Understanding How EBITDA and EBITDA Multiples Are Calculated

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NEW DIRECTION PARTNERS

Figuring a company's selling price begins with establishing its valuation. Here is how sellers can expect buyers to do the math.

Most owners of printing and packaging companies are generally familiar with EBITDA, EBITDA multiples, and the effect they have on the valuation of their businesses. Because buyers of businesses in almost all industries (not just printing and packaging) use multiples of EBITDA to determine value, selling owners should make certain they also understand how EBITDA is calculated, what the multiples represent, and what it all means for the kinds of offers they are likely to receive.

EBITDA stands for earnings before interest, taxes, depreciation, and amortization. It essentially measures how much operating cash flow the business generates. Besides setting a baseline for valuation, this also gives the buyer a way to compare similar businesses by focusing on their underlying profitability.

A company's EBITDA is calculated by taking net income and adding back interest expense, taxes, and the costs of depreciation and amortization. Also added back are any discretionary expenses that the owner currently incurs, but will cease after the sale closes. Country club dues, company cars for personal use, and payments to non-participating family members are just a few of the many potential addbacks that are sometimes relevant in a privately held business.

The buyer multiplies EBITDA that has been adjusted in this way to arrive at an offering price. The higher the multiple of EBITDA, the greater the size of the offer. Deciding what the multiple will be is where the process becomes somewhat subjective. While two companies might have similar EBITDA numbers, the multiples they attract could differ according to the types of businesses they are, the capabilities they have, the print markets they serve, and the age and efficiency of their equipment.

Two Qs of Decision-Making

The multiple reflects the buyer's sense of which companies will be the most profitable to invest in. Buyers use both qualitative and quantitative measures to determine this. Qualitatively, customer loyalty, competition-proof specialties, and first-class management talent tend to attract higher multiples. Sales and earning growth, non-concentrated accounts, and critical mass within a market are among the quantitative factors that buyers want to see.

Generally speaking, the greater the organic growth a printing business has experienced, and the less exposure to recession the business has, the higher its multiple of EBITDA will be. This has a great deal to do with the market segments the company is most active in.

Right now, a packaging printer serving makers of OTC personal care products such as toothpaste is a lot more recession-proof than, say, a commercial printer concentrated in travel and hospitality. Buyers are sophisticated enough to know which sectors will be most stable and profitable in the long run, and they will pick their acquisition targets accordingly.

A company's product applications and technical capabilities will also influence its EBITDA multiple. In buyers' eyes, the premium segments for print include large-format and POP, Web-to-print, customized 1:1 direct marketing, and data analytics. Nearly everything commands a premium in packaging, from corrugated to flexible.

At New Direction Partners, we see all of these trends reflected in the transactions we handle for our clients. One of them, a general commercial printing and mailing operation, currently is reviewing three offers at EBITDA multiples of 3.8 to 4.5. Another, a highly profitable large-format shop, has two offers at a multiple north of 7. Both are solid, well-run businesses, but with different yardsticks of valuation in a still-recovering market for print M&As.

We should point out that selling on a multiple-of-EBITDA basis assumes that the company is profitable and will show a good valuation when measured in this way. When the value of the company based on typical EBITDA multiples exceeds the value of its assets, multiple of EBITDA is the way to go. When it fails to, some other type of transaction – perhaps a tuck-in or a cashless merger – will be more to the seller's financial advantage.

Enter EBITDAC

Many sellers had to face tough facts about valuation during the COVID-19 pandemic, when revenue streams dried up and the pace of deal closings slowed down dramatically (although the dealmaking never completely ceased). 2021 is closing on a decidedly more positive note for the industry than 2020 did, but questions remain about how long it will take for a full return to pre-pandemic conditions.

Fortunately, the M&A marketplace has shown itself to be resilient and creative throughout the long siege of COVID-19. For example, in cases where the buyer could see that the seller had bounced back, the buyer often was willing to replace three to six months of poor financial results with better numbers from the same period in the previous year.

In effect, this cancelled or lessened the penalty imposed upon valuation by the pandemic. We liked to think of it as EBITDAC: earnings before depreciation, amortization, and coronavirus.

With or with or without the "C," EBITDA is a simple but useful tool for assessing a company's value and estimating a realistic price for its sale. Calculating it correctly is the essential first step toward planning and executing a successful transaction.

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.