

Owner's Discretionary Cash Flow

By Michael L. Terry

Most often, small businesses are purchased by someone who is "buying a job". Certainly, other factors and reasons are involved, but this is a very important one for most. So, if you are buying a job...what do you look for? Salary and benefits (after accounting for debt service, since most sales are financed), right? When we sell a business, we are going to be looking for all the real or actual cash flowing through the business that would give benefit to its owners. This includes salary, profit, benefits, personal expenses ran through the business, and anything that is not necessary to operate the business. Generally, non-cash expenses, interest expense and non-recurring expenses are added back and capital and needed equipment replacement is subtracted, as well. The end result will be owner's discretionary cash flow. It is determined from the business's financial statements or tax returns and basically "unravels" what the accountant does for the business owner. The accountant minimizes the taxable income for the business...the broker or appraiser tries to find all the potential income that can be reasonably shown to exist.

This key figure will be used in determining potential estimates of salary and benefits after debt service and valuation of some businesses. So, when it gets time to sell, start thinking of all the things that might contribute to owner income and benefits and make sure everything "reasonable" gets counted. It can easily make tens of thousands of dollars difference in the sale price of a business.