

Fundamentals of Valuation for Sellers and Buyers

By Thomas J. Williams

To the owner of a packaging or a printing business, there will always be something subjective about the idea of its value. But, practical methods of business valuation do exist, and it's wise for owners to incorporate them into their business strategies.

Everything in a business has value, whether the thing possessing the value is a physical object (for example, a piece of machinery or a building) or something intangible (the company's reputation in its marketplace, or the strength of its patents and brands). The value of a privately held packaging or printing company is the sum of its valuable assets – and the main determinant of its selling price in an acquisition by another company.

It's good business practice for owners to monitor valuation and to update it annually. In industries as rife with consolidation as the printing and packaging sectors presently are, an offer to be acquired could come at any time. An owner without a clear picture of the value of his or her company is an owner at a disadvantage from the outset.

At New Direction Partners, we give clients some of the insight they need by performing "desktop valuations": preliminary appraisals of what a business is worth based on information supplied by the client and our broad knowledge of the printing and packaging industries. We perform the calculation in two ways, showing the client which approach yields the greater measure of value.

The first is multiple of EBITDA (earnings before interest, taxes, depreciation, and amortization), commonly used in acquisitions of financially healthy printing and packaging firms. The other method is to estimate the company's orderly liquidation value: the amount of money it would receive by selling machinery, equipment, and similar assets to the highest bidder in a reasonable amount of time (in other words, without being under pressure to sell).

For many sellers, valuation by multiple of EBITDA will be the preferred option. To present it accurately for the buyer's purposes as well as the seller's, we include a factor called owner's discretionary cash flow.

Also known as adjusted EBITDA, owner's discretionary cash flow is a calculated figure that helps a buyer determine how much free cash flow will be available to a new owner if he or she buys the business in question. ("Free cash flow" is how much cash the business generates after deducting operating costs and capital expenditures.)

Without this adjustment, the selling price of a company with an EBITDA of \$1 million and a multiple in the 4X to 6X range would be about \$5 million. But, that number doesn't include items that can be added back to EBITDA: expenses that will not pass to the new owner after the transaction closes, thus increasing the value of the company being sold.

The calculation starts with either taxable income from the tax return or net income or net loss from the income statement. Add-backs then include the owner's compensation and payroll taxes along with medical and life insurance expenses; automobile, cell phone, and pension-related expenses; and miscellaneous charges such as dues and subscriptions.

Also added back are the expenses of amortization, depreciation, interest, and non-recurring items. Examples of the latter are major software upgrades, litigation expenses, major repairs and maintenance, consulting expenses, and anything else that will not affect the new owner.

Sellers of family-owned businesses will have to make employee-related adjustments for family members who do not work for the company but are being paid by it. If a family member working for the business is being paid above or below the market rate for that position, the add-back will either be positive (if overcompensated) or negative (if underpaid).

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The same applies to non-family members working for more or less than market wages. And, in cases where two working owners leave the company and the buyer does not have a spouse or a partner to replace one of the positions (assuming that the buyer fills the other one), there will have to be a negative add-back for a replacement employee at a market rate of pay.

Correctly accounted for, add-backs make valuations more precise and pricing objectives more realistic. Adding \$250,000 worth of non-recurring charges to an EBITDA of \$1 million puts \$1.25 million in front of the EBITDA multiplier – a fair reflection of the company's value, and a good starting point for the negotiations to follow.

The in-depth business valuations that we also conduct go into considerably more detail, but the desktop exercise is a reliable way for owners to get a basic grasp of the value they have created. Some of our packaging and commercial printing clients ask us for desktop valuations regularly – a wise practice, since company performance and market conditions are always subject to change. In these assignments, we'll look back at the numbers over three years to spot positive or negative trends that the client should be aware of.

We can't overstate the importance of understanding valuation's role in business strategy. Owners seeking an exit path should realize that in many cases, accepting orderly liquidation value will be the quickest and most remunerative way to wind things down. Owners fielding overtures from potential acquirers have to think of value not as something that they can dictate, but as a perception influenced both by market trends and by whatever the buyer hopes to accomplish in closing the deal.

Nothing is more frustrating than watching a potentially good deal fall apart because the selling owner wouldn't budge from his or her insupportable idea of what the company was worth. Performed regularly by qualified examiners, valuations provide the realism and the perspective that can guide both parties to the best possible outcome.

New Direction Partners is an investment banking and financial advisory services formed by Peter Schaefer, Paul Reilly, Jim Russell and Tom Williams to serve the printing and related industries. Services include merger advisory services through the representation of selling shareholders as well as buy side representation, valuation services, financing and refinancing efforts, turnaround and restructuring services, and temporary/interim management consulting. To learn more about New Direction Partners, visit New Direction Partners' website at www.newdirectionpartners.com.