

FIGURES & MULTIPLES FOR VALUING 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.

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, $SP/SDE = SDE \text{ Multiple}$. 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.

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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, $SP/AS = \text{Sales Multiple}$. 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.