

*February 2015 - In This Issue:*

**BUSINESS VALUATION & SDE**

**WHAT IS MY BUSINESS WORTH?**

**WE BRING YOU SERIOUS BUYERS**

**COMMON BUSINESS SALES  
MYTHS**

**IT ALL STARTS WITH YOU**

## **INDUSTRY KNOWLEDGE & ACCESS TO BUYERS NATIONWIDE**

Our presence as a Professional Business Broker is extended nationally as a result of being an affiliate of [BHarmony, LLC](#).



We also bring decades of experience and functional expertise in all the popular market segments as a result. Nothing takes the place or value in that of experience.

We partner with our clients to deliver solutions that help solve their most complicated needs prior to, during,

## **How Small Businesses Are Valued Based on Seller's Discretionary Earnings (SDE)**

Public companies and middle market businesses are valued as a multiple of EBITDA - Earnings Before Interest, Taxes, Depreciation and Amortization. However, smaller businesses are valued as a multiple of Seller's Discretionary Earnings (SDE), which can be defined as EBITDA + Owner's Compensation. Therefore, SDE is typically the net income (or net loss) on the company tax return + interest expense + depreciation expense + amortization expense + the current owner's salary + owner perks.

### **Seller's Discretionary Earnings normalization**

To arrive at SDE, the seller's financial statements are "normalized" (alternate terminology includes: "recast" or "stabilized"). The typical "SDE Normalization" presents the seller's regular income statement and then shows each normalizing adjustment (with an explanation) to arrive at the normalized SDE.

### **Seller's Discretionary Earnings adjustments resulting from personal and/or discretionary expenditures**

In addition to the adjustments of EBITDA + Owner's Salary, other adjustments may be necessary. For instance, it's no surprise that many small business owners run a lot of personal expenses through the business that have nothing to with operating the business. If properly documented, those personal and/or discretionary expenditures may be added back to SDE.

and at the conclusion of the selling process. Our services are designed specifically to help small/medium size businesses and at a small business price. We go beyond the norm to develop new insights, prepare, market and drive results in the sale, thus insuring you receive the most value at closing. [Learn More](#)

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## AVOID COMMON BUSINESS SALES MYTHS

### Myth #1 - I Can Sell It Myself

Many owners believe they're qualified to sell their business without professional assistance, but selling a business is not like selling a product or service. If you're looking to sell on your own, confidentiality is lost. If word of a potential sale gets out, there are definite risks of losing clients, employees and favorable credit terms.

Do you really have the time to run your business and compile marketing materials, advertise, screen buyers, give tours and facilitate due diligence? When you're looking to sell, you want to put even greater emphasis on running your business, boosting your sales, and not taking on new challenges.

### Myth #2 - I'll Sell When I'm Ready

Certainly, an owner wants to be sure he or she is mentally and emotionally prepared to sell. But personal readiness is just one factor.

Economic factors can have a significant impact on the sale of a business.

Sale prices can be affected by industry consolidation, interest rates, unemployment and many other economic measures. Talk with a professional and aim to sell when your personal goals and market

## Other types of Seller's Discretionary Earnings adjustments

- Many small business owners personally own the real estate the business occupies. If the business is overpaying or underpaying facility rent, the amount needs to be adjusted up or down to reflect the rent a prospective buyer of the business would expect to pay.
- Occasionally there are non-recurring expenses, such as an extraordinary legal bill due to a lawsuit, that may be added back to cash flow.
- There can also be non-recurring income (i.e. sale of a fixed asset at a large gain).
- Some businesses employ multiple family members who may receive above-market compensation. The above-market portion of their salaries can be added back to the extent there is sufficient expense remaining to enable a prospective buyer to replace those family members at a competitive market rate (or adjust their salaries if they stay on board).

-These are some of the common adjustments, but there may be justification for others.

## Small business valuations are based on multiples of Seller's Discretionary Earnings

When it comes to valuing a small business (under \$3,000,000 in value), SDE is the common denominator to which a multiple is then applied.

The multiples are driven by a range of financial factors including: 1) financing formulas; 2) the buyer's need to have a reasonable return on investment after paying debt service on the acquisition; and 3) the buyer's need to receive reasonable compensation for the time and effort required to run the newly acquired business. There are numerous other factors, including the industry, that can also affect the selection of an appropriate multiple.

But one of the primary factors is the level of SDE itself. For financial reasons, buyers are willing to pay a higher multiple for higher SDE. The following is representative of the range of multiples at various "cash flow" (SDE) levels:

conditions align.

**Myth #3 - I Know What it is Worth**

Some owners will base the company value on what they need for retirement. Others will tell you they want \$100,000/year for "sweat equity."

A third party valuation is a good idea for anyone seriously considering the sale of their business. An outside valuation will include a thorough analysis of the business and the market it operates in. This will provide a solid understanding of the company's growth potential, not some vague industry average.

**Myth #4 - It's Like Selling a House**

Selling a company is much more complex than selling a house. A successful business sale usually requires a great deal of pre-planning, at least a year and maybe as long as three years to drive sales, develop key staff, document the operations and control expenses. The average house will sell in less than four months, while the average business sale is nine months to a year. Even after the business is sold, the seller can be expected to put in at least a few months, and possibly years of transition time, helping to make the new owner a success.

## IT ALL STARTS WITH YOU

"All personal achievement starts in the mind of the individual. Your personal achievement starts in your mind. The first step is to know exactly what your problem, goal or desire is."

**W. Clement Stone**

**DON'T MISS OUT** - Interest rates are low, Strategic Buyers, Family Offices, and Private Equity Groups are very active. It costs nothing to discuss the value of your Business - [contact us](#).

SDE	Multiple	Business Value
\$50,000	1.0 - 1.25	\$50,000 - \$62,500
\$75,000	1.1 - 1.8	\$82,500 - \$135,000
\$100,000	2.0 - 2.7	\$200,000 - \$270,000
\$200,000	2.5 - 3.0	\$500,000 - \$600,000
\$500,000	3.0 - 4.0	\$1,500,000 - \$2,000,000
\$1,000,000	3.25 - 4.25	\$3,250,000 - \$4,250,000

**CAUTION:**

***The above multiples do not apply to all industries. For instance, the construction industry would typically have lower multiples than displayed above.***

### Seller's Discretionary Earnings is a very important concept to understand

Because it is the foundation of business valuation for small businesses, Seller's Discretionary Earnings (SDE) is an important concept to understand. Having an SDE below \$100,000 is a major obstacle to a successful sale of a business (but not impossible).

## WHAT IS MY BUSINESS WORTH?

It will cost you absolutely nothing and there is no obligation in giving us a call or an [email](#) to request a simple valuation of your business. Relying on a professional that understands your industry is important. It is also wise to work with someone who is aware of current trends; and that is working

with both buyers and sellers daily. This approach insures you plan for and receive the maximum return on the transfer of your business.

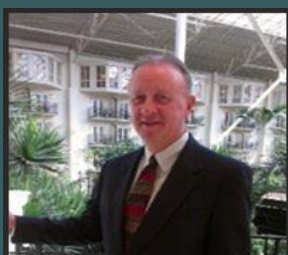
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## **Next Issue:**

***SDE vs. EBITDA vs. Adjusted EBITDA  
Leads to Multiples Confusion.***

**[Contact Us](#)**

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