KRATOS CAPITAL
ONE CLIENT AT A TIME

White Paper: Magic Tricks to Help You Get the Valuation You Want...

Takeaway: *Valuing a company is more black magic than science. These tricks will help you get the highest possible price.*

People often talk about the purchase price paid for a business as multiples of EBITDA. Whenever I hear business owners that have successfully navigated the sale of their business say, "I sold my business for five times", I think to myself, "5 times what? TTM EBITDA? NTM EBITDA? Maybe it was revenue. Wow, that would be nice!"

I never have the guts to say it out loud because I am certain they would only hear the sarcasm in my voice. When selling a business, it's great to brag about getting a high valuation multiple but for me, I'd rather just help my clients get the highest possible price - and one that greatly exceeds their expectations.

So how exactly do I do that? If you are selling your business, here are three valuation tricks you can perform prior to a sale to help you achieve or exceed your value expectations.

Trick 1: Calculate Your Implied Valuation Multiple
I call this the EBITDA shell game. Similar to sellers bragging about selling for high valuation multiples, buyers like to boast about how they got a great deal, paying a low multiple.

Use this to your advantage, and remember that the end goal is to get the highest purchase price, not the highest multiple. You can calculate the valuation multiple based on various metrics to find - and show - the one that is the lowest.

Let's say that your business has EBITDA for the last fiscal year-end at December 31st of $5 million. Today is June 30th, and your TTM EBITDA has increased to $5.2 million. The company is anticipating an upward trend, and will reach NTM EBITDA of $5.8 million.

If your valuation expectation is $22 million, then the implied valuation multiples are: ·

- 4.4x Last Fiscal Year EBITDA
- 4.2x TTM EBITDA
- 3.8x NTM EBITDA

So, what I tend to do is help potential buyers find the lower EBITDA multiple so that they can gloat to their board of directors, investors and other stakeholders that they got a steal of a deal for your company by only paying 3.8x - even though it's really just a different way of portraying the same valuation.

Trick 2: Understand Acquisition Financing and a Buyer's ROI
This is what I call IRR behind the ear. A smart buyer will know the cost of equity and will only make investments that provide a return in excess of that cost. In general terms, financial buyers of mid- market companies are looking for a return on equity (ROI) or internal rate of return (IRR) in the range of 25-35 percent depending on the inherent risk of the business.

Provide proof that purchasing your business at your valuation expectation will allow the buyer to achieve the IRR thresholds it's looking for. Here's a step-by-step summary of how you perform the analysis:

1. Figure out how the acquisition of your businesses will be financed. Talk to an investment banker and ask what the current level of debt to equity is on M&A deals. Using that ratio, apply it to your value expectations.

   Using the example above of a $22 million value expectation, let's say that an appropriate debt-to-equity ratio in the current M&A environment is 50 percent debt and 50 percent equity. In that case, an acquisition of your business could be financed as $11 million in debt and $11 million in buyer's equity.

2. Determine the free cash flows of the business over the next five years, including the cost to service the debt amount used in the acquisition.

3. Calculate the equity remaining for the buyer assuming that the company will be sold after five years at a conservative multiple of EBITDA (usually the same as the entry multiple).

4. Use the initial equity investment determined in No.1 above, the free cash flows after debt servicing in No.2 and the equity remaining for a buyer upon a subsequent sale in No.3 to calculate the potential IRR on their investment.

Hopefully, this analysis proves that the valuation of your business will earn your buyers a fair return on investment. If not, you might have to reassess the reasonability of your valuation expectations. Effectively, in this analysis, you have taken the buyer's IRR and pulled it from behind their ear.

Magic!

Trick 3: Be Prepared to Show Your Cards
I call this pulling a valuation out of a hat, and it's a pretty straightforward trick. Try telling a buyer your valuation expectations upfront and provide them with the supporting calculations to prove your number. Sounds silly, doesn't it? In an auction process, the common practice is to provide the buyer with enough information to formulate a valuation. In this scenario, you take the offensive rather than defensively waiting to receive offers.

Some would argue that this method might preclude a seller from getting a premium offer because the valuation will create a ceiling price that a buyer is willing to pay. From my experience, it is much more likely that buyers' offers, even in a competitive auction process, will fall short of a seller's expected value.

Unless you truly believe that there will be a number of strategic buyers willing to pay a premium for your company, this strategy could help you pull your valuation out of a hat.

Some Sage Advice About Valuation
Valuing a company is more black magic than science, but if you are prepared and apply a little slight of hand, you can work toward getting the valuation you want. And you don't

have to let a buyer dictate the assumptions used in determining the value of your business.

Kratos Capital LLC is a privately held, transaction-oriented, M&A advisory firm. Our principals have experience in a variety of strategic liquidity solutions including sales, divestitures, and mergers. We also work extensively with companies committed to expansion through acquisition.

We are an experienced, highly effective firm specializing in managing transactions with capitalized values of $5 million to $200 million. The firm provides industry tailored investment banking expertise, in order to help owners maximize the value of their investment of time, money and hard work. Each of our clients are represented by seasoned bankers, who bring a wealth of knowledge and experience. Our bankers comprise an aggregate of well over one billion dollars in completed transactions on behalf of the private middle market.