

What Is Your School Worth? *Pulling Back the Curtain—Bids on Actual Transactions*

by J. Mark Jopling

Introduction

When Harris Miller asked me to speak at the CCA Convention on “How Much is My School Worth?” I jumped at the opportunity to try to clear up some common misperceptions. Over the years there have been many presentations and lots of chatter about EBITDA multiples, mostly without adequate explanation as to what the term actually means and often without sufficient emphasis on how a school’s size and character and the buyer’s unique attributes affect transaction prices. These failings have obscured the complexity of predicting any particular school’s market value. My presentation in New Orleans attempted to clear up some of these misperceptions, in part by looking at several actual transactions.

The Schools

The transactions analyzed here represent the actual sales of four mid-

sized, multi-campus schools. Each school had revenue between \$12 million and \$30 million, Adjusted EBITDA between \$3 million and \$8 million and student populations ranging from 900 to 2,800. Various programs, accreditations and locations are represented. All the transactions occurred fairly recently, but may not reflect future market conditions or the results that could be expected for much smaller or larger schools.

The Bidders

All of the bids shown were from “bona fide” bidders. That is, all of the bidders were knowledgeable about the career school sector, had the financial and administrative capability to consummate a transaction and met the Department of Education’s standards for change of ownership. In each transaction, we received multiple bids from public companies and from private equity groups (“PEGs”), many of



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which had already made investments in the sector. We conducted extensive due diligence on each school and furnished comprehensive offering memoranda on the schools to each bidder.

What is the Real “EBITDA Multiple”?

Despite its popularity as a valuation benchmark, the meaning of the term “EBITDA Multiple” is frequently misunderstood, which leads to potentially misleading generalizations. Most people know that the EBITDA Multiple is Price divided by EBITDA. But “Price” does not mean proceeds received by the sellers, and EBITDA can have several different meanings.

Enterprise Value

Price in this case refers to “Enterprise Value,” which is the debt-

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free value of the company assuming a normal level of working capital, usually considered to be cash and accounts receivable at least equal to total current liabilities. If the

company has excess cash, assets not used in operating the school, or owned (rather than leased) real estate, the owners can expect extra proceeds beyond Enterprise Value. Conversely, proceeds will be reduced for debt.

Adjusted EBITDA

Understanding Enterprise Value is relatively easy compared to understanding EBITDA, earnings before interest, taxes, depreciation and amortization. M&A professionals generally talk in terms of “Adjusted” EBITDA, which means adjustments

have been made for nonrecurring items and changes in economics likely to occur under new ownership. Common adjustments to EBITDA include adding back *excess* (not total) compensation of owners over that needed to attract qualified replacement management, deducting rent (if real estate now owned is to be leased by the new owner) and correcting the effects of improper accounting practices (typically improper revenue recognition, inadequate bad debt reserves and missing accruals, such as vacation pay). This list of adjustments is by no means all-inclusive, but does illustrate that often there is a *huge* difference between EBITDA reported on the company’s financial statements and the Adjusted EBITDA used in determining value.

To obtain the best price, the seller must develop credible projections of Adjusted EBITDA for the trailing twelve-month period as of an expected closing date and for at least the first year thereafter. This is not a trivial exercise.

It is very important that sellers be *reasonable* when adjusting EBITDA. Overreaching by making excessive, unrealistic addbacks and failing to make necessary deductions will not fool the “smart money.” Instead, this will lead to a loss of credibility and reduced bids. In this regard, the treatment of corporate overhead often becomes a point of contention between sellers and buyers. Many sellers try to add back all corporate overhead. This is almost always unrealistic, as *any* buyer will require some level of additional overhead to

support the newly acquired operation. This is a special area that requires thoughtful consideration in the seller's presentation of Adjusted EBITDA. An adjustment with respect to startup losses from new campuses or programs is another area requiring careful judgment.

