

Demystifying Business Valuation

A successful small business sale begins with a solid grasp of business valuation. Here's what you need to know to set your company at the right price.



Valuation can make or break a business sale because for many sellers, attaching a dollar value to their company is a touchy subject--especially if they have spent years building it from a fledgling start-up to a profitable enterprise. Left unchecked, the valuation process can quickly devolve into a pricing routine that is rooted in personal attachments and other subjective inputs rather than solid data based on marketplace realities.

Let's be clear: the actual value of your business is the amount someone is willing to pay for it in the business-for-sale marketplace. Period. Personal feelings about your company's worth are far less important than sound valuation methodology, accurate documentation, seller financing and other factors that could potentially influence value.

Common Valuation Methods

One of the reasons business valuation is such a complicated issue is because there are many acceptable valuation methods. Rather than using a "one-size-fits-all" valuation approach, sellers need to decide which method is right for their business based on industry, size and the circumstances of the sale.

An **asset-based valuation** is a straightforward method in which the value of the business is determined by the total value of the company's tangible and intangible assets. The challenge with this method is that asset-based valuations can over-simplify the process and neglect the value of the company's earnings potential. That is why asset-based valuation is a common method for the sale of defunct businesses and liquidations, but not as common for thriving companies.

The **earnings multiplier method** is often the best way to assign value to a healthy business that will be listed on the open marketplace. By basing price or value on some multiple of the business's earnings potential, prospective buyers gain the ability to translate the purchase into earnings and an informed return on investment (ROI) estimate. This also provides a more tangible and simpler basis by which to compare different businesses in different industries or locations.

However, even the earnings multiplier valuation method presents challenges. Although earnings data is based on the business's historical financial performance, the calculation requires earnings to be precisely defined and agreed upon by both parties. Likewise, you will need to select the right multiplier to apply to defined earnings. There can be a large variance in multipliers (e.g. 1, 3, 5, 10 or more) since the valuation reflects business risk and industry standards. With that being said, a simple way to get to a proper multiple is to work with a business broker who can share recently sold business comparables (commonly known as "comps"), so that you can see what multiples businesses in your industry and location have historically or recently sold for. Prior to working with a broker, you can visit business for sale websites like BizBuySell.com or BizQuest.com to see what prices and multiples of cash flow or revenue current businesses are listed for and have sold for.

How to Improve Business Value

M & A Advisors and valuation experts often find that sellers are surprised to discover that the valuation process yields a lower-than-expected asking price for their business. The good news is that if you are not happy with your business' estimated value, there are steps you can take to increase it prior to a sale. It is important to start immediately however, as you need to start planning months or years in advance to implement the kinds of changes that substantially improve the value of your company.

From a buyer's perspective, proven profitability and future earnings potential are the most attractive qualities in a potential business acquisition. By documenting a multi-year track record of profits and positive cash flow, you can drive up the value of your company--substantially, if you choose to use the earnings multiplier valuation method.

But it's also important to strategically position your business for future earnings, identifying advantages your business either has or will have in the general marketplace. In some instances, the future prospects of the sector itself can be a factor in driving up business value.

Another strategy for improving business value is basic organization. Carefully maintained financial records, documented employee policies, a neat and clean facility--it all counts when it comes to the amount buyers are willing to pay for your business. Simplicity has value, and the easier it is for buyers to understand your business and envision themselves at the helm, the more likely it is that your business will sell for its full value.

Seller financing also plays a role in improving the value of your business. Although financing part of the sale is not an option for every seller, buyers are willing to pay more for businesses that include some level of seller financing, particularly in tight credit markets. In fact, in today's tough lending environment, we have seen seller financing become an essential tool to completing transactions. Business owners who use their network and business-for-sale website listings to advertise their willingness to finance part of the deal should expect a significant uptick in the number of offers.

Finally, most sellers ultimately realize that they need to enlist the assistance of a qualified business appraiser or broker to accurately value their companies. A good appraiser or broker, with a proven track record in your industry, can significantly shorten the sale process by ensuring that your business is priced to move in the current market.

United Health Care Capital is committed to helping small business owners with valuations, business transition and exit plan strategy. If you are interested in learning more, [contact United HealthCare Capital](#) to see how we can assist with your business transition and exit planning.

David Keene
CEO
United Health Care Capital
www.unitedhealthcarecapital.com
david.keene@unitedhealthcarecapital.com
770-823-3984

