Key Numbers a Buyout Firm Uses Cheat Sheet

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Introduction

Any business owner seeking to sell his or her company can benefit from an understanding of the basic math behind a buyout and the variables that drive the valuation of a company.
Let's look at a quick example to see how a buyout fund considers the value in your company and what your company can do to make it an attractive investment for that investor.

Source: https://www.inc.com/ed-powers/5-key-numbers-a-buyout-firm-uses-to-value-your-company.html

1. Multiple of EBITDA

The investor thinks of the value of your company as a multiple of EBITDA. They are considering what the future stream of cash flows from your company will be worth. A simple way to think about the value of your company, in this framework, is to assign your annual cash flow a multiple. In this example, let's say a buyer thinks your company is worth five times EBITDA right now, or $2 million.

2. Growth in revenue

Your company has grown well over time, but the investor most likely will consider a scenario in which that growth isn't quite as fast. In this case, assuming a 5 percent compounded annual growth rate, your revenue will grow from $4 million to $5.2 million over the next five years.

3. EBITDA margin

Let's call your EBITDA divided by your revenue your EBITDA margin. Right now, it is 10 percent. Because your company will be valued as a multiple of EBITDA, growing EBITDA by either increasing revenue or increasing your EBITDA margin is very valuable. Let's assume you are able to make your company a bit more efficient over time, so your EBITDA margin climbs to 12 percent by the end of five years, yielding EBITDA of $610,000.

4. Amount of leverage

The investor is likely to use debt to purchase your company, as the company has nice cash flow and can service that new debt. Let's assume the investor will finance half of the purchase price of your company--$1 million of the total purchase price of $2 million.

5. Ownership

Finally, you and your investor need to negotiate how much of the company they are actually buying. If they buy 80 percent of your company, and your company is valued at $2 million, they write you a check for $2 million. They will ask to roll over 20 percent of the equity also, so you will put $200,000 back into the company (and they will invest $800,000, with the other $1 million being debt). Another way of thinking of it is the investor buys 100 percent of your company, and you buy 20 percent back on the same terms that the investor has..