cycles, investment bankers play a crucial role in helping business sellers stay focused and avoid becoming overwhelmed by emotions and "deal fatigue" during the selling process. Selling a company is a momentous and life-altering event, often eliciting a range of emotions such as anxiety, stress, and even a sense of attachment to the company being sold. The process of selling a business can be lengthy and demanding, requiring substantial time, effort, and attention from the seller. It is not uncommon for sellers to feel overwhelmed or fatigued as negotiations progress, particularly when faced with challenging issues or unexpected delays. These emotional factors can sometimes cloud judgment and impede effective decision-making. Investment bankers serve as impartial and objective facilitators, guiding sellers through the process and offering the necessary support to ensure a successful transaction.

Managing the M&A Process and Strategy

An investment banker will undertake a thorough due diligence process to identify and organize all the relevant documents, develop financial projections to justify value, and create a confidential information memorandum (CIM) to highlight important aspects of the business. This process requires an extensive time commitment, but it is well worth the effort. The investment banker will also handle introductory calls with potential buyers, coordinate with other advisors and attorneys, and negotiate and structure the transaction. A study conducted by Fairfield University that polled 85 business owners who sold their businesses found that managing the M&A process and strategy was the most critical area in which sellers perceived investment bankers to add value during a transaction[(2)]. In an investment banker run process, owners can expect to receive multiple offers from buyers, allowing them to balance fit and price when making their decision.

Minimize Time Away from Running the Business

Maintaining focus on your core business is paramount, particularly as a fiduciary who must prioritize serving your clients. Attempting to sell your business on your own requires a significant investment of time and attention, which can divert your attention away from your firm's daily operations and increase the risk of a performance decline. This, in turn, could provide an opportunity for a buyer to reduce their initial offer or even back out of the deal entirely. By engaging an experienced investment banker, you can entrust the sale process to them while you focus on serving your clients and running your business. This is akin to working with financially savvy clients who may be capable of managing their portfolios and achieving their goals but lack the time to execute their strategy as they do not want to direct time and attention away from their career and family.



(2) McDonald IV, Michael B., The Value of Middle Market Investment Bankers (October 2016). Fairfield University.

CASE STUDY

While we can quantify the results of the impact that an investment banker has on a transaction it can be difficult to attribute value to individual actions as they are all interconnected. For instance, we cannot bifurcate the value added from the IB marketing activities from the value added from an IB led competitive bidding process. We can however quantify the value from the result of these actions in aggregate and assign them to different stages of the transaction. The hypothetical example below walks through a sales process at a high level while assigning an advisor value for each step. We then net the added value with the fees paid to the investment banker to get to a net fee which is the investment banker alpha.

SCENARIO A – SALE WITHOUT INVESTMENT BANKER

Andy owns and operates an independent RIA and decides he wants to sell and partner with a firm that will take on the compliance and back-office responsibilities so that he can spend more of his time working with clients. Andy decides not to hire an investment banker and uses his own network to negotiate a deal with a buyer for $8M based on $925K of EBITDA with 60% of the proceeds paid at closing.

AUM	$ 300,000,000
Revenue	$ 1,950,000
Expenses	$ (1,025,000)
EBITDA	**$ 925,000**
Accepted Offer	$8,000,000
EBITDA Multiple	8.65x

Deal Structure	**Payment Amounts**	**Present Value of Payments***
Cash Paid at Closing (60%)	$ 4,800,000	$ 4,800,000
Retention Payment Paid at 12-Months	$ 3,200,000	$ 2,857,143
Total Payments	$ 8,000,000	$ 7,657,143
EBITDA Multiple	8.65x	8.28x

**Calculated using a 12% discount rate*

SCENARIO B – SALE WITH INVESTMENT BANKER

Andy owns and operates an independent RIA and decides he wants to sell and partner with a firm that will take on the compliance and back-office responsibilities so that he can spend more of his time working with clients. Andy decides to hire TCC to serve as his advisor for the transaction.

