

HOW MUCH WILL PURCHASERS PAY?

Most purchasers calculate the base price for a business as a return on investment (ROI) based on future maintainable earnings (FME).

The simplified formula is xy , where x is FME and y is the multiple of earnings. The earnings multiple is also the payback period in years and is also the reciprocal of the capitalisation rate the investor is prepared to pay. For example, if the investor requires 25% ROI, the reciprocal is 4.

Using the capitalisation rate (or multiple of earnings) method of valuing a business is effectively valuing the free cash flow from the business. This value includes the assets required by the business. The assets may include plant and equipment and stock of raw materials, work in progress and finished goods. It also includes the net investment in working capital, comprising trade debtors, less trade creditors and employee entitlements. This is because investors are looking at the total return of the business which includes all assets employed in the business.

This is a simplification of Net Present Value or Internal Rate of Return methodology, calculating a future cash flow stream over a notional investment period, simplified to infinity and indexed by exactly the inflation rate, to neutralise most factors.

Where the capitalisation rate method calculates a value less than the business' net tangible assets (NTA) the theoretical minimum value is NTA.

Regardless of which category the purchaser comes from, the best price will usually be achieved from the purchaser who has the least to risk and the most to gain from the acquisition. Supertrac's role is to find the purchaser with the greatest strategic motivation to proceed.