Valuing Your Business

By Gary Papay, CBI, M&AMI

As a business owner considers placing his or her company on the market, ascertaining the proper value for the company is critical. Too often the owner assigns an unrealistic and unachievable arbitrary value then proceeds into the sale process only to be disappointed with the market's response. As a result, the asking price is reduced several times. During this unfortunate period buyer prospects and valuable time is lost.

In truth, a company's value is determined by a compilation of factors such as the company's sales, earnings, performance, market outlook, personnel, net book value and fair market replacement value of equivalent operating assets. But it can also be influenced by intangible assets like the company's image, reputation and goodwill.

There are several approaches to valuing your business.

Balance Sheet Value

There are several balance sheet valuation methods, including adjusted book value, book value and liquidation value. The adjusted book value is determined by revising the asset's book value to reflect the cost it would take to replace the assets in their current condition. This method requires the total values to be offset against the sum of the liabilities.

The book value considers the figures from the company's financial records, as depreciated at the time of the sale. The book value can pose some difficulties for sellers, particularly if the seller has depreciated the assets too much to gain prior tax advantages.

The liquidation value is the amount that could be realized if all assets – equipment, furnishings and inventory – were sold separately. This value is typically much lower since it doesn't consider a company's intrinsic value.

Income Approach

The income approach takes into consideration the company's level of earnings using a capitalization rate, discount rate or multiplier. Several income approach methods are frequently used. Each method requires a level of earnings and a conversion factor to translate the earnings into a company value. Selecting the proper level of earnings – after-tax, pretax, discretionary or cash flow – and matching it with the proper conversion factor – discount rate, cap rate or a multiplier – is critical to calculating a reasonable value.

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Market Approach

The market approach sets a value based on the values of other businesses that have been sold. Setting the market value involves researching the sale prices for similar businesses in a geographic area. In some cases, however, finding a company that is similar in many ways to your company may be difficult.

Whatever your goal, you want a good advisor to help you assess the value of your company. Question your advisor on the effects of deal structure and how multiples are used. A business owner should never accept a computer-generated valuation or a one-size-fits-all approach when selling the business. And don't be impressed by the person who presents the highest value – you may only be setting yourself up for failure during the sale process.

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