

The Top 3 Key Factors to Consider About Earnings

Two businesses could report the same numeric value for earnings but that doesn't always tell the whole story. As it turns out, there is far more to earnings than may initially meet the eye. While two businesses might have a similar sale price, that certainly doesn't mean that they are of equal value.



In order to truly understand the value of a business, we must dig deeper and look at the three key factors of earnings. In this article, we'll explore each of these three key earning factors and explore quality of earnings, sustainability of earnings after acquisition and what is involved in the verification of information.

Key Factor # 1 – Quality of Earnings

Determining the quality of earnings is essential. In determining the quality of earnings, you'll want to figure out if earnings are, in fact, padded. Padded earnings come in the form of a large amount of "add backs" and one-time events. These factors can greatly change earnings. For example, a one-time event, such as a real estate sale, can completely alter figures, producing earnings that are simply not accurate and fail to represent the actual earning potential of the company.

Another important factor to consider is that it is not unusual for all kinds of companies to have some level of non-recurring expenses on an annual basis. These expenses can range from the expenditure for a new roof to the write-down of inventory to a lawsuit. It is your job to stay on guard against a business appraiser that restructures earnings without any allowances for extraordinary items.

Key Factor # 2 – Sustainability of Earnings After the Acquisition

Buyers are rightfully concerned about whether or not the business they are considering is at the apex of its business cycle or if the company will continue to grow at the previous rate. Just as professional sports teams must carefully weigh the signing of expensive free-agents, attempting to determine if an athlete is past his or her prime, the same holds true for those looking to buy a new business.

Key Factor # 3 – Verification of Information

Buyers can carefully weigh quality and earnings and the sustainability of earnings after acquisition and still run into serious problems. A failure to verify information can spell disaster. In short, buyers must verify that all information is accurate, timely and as unbiased as is reasonably possible. There are many questions that must be asked and answered in this regard, such as has the company allowed for possible product returns or non-collectable receivables and has the seller been honest. The last thing any buyer wants is to discover skeletons hiding in the closet only when it is too late.

By addressing these three key factors buyers can dramatically reduce their chances of being unpleasantly surprised. On paper, two businesses with very similar values may look essentially the same. However, by digging deeper and exercising caution, it is possible to reach very different conclusions as to the value of the businesses in question.

About CK Business Consultants, Inc.:

CK Business Consultants, Inc. has been dealing exclusively in the sale and acquisition of petroleum and propane related mid-market companies since 1976. We are qualified, experienced, and highly professional intermediaries working with both buyers and sellers in the successful transfer of business ownership. We handle all phases of the project including initial analysis, valuations, developing a confidential information memorandum, locating qualified buyers, negotiations, and execution of the transaction. For more information, please call or email Gary Papay @ 570-584-6488, gpapay@ckbc.net or visit our website @ www.ckbc.net.