Overview

Clare Capital Tech Insights 84 - To sell or not to sell - 20180615

This Tech Insights report looks at the acquisition of private businesses and the difference between weighing up how much you receive now for your company (Enterprise Value of Company) versus if you were to not sell and how many years it would take to earn the same amount through the company's cash flows or dividends (Present Value of Cash Flows).

Definitions

PV = Present Value of Cash Flows
EV = Enterprise Value of Company

Case Study

In February 2018, ASX-listed ELMO Software acquired Christchurch-based (NZ) Pivot Software for AUD $8.8 million. Pivot Software is a SaaS company specialising in cloud-based remuneration software. Details of the transaction were disclosed:

Enterprise Value	AUD M	8.8
Revenue	AUD M	4.5
EBITDA	AUD M	1.4
EBITDA Margin	%	30%
EV/Revenue Multiple	x	2.0
EV/EBITDA Multiple	x	6.5
Employees	#	22
Revenue per Employee	AUD	204,545
Recurring Revenue	%	86%
Revenue Retention	%	93%
Churn	%	7%
Customers	#	120
Recurring Revenue	AUD M	3.9
Monthly ARPU	AUD	2,688

The details above are a mixture of publicly available information from an ELMO Software ASX announcement (e.g. revenue, EBITDA margin, customers) and some Clare Capital assumptions (e.g. churn, monthly ARPU).

Analysis

While the ELMO Software acquisition of Pivot Software was completed at a 6.5x EV/EBITDA multiple, based on our calculations/assumptions, it would have taken the shareholders of Pivot nine years to have generated the same level of cummulative cash flows to match the acquisition price (Chart 1).

Chart 2 shows the impact of a change in the EBITDA multiple on the number of years it would take for the cash flows to be greater than the acquisition price.

Two key elements that are important to understanding this analysis: 1) EBITDA is a pre-tax measure and 2) there is a time value of money.

It is important to note that this analysis does not include any terminal valuation calculations. Should you choose not to sell and after nine years cash is greater than the implied EV, as well as the cash received you are also still the owner of the company.

Chart 1: Case Study Example

Calculations on the back page

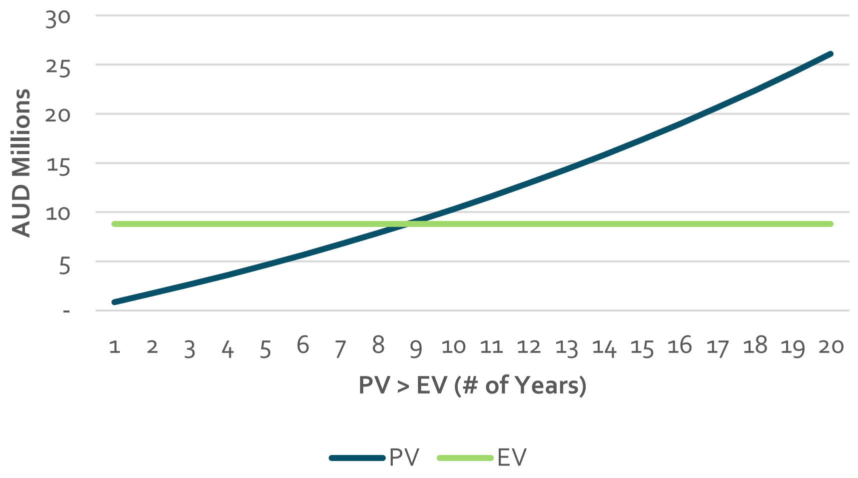
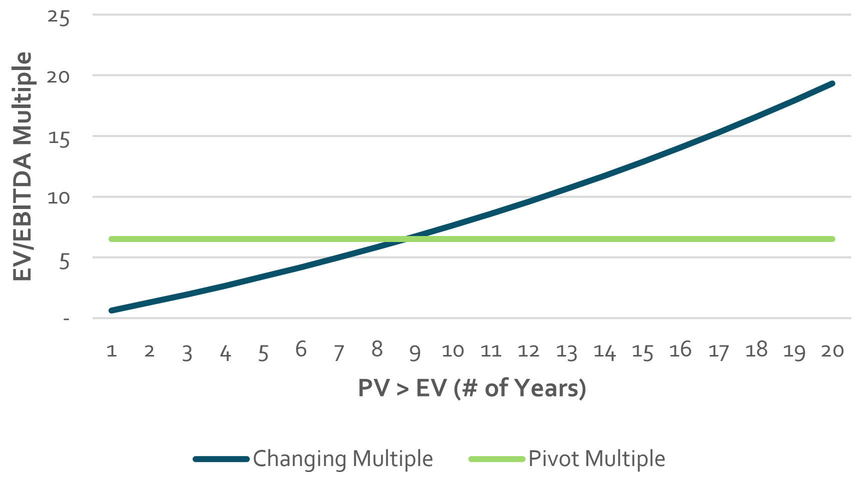


