



What Is Your Business Really Worth?

For many owners, the answer to one question determines whether they can leave their companies: “How much money will I get when I sell?”

This question is critical, and answering it is Step Two of The Seven Step Exit Planning Process™. Realistically, you can't exit your business unless you achieve financial independence, and the primary source of that independence is likely to be the funds you receive for your business when you leave.

Let's look at fictional owner Ron Nee, the owner of Landscaping Supply Company, to see why getting a valuation well before your exit date is so important.

For years, Ron figured he could sell his business for more than enough money to retire comfortably. He based that belief on his understanding of his industry's valuation rule of thumb: a percentage of gross revenue. Using that rule, Ron calculated that his company was worth about \$2 million—more than enough to finance his post-exit life.

When Ron decided that it was time to sell and met with a transaction intermediary, he learned that the rule-of-thumb approach didn't apply. Ron discovered that buyers for the company would base their offers on cash flow rather than on revenues (the basis for Ron's estimate).

Because Ron relied on an incorrect assumption about the value of his business, he had wasted valuable time coasting along to his exit date. Had he retained a professional to estimate value or provide a range of likely sale prices before he was ready to exit, he could have spent his time focused on increasing the value of his business.

How Can Owners Avoid Ron's Predicament?

Ron Nee failed in a critical aspect of ownership: knowing the value of his business. By not getting a professional valuation or estimate of value, he never knew how far away he was from exiting. He had no accurate information on which to base a plan to grow value.

Benefits of Valuation

An accurate valuation of the business does the following.

- It objectively tells owners how much value they need to add to the business.
- It gives owners the ability to monitor their progress toward their ultimate financial objective. For example, if Ron had discovered that his business was worth \$1.5 million (pre-tax) instead of \$2 million, he could have created and implemented a plan to increase the business' value to \$2 million by the time he wanted to exit. His plan could have included interim goals and laid out strategies to achieve each interim goal.
- It determines whether and when owners can reach their Exit Objectives.
- It provides a basis for estimating and minimizing tax consequences of Exit Path alternatives.

Whether owners are ready to exit their businesses today, tomorrow, or in 10 years, they need more than a thumbnail sketch (i.e., a rule of thumb) of value. An experienced appraiser should be able to answer the question, “Can my company be sold today for enough money, after tax, to allow me to reach all of my Exit Objectives?” If the answer is no, owners can use that knowledge as the basis for a plan to build business value.

Cost

The scope and cost of hiring an appraiser or business intermediary varies substantially. For example, if an owner is several years away from a transfer of ownership, a full-blown valuation may be unnecessary. Instead, that owner needs a value approximation (or range of likely sale prices). If an owner is ready to exit and plans to sell to a third party, a transaction intermediary can prepare a range of likely sale prices. If that owner plans to transfer the company to employees or family members, a certified business appraiser can prepare a “calculation of value.”

Estimates of value, thorough valuations, and marketability appraisals all have their places. Don’t skimp on obtaining the valuation you need, but don’t secure a more precise valuation before you need it.

What If?

Finally, let’s return to Ron’s situation: What might have happened had Ron obtained a business appraisal and learned—well before his target exit date—that his company would likely sell for a price that would meet his financial objective? Should he have taken immediate action to sell? What would you do if you learned that you could exit your business today for an amount of after-tax cash that would meet all of your financial objectives? How would knowing that your business’ value is 60, 75, or 110% of what it needs to be affect your actions? Life offers no guarantees regarding your health or longevity, and volatile economies can provide an excellent reminder that there are plenty of circumstances beyond your control. For all of these reasons, knowing the value of your company is a fundamental, indispensable element of sound decision-making.

For more details about how we can help you value your business, contact us today.

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