

FOR EXECUTIVES SEEKING TO BUY, SELL, OR RECAPITALIZE BUSINESSES

Double Lehman Explained

How do M&A intermediaries get compensated?

We use a Double Lehman fee structure for helping sell our customers business. Some of our clients are familiar with the Double Lehman structure and some others have heard about Lehman formula and some have not heard of either of these fee structures.

Lehman Formula, a precursor to Double Lehman, is a compensation structure developed by Lehman Brothers many decades back for investment banking services. The basic Lehman fee structure is as follows:

- ❖ 5% of the first million dollars of transaction value
- ❖ 4% of the second million
- ❖ 3% of the third million
- ❖ 2% of the fourth million
- ❖ 1% of everything thereafter

This formula suggests that a seller would pay an M&A firm a fee of \$150 thousand on the first \$5 million of transaction value. The M&A firm would get an additional 1% for transaction value in excess of \$5 million. A \$100 million transaction, a small transaction by investment banking standards, would generate a transaction fee of \$1.1 million, or 1.1% of the transaction value. Over the decades, as inflation kicked in and as the complexity of the deals grew, this fee structure has evolved. In modern investment banking transactions, this Lehman structure is augmented heavily by upfront fee, retainers, hourly fee and other fee to compensate for the expenses in the transaction.

For large deals, the Lehman Formula provides huge fees and national M&A firms such as Goldman Sachs, Merrill Lynch compete to win these deals. These deals are highly customized and the M&A firms' compensation tend to be tailored per the objective of the deal. Typical time to consummate these deals is between one and two years and it is common for investment bankers to derive most of their income from upfront fee and monthly/hourly fee well before the deal consummates.

On the other end of the transaction size spectrum, business brokers typically charge 10-12% of the transaction proceeds. These deals tend to close in a matter of a few months and brokers derive most, if not all, of their fees at the closing of the transaction.

Mid market M&A specialists have a challenge in the sense that the work of closing mid market deals can be as difficult as or more difficult than for larger deals. The time taken to consummate the transactions is also similar to that of the larger deals. Lehman was not developed for these smaller deals and working at the compensation level implied by Lehman is untenable for M&A firms. On the other hand, charging clients 10-12% fee as business brokers charge can be detrimental to the interest of the client selling a multi-million dollar business.

Double Lehman is a compensation structure designed by M&A specialists to solve this problem. Double Lehman is a variation on the Lehman Formula to bridge the gap between the small (less than \$1 million) and large (greater than \$100 million) deals.

Under Double Lehman, the M&A specialist fee is structured as follows:

- ❖ 10% of the first million dollars involved in the transaction
- ❖ 8% of the second million
- ❖ 6% of the third million
- ❖ 4% of the fourth million
- ❖ 2% of everything thereafter

The Double Lehman provides for a fee of \$300,000 for a \$5 million transaction (6% of transaction value). The fee on a \$20 million deal would be \$600,000 (3% of transaction value). Due to the complexity of the transaction and the duration of time it takes to consummate the transaction, mid market M&A professionals typically charge upfront fees and retainers in addition to the Double Lehman based fee structure.

Bottom Line: The Double Lehman is a convenient way to begin discussions regarding M&A specialist compensation for selling mid-market companies. For most mid market transactions, the fee structure is likely to be a combination of upfront fee and success fee and most deals are negotiated. The seller and the M&A specialist can work together to create win-win deals.

Chak Reddy is a Mergers and Acquisitions Advisor with Elite Mergers & Acquisitions, Inc. [Elite Mergers & Acquisitions](#) specializes in selling California Central Valley businesses with revenues between \$1 million and \$100 million - Businesses too large for business brokers to adequately handle but too small for the national M&A firms. Mr. Reddy is a business M&A and Marketing expert, and is the chief deal maker at Elite. You can reach Mr. Reddy at 916-220-3052 or by email at creddy@elitemanda.com.

For assistance with selling or recapitalizing your mid market company, contact:

Chakradher (Chak) Reddy

Elite Mergers & Acquisitions

creddy@EliteMandA.com www.EliteMandA.com

2260 E. Bidwell St #1114, Folsom, CA 95630

Ph: 800-335-3068; Fax: 888-502-3817

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