Chart 2: Case Study Example - Changing EBITDA Multiple



Case Study (all numbers in AUD '000s)

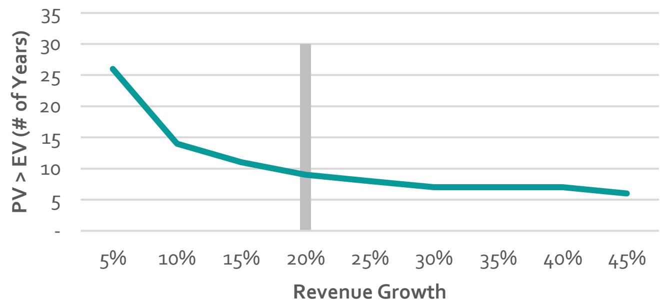
			1	2	3	4	5	6	7	8	9	10	11
Revenue	20%	Growth	4,500	5,400	6,480	7,776	9,331	11,197	13,437	16,124	19,349	23,219	27,863
EBITDA	30%	Margin	1,350	1,620	1,944	2,333	2,799	3,359	4,031	4,837	5,805	6,966	8,359
Corporate Tax	(28%)	Rate	(378)	(454)	(544)	(653)	(784)	(941)	(1,129)	(1,354)	(1,625)	(1,950)	(2,340)
Capital Expenditure	-	Margin	-	-	-	-	-	-	-	-	-	-	-
Free Cash Flow			972	1,166	1,400	1,680	2,016	2,419	2,902	3,483	4,179	5,015	6,018
Discount Rate	15%	Rate	0.87	0.76	0.66	0.57	0.50	0.43	0.38	0.33	0.28	0.25	0.21
Discounted Free Cash Flow			845	882	920	960	1,002	1,046	1,091	1,139	1,188	1,240	1,294
Cumulative Discounted FCF (PV)			845	1,727	2,647	3,608	4,610	5,656	6,747	7,885	9,073	10,313	11,607
Enterprise Value (EV)			8,800	8,800	8,800	8,800	8,800	8,800	8,800	8,800	8,800	8,800	8,800
PV > EV (# of Years)	9		FALSE	FALSE	FALSE	FALSE	FALSE	FALSE	FALSE	FALSE	TRUE	TRUE	TRUE

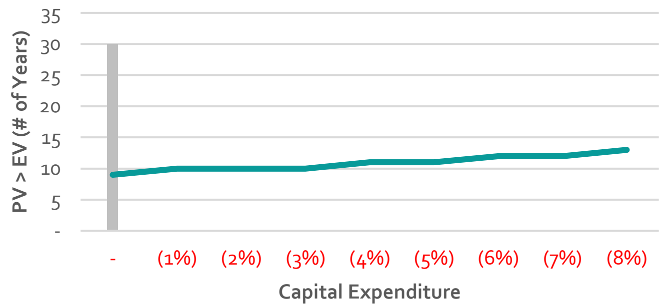
Sensitivity Analysis - # of Years for PV > EV

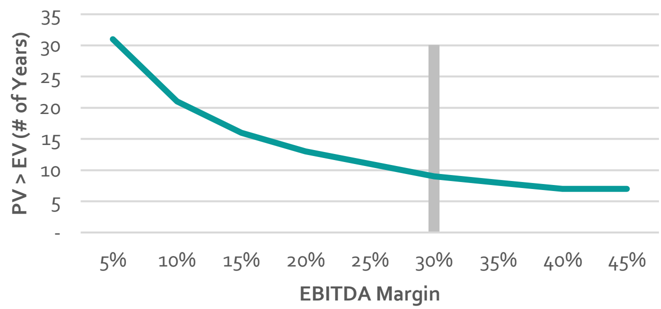
The charts on the right illustrate how changing the inputs can affect the results of the case study.

The key premise is that the EBITDA multiple (in this scenario 6.5x) doesn't equate to how long it will take to receive the same value today. In future cash flows (in this scenario is takes 9 years); given that tax is taken off and a discount rate applied.

We have also assumed that 100% of free cash flow is distributed to the shareholders each year. This is an optimistic assumption, as it will only increase the number of years for the PV to be greater than EV.







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