VALUE INSIGHTS SERIES, ISSUE 4

IT'S ALL ABOUT THE MULTIPLE (…OR IS IT?)

I get asked all the time…*'what kind of multiple would my treatment center command?'*

'NOT SO FAST'…THERE'S NO STRAIGHT ANSWER.

I would go as far as saying it's irresponsible to give guidance simply in the form of a multiple without knowing the other half of the valuation equation – **Adjusted EBITDA.** The Adjusted EBITDA can be dramatically different depending on whether it is based on a trailing twelve-month (TTM) period, calendar year, annualized pro- forma, or some other formulation. It can also vary significantly based on the buyer and which adjustments will be considered.

The question should be, *'what kind of **VALUE** would my treatment center command?'* which is more complicated.

Let's take a step back and explain the value equation that is commonly used in the industry.

Value = (Adjusted EBITDA) x (the Multiple), whereby:

- Adjusted EBITDA (or **E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation and **A**mortization) is a proxy for "normalized" cash flow (normalizing for typical variations in a company's revenue cycle).
- The Multiple is the inverse of the go-forward risk of that cash flow continuing after the transaction is complete. The lower the risk of cash flow deterioration, the higher the multiple. For example, a 7x multiple implies a 14.3% return and a 5x implies a 20% return, so the 5x multiple is viewed as a riskier investment for the buyer, therefore he/she requires a higher rate of return.

Pretty straightforward, right? Well, not always. And here's why …**Adjusted EBITDA is in the eye of the beholder.**
Consider three case studies to illustrate:

continued on reverse →

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THE FAST GROWING COMPANY

We represented the seller of an opioid treatment program with the following value drivers:

- Trailing 12 months (TTM) revenue of $9,100,000;
- Trailing 12 months adjusted EBITDA of $2,400,000 (~26% of revenue);
- Strong growth;
- Multiple locations;
- Strong clinical and compliance program; and
- No seasonality.

After receiving multiple bids, and after negotiations, the successful buyer (a large private equity fund) came in with a valuation of $34,000,000. Clearly a healthy multiple of 14.2x ($34,000,000/$2,400,000), right? I can assure you the buyer was looking at this differently. Remember, this was a fast growing company that had no seasonality.

	Trailing 12 months (TTM)	Last 3 months, annualized
Revenue	$9,100,000	$16,800,000
Adjusted EBITDA	$2,600,000	$4,500,000
Multiple	14.2	7.6

So, what was the multiple? Depends on who you ask. The buyer was telling their board that they got this company for a fair price – a multiple of 7.6 My client, the seller, was telling his golf buddies he sold for a multiple of 14.2x... **EBITDA & multiples are in the eye of the beholder.**

CORPORATE OVERHEAD AND SYNERGIES

Here's an example of a multi-location residential treatment center we represented:

- Trailing 12 months revenue: $9,600,000;
- Trailing 12 months adjusted EBITDA: $1,600,000;
- Modest growth;
- Strong clinical and compliance program; and
- Primarily in-network revenue.

After running a competitive bid process, the buyer agreed to pay $21,000,000. This company commanded a multiple of 13.1x, ($21,000,000/$1,600,000) right? Maybe/Maybe not...

In this case, the seller was paying an annual salary of $500,000 to a high-priced CEO who was not an owner of the company, but a close confidant who had a long business relationship with the seller, and worked part-time in the business. Although he was instrumental in the success of the company, he was not needed by the buyer. The buyer had a regional VP who had the bandwidth to take on these responsibilities. So the buyer would enjoy an immediate $500,000 bump in EBITDA on day one – to $2,100,000. To the buyer, this company was purchased for a multiple of 10x ($21,000,000/$2,100,000).

THE LOW MARGIN BUSINESS

Another example:

- Trailing 12 months revenue: $5,100,000;
- Absentee owner, not involved in the day-to-day operation;
- Trailing 12 months EBITDA: $300,000; and
- Revenue derived primarily from public funding.

The sale price was $7,000,000, or a multiple of **23.3x** ($7,000,000/$300,000). Clearly not a standard industry multiple for a single-location, privately held treatment center, but it was a competitive process and the company had a high strategic geographical interest to this industry buyer. In this case, the buyer saw opportunity that wasn't being capitalized by the current owner. This buyer had a very strong marketing group and in-network relationships that could bring the center's occupancy from 12% to 70% within 12 months. Because of the competitive nature of the offering, they valued the treatment center based on it's pro-forma financial performance – what they could do with it <u>after</u> the closing

So that begs the question…what is the multiple of a break-even (or money-losing) treatment center that sells for **any** price? It's all about the **value.**