



WHAT SHOULD YOU USE FOR BUSINESS EVALUATION?

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There are various ways of measuring the earnings of a business and it may seem a bit confusing at first. If you are selling your business which one should you choose to show its worth? Let's have a look in turn at each of the usual ones that are used for small to medium-sized businesses:

➤ **Net income (NI).** This can also be referred to as net earnings or the bottom line. Basically it is the income of the business after all the expenses are deducted. This may seem simple enough, but for a large organization this can be a very complicated figure to come up with. Expenses include all taxes and operating costs like salaries, rent, amortization, depreciation. etc. This may be regarded by some as the true figure of earnings, but you need to bear in mind that many smaller businesses have mastered the art of keeping the taxes low, so it may not always be a good number to rely on.

➤ **Earnings before Interest and Taxes (EBIT).** This measurement can also be called the 'operating profit'. Many view that this gives a clearer idea of the earning potential since it takes out of the equation two variables that can be very dependent on the accounting system and the owner's preferences. Both taxes and interest payments can vary according to the financial strategy, which then affects the NI. Taking these two out gives a fairer figure.



➤ **Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA).** A further measure of a business takes away the effect of depreciation and Amortization. This figure places the focus totally on the financial outcome of the operating of the company removing non-operating factors which can vary according to management decisions. However, this figure can be quite misleading as the depreciation and amortization can vary according to the business, so it does not always give a good gauge of the earnings.

➤ **Seller's Discretionary Cash Flow (SDCF).** When smaller businesses are owner operated, it is common to use SDCF as the measure of the company's worth. It is made up of profit before tax and interest and before benefits and one-time expenses. Sometimes the buyer and seller may disagree with what should be included in this figure, so some discussion may need to be carried out to come to an agreement, for instance there may be a discrepancy over what is classed as a one-time expense.

All these calculation can have their uses in showing the value of a business and a lot depends on the type of business and its size. In general the EBIT or EBITDA are the most useful ones to use in order to reflect the earnings.



When you have used one of the methods for measuring the earnings of a business it is necessary to understand what the normal range of multiples is. The multiple compares the earnings with the Enterprise value of the company. For a small company the multiple when using SDCF can be 1 -3, but for a medium size company it will be 3 to 5 using EBIT. The multiple will increase when using EBITDA. However, all these are just guidelines and the more unique a company is the more likely it will be outside the normal range. In any case, it is important to understand the limitations of any one way of measuring earnings and understand how it has been calculated. The figure should not just be taken at face value and out of context, but should be used as a helpful indicator.

In summary, there are a number of different ways of calculating the earnings of a company. There are advantages and disadvantages in each and sometimes the size or type of business will dictate which one is more appropriate. However, it is important not to just take these measurements at face value.

Keywords : business evaluation, earnings measurement, NI, EBIT, EBITDA, SDCF.



Our M&A Process

TARGET APPRAISAL	APPROACH	DUE DILIGENCE	NEGOTIATION & CLOSE	POST MERGER INTEGRATION (PMI)
Key Areas				
<ul style="list-style-type: none"> Target & market analysis; Initial assessment of synergies & value drivers; Indicative valuation; Go or No-Go decision; Preparation of transaction documents (NDA – Non-disclosure Agreement/LOI-Letter of Intent); Select Transaction team; Appoint advisors; Consider funding ability. 	<ul style="list-style-type: none"> Initial approach letter; Signing of NDA; Prepare & share initial information requests; Formulation of LOI (Letter of Intent) & possible negotiations; Initial meeting and Q&A; Circulate information on the Target to the Transaction team. 	<ul style="list-style-type: none"> Set scope of due diligence; Set up VDR (virtual data room); Coordinating of due diligence, further meetings and Q&A sessions; Consider points relevant to the Post-Merger (PMI) phase; 	<ul style="list-style-type: none"> Revisit indicative valuation & prepare detailed valuation based on due diligence findings; SPA negotiations with the seller; Development of final structure (share/asset deal) and final valuation; Approvals; Signing of SPA & Close. 	<ul style="list-style-type: none"> Consider the extent of integration; Development of 100 Day PMI Plan; Consider short & long term objectives; Estimate requirements to capture synergies; Determine resource needs & optimal allocation.
Parties Involved				
<ul style="list-style-type: none"> CFO; Head of M&A; Accountants; Corporate finance advisors; Consultants. 	<ul style="list-style-type: none"> Senior management; CEO, CFO, CTO; Strategy director; Head of M&A; Head of Business Development; Consultants. 		<ul style="list-style-type: none"> Company general counsel; Lawyers; Senior management. 	<ul style="list-style-type: none"> Company general counsel; Lawyers; Senior management/HR.

An overhead view of a business meeting around a wooden table. Several people in business attire have their hands stacked in the center of the table, symbolizing agreement or partnership. The table is cluttered with various items: a laptop, a calculator, a coffee cup, a glass of water, a pen, a notepad, and some documents. One document is titled 'INFORMATION'. The lighting is warm and focused on the hands in the center.

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