



**SUNBELT**  
The place to go to buy or sell a business

### Contributed by Sunbelt Business Brokers

Contact: Erik Twohig, Sales Representative,  
[erik.twohig@sunbeltnetwork.com](mailto:erik.twohig@sunbeltnetwork.com)

## What the Profit & Loss Statement Doesn't Tell You!!

One of the key mistakes that business Sellers make is improperly pricing their business, and, not understanding how and what a reasonable price is.

One of the key mistakes that Buyers make is to assume that the Profit & Loss Statements of a business will give them the financial information they need to assess value.

Profit & Loss Statements are not designed to tell you 'what a business is worth', or even to tell you 'how much money' the business makes. They are designed to help an owner keep track of their revenues and costs in an orderly fashion – but mostly to provide the financial information that a business owner needs to provide to the Canada Revenue Agency about their operations.

While this is critical information, and necessary, it is absolutely **not** what Buyers need, and in fact is often confusing to Buyers, and sometimes to their advisors. What a Buyer needs to know is: how much cash is available from this business, after paying all the operational costs, that I can use to pay myself a wage, and service all of the debt I have incurred to purchase the business.

This number is called a lot of different things – normalized cash flow, discretionary earnings, free cash flow, and others. We call it '*owners discretionary earnings*', and it is a key component to what a rational Buyer would pay for a business, and equally as importantly, what would get through the 'sober second look' of lenders, and other advisors in a transaction.

**It is, however, only one element of value, and is dangerous to apply by itself, or without considering other elements!**

There is a reasonably simple way to get to this critical number.

Take the taxable net income of the company,

- add back the non-cash expenses (like amortization),
- add back the cash expenses that would not apply to a Buyer (like interest payments),
- add back the Sellers wages (only one Seller),
- add back all personal owners benefits (home office expense, non-necessary travel, personal insurance, perhaps cell phone, subscriptions, etc),
- double check that all family members working in the business are paid 'at market' wages – add or subtract to adjust,
- double check that things like rent are also 'at market' – add or subtract to adjust,
- and then look at the total.

Compare this with previous years to establish consistency over time, and there you have it – a basis for determining the owners discretionary earnings that are the heart of what you are selling.

Remember, however, there are more variables – owner relationships, need to replace equipment, etc., that come in to play here, but this part is pretty critical.

**BEWARE, as a Seller you will be, or should be, expected to prove each and every one of these adjustments!**

Having this information prepared for potential Buyers has great value for you. It reduces the Buyer risk, which increases their willingness to pay you, it gives you the opportunity to show what your business really does, it shows you are thoughtful and serious about selling, and it starts the process of you being organized to survive Due Diligence. It also allows you to work with the Buyer to reasonably objectively get to what you both want – a successful business transferred to a new owner!

**WANT TO LEARN MORE?** The London office of Sunbelt offers a free program called Buyer 101. In that 2 hour seminar we discuss only 4 key issues that are critical to a potential business Buyer – Importance of Confidentiality; How to Determine Value; Financing a Purchase, and; the Offer and Due Diligence process. These same elements are critical to – and the same for – business Sellers! Email us, or call 519-473-2227 to register for the next course!