



Exit Planning

NAVIGATOR

Exit Planning Strategies for the Entrepreneur



Issue 33

Cash Is King

It is not uncommon for a business owner to hear that one of his friends sold her business for a “six times multiple.” That owner’s first question to his own advisors typically is, “Can I get the same type of multiple if I sell my business?” The answer is “Yes and No.” To understand these answers, we need to understand exactly **what** is being multiplied. To begin, let’s turn to our favorite item to be multiplied: cash.

The favorite phrase of investment bankers, and sellers of all kinds, is, “Cash is King.” After all, when one is selling anything, cash removes the seller’s risk in the transaction. When selling a business to a cash buyer, that buyer wants to know exactly how much cash the business is producing.

What the buyer wants and needs is a slight variation on our favorite phrase, “**Cash flow is King.**” In fact, few cash buyers are willing to part with their money unless they see an increasing stream of cash flowing from the business, both historically and prospectively—after they acquire your company. The balance of this article explores the definition and importance of cash flow when selling a business to an outside third party cash buyer.

The Importance of Cash Flow

The frenetic period of consolidation is over. Merger and acquisition activity is down as much as 80 percent from 1999. During the heyday of consolidation, companies used their own publicly-traded stock to aggressively pursue the acquisition of similar companies. This aggressive activity led to payment of multiples of earnings—sometimes of future earnings—that today seem stratospheric in our more sober business world.

Today’s buyers are still anxious to acquire companies, but they are looking for what they call, “good” companies. Almost always, these “good” companies have increasing cash flow, good growth potential, and strong fundamentals (such as a strong management team and good operating systems). Of course, these characteristics have always been important and have always been the signs of a good company. But, given the high failure rate of recent mergers and acquisitions, cash flow has never been more important. Acquiring a business with existing strong cash flow reduces the buyer’s risk in the transaction. So, for many sellers, getting “six times multiple” of cash flow depends on what exactly is “cash flow.”

The Definition of Cash Flow

What is “cash flow?” Yet another favorite (albeit less succinct) saying of investment bankers is, “Sure, I can get you five or six times multiple of your cash flow as a purchase price for your business. All you have to let me do is define cash flow.” The devil truly is in the details, or in this case, in the definition. There are several definitions or measures of cash flow, each with a potentially significant and substantive difference.

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Cash Is King (continued)

Typical measures of cash flow include:

EBIT: Earnings Before Interest and Taxes.

EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization

True Cash Flow: The amount of pre-tax money distributed to owners via salary, bonus, distributions from the company such as S-distributions, and rental payments in excess of fair market rental value of the equipment or building used in the business.

Each of these measures of cash flow produce a different cash flow amount. Add to these measures, the need to recast cash flow by using "add backs" such as excess rents, salary or bonuses paid to the owner and his or her family.

Which brings us back to our original question: Can you get a six times multiple when you sell your business? Sure . . . it just depends on how you define cash flow. To determine which measurement of cash flow is appropriate for your business, look first to the measurement that the marketplace uses when selling the business to insiders. This "true cash flow" measurement reflects what your "penniless" buyers must use to pay for the business.

*Subsequent issues of **The Exit Planning Navigator®** discuss all aspects of Exit Planning.*

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