

Figures & Multiples for Valuing a Small to Medium Sized Businesses

The following Figures and Multiples are often used by Buyers and Sellers to place a value on a business opportunity. An understanding of the following numbers will help Buyers and Sellers prepare for the sale of a business and set realistic expectations. Most Buyers have an understanding of Industry Norms or Rules of Thumb and will quickly size up a business opportunity by using the following factors.

Seller's Discretionary Earnings/Annual Sales (SDE/AS)

This figure is often considered a Small to Mid-Sized Business's Profitability measurement. Buyers will use this figure to get a feel for the businesses health and gauge the viability of the Seller's Profitability claims.

For Example: assuming a specific Industries Norm for profitability is between 10% – 15% for a healthy Business in that Industry, one of following three things will happen in a Goodwill Sale.

1. The Seller's Profitability Claim is between 10% - 15%. Most Buyers will view this as a healthy business and pursue the business if their other key criteria are met. A business with healthy provable Profits has an increased probability of selling and will usually attain the higher Multiples for a Sale Price.
2. The Seller's Profitability Claim is lower than the Industry Norm. Many Buyers looking for the best Return on Investment will avoid this opportunity but this does not mean the business will not sell for Market Value. Some Buyers are looking for "Turn Around" opportunities and only pursue this type of business. In this case, the Seller may focus on other strengths of the business or provide projections to help attain Market Value Offers. Note: Often times businesses with higher annual sales experience somewhat lower profit margins and are still considered "healthy."
3. The Seller's Profitability Claim is Higher than the Industry Norm. The Market reaction to this is typically skeptical. When making claims of above normal, the Seller should provide an explanation along with the original claim. Otherwise the Seller risks being bypassed by serious Buyers who want to avoid wasting time with Sellers making fraudulent claims. Sellers need to remember that most Buyers have reviewed other business opportunities prior to theirs. Many Buyers have been misled by inaccurate claims of income or the ability to prove that income and will not pursue anything that looks suspicious. Immediately state how you will prove your profit claims if you do have the ability to prove.

Sample: Central Oregon Co. has Annual Sales of \$1,000,000 and a provable SDE of \$130,000. The Profitability of Central Oregon Co. is 13% ($130,000/1,000,000 = .13$ or 13%). This would be considered a healthy Business by most Buyers' standards.



Brody Mape, CBI and Peter May, MBA

Business Sales & Acquisition Services

Office: 541.383.2444, Fax: 541.610.1923

Brody Cell: 541.390.7653, Peter Cell: 541.408.3888

www.compasscommercial.com – biz@compasscommercial.com

Sale Price/Seller's Discretionary Earnings (SP/SDE) – SDE Multiple

This is the most common Multiple used in valuing small to mid-sized businesses. This figure is easily arrived at by Dividing the Sales Price by Seller's Discretionary Earnings, $SP/SDE = SDE$ Multiple. The figure of Sales Price is used when looking at the comparables, however, for a business that has not yet sold, the Asking Price figure should be substituted for the Sales Price to find the SDE Multiple. If the Industry Norms for the SDE Multiple are between 2 – 3 times SDE for a business, Sellers should be aware of the following observations regarding SDE Multiples and Asking Price.

1. Sellers who are truly Ready, Willing, and Able to sell their business for a good price should take the advice of experienced council and be prepared to Sell the business for Market Value. On average, it takes between 4 to 8 months to sell a Small to Medium size business.
2. Sellers who want to get out fast, for whatever reason, should consider pricing at a lower multiple and position the opportunity as an excellent value and push for a quick closure & favorable Terms in return for the lower Multiple. Be prepared for Skeptical Buyers by providing your Reason for Sale and emphasize urgency during first contact with the Buyer.
3. Sellers who require a Sale Price high above the Industry Norm should be prepared to demonstrate a unique advantage that offers the Buyer significant upside. When asking for above Market multiples, be prepared for the reality of not selling the business. It is a rare Buyer Type that will pursue business opportunities with multiples out of Market Value.

Example: Central Oregon Co. Sold for \$360,000 with a SDE of \$130,000. The Price to SDE Ratio = 2.8; ($360,000/130,000 = 2.77$). Assuming there were no extenuating circumstances, the Seller of Central Oregon Co. did well and sold for Market Value regarding the SDE Multiple.

Sale Price/Annual Sales (SP/AS) – Sales Multiple

This Multiple is often used when the Seller's Discretionary Earnings is unclear or cannot be adequately supported. Since Annual Sales are often easier to prove than SDE, many Buyers are left with this Sales Multiple to estimate a Market Value for the Business. This figure is easily arrived at by Dividing the Sales Price by Annual Sales, $SP/AS = Sales$ Multiple. The figure of Sales Price is used when looking at the comparables, however, for a business that has not yet sold, the Asking Price figure should be substituted for the Sales Price to find the Sales Multiple. Assuming Industry Norms for the Sales Multiple are between 30% to 40% for a business, Sellers should be aware of the same observations made about the SDE Multiple stated above. Sellers should note that reliance on this Multiple will reduce the amount of interested Buyers because it increases speculation of Profitability.

