

ESTABLISHING YOUR SELLING PRICE

**SUCCESSION
ONTARIO** 

Fair Market Value: **WHAT IS IT?**

- ▶ Seller Discretionary Earnings (SDE)
- ▶ Earnings Before Interest, Tax, Depreciation, Amortization (EBITDA)
- ▶ Income Approach (2 methods)
- ▶ Market Approach
- ▶ Asset Approach

SELLER DISCRETIONARY EARNINGS (SDE)

Owner Operated Businesses with
\$500k - \$2m revenue

Net Profit of the Business add back:

- ▶ *Owner salary and benefits*
- ▶ *Personal expenses paid by the business*
- ▶ *Tax, interest, depreciation & amortization*
- ▶ *Non-recurring expenses*

Main Street Small Business	SDE < \$500k	1.5 to 3x SDE
Profitable, Scalable	SDE < \$2m	3 to 5x SDE

METHODS OF SDE

INCOME BASED	MARKET BASED	ASSET BASED
Based on future cash flows of a business. Discounted Cash Flow This method is used when cash flow is expected to fluctuate significantly in future years, typically when a company is growing quickly. Capitalized Cash Flow This method is used when cash flow is expected to be stable in future years.	Uses market comparables to calculate business value. Public Company Method This method is used when comparable public companies exist. It uses multiples at which comparable companies trade to calculate value. Comparable Transactions This method values a business using multiples paid in actual transactions for comparable businesses.	Value based on assets after removing all liabilities Liquidation Method This method is used when a company is not a going concern. The value of a company's assets less the value of paying off its liabilities. Adjusted Net Asset The fair value of a company's assets minus the value of its liabilities.

INCOME METHOD

#1

CAPITALIZED CASH FLOW

1. Calculate the **EBITDA** (Earnings)
2. Establish the Capitalization (Cap) Rate

The **lower** the Cap Rate the **higher** the value

Earnings/Cap Rate = Value

$$\frac{\$200k}{0.25\%} = \$800k$$

OR

Earnings x 4 multiple = Value

$$\$200k \times 4 = \$800k$$

INCOME METHOD

#2

DISCOUNTED CASH FLOW

- Forecast the cash flow (Earnings), usually over 5 years
- Evaluate the discount rate

**Discount Rate = Risk +
Opportunity of Capital**

- Converts future cash flow to today's dollar

**Stable Profits use Capitalization Method
Changing Profits use DCF Method**

EBITDA

Earnings Before Interest, Tax, Depreciation and Amortization

Net Profit of the Business (average over the last 3 to 5 years) and add back:

- **Interest, tax, depreciation** and **amortization**
- **Owner's salary** and benefits percentage, if over market value
- **Personal expenses** paid by the business
- **Non-recurring** expenses

Revenue	< \$2m	3 to 5x EBITDA
Profitable, Scalable	\$2m to \$5m	4 to 6x EBITDA
Profitable, Scalable	\$5m to \$10m	6 to 10x EBITDA

MARKET & ASSET BASED

MARKET BASED

What did similar businesses in the market sell for?

ASSET BASED

What is the Future Market Value of the assets?

WHICH METHOD IS RIGHT FOR YOU?

REVENUE	CONSIDERATIONS	EXAMPLES
<\$1 million	Seller Discretionary Earnings Owners Income	Owner Operated: Salons, Trades, Repairs, Consulting
<\$2 million	Seller Discretionary Earnings/Assets Cashflow, equipment	Owner Operated: Restaurants, Stores, Cafes
<\$5 million	EBITDA Scalable, MRR, Assets	Architects, Accountants, Digital Marketing/Design Agencies
<\$20 million	EBITDA Scale, Cash, Assets, WIP	Manufacturing

WHO IS GOING TO BUY?

- Intergenerational
- Employee(s)
- 3rd Party Sale
- Private Equity/Investment Bankers
- Asset Sale

BARRIERS TO ACTION

- ▶ **Time constraints** and competing priorities
- ▶ Financial worries and **lack of knowledge**
- ▶ **No successor**/buyers market
- ▶ Complexity of **professional costs**
- ▶ **Avoidance:** psychological barriers

CLOSING CONSIDERATIONS

Closing Adjustments

- Inventory
- Accounts Receivable /
Accounts Payable
- Prepaid Expenses

Share Purchases

- Working Capital

**Current Assets - Current
Liabilities = Working Capital**

The expectation is that there is
enough cash to operate on Day 1.

**THANK
YOU**

**SUCCESSION
ONTARIO** 