STEP 1 - IB PREPARATION AND EBITDA OPTIMIZATION

After reviewing Andy's financial statements TCC found justification for increasing revenues by $50K and identified $25K in non-recurring expenses. These adjustments increased Andy's marketed EBITDA from $925K to $1M. TCC also identified several areas where a buyer might find operational efficiencies but could not quantify as they will be unique for each buyer given their service model and related cost structures. If we use the multiple that Andy received in Scenario A we can deduct that discovering these adjustments carried a value of $650K ($75K * 8.65) to Andy and potentially more if a Buyer is able to find additional savings based on operational areas TCC highlighted for them.

EBITDA	$	925,000
Adjustements to Revenue	$	50,000
Adjustments to Remove One-Time Expenses	$	25,000
Adjustments to Operating Expenses		
Adjusted EBITDA	**$**	**1,000,000**
Increase in Marketed EBITDA		*8.11%*
Total Adjustments to EBITDA	$	75,000
EBITDA Multiple from Scenario A		8.65x
Implied Advisor Value Added	**$**	**650,000**
Present Value of Implied Advisor Value Added*	**$**	**622,143**
**Calculated at 12% DR with 60% paid at closing*		

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STEP 2 - IB LED MARKETING AND PROCESS

TCC creates marketing materials to frame the opportunity for prospective buyers. Moreover, they utilize their extensive network of buyers to conduct a two-round auction, with an initial round of 15 bidders and a final round of 5 bidders. Across all bids, the average bid in the initial round was $8.76M, while the average bid across the 5 finalists was $9.4M. We can extrapolate from this that the marketing and the presence of completion added $750,000 of value, as determined by subtracting the average bid of finalists from Scenario A's purchase price and the value added by optimizing EBITDA.

Average IOI of Finalists	$	9,400,000
Less: Scenario A Purchase Price	$	8,000,000
Less: EBITDA Optization	$	650,000
Implied Advisor Added Value	**$**	**750,000**
Present Value of Implied Advisor Value Add	**$**	**717,857**
**Calculated at 12% DR with 60% paid at closing*		

STEP 3 - IB LED STRUCTURING AND CONTRACT NEGOTIATION

Andy identified Buyer 13 as his favorite going into the final round of bidding and with the competitive process TCC was able to get Buyer 13 to increase offer by 6.4% from $9.4M to $10M. In addition to purchase price TCC was also able to use the competitive process to negotiate better terms for the sale including increasing the % paid at closing from 60% to 75%. By utilizing the investment banker's skill of creating a competitive negotiating environment Andy was not only able to increase his headline purchase price by $600,000 but was also able to increase the present value by an additional $160K by negotiating better terms on the amount paid at close.

Negotiating the Price		
Buyer 13 Final Bid	$	10,000,000
Buyer 13 IOI Bid	$	9,400,000
Implied Advisor Added Value	**$**	**600,000**
Present Value of Implied Advisor Value Add	**$**	**574,286**
**Calculated at 12% DR with 60% paid at closing*		

Negotiating the Terms		
PV of Scenario B	$	9,732,143
Less: PV of Scenario B with Scenario A Terms	$	9,571,429
Present Value of Implied Advisor Value Add	**$**	**160,714**

AUM	$	300,000,000
Revenue	$	2,000,000
Expenses	$	(1,000,000)
EBITDA	**$**	**1,000,000**
Accepted Offer		$10,000,000
EBITDA Multiple		10.00x

Deal Structure		**Payment Amounts**		**Present Value of Payments***
Cash Paid at Closing (70%)	$	7,000,000	$	7,000,000
Retention Payment Paid at 12-Months	$	3,000,000	$	2,678,571
Total Payments	$	10,000,000	$	9,678,571
EBITDA Multiple		10.00x		9.68x

**Calculated using a 12% discount rate*

EXAMPLE SUMMARY

In summary, because of TCC's process and negotiation Andy accepts a deal with a buyer for $10M based on $1M of EBITDA with 75% of the proceeds paid at closing. This represents a 25% increase in the headline purchase in line with the previously referenced study conducted by the University of Alabama and Portland State University. When comparing these two scenarios it is clear that the involvement of the investment banker has added a significant value to the seller but still need to explore the net benefit after taking into account IB fees. For this example, we will assume that TCC and seller agreed to a success fee equal to 5% of the purchase price. We can see in this example that fee charged to the seller less the IB added value resulted in a net fee to the seller of (15%) and that net proceeds to the seller increased by 18.75%. When PV is taken into account, we see that this value is even greater as a result of the negotiated deal terms with the net fee to the seller dropping to (16.18%) and net proceeds to the seller increasing by 20.57%.