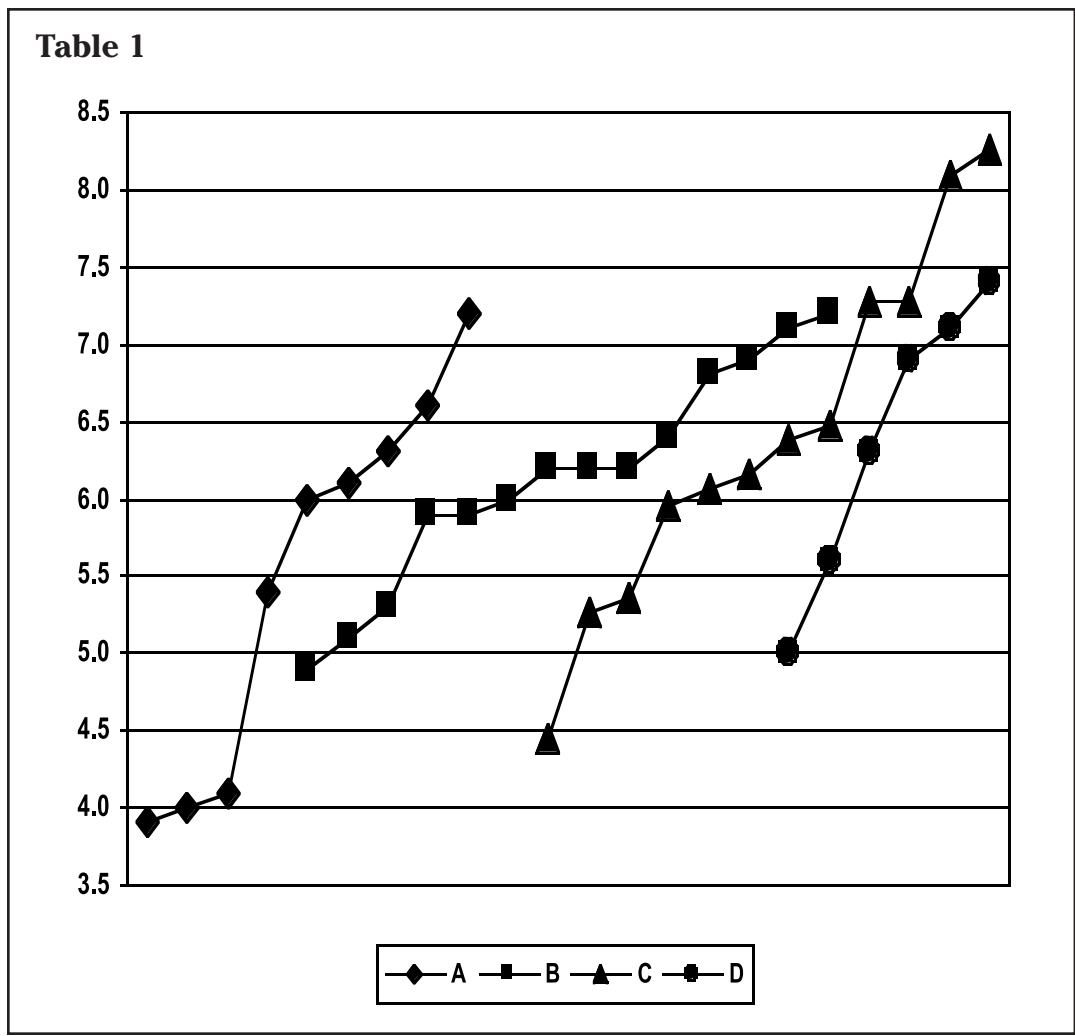
Time Period

PEGs have been driving the market for the last several years, and most PEGs fund their investments with a combination of debt and equity. The more debt they can borrow, the more they can pay for an investment. The trailing twelve months ("TTM") Adjusted EBITDA as of the closing date has a significant effect on the

amount that can be borrowed, and projected performance under new ownership obviously affects a bidder's view of likely return on investment. Therefore, to obtain the best price, the seller *must* develop credible projections of Adjusted EBITDA for the trailing twelve-month period as of an expected closing date and for at least the first year thereafter. This is not a trivial exercise.

Results

The bids received on these four transactions are shown below. (Note that the EBITDA Multiples displayed are for Enterprise Value divided by Projected TTM Adjusted EBITDA as of the expected closing date.)



Transaction	A	B	C	D
No. of Bids	9	14	12	6
TTM Adj. EBITDA Multiple:				
Low	3.9	4.9	4.5	5.0
High	7.2	7.2	8.3	7.4
High Bid/Low Bid	182%	149%	185%	147%
Price/Reported EBITDA from Last Audit	37.5	12.6	12.1	18.5
Price/Adjusted EBITDA from Last Audit	24.8	13.0	13.8	9.6

These transactions generated a total of 41 bids from sophisticated, motivated and capable parties having access to the same data. Rather than being closely grouped around some “expected” value, the bids exhibited a wide range, with the high bids exceeding the low bids by as much as 85 percent, as summarized above.

