BABM
BAY AREA BUSINESS MAGAZINE

March/April 2009

Knowing Your Business Value
What's it Worth to You (them)?

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Valuation –The Eye of the Beholder Strikes Again
"Fair market value" is often defined as the amount at which property would change hands between a willing buyer and a willing seller when neither party is under any compulsion to buy or sell and when both parties have reasonable knowledge of relevant facts. That's a mouthful, often misunderstood, and also "pie in the sky." First, if there is no compulsion to buy or sell, there will be no transaction. Second, in the entrepreneurial business arena, having a grasp of all relevant facts is only but a dream. What it comes down to is a simple definition: a business is worth only as much as someone is willing to pay for it, and that value is always in flux. In today's volatile economy, minimizing the "flux factors" is key to success.

What are You Selling? A Business or a Job? Both are in Demand.
A business is fundamentally an investment and determining a reasonable value doesn't have to be confusing. Investments are priced on their ability to generate financial returns. Consequently, a business's value is based on its ability to generate profits.

In computing the financial returns, sometimes called seller's discretionary earnings (SDE), the owner's salary is often added back to income to compute discretionary earnings generated. Unless you're "selling a job" as part of the package, be careful. A new owner is entitled to a wage for services rendered in running the business in addition to earning "investment" returns. Just as professional managers wouldn't pay a company for the right to work there, business sellers shouldn't exaggerate the business's investment return by including the entrepreneur's fair wage as a component of the investment return. Keep salary and investment return separate.

For example, say a business generates a cash flow of $250,000 per year, before owner salary. If a fair wage for the business manager is $100,000 (whatever it would take to lure a qualified manager), then the "investment earnings" are $150,000. If buyers are seeking a 20% investment return, a reasonable purchase offer would be $750,000 or a price equal to five times the "investment earnings". Note: in this example, the offer is only 3 times SDE, not the factor of 8 to 10 that gets overheard in cocktail party settings. Most entrepreneurial businesses sell based on earnings multiples between two to four times earnings. Multiples increase as the size of businesses increase, generally due to perceptions of less risk.

Proper Tax Reporting is Key to Successful Pricing – And to Financing
A note to sellers here is especially important: buyers and bankers discount any earnings claims not properly reported on tax returns. Getting a multiple on earnings in the form of a higher sales price far outweighs any benefit from saving a few tax dollars by being "unintentionally aggressive" in your income tax reporting.

The Future May Be Golden, but You Still Can't Sell Silver for the Price of Gold
Sellers asking higher earnings multiples should be prepared to demonstrate the likelihood of the business generating future earnings that are trending higher than current earnings. Market

studies, business plans and competitive analyses are more important in today's economy than ever before. Sellers should also be prepared to answer questions about their reason for selling the business when "the next big deal" is at hand. Too often, the "big deal just around the corner" is a myth. Be prepared to negotiate an "earn out" to put teeth behind "anticipated" earnings claims.

All Businesses Aren't Created Equal
Companies are unique, and searching for truly comparable businesses is often a ghost chase. Don't put much faith in the comparable method. There are many variables to investigate when valuing or buying a business. Factors making a difference include management teams, documentation of policies and procedures, updated information systems, financial controls, independently prepared financial statements, curb appeal, and many more.

In Entrepreneurial Business Valuations, Art Wins Again
Valuing a business is far from science. A valuation is more of an art form and is based on facts, historical multiples, perceptions, and full disclosure. Having a third party valuation is always wise. In fact, having an independent valuation increases the odds of successfully selling the business. Whatever valuation approach is used, be sure to keep the presentation simple. Sophistication doesn't always sell. If the buyers don't understand the methods used, they won't be compelled to close the deal.

The Financing Roadway Isn't a Straight Path
In today's current market, banks are not anxious to lend money for business acquisitions. Only the best-run and best-documented companies get financed. Be prepared. The Obama Administration has plans to ease financing restrictions and lower SBA fees. Don't be left out.

Good Businesses are in High Demand
The current economy, uncertain employment outlook, and pent up demand of Private Equity Groups for business acquisitions all bode well for prepared sellers of successful, properly valued businesses. Throughout the valuation and business transfer process, continue to ask yourself the questions: "Would I pay my asking price?" and "Would I buy my own business?" Document your answers. Be ready for the questions from cautious buyers.

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