CBI
Acquisition, Brokerage & Financial Services

What is Your Business Worth?

Whenever a business owner contemplates a succession plan, one of the first questions that arise is always: what is the business worth? This is a complex question with as many answers as there are advisors. We'll try to shed some light.

Every business owner should spend time considering the sale of the business. After all, the sale should be the point where the owner reaps the financial rewards for their efforts over the years. Preparing the business for sale is not an overnight process and should be the result of careful planning and consulting with professionals (business brokers, accountants & lawyers) to maximize the return.

When establishing the value of the business, the broker should consider the buyer perspective. The business is worth what a knowledgeable buyer will pay for it. Here we will focus on individual buyers although similar criteria hold for corporate buyers. In order for a business to sell at a specific price, it must be generating enough cash to:

- · Pay a reasonable salary to the new owner
- · Retire the debt assumed to buy the business
- · Provide for a return on the down payment
- · Replace the assets as they wear out

Another consideration is the cost to establish a similar business. A business priced higher than the cost to replace it will not likely find a buyer willing to pay a premium over the replacement cost.

What is the business worth? It is worth the fair market value of its tangible assets plus a premium for its excess earnings (goodwill). Excess earnings are defined as the amount of money that the business generates in excess of an equivalent low risk investment. The existence of excess earnings produces "goodwill".

A number of factors contribute to the business' future ability to produce excess earnings all of which affect the price that a buyer will pay:

- Type of industry: expanding? many competitors?
- Location: workforce, tax structure
- Management: solid second tier, different ages, turnover, strong control evidenced by monthly statements?
- Facilities: capacity for expansion, technically up to date?
- Products or Services: multiple industry customers, proprietary, diversified, pricing power, brand name, new products or services
- Customers: concentration, long-term, sales process generating new customers?
- Competition: any overpowering competitors?
- Suppliers: multiple sources for key supplies

Other factors can impact the valuation and may produce a higher market value. Is there a recent appraisal of the fixed assets? If so, it may be higher than book value that could raise the value. Have the company's financials been audited? If so, assets such as inventories and receivables will have been verified which could also affect the value.

A complete valuation of the business will adjust the financials to reflect what a typical buyer would expect. Some items that may need adjustment include:

- Owner compensation if excessive
- Expenses which may have been capitalized
- Order backlogs at unprofitable prices
- Under reserved warranties
- Under funded pension plan
- Under accrued liabilities for taxes, vacation, sick leave
- Unaccounted for off balance sheet liabilities or contingent liabilities
- Unrealistic depreciation rates on capital equipment
- Insufficient insurance coverage
- Allowance for bad debts

All of the above go into the business valuation to achieve the best return for the owner in the marketplace. Once the owner and broker have agreed to the valuation, the next step is the marketing of the business. Here, buyers should see confidential information supporting the listed price giving them the confidence to produce an offer.