

# What Effect do Interest Rates Have on Business Value?

Interest rates can have a significant impact on the value of a business, particularly in cases where debt is involved in the purchasing process. When rates rise, business purchasers may find it more challenging to secure the necessary funding to acquire. Ultimately, the amount of debt that lenders are willing to approve is reduced. As a consequence, buyers will either need to increase their cash injection or decrease their offer. Average values tend to decrease at a broad level - however, not all buyers will decrease their offers as a result.

How large is the effect? As an example, let's assume the following terms:

- A company generates an annual EBITDA of \$1,000,000
- \$4,000,000 in debt to be financed
- 10-year term
- 7% interest rate

This comes to a payment of \$46,443/month or \$577,316/year. Suppose interest rates increase by 1%, the monthly payment for the loan will increase to \$48,531/month or \$582,372/year - a difference of \$25,056 annually. Taking this into account, a lender will calculate the debt service coverage ratio ( or DSCR, the key factor in determining the loan amount) by dividing EBITDA by the payment. In most cases, the DSCR needs to be above 150%. In this example, a 1% increase in interest rates would lower the DSCR from 179% to 171%

Although most changes in interest rates have a minimal impact on business value, the cumulative effect can be significant over time.

*If you're interested in selling your business with a trusted advisor, contact Vista Business Group today at (913) 944-2285.*

