Links Capital's Perspectives

EBITDA Versus Years of Cash Flow When Selling

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EBITDA Versus Years of Cash Flow

When businesses are sold the owners receive a multiple of EBITDA. Some business owners like to refer to the multiple as being how many years of cash flow they are giving up to divest of the business and receive the consideration now. This is not a correct assumption.

If a company is sold for 6.5x EBITDA it doesn't relate to 6.5 years of cash to the shareholders. It is 6.5 years of EBITDA, but then one must consider other annual deductions that are needed to run the business and the respective tax on the distribution of cash to the shareholders (whether it is management fees or dividends).

The annual after tax cash flow that is distributable to the shareholders must consider certain cash flow items when comparing with EBITDA such as:

- Long-term debt and line of credit and their respective interest costs;
- Annual capital expenditures;
- Other capitalized items, e.g. R&D costs, leasehold improvements;
- Corporate taxes;
- Personal tax rates; and
- Eligible dividend tax rates.

EBITDA	16,000,000
LOC Interest ($7.5 million @ 5%)	375,000
LTD Interest ($10.0 million @ 6%)	600,000
Annual Capital Expenditures	750,000
Cash Flow for Distribution	14,275,000
Management Fees (47% tax rate)	6,709,250
Annual After Tax Cash Flow	**7,565,750**
Multiple 6.5x	6.5
6.5 Years of After Tax Cash Flow	**49,177,375**

When one closes a transaction, the long-term debt is deducted from the tangible enterprise value (EBITDA times the market multiple) to arrive at the tangible equity value. The tangible equity value is the amount of pre-tax proceeds or cash flow that the shareholder would receive after paying off all long-term liabilities such as long-term debt or capital leases. The operating line of credit balance is a current liability that is typically caught in the working capital calculation (a required amount of working capital left at close to operate the business). The higher the line of credit is, the more cash, accounts receivable or inventory that must be left in the business reducing the ultimate net proceeds to the shareholders.

Links Capital specializes in the divesting and financing of businesses in the Canadian middle market.

Links Capital's philosophy is to preserve value throughout the entire transaction process. Senior partners handle all aspects of the transaction from inception to close and beyond, maximizing proceeds.

Being experts in private equity markets and corporate finance enhances value to our clients through extensive buy and sell-side experience.