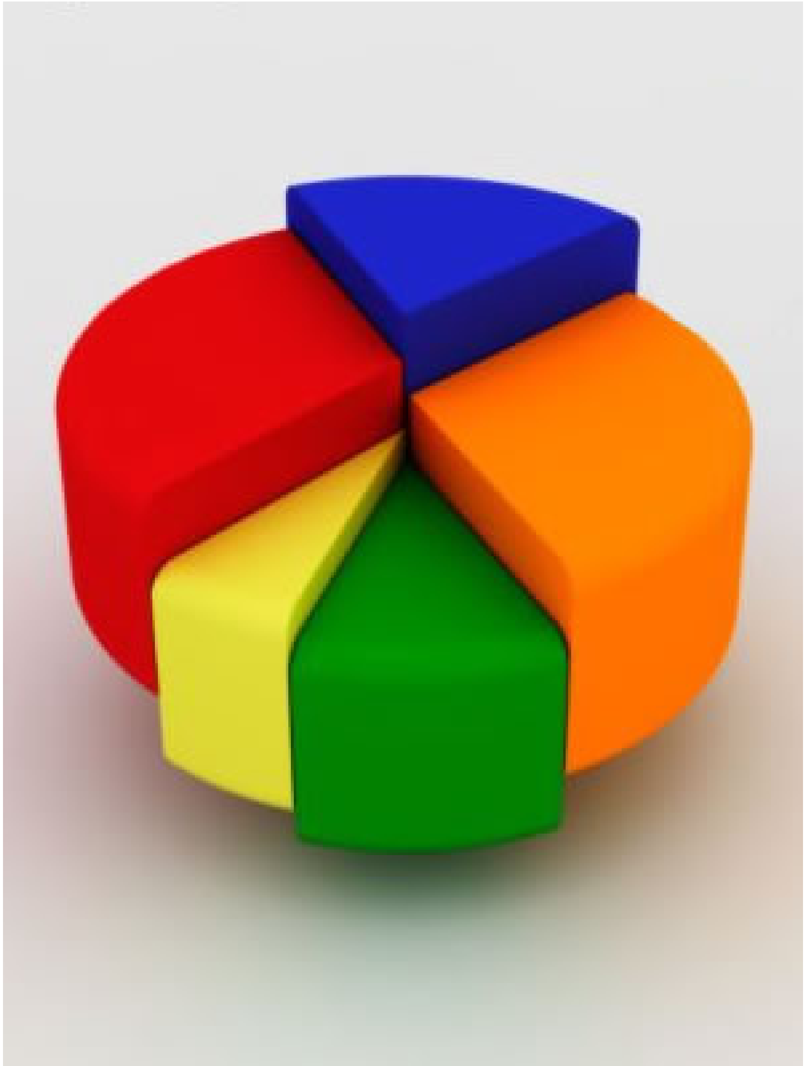
How Normalization of Income helps you establish a value for your company.



To determine an expression of value of the net worth of shares or assets of a company, the first exercise is to analyze and normalize the company's financial performance as if it were a company being run "By the Book".

Today, the most common "thumbnail" valuation methodology is based on a multiple of normalized **EBITDA**. (**E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation, and **A**mortization)

EBITDA is the approximate measure of a company's operating cash flow based on the company's financial statements, before charging, interest, income taxes, depreciation and amortization, plus all other normalizing adjustments; some of the more common being described below.

Common items requiring a normalization adjustment to net income include, but are not limited to:

- **Management Salaries** – Careful consideration should be given to what a normal management salary, or salaries, would be for the new owners to operate the company effectively. Net income should be adjusted accordingly.
- **Costs** that would not exist under new ownership. Automobiles, cell phone, gas cards, car insurance, internet home office costs etc,
- **Family members** or others on the books, who draw a salary or receive other benefits but do not actually perform work for the company.
- **Commercial rent or property costs** should always be adjusted to reflect actual market costs that would be incurred if the business premises were to be leased by the new owner at prevailing market rates.
- **Perks** that will not exist under new ownership. Examples are personal meals, entertainment and memberships.
- **Owners benefits** such as key man insurance or personal term or whole life insurance, as well as pension or RRSP contributions being paid for by the company.

Each individual company may have other costs or revenue adjustments that may be required; the above are the most common.

A review of the Balance Sheet should then be conducted to determine what the true retained earnings or net worth of the company is. This exercise helps identify other assets or liabilities that may impact on the valuation of the company. In the case of a share sale, this review will also help determine how much cash will be required to be left in the business as “working capital”.

Other important shareholder items of concern are loans to, or advances from, the company, and capital gain taxation considerations

The final factor to be determined is appropriate multiple of EBITA, essential to establishing a provisional value of your company.

The Multiple x Normalized EBITDA = Provisional Value.

This preliminary valuation may be undertaken prior to contacting us. To help you establish the value of your company a complimentary EBIT/EBITDA printable worksheet is provided for your convenience .

Mercantile Mergers & Acquisitions Corporation will be happy to assist you in this process at no cost or obligation. Contact us here for a free consultation.