Raven A. Herron & Company, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

Valuing Your Business

If you're struggling to determine your company's value, you aren't alone. It's often difficult to find the actual value of a business because the criteria used are subjective. Still, there are some common practices you can use to find a strong starting point for your negotiations. Here are the steps to take:

Organize Your Finances

Before you or anyone else can accurately determine an estimate of your company's worth, you must prepare financial statements. Hopefully, you've been keeping detailed financial records, organizing your transactions, and balancing your books. If you haven't, now is the time to start.

Ideally, you will need at least three years of financial statements to provide potential buyers. You should include the following basic financial statements:

- Income statement: Your income statement provides an overview of your revenue and expenses for the financial period, giving buyers an idea of your average net income.
- Cash flow statement: The cash flow statement shows the actual cash that flowed through your business within the financial period. It includes the money received from all business-related activities, as well as all the money you spent on the business. In some situations, the cash flow statement gives a more accurate view of the company's finances because it is based on cash accounting rather than accrual accounting methods.
- Balance sheet: The balance sheet shows the current balances of your accounts (assets and liabilities) at a certain point in time. Most buyers will request a current balance sheet to determine your financial position. They may also request updated balance sheets over the course of the acquisition if they decide to purchase your company.

In addition to the current and historical financial statements, you should also prepare Financial Projections to show a forecast of future revenue and expenses. Financial Projections provide another data point when determining the value of your business and also can help immensely when discussing various future strategies for your business.

If you haven't kept proper financial records for the past three years, you may need a professional's assistance to ensure accuracy.

Value Your Assets

Once you've prepared your financial statements, it's time to determine the current value of your tangible assets. These include items like furniture, computers and other IT equipment, vehicles, buildings, land, machinery, inventory, etc. – if you can see it, touch it, and it's primarily used for business purposes, it is most likely considered a tangible asset.

You will use the current fair market value (FMV) of the asset to determine its worth. You can find the FMV by researching similar items or taking the items to a professional appraiser. In most situations, you can estimate the value yourself by averaging the sale price of several similar items. However, if the item is rare or valuable, you may need an appraisal.

Once you've determined the value of each of your assets individually, add these amounts together to determine your liquidation value. Your company should be worth at least this amount in a sale. If you can't find a buyer willing to pay at least the current FMV of your assets, then you should consider liquidating your assets instead.

Determine Your EBITDA

Certain expenses like depreciation and amortization may not accurately reflect the current value (or remaining lifespan) of your assets. For example, a vehicle may be depreciated over the course of five years, though it may still have years of usage left after the five-year mark. Noting this and other fluctuating factors, many people have started using a modified version of net income to determine a company's financial position; it's called Earnings Before Interest, Taxes, Depreciation and Amortization (or EBITDA). This method may or may not give a more accurate view of the company's potential, but it's often used as the basis for business negotiations, especially with the acquisition of larger companies.

To calculate your EBITDA, you can use a simple formula:
Net Profit + Interest + Taxes + Depreciation + Amortization = EBITDA

Essentially, the EBITDA is used to make sure the buyer is able to look at the company's position objectively, without considering the financing decisions, capital structure, or tax implications – all of which may vary depending on the owner's personal decisions. It's also considered a better method for comparing one company against another when making a purchasing decision because it "levels the playing field," so to speak.

Compare Other Businesses

Now that you have all of your financial information, you can start looking for comparable companies. As you research other businesses, remember to focus on all of the different aspects of the company that may affect its overall value. These may include:

- Industry: You should look for companies in the same industry as your own. Otherwise, it's really an apples-to-oranges comparison. Keep in mind that the valuation multiplier standard varies from one industry to the next.
- Reputation/Brand: The company's reputation and brand are important. Brand recognition is quite appealing to potential buyers.
- Performance: How well has the company performed in the past? Are they likely to continue this trend?
- Transition Difficulty: How difficult will it be for the company to transition to a new buyer? Organization and a detailed business plan are just a couple of ways to make the transition easier.
- Records/Finances: Accurate, well-maintained financial records are a necessity in the business world. Electronic records with backups are typically standard.
- Customer Base and Location: Does the business' product appeal to a large customer base, or is it a niche product? Is the physical location of the company prime, or would relocating help sales?
- Products/Service/Marketability: How are the products or services performing? Will R&D expenses be necessary soon? How are current marketing efforts performing? Does the company need a new marketing strategy?
- Revenue: What is the actual revenue of the company, and is this number increasing or decreasing? Are there any recurring streams of revenue?
- Key Personnel: Oftentimes, the business owner or executives are critical to the success of the company. How many key personnel are staying throughout the acquisition, and how many are leaving? How detrimental would their move be for the company overall?

Your goal here is to determine which multiplier to use to estimate your own company's worth. The multiplier may be any number that seems fitting, but the customary range is somewhere between one and four.

Choose Your Valuation Method

Now that you have your multiplier, you can use one of several methods to estimate your company's value. Alternatively, you can use more than one method to determine a range of values. The most common methods include:

Assets-Based

This method is easy, but it usually gives the absolute lowest value for a company, and it's generally not an accurate depiction of the company's total worth. To use this calculation, simply add up the total value of your physical assets, then subtract your current debts.

Discounted Cash Flow

The discounted cash flow method is used to determine the future value of the company's cash flow in today's money. You can use the projected cash flow over a future time period using previous cash flow statements. In general, the more stable your company is, the further into the future you can project. If your company is considered risky, then a buyer may use a much shorter period of time for projections.

With this method, the time value of money is taken into consideration, and the projected cash value should be discounted accordingly. The discount will depend on a few different factors that will vary from one buyer to the next, including their means of acquiring capital and their own financial risk. This method does not take assets directly into consideration because they are simply used to generate profit.


Value

Multiplier Method

Many people opt to use the multiplier method when valuing a company. With this method, simply use the multiplier from your business comparison along with any "bottom line" number. Small to medium-sized businesses usually calculate the multiplier against net income. Larger companies may use the EBITDA instead. For example, if your multiplier is 2 and your company is small, you would simply double your net income to determine your estimated value.

Final Thoughts

Even with solid numbers, the value of a company is fairly subjective. Ultimately, your company is worth what a buyer is willing to pay for it. To ensure you get the most you can for your business, remember to keep all of your personal information out of the conversation. If a buyer feels like you're desperate to sell the company, they will likely offer less than its fair market value. You should also strive to remember that the hard work you spent building the company are not important to a new buyer who is only interested in what the business can give back. When negotiating, you should stick to the facts. Also, though you should certainly estimate the company's value yourself, please remember that the buyer will have their own method and logic when writing an offer. If you feel like your company is worth far more than the offers you are receiving, you should seek a third-party professional opinion to see where the discrepancies are.

About us

At Raven A. Herron & Company we perform many different types of accounting and tax services to meet the needs of both individuals and business owners. We understand the importance of having a well organized, knowledgable team guide you through the ever-changing economic landscape.

Our team of professionals have become known for providing expert analysis and excellent customer service. Additionally, our service offerings are supported by the industry's latest technologies, providing more customized services and giving you greater access to the pertinent financial information you need to make well-informed decisions.

Contact Raven A. Herron & Company whenever you find you need more than just an accountant, but a partner who takes pride in watching you succeed.

Raven A. Herron & Company, PC

110 Par Three Court
PO Box 4237
Horseshoe Bay, TX 78657

830-598-5300

info@ravenherroncpa.com

www.ravenherroncpa.com