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The Sale of Privately-Held Businesses

White Paper #1: How Businesses Are Valued

The White Paper is intended to be a helpful resource for private company owners who are considering selling their business.

Valuation Considerations

The first question any business owner considering a sale wants to know is: what is my company worth?

No two businesses are exactly alike, and a wide range of factors which impact valuation come into play for each specific deal. Also, because M&A transactions tend to take a lengthy period of time to complete, valuations can also be impacted before closing by changes in the capital markets and the economy.

With those caveats in mind, below are the most important issues which determine valuation.

Cash Flow

The single most important valuation metric is annual cash flow. For investors, cash flow is generally referred to as EBITDA, or earnings before interest, taxes, depreciation and amortization.

Most deals for institutional-quality private companies generally fall within the range of 6-12 times EBITDA, with even higher multiples available if certain favorable attributes for the company are present.

Growth and Profit Margins

The growth rate of a business is quite important. In general, investors will place a disproportionately high premium on growth, which is the primary reason why successful technology companies, for example, typically command higher valuation multiples.

Another important factor is the level of profitability as measured by operating margins. Similar to growth rates, higher margins generate greater interest from investors.

Other Factors

While EBITDA, growth rate and profit margins are the most important factors which drive value, there are other issues which investors will consider. These include:

- Industry Outlook
- Market Share
- Level of Debt
- Historical Performance
- Regulatory Considerations
- Future Capital Requirements
- Technology and Other Intellectual Property
- Customer Concentration
- Quality of Management

Interest Rates and Cost of Capital

Interest rates are near historic lows. Low rates make the value of future earnings more valuable in current dollars, which helps drive valuations upward. Also, debt is readily available for Private Equity and corporate strategics to fund acquisitions. In general, a widely available low-cost capital boost private company valuations, and higher interest rates and tighter availability of credit create downward price pressure.

Summary

Valuation is part art, part science, and part timing. Market conditions are currently favorable for financially attractive private companies. However, the M&A process is complex and time-consuming. Even in a seller's market, significant time, effort and professional expertise is required to complete a successful transaction.

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