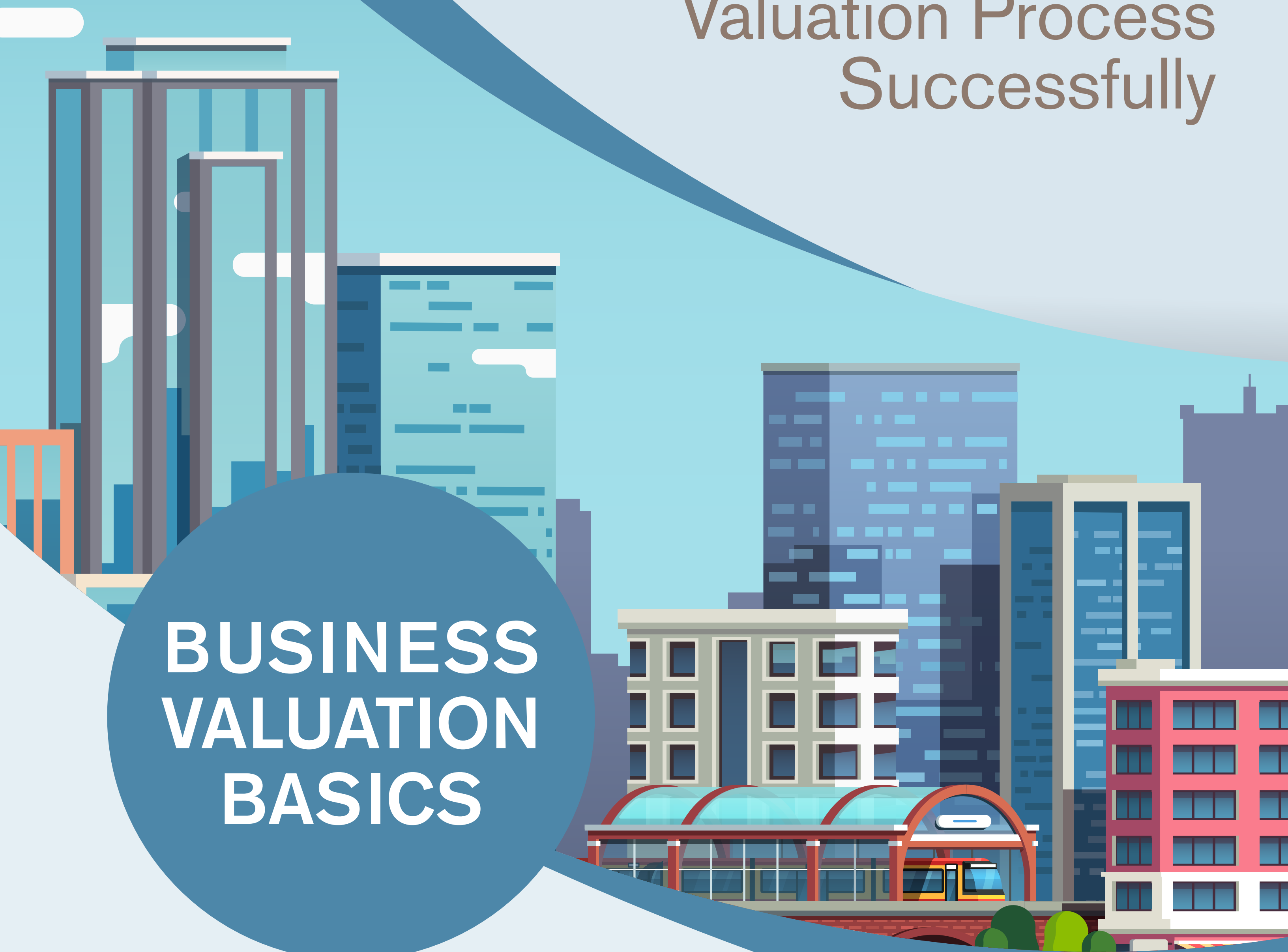
HOW TO NAVIGATE

The Business Valuation Process Successfully



BUSINESS VALUATION BASICS

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Why Value a Business?

No one can tell a business owner when it's the right time for them to sell their business. Some might be motivated by retirement or other life changes. Some might be interested in value for tax-related or legal-related appraisals. There are a few considerations, however, that can be made based on valuation data. Whether someone is looking to sell in the near-future or simply wanting to know the current value, both allow owners to make informed decisions and plan accordingly.

What is a Business Valuation?

A data-based, analytical process that determines the market value of a business. The valuation process is primarily dependent on industry, financial history, current market, economic outlook, and comparable sales. An appraiser will take all these factors into consideration when adjusting certain numbers up or down to come to a business value conclusion in an independent, un-biased report.

Valuation Techniques

Common business valuation methods include:

Discounted Cash Flow Analysis – DCF Method uses future cash flow forecasts to estimate investment value. This method is typically used when the subject company's past and current performance, coupled with management's growth expectations into perpetuity, are the most effective indicators of determining company value. It essentially compares the return on initial investment by measuring growth in relation to the time value of money

Fair Market Value – Fair Market Value, also known as the Market Approach, is based upon analyzing the sales data from recently completed transactions of comparable companies. While some adjustments will need to be made to account for the differences with the other businesses, the comparables should be close enough in size, industry, and revenue to make a reasonable comparison. Generally, the valuer will arrive at a valuation conclusion based upon a combination of Earnings Before Interest, Taxes, Depreciation, Amortization (EBITDA) and Seller's Discretionary Earnings (SDE) for Main Street and Middle-Market businesses. This also includes a list of assumptions that will be highlighted by the individual performing the valuation.

Asset Approach – While this method is more common with underperforming or distressed companies, value is determined by finding the market value of the difference between the company's assets and liabilities. Also, holding companies commonly use this method because income is primarily generated by a return on assets (usually other businesses) within the portfolio

How Buyers Value Businesses

There are many ways to value a business, where some are more qualitative than others. Most prospective buyers, both strategic and private equity, will use some form of multiple calculation to arrive at a value number and purchase price. Just like real estate, many industry multiples are based off of recent sales and current market conditions.

While the financially savvy business owner can estimate their own business value, it is highly recommended that he or she seek a professional that knows exactly where to discover dollars buried in the books and has access to all of the necessary sales data. The expense for having a third party perform a valuation is typically negated by the increased sales price of the final transaction and well-worth the investment.

Documents Needed for Valuation

Although recent three-year financial performance data is typically the most important for analytical purposes, historical finances also tell a story and can assist with many of the valuation approaches. Companies that have been consistent during times of recession and external interference (pandemics and such) will sometimes get bump in their value because of long-term sustainability and resistance to loss of revenue. At a minimum, the business owner will need to provide three years of tax returns, profit/loss statements, and a list of business expenses that are not necessary for operations and that a new owner would not need to spend.

How Valuations are Used

Business owners have the option of either selling on their own or engaging a business brokerage to assist with the transaction. Typically, brokerages will negotiate a higher selling price than an individual sale because of great access to buyers, strategic marketing plans, listing sites, and transactional experience with financing options. That said, many Small Business Administration (SBA) financing options require a company valuation, in addition to other documentation, to assess risk and decide whether to fund the deal and under what terms. Also, businesses not planning to sell can use valuations to measure growth and the impact of strategic decisions over a given period.

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