

## **'Recasting' Helps Determine Business Value**

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If you are a business owner, chances are you'll sell your company to someone who has also owned a business. All business owners play the 'perk game.' Any personal expense the owner can legitimately expense through the business to reduce taxes is fair. The main benefit is the perk game reduces taxable income. However the net profit on the profit and loss statement usually takes a beating.

Once you decide to sell your business, it's critical to tell the potential buyers what you've taken out of the business by way of salary, draws, benefits, perks, etc, and to what extent it has reduced your net income and taxable profit. They won't think less of you; most likely they'll do the same thing.

The process of identifying a total compensation package for an owner is called 'recasting.' This means adjusting past financial statements to better reflect true cash flow; otherwise known in the industry as Seller's Discretionary Cash (SDC). The goal is to identify various ways in which you and your family have benefited by owning the business. When the time is right, any qualified potential buyer has the right to see a standard version of your financial statements as well as a 'recasted' version.

Here is a quick rule-of-thumb for recasting, normally done with the last 3 years of financial records: take the net profit (either on tax returns or a P & L statement), add to it one owner's compensation and all the discretionary benefits which get expensed through the company but are for personal benefit of the owner or owner's family. Taking a closer look, an owner's compensation may include his or her salary, draws, bonuses, dividends, personal loans, etc.

Second, owners may receive non-direct compensation which may include contributions by the company to 401K plans, pension or retirement plans, various forms of savings accounts, or even college savings plans. In addition, look at more personal expenses such as automobile leases/payments, health and life insurance, personal travel and entertainment, country club memberships, etc. These added together can amount to a substantial portion of an owners total compensation package.

Fourth, adjust for any lease-backs which may exist with real property, cars, equipment, and so on. The most common adjustment exists when the owner of the business holds the real property and improvements in a separate entity and pays himself or herself market rent.

Last, adjust for extraordinary items: legal fees for a lawsuit that has already been settled, non-typical bad debt that was due to one bad customer, one-time expenses which a potential buyer would not expect to incur. Examples may include replacement of a roof on the building, extraordinary product development costs or large equipment purchases that were expensed up to the legal limit.

There are numerous items to be considered, it's impossible to list them all. But take the time to look at each item on your tax returns or profit and loss statements, many expense categories may be an opportunity to recast.

Obviously the recasted earnings affect and help determine the overall value of the company. Thus, recasting is a critical step; often times the foundation for determining value in your company.

When trying to determine a value or sales price for your business, a business broker or CPA can assist with the valuation and recasting process; identifying the maximum value for your company.

Ultimately the market will determine what your company is worth, our goal is to identify the value available, ensuring a maximum return and yield for your life's work.

*Jeff Kraai is president of Exit Strategies, Inc., specializing in business sales and retirement transitions. He can be reached confidentially at 360.696.5812 or [jeff@perfectexit.com](mailto:jeff@perfectexit.com).*