Example: Central Oregon Co. Sold for \$360,000 with Annual Sales of \$1,000,000. The Price to Sales Ratio = 36%; ($360,000/1,000,000 = .36$ or 36%). Assuming there were no extenuating circumstances, the Seller of Central Oregon Co. did well and sold on the high side of Market Value for the Annual Sales multiple.



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Glossary of Terms

Annual Sales – Total Revenues (AS)

Annual Sales is all income the business received before any cost-of-goods or expenses have been deducted; normally this is the sales amount before sales tax has been added.

Asking Price

The Seller's Asking Price for the Business. This is not to be confused with Sale Price.

Asset Sale

The sale of a business under the caption "Asset Sale F/F/E" is for a business that the Seller has put on the market whereas they cannot prove profits, or there is no profit, or it is break even. The Seller cannot always prove the profits of many businesses that are cash driven. Many of these offerings can be excellent values for a Buyer with the vision to change or turn around a business. Many times the Asset Sale F/F/E price of the business is substantially less than if you were to go and buy the fixtures and equipment, do the build-out, and start from scratch. You will also enjoy some good ongoing sales from the previous owner. There is no books and records review in an Asset Sale transaction.

Common Area & Maintenance (CAM)

Additional Lease Fee often added on top of base rent. This fee is usually for the maintenance of the common areas shared by a multi-tenant property.

Days on Market

Actual Number of Days on the Market before the business was sold or taken off the market.

Due Diligence – Books & Records Review

The most critical part of the sales process of a business being sold is the Due Diligence Period. This is the time when a Buyer gets to review the details of the business, have their questions answered, and verify the Seller's claims. It is the current business owner's responsibility to prove claims used to solicit Offers for the Business. Due

Diligence begins with the first Buyer contact and continues until the Opening of Escrow. The majority of the Due Diligence is usually done after an agreed upon price and terms have been established between the Buyer and Seller. It is the Seller's responsibility to provide the documentation to prove sales and profits, and it is the Buyer's responsibility to perform Due Diligence to their satisfaction.

Furniture, Fixtures & Equipment (FF&E)

All Furniture, Fixtures and Equipment that will remain with the business; this may include a POS System, decor elements of a showroom, Manufacturing or Kitchen Equipment, computers and office machines, display cases, Tables & Prep Station, Alarm & Surveillance System, etc. FF&E value has relevance when valuing a business opportunity.

Franchise Fee

Ongoing franchise expense paid by franchisees to the franchisor; usually a percentage of sales.

Goodwill Sale

The sale of a business showing sales and profit is considered to be a Goodwill Sale. The fixtures and equipment are included in the sale unless otherwise specified. The sales and profit of the business must be proven to a Buyer through the review of the Seller's books and records during the Due Diligence period. It is the Seller's responsibility to provide the Buyer with documentation. If the business is not listed as an "Asset Sale" it is most likely a "Goodwill Sale."

Inventory (INVEN)

Inventory Amount at the time of sale. Should be represented at Owners Cost.

Market Value

The amount of money a typical, well-informed, unrelated Buyer would be willing to pay for a Business.



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Multiples

A figure or measurement used to help establish the value of a Business Opportunity.

Ownership Type

The type of legal entity that owns a business. Types of Ownership include: Sole Proprietorship, Limited Liability Company, S-Corporation, C-Corporation.

Owner Participation

The Seller's current participation in the day to day operations of the business. Types of Owner Participation include: Owner-Operator, Semi-Absentee, and Absentee.

Payment Terms (Terms)

Interest Rate and Terms of New or Assumed Loans/Encumbrances. Includes but not limited to: the Term of the Note, Interest Rates, Payment Structures & Expectations.

% Down (Percentage)

Down Payment as a Percent of Sale Price. Relevant with Seller Notes.

Rent %

Rent as a Percent of Sales. Annual Rent Paid as a Percent of Annual Sales.

Sale Price (SP)

Actual Price Business Sold for. Not to be confused with Asking Price.

Seller's Discretionary Earnings (SDE)

This is considered the most relevant figure in valuing a Small to Medium sized Business. This figure reduces the Buyer's speculation and reliance on projections and provides real numbers to use in Return On Investment analysis and confirm the business can cover their Income Requirements.

SDE = Net Profit before Taxes and any Compensation to the Owner plus Amortization, Depreciation, Interest, Other Non-cash expense and Non-business related expense, normally to One Working Owner (Owner Operator). The Discretionary Earnings figure is arrived at by recasting the profit and loss statements & balance sheets. This process adds back the expenses that are not necessary to carry on the business as well as one time expenses that are not anticipated to be incurred again.

Seller Note – Seller Financing

This is when the Business Seller will take a Down Payment upfront then take the remainder of the balance at intervals over a period of time, like a traditional banking institution. The Terms of the note are negotiated as part of the Offer to Purchase. It is very common for the sale of a business to include seller financing as part of the deal structure. Seller financing can oftentimes help a Buyer pay more for the business than the price that would be offered if the deal were financed only through traditional financing sources.