There can be huge differences among the different types of EBITDA.

Often the biggest factor influencing bids is whether the school is of sufficient size and has strong enough management, systems and brand identity to become a “platform” acquisition.

Depending on which definition is used, the Seller in Transaction C could correctly claim a multiple of 8.3, 12.1 or 13.8. This is the type of “definitional problem” that

creates misperceptions among potential sellers.

Why Such Divergent Views of Value?

Schools aren’t simple commodities traded in an efficient market where prices easily adjust to balance supply and demand. Each school and each prospective buyer is unique. The

following is a brief description of some of the key factors that can affect bids.

Fit

What might be a good fit for one bidder might not be so good for another. Often the biggest factor influencing bids is whether the school is of sufficient size and has strong enough management, systems and brand identity to become a “platform” acquisition. The power of the private equity model allows PEGs to pay high prices for platform acquisitions and still earn acceptable returns on investment. However, if a bidder does not view the school as a platform or doesn’t need a platform, its bid usually will be much lower.

Different bidders have different views of the risks and rewards offered by any particular acquisition opportunity.

A bidder may also be willing to pay more for an “add-on” acquisition that offers logical geographic expansion or an opportunity to transplant programs between existing campuses and the seller’s campuses.

Timing

The timing for one bidder may be much better than for another. Sometimes a potential bidder is just too busy to pursue a particular acquisition that otherwise would be of interest unless it appears likely to go for a bargain price, especially on smaller acquisitions that are perceived as “nice-to-haves” rather than “must-haves.” Sometimes a seller is skillful (or lucky) enough to find a bidder who has recently made a decision to pursue just that kind of school. And sometimes one or more similar schools may come to market at the same time, “flooding the market” and perhaps lessening the appeal of all.

Different Acquisition Philosophies/Strategies

Buyers have different acquisition philosophies and strategies. Some buyers are not willing to pay as much as others just on general principle. Some buyers hope to secure bargains by spending a lot of time, energy and expense finding and pursuing schools that are not officially for sale but that are willing to talk and generally have no investment banking representation. Other buyers will pursue only larger transactions, feeling the effort required to close any transaction isn't worth it unless the target is of a meaningful size.

View of Risk/Reward

Different bidders have different views of the risks and rewards offered

About Jopling, Inc.

Jopling, Inc. is a small investment-banking firm based in Pittsburgh having a specialization in the career school sector. The firm has a reputation for thorough due diligence, accurate and full disclosure, attention to detail and providing follow-up support post closing.

by any particular acquisition opportunity. Some bidders may get excited about seemingly obvious ways to improve operations (“low-hanging fruit”), while other bidders may perceive the same opportunities as requiring a lot of work and having an uncertain outcome.

Alternatives

Some bidders have more alternatives than others. If a bidder has many good alternatives, that likely means its bid will be lower.

View of Likely Competition

Once a bidder determines what he is *willing* to pay, he then asks, “What do I *have* to pay?” If the opportunity has wide appeal and it is apparent that the marketing

process will be professionally and efficiently handled, then the bidder may

feel that he has to stretch on price to have a chance of success. It is unusual for a seller to obtain the highest price and best terms from a buyer who does not have actual or potential competition from another bidder.

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Key Takeaway Points

- The bids made for these schools demonstrate that there is a wide range of bids that different prospective buyers will make for the same school. The different characteristics of the buyers largely explain these valuation differences. **Finding the right prospective buyers and creating competition makes a big difference in obtaining the best price.**
- **How EBITDA is defined has a huge effect on the EBITDA**

multiple people quote. Rules of thumb and generalizations can be misunderstood and misleading.

- **Guiding bidders to focus on the highest *reasonable* Adjusted EBITDA for the appropriate time period is critical to getting the highest bids.** It is important that bidders see that the sellers and their advisors understand the “true” numbers and have

demonstrated realism by not overreaching on adjustments.

- Although experienced advisors should have some idea of a reasonable price expectation, no one can know with certainty what the *highest* bid is likely to be. **The only way to know a school’s value for certain is careful due diligence, proper packaging and effective marketing.**