

How to Determine SDE

Seller's Discretionary Earnings (SDE) is an estimate of the total financial benefit a full-time owner operator would derive on an annual basis. It is also variously referred to as Seller's Discretionary Cash Flow, Adjusted Cash Flow, Owner Benefit, Recast Earnings or Normalized Earnings, although Seller's Discretionary Earnings is the official terminology advocated by the International Business Broker's Association (IBBA).

To estimate SDE, start with a Profit & Loss Statement (P&L) for a minimum period of one year. This could be the last 12 months (for example April 2016 through March 2017), or it could be for the last calendar year or last fiscal year. If data is available, it is better to use three or five years of data for the estimate. Using multiple years lets you see trends and better estimate what may be expected in the future.

Review each line of the P&L and identify adjustments as follows:

1. **Extraordinary nonrecurring items:** Remove any income or expense that is not likely to recur in the future. Examples might be income received from a legal settlement or expenses for the attorney you hired to get the settlement.
2. **Owner's salary and benefits:** To estimate SDE you must remove the total financial benefit on one full time working owner. This includes salary (if any), payroll taxes on that salary, health-life-disability insurance, and retirement plan contributions. Additionally, you will want to remove any owner's perks that may be on the books. Examples of perks commonly found on the books of a business are: auto expense and leases for personal vehicle(s); personal travel, meals and entertainment; non-business telephone and internet expenses; and contributions-donation or dues-subscriptions not necessary for the business.
3. **Other salary and benefit adjustments:** If more than one owner works in the business, it may be necessary to adjust compensation of the other owners or their family members on the books. One example is a spouse who works in the business but is not paid and would have to be replaced or paid. In this case you would add an expense estimating the cost (salary, taxes, and benefits) to hire someone to replace the worker. Another example is non-working family members who are on payroll. In this case you would remove their cost (salary, taxes, and benefits) from expenses.
4. **Fair market rent:** If rent expense is below market and is likely to be adjusted when the business is transferred, cost should be adjusted to a fair market amount.
5. **Depreciation and amortization:** Remove any depreciation and amortization expenses from expenses.
6. **Interest on loans:** Remove interest on loans from expenses.
7. **Income taxes:** Remove any income taxes that are included in expenses.
8. **Supplier rebates:** In some cases the business receives supplier rebates that are not recorded on the books. These would be additional income.

It is important that the P&L you use for the estimate is accurate. If you are not sure about this, BizReady strongly suggests you have an accounting professional look over a full set of financial reports for the business and perhaps help you estimate SDE.

An example of calculating SDE is shown on page 2. After the adjustments are made, the resulting amount is an estimate of SDE – the amount one working owner can expect to earn from the business. This example shows 3 years of data. You can average the years or apply a weighted average to estimate SDE. Applying a multiple to SDE (see [Estimating a Multiple](#)) can give you an idea of the value of a business.

Seller's Discretionary Earnings Worksheet			
	2014	2015	2016
Sales	\$1,179,996	\$1,240,867	\$1,205,540
<i>Less</i> Cost of Sales	\$721,217	\$748,300	\$756,577
<i>Less</i> Operating Expenses	\$430,614	\$423,915	\$447,579
<i>Equals</i> Net Income Before Taxes	\$28,165	\$68,652	\$1,384
<i>Plus</i> Depreciation	\$33,336	\$14,254	\$15,125
<i>Plus</i> Amortization	\$0	\$0	\$0
<i>Plus</i> Interest on Loans to Business	\$18,127	\$15,751	\$11,046
<i>Plus</i> Officer/Owner's Salary	\$0	\$39,731	\$66,000
<i>Plus</i> Payroll Taxes on Officer/Owner's Salary	\$0	\$3,973	\$6,600
<i>Equals</i> Preliminary Seller's Discretionary Earnings	\$79,628	\$142,361	\$100,155
Adjustments			
Salaries to Non-Working Family Members	\$0	\$0	\$0
Salary Adjustments for Other Owners & Family Members	\$0	\$0	\$0
Payroll Tax Additions/Deletions For Above	\$0	\$0	\$0
Bank Charges	\$9,268	\$11,130	\$11,907
Dues & Subscriptions	\$358	\$214	\$645
Auto Expenses for Owner's Benefit	\$0	\$0	\$0
Auto Insurance for Owner's Benefit	\$0	\$0	\$0
Contributions & Donations	\$0	\$0	\$0
Fair Market Rent Additions/Deletions	\$0	\$0	\$0
Insurance Premium for Owner's health, life, etc.	\$5,266	\$5,266	\$5,266
Non-Business Professional Services (legal/accounting/tax)	\$0	\$0	\$6,709
Retirement Plan Contributions	\$0	\$0	\$0
Non-Business Meals & Entertainment	\$0	\$0	\$0
Non-Business Travel	\$0	\$0	\$0
Non-Business Telephone, Internet & Cell Phone Expenses	\$0	\$0	\$0
One Time Non-Recurring Charges or (Income)	\$0	\$0	\$0
Inventory Adjustments/Supplier Rebates	\$0	\$0	\$0
Sum of Discretionary Earnings Additions/Deletions	\$14,892	\$16,610	\$24,527
Total Seller's Discretionary Earnings (SDE)	\$94,520	\$158,971	\$124,682