foresight Business Sales
commercial agents & brokers

A GUIDE TO

P&L ADJUSTMENTS & PRICING

By Brendon Falk

1.0 Appraisal Method - The appraisal methods used to determine the market price of this business are based on the future maintainable earnings (FME) derived from the profit and loss statements supplied by the vendor or vendor's financial representative. We use either (i) the most recent trading figures or (ii) a weighted average from current and previous years to duly reflect the FME. In most instances, these figures are adjusted for owner operator's add-backs (see section 2.0). Secondary data sources are researched in order to obtain reliable return on investment (ROI) percentage. These are obtained from actual market sales and therefore reflect what market return is required within 1 or 2 standard deviations of the normal distribution. These ROI percentages however may be varied based on a risk assessment of the business. Using the ROI method the adjusted annual net profit is multiplied by 100 and divided by the ROI to arrive at an approximate asking price.

2.0 Adjusted Net Profit - To calculate the net profit on a business, we take the earnings before interest and taxes (EBITDA). This is a standard method for determining the profit from micro-business up to public listed companies (PLCs). This is due to the fact that taxation will vary depending on the buyers individual tax circumstances. Depreciation is not a cash outlay and interest will depend on the buyer's finance structure (whether they decide to finance all or part of the purchase capital).

3.0 Compilation Report / Add-back Schedule - Add-backs simply help the buyer as owner operator determine the amount of profit that will be available to them on a FME basis. Add-backs can be categorised into four areas: (i) non-reoccurring expenses or liabilities (ii) tax minimisation or non-cash expenditure (iii) owner's particular financial or capital structure (iv) owner's wages, super, fringe benefits or private expenses. Once the operating profit has been determined, the new owner can then apply their own personal expenses and fringe benefits (see section 6.0).

4.0 Asset Value - When determining the asset value, we choose to use economic depreciation and not taxation based methods. Taxation based depreciation is use for to create a tax advantage where as economic depreciation is more accurately reflective of the market value of the assets in-situ (in place). Therefore, asset value is equal to purchase or replacement cost less economic depreciation over the period being determined. That is the value at Period 1 less the value at period 2. This depreciated amount then becomes the market value in-situ or the estimated amount at which the asset should exchange between buyer and seller. This assumes the assets are sold by private treaty between two willing parties and that all assets are fully unencumbered at settlement.

5.0 Goodwill - Goodwill can be determined by your purchase price less stock and assets. However, if assets plus stock is greater or equal to the asking price, then the business has no goodwill or intangible component attached.

6.0 Stock-in-Trade & Work-in-Progress - Stock is valued at landed invoice costed (inc GST & freight) or as mutually agreed. If there is work-in-progress, both parties must agree to the value otherwise the value will be determined by an stockbroker appointed by the agent. The cost will be borne equally between the parties.

7.0 Buyer's Investment Decision - This should take into account the buyer's opportunity cost being wages, entrepreneurship, interest, and the budgeted renewal of plant (equal to economic depreciation). This should determine whether the business is suitable and whether there is a sufficient safety margin. Note this decision should be made in conjunction with your financial advisor.

Should you require any further information or assistance on this topic, I invite you to contact me on my mobile 0412 311 803 or by email bfalk@foresightbusiness.com.au.

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