

Buying Out the Founder

Student brief

The Njoroge family runs a small Nairobi holding company. They own a building-materials distributor and a printing business, and they look for additional businesses to buy when good ones come up.

They have been offered Rift Valley Cooling Limited — a commercial refrigeration and air-conditioning contractor that installs and maintains cold rooms for supermarkets and food processors, and air conditioning for office buildings.

The company is eighteen years old with thirty-two staff. About **fifty-five percent of revenue comes from annual service contracts** on equipment it installed; the rest is new installation work. Revenue last year was KSh 840 million.

The founder is sixty-four, wants to retire, and is asking **KSh 480 million** for one hundred percent of the equity. He wants an answer within sixty days.

The Njoroges have made clear they are comfortable walking away.

Exhibit 1 • Free cash flow to the firm, as forecast

FREE CASH FLOW TO THE FIRM, AS FORECAST

KSh millions

LINE	Y1	Y2	Y3	Y4	Y5
Revenue	890.0	943.4	1,000.0	1,060.0	1,123.6
EBIT at 9%	80.10	84.91	90.00	95.40	101.12
Tax at 30%	(24.03)	(25.47)	(27.00)	(28.62)	(30.34)
After-tax EBIT	56.07	59.43	63.00	66.78	70.79
Add depreciation	18.00	18.00	18.00	18.00	18.00
Less capital expenditure	(24.00)	(24.00)	(24.00)	(24.00)	(24.00)
Less increase in working capital	(6.00)	(6.41)	(6.79)	(7.20)	(7.63)
FREE CASH FLOW TO THE FIRM	44.07	47.03	50.21	53.58	57.16

The present value of Years 1 to 5 at 16% is KSh 161.91m. Note that capital expenditure exceeds depreciation every year — this business has to keep investing to stay the size it is.

Exhibit 2 • Valuation assumptions and the bridge

VALUATION ASSUMPTIONS

ITEM	VALUE
Weighted average cost of capital	16%
Long-run growth after Year 5	7%
Exit multiple, comparable transactions	5.0× to 6.0× EBITDA
Year-5 discount factor at 16%	0.4761

THE BRIDGE FROM ENTERPRISE VALUE TO EQUITY

KSh millions

ITEM	VALUE
Cash and equivalents	22
Bank debt	65
Plot of land at Athi River, held for sale and not used in the business	35
Minority interests	none

Exhibit 3 • Equity value across WACC and growth

WACC \ GROWTH	6%	7%	8%
14%	555.5	615.9	696.5
16%	442.4	477.4	521.3
18%	367.0	389.3	416.1

Question 1 • 15 minutes

Compute the enterprise value two ways: using the perpetuity terminal value, and using an exit multiple of 5.5× Year-5 EBITDA.

Then bridge the perpetuity figure to equity value and compare it with the asking price.

One check worth doing: what exit multiple does the perpetuity terminal value imply?

Question 2 • 13 minutes

Read Exhibit 3. At which combinations does the equity value fall below the KSh 480 million asking price?

Which of the two assumptions does the decision actually depend on — and by how much more than the other?

Question 3 • 9 minutes

What do you recommend to the Njoroges, and at what price would you walk away?

Then: the founder is sixty-four and leaving, and fifty-five percent of revenue sits in service contracts. Exhibit 3 does not capture that risk at all. Explain why not, and propose a deal structure that would address it.