

VALUING YOUR BUSINESS

This whitepaper was first featured as an Inc. Magazine column in the Inc.com Buy and Sell a Business Resource Center. It has been updated for 2023 and is provided here as a resource for small business owners and entrepreneurs.

BURLEY
CONSULTING

VALUING YOUR BUSINESS

You've prepared your business for sale and you're ready for the market, but what is your business worth?

Or more importantly, what can you get someone to pay and under what terms?

When considering the sale of their company, most business owners want to know what their business is worth. The answer will vary widely. A valuation analyst will want to produce a report that explains the Fair Market Value. A business broker will likely want to apply a rule-of-thumb multiple to cash flow or earnings. An accountant may look to the company's assets, return on assets, or other financial ratios. All approaches have merit, but the key to getting the information you need is to ask the right question. I would argue that the right question is not "What is my business worth?" but rather "What kind of offers might I receive?" The answer to this question sets the stage for a successful sale.

The right question is not "What is my business worth?" but rather "What kind of offers might I receive?"

Beware of Fair Market Value

Fair Market Value, or FMV, is the price in cash or equivalent that a buyer could reasonably be expected to pay and a seller could reasonably be expected to accept, if the business were for sale on the open market for a reasonable period of time, and both buyer and seller being in possession of all pertinent facts and neither being under any compulsion to act. Further, FMV assumes a hypothetical buyer, not a specific buyer and not a "strategic" buyer. This poses two problems:

Problem One Many transactions are not all cash or equivalent.

Problem Two Businesses don't sell to hypothetical buyers. In real life, a private equity group will value a business differently than a competing corporation, which will be different than an individual investor or an owner-operator.

Whether working with a valuation analyst or advisor, ask about possible deal scenarios, not just what the business is worth based on a single accepted definition.

The Deal Structure Effect

The structure of the deal itself will have an enormous effect on the price being paid. For instance, the sale of the company's assets is very different than the sale of stock. The net takeaway for the seller, and the net financial impact to a buyer are very different in each scenario. Also, if the seller finances part of the purchase price (a seller note), the risk equation changes, and so should the price. Or, if a portion of the price is contingent on future performance or events (an earnout), the deal should be different than what would be paid in an all-cash or other scenarios.

The structure of the deal itself will have an enormous effect on the price being paid.

In addition, purchase consideration is not always cash or equivalent. If stock (especially private or bulletin-board stock), warrants, rights and royalties, or even the ability to re-invest in the company are part of the deal, then the price paid will be affected.

For all of these reasons and more, be careful not to get locked into one way of thinking on how the deal is structured, and don't allow anyone to convince you that there is one "value" for your business.

Assessing Value

With so much dramatically affecting your company's value, there is one thing that is always considered -- earnings. In some cases, one may look to a multiple of earnings. The multiple may be derived from market data (what other similar companies have sold for as a multiple of their earnings), from an investment model (such as what return on investment would be needed relative to the risk), or from other calculations and sources. In any event, be sure your advisor is applying the right multiple to the right figure. Many make the mistake, for example, of applying an EBITDA multiple (earnings before interest, taxes, depreciation, and amortization) to the seller's discretionary cash flow, or applying an after-tax multiple to a pre-tax profit figure.

While multiples of earnings are a very common way to assess value and determine an offer price, there are many other investment and financial models. Some look forward to projections and adjust them based on a perceived level of risk, and some look backward to historical data as the proxy for the future. While there are dozens of methods, they almost always have earnings at the core, whether past or future, estimated or actual.

Proceed with Caution

Rule-of-thumb multiples have a lot of value in a variety of scenarios. However, they can be extremely dangerous as well.

When using rule of thumb multiples, consider the following:

What should the multiple be applied to? Net profit? Discretionary cash flow? EBITDA? After-tax profit? Revenue? Assets?

What deal structure does this multiple assume? An assets sale? A stock sale? Is this a market multiple where most of the price was paid in stock or earnout?

Is this multiple for publicly traded or private companies?

Is this multiple appropriate for the size of the company being valued?

Tell Your Advisor What You Want

Whatever your goal, you will need a good advisor to help you assess the value. When you hire your advisor, tell them what you really want. Do you want a consultation on what type of deal you might get in the market, or a Fair Market Value opinion? Quiz the advisor on the affects of deal structure and how multiples are used. Don't accept a computer-generated valuation or a one-size-fits-all approach when selling your company. And don't just opt for the person who gives you the highest value -- you're setting yourself up for failure. Buyers don't care at all about what your valuation report says. If you want your advisor to tell you what kinds of offers you might really get for your business and how to negotiate the best one, tell them that -- don't ask what your company is worth.

“**don't ask what your company is worth**”

“**If you want your advisor to tell you what kinds of offers you might really get for your business and how to negotiate the best one, tell them that**”

About the Author

John Burley is the principal consultant at Burley Consulting LLC, a national mergers and acquisitions firm based in Washington DC. His primary areas of expertise include business valuation, acquisition consulting, deal structuring, negotiations, due diligence and strategic growth planning.

Mr. Burley and his firm provide professional services to small businesses seeking to be acquired or grow through acquisition, including business valuation, identifying buyers and acquisition targets, negotiating Letters of Intent and Purchase Agreements, deal structuring, managing due diligence, and closing transactions.

Over the course of his career, John has served as President, Vice President, Director, and Board Member of companies ranging in size from \$1 million to \$200 million in annual revenues. With over 20 years experience in operations, marketing, management, technology, and M&A, John has led numerous growth plans, turn-arounds, corporate acquisitions, small business purchases, and start-ups.

Mr. Burley is faculty for the American Management Association where he teaches AMA's Course on Mergers and Acquisitions. He has served as the Expert in Residence for Inc Magazine's Buy & Sell a Business Resource Center, and is a published author of articles relating to mergers and acquisitions, business valuation, and the technology industry. Mr. Burley and members of his firm have been expert guests on talk shows, and have delivered numerous seminars and trainings on topics including corporate development, M&A and business valuation.

As a leader in community, John has also served in roles ranging from volunteer to chairman. He is the recipient of numerous awards from the State of Maryland, the Montgomery County Council of PTSAs, Board of Education, and has contributed to numerous award-winning projects including the Award for State Neighborhood Project of the Year and the Award for Outstanding Local Government Innovation.

For more visit burleyonline.com.