



What's your company worth?



Kevin Kehoe
Kehoe & Associates

Almost everyone wants to sell his or her company someday. The most basic question is, "What is it worth?" In this short article, I address some of the fundamental issues of the *valuation* and the *sale*. Although it would take several articles to address ALL the issues in detail, here are some solid rules of thumb.

Valuation

Your business is usually valued using an earnings multiple formula. For example, if your earnings are \$100,000 and the earnings multiple you negotiate is 5 times (5X) your earnings, then your business is worth \$500,000. The multiple you negotiate can be anywhere from 3 to 6 times earnings for a grounds maintenance company, and 2 to 3 times earnings for a construction/installation company.

Definition of earnings

Earnings are called EBITDA (Net Profit Before Interest, Tax, Depreciation, and Amortization). This number will be adjusted for certain add-back expenses that —

- Exist prior to a transaction that will not exist after, like excess owner's compensation/distributions and perks.
- Are one-time nonrecurring expenses, such as a move or hurricane.
- Are based on differences in accounting procedures (primarily the handling of accelerated depreciation).

Definition of multiple

The multiple is the risk/reward value that an investor places on the business's future earnings. It is defined by

multiples that are paid for like-type businesses in recent business sales. Think of it as a factor that is established similar to the way most housing prices are determined — by comparison to like-type dwellings. In the end, the comparables only provide a range of multiples. It is the buyer and seller that negotiate within that range to establish the business valuation.

... get busy planning the sale early and get a team to help you maximize your cash.

Getting a high multiple

Your earnings multiple is based on several factors. The more of these factors you have in your favor, the higher the multiple and, therefore, the higher the value of your business. If, for example, you have EBITDA of \$100,000 at a 4X multiple, your business is worth \$400,000. If you have a 6X multiple, the same business is worth \$600,000 — fully one-third more. Here are several factors that drive higher multiples (listed in order of importance).

- **Revenues** — Bigger companies get higher multiples.
- **Sales growth** — Higher/consistent annual growth rates get higher multiples.
- **Margins** — Margins above industry benchmarks get higher multiples.
- **Recurring contracts** — Maintenance contracts are more valuable than construction sales.
- **Customer base/mix** — Larger average job size/contract values get higher multiples.

Business Basics

continued from page 22

- **Location** — Sun-belt locations get higher multiples than rust-belt locations.
- **Account quality** — Length of relations/high extras sales history get higher multiples.
- **Management** — Stable/high quality management team gets higher multiples.
- **Systems** — Quality of human resources, accounting, and oper-

ating procedures get higher multiples.

- **Equipment** — Quality and youth of operating equipment get higher multiples.

Sales

The sales process is not complete until the final cash distribution. Distribution issues must be addressed before you see any cash from the sale. The primary issues that affect the cash distribution are the payment scheme (total and net), debt pay-off, advisor fees, and, of course, taxes.

Total payment

Once you negotiate the price, then you negotiate payment. There are several ways that you can anticipate receiving payment. First is the “all cash” deal. These are very rare for many reasons, primarily because most buyers want some performance insurance. They do not want to buy a business where all the customers and managers flee in the first year.

Second is the “some cash now/some cash later” deal. This is the most prevalent. The “some cash now” part of the deal can be anywhere from 25 percent to 75 percent of the sales price. This is also negotiated. The “some cash later” part of the deal might be paid off in one to three years based on performance metrics like customer account/revenue retention and management retention. Management retention might

include a consulting contract that retains your services for some period of time during the transition to new ownership.

Net payment

Once the business is sold, you will pay off and subtract your debts (third-party and long-term debt) in order to get to your net payment or *equity value*. Your final distribution is realized after paying off advisor fees and taxes.

Thought it was easy to sell a business? It is and it isn't. I agree with Brian Corbett of CCG Advisors in Atlanta, who has negotiated many deals in the landscape industry. If you want the highest valuation and the best net payment deal, you need to —

- Start planning at least two years in advance of your desired exit date.
- Analyze and work on your business to maximize the factors that affect the earnings multiple.
- Hire some pros (who work for you — not a business broker) to help you negotiate the best deal.

The lesson — get busy planning the sale early and get a team to help you maximize your cash. I am happy to respond to questions regarding the information in this article. Direct them to my e-mail at kkehoe@earthlink.net. 