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How Much is My Business Worth

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Serving the Electric Wire and Cable Processor
WIRING HARNESS NEWS®
Voice of the industry
P.O. Box 527 • RICHMOND, ILLINOIS 60071

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By Loren Smith

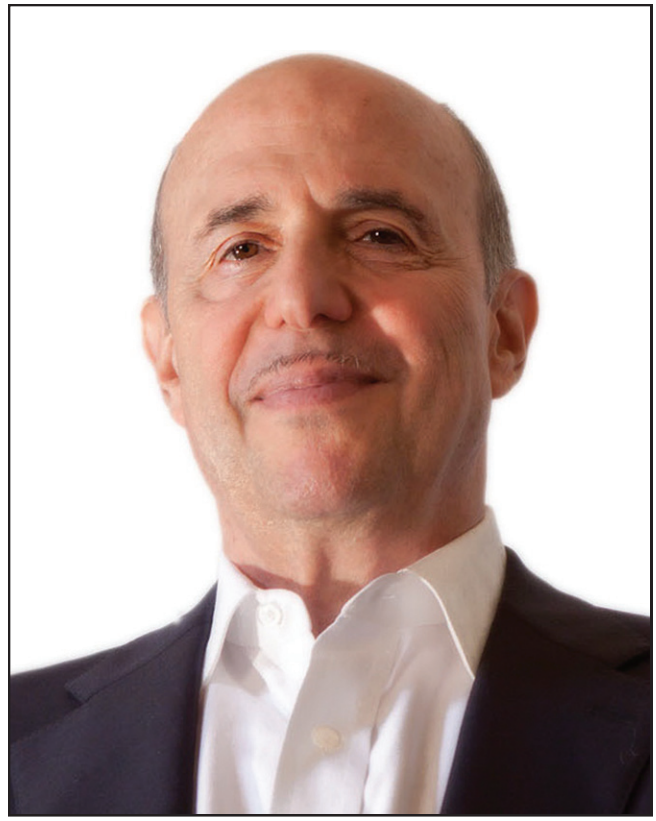
When I am asked by owners of wire harness companies how much I think their business is worth, I can explain the data points that determine price ranges, but I always emphasize that these are just indicators. For example, if the sale process attracts a few highly competitive buyers, the projection can be exceeded. Let's review some key factors determining the sale price.

The starting point: EBIDTA. The fundamental value of a business is a multiple of earnings before interest, taxes, depreciation and amortization (EBITDA) plus add backs. For wire harness businesses the sale price generally ranges from four to six times EBITDA.

EBITDA tells a prospective buyer what the company's cash flow is before paying interest and taxes and reducing income by calculations of annual depreciation and amortization. Add backs are expenses the company is incurring under current ownership that would not continue under new ownership.

For example, if an owner who wants to retire immediately after sale has been paying himself twice the normal salary for a CEO running a company of that size, the new owner can add back half the current owner's compensation. But this example illustrates the subjective nature of some add-back components. Perhaps no fully qualified CEO candidates can be found at half the current salary.

Risk. What is the probability that historic cash flow (particularly over the last few years) will continue in the near future? Is there reason to suspect that the next few years will see a precipitous drop in revenue and cash flow––or is there reason to anticipate a spike because of market conditions or opportunities that have not been realized?



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High on the list of factors to consider are the quality and duration of the company's customer relationships. And if the company's large-customer base is highly concentrated, it can expect its multiple to be discounted because of the projected impact of losing one key customer.

Management team. Will the management team responsible for recent performance stay in place for the foreseeable future, and is the current management team capable of growing the business?

Growth potential. Two favorable factors for a harness company are customers that appear likely to expand and customers that currently award only a small percentage to the harness company and seem eager to increase that share based on recent performance. But the worth of a company needs to be downgraded if it is close to its ceiling in revenues from current customers.

Market. Some harness companies can demand higher multiples than the standard four to six times EBIDTA because they primarily sell to customers operating with higher margins. Cases in point are military and medical equipment harness companies because their customers are in less competitive markets.

Size. A $20 or $30 million revenue harness company will demand a higher multiple than a $5 million company.

Complexity of product. A company producing wire harnesses with hundreds of circuits often enjoys a more secure position with its customers. Specializing in complex products leaves less room for competition.

Status of computer system. Today, the capabilities of a company's hardware and software are crucial. Potential buyers will evaluate whether a company has outgrown its computer system or stayed ahead of the curve.

Bottom line. Many owners are so focused on running their business they have little idea what their business is worth. But once they do contemplate selling, a solid beginning is multiplying the EBIDTA by four to six and then adjusting for the kinds of factors I've suggested. If they score reasonably high on these measurements and engage in a competitive sale process, they will optimize the price.

But no matter how the calculations turn out, the decision to sell is almost always an emotionally difficult matter.

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