INVESTMENT BANKER ALPHA

Cash Value	Scenario A (No IB)	Scenario B (w/IB)	Change	Change %
Purchase Price	$8,000,000	$10,000,000	$2,000,000	25.00%
Less: IB Success Fee @ 5%	$0	($500,000)	($500,000)	
Net Proceeds	**$8,000,000**	**$9,500,000**	**$1,500,000**	**18.75%**
IB Success Fee	$0	$500,000	$500,000	
Less: IB EBITDA Optimization	$0	($650,000)	($650,000)	
Less: IB Led Process	$0	($750,000)	($750,000)	
Less: IB Led Negotiation	$0	($600,000)	($600,000)	
Estimated Effective Fee	**$0**	**($1,500,000)**	**($1,500,000)**	
Estimated Effective Fee %	*0.00%*	*-15.00%*	*-15.00%*	
Present Value @ 12% DR	**Scenario A (No IB)**	**Scenario B (w/IB)**	**Change**	**Change %**
Purchase Price	$7,657,143	$9,732,143	$2,075,000	27.10%
Less: IB Success Fee @ 5%	$0	($500,000)	($500,000)	
Net Proceeds	**$7,657,143**	**$9,232,143**	**$1,575,000**	**20.57%**
IB Success Fee	$0	$500,000	$500,000	
-IB EBITDA Optimization	$0	($622,143)	($622,143)	
-IB Led Process	$0	($717,857)	($717,857)	
-IB Led Negotiation	$0	($735,000)	($735,000)	
Estimated Effective Fee	**$0**	**($1,575,000)**	**($1,575,000)**	
Estimated Effective Fee %	*0.00%*	*-16.18%*	*-16.18%*	

CONCLUSION

The value proposition of hiring an investment banker remains challenging to quantify precisely due to the unique characteristics of each firm involved. However, it is evident that investment bankers bring tangible benefits and can significantly impact a transaction. The example presented in this paper demonstrates the quantifiable value they can add. Beyond the quantifiable aspects, engaging an investment banker reduces seller risk, allowing them to focus on their business while increasing the likelihood of a successful and timely transaction. When it comes to selling your firm and securing a lasting home for your clients, it's crucial to make the most of your opportunity. By enlisting the expertise of a skillful investment banker, you can significantly enhance the likelihood of a successful transaction that optimizes the value of your firm. I will leave you with this question: If your client were selling their business, would you recommend that they go at it alone or hire an investment banker to manage the process?

Firm Overview

The Chicago Corporation ("TCC") is a Chicago-based investment bank with an experienced team providing best-in-class investment banking advisory and transactional services to middle market companies owned by entrepreneurs, families and financial sponsors with up to $300M in revenue. The firm's expertise supports clients considering growth, a change in capital structure, ownership transition or a liquidity event.

Services

Mergers & Acquisitions Advisory
- Valuations
- Sale of Companies
- Acquisitions
- Corporate divestitures/Spin-offs
- Leveraged buyouts, Rollups and Recapitalizations

Private Capital Raising
- Senior debt
- Junior debt
- Convertible securities
- Preferred equity
- Common equity

Strategic and Financial Advisory
- Strategic alternatives analysis
- Transaction preparation
- Capital structure analysis
- Shareholder liquidity alternatives

Bryan Cheverud
Managing Director, RIAs
O: 312.283.0806
C: 312.848.9051
Bryan.Cheverud@thechicagocorp.com