

Business Valuations

By Glen Boyls

Introduction

The valuation of a business can be an extremely complex and time consuming process. To assure that you receive fair and accurate valuation, you should consider using a qualified valuation professional.

Valuation Considerations

To assure your business valuation best meet your needs, you must know the following:

- What is the purpose of the valuation?
- What is the scope of the initiative?
- What type of report do you require at the conclusion of the valuation process?

Business Valuation Approaches

There are three approaches to determine the value of your business and there are levels of complexity associated with each approach.

1. Market Comparison Approach,
2. Asset-Based Approach, and
3. Income-Based Approach

Market Comparison

The market comparison derives the market value of your business by looking at similar businesses (guideline companies) that have been recently bought or sold. The analyst will examine the similarities and differences between your business and the guideline company and document the results. If the guideline company is publicly traded, there are a number of financial ratios that can be applied to help with the valuation process. Some of the most common financial ratios are:

- Price Earnings
- Price to Net Earnings
- Price to Pre-Tax Earnings
- Price to Cash Flow
- Price to Revenues
- Price to Dividends Yield
- Price to Operating Income
- Price to Gross Profit
- Price to Book Value

A third method is to use industry methods or rule of thumb formulas to assist in determining the value of the business. The AICPA is an excellent resource for industry valuation formulas and related publications.

Asset-Based

The most common asset based approach is the adjusted book value method. Using this approach, all of the company's assets and liabilities are valued at fair market value. At the end of the process all of the values are added and the liabilities are subtracted to derive the total value of the business. The adjusted book value method is not used for service oriented businesses or business with only a few tangible assets. Likewise, it cannot be used to assess the value of intangible assets.

Business Valuations (continued)

A second asset based approach takes into account each component of the business and provides a separate value. At the end of the process all of the values are added and the liabilities are subtracted to derive the total value of the business. This approach cannot be used to assess the value of intangible assets.

The third asset based approach is the liquidation value method. This method assumes that the company's assets will bring the greatest value if sold to the highest bidder and the company ceases to be a going concern. At the end of the process all of the values are added and the liabilities (including the cost of the liquidation process) are subtracted to derive the total value of the business. As in the other previous two methods, the value of intangible assets cannot be assessed.

Income-Based

The income based approach assumes that an investor would be interested in the assets of the business but not necessarily the business itself. Under the income approach the operating assets associated with the future benefits (pre/after-tax earnings, gross/net cash flow EBIT/EBDIT, etc.) stream are divided by the required rate of return for the capitalized benefits stream. The non-operating assets are then added to the operating assets value to determine the total value of the specific business or business component.

Some of the capitalization benefits methods include:

- Capitalization of Benefits,
- Discount Future Benefits, and
- Excess Earnings.

Tax Considerations

Regardless of the purpose of the valuation, your business valuation should take into account IRS policies, procedures, guidelines, and rulings that relate to your business valuation.

Summary

As you can see, there are many factors and considerations that go into the business valuation process. However, the actual value of your business comes down to "what a buyer is willing to pay". In some situations the buyer may be willing to pay more than the proposed business value and in some cases you will be offered less than the proposed business value. In free market economics buyers and sellers negotiate prices and establish "fair market value" for a specific business or business component.

Please contact me if you have any questions regarding business valuation or the concepts presented in this document.

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