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What is a business worth?

Katrina Loftin Winke, 3/30/2009

As a business owner considers planning an exit strategy, there are several factors to consider. Typically, the first thing you will want to know is the value of the business. The "market" price and the "valuation" price may differ. In today's challenging economy, that has never been more valid. The market price is what a ready, willing, and able buyer will pay for the business. Meanwhile the "valuation" price is what the business should be worth, based on earnings in a stable market under all the right circumstances.

Similar to your home, an appraisal or valuation takes comparable sales and market conditions into consideration. Fortunately, the value of a business has a great deal to do with the earnings, the assets of the business and the performance over a period of time and not just comparable sales and market conditions. In addition, goodwill, personnel and reputation also factor into the value of the business.

The most common approaches to valuing your business are the Income Approach, the Market Approach and Balance Sheet Value.

Income Approach

Typically, several different income methods are studied in the Income Approach. One common approach is "Sellers Discretionary Cash Flow" in which adjustments are made to net profit to determine what an owner-operator would expect to take home before taxes, discretionary and non-cash expenses. Another approach is EBITDA (Earnings before interest, Taxes, Depreciation, and Amortization). In both approaches, the adjusted earnings are then converted into the value of the business using a multiplier, discount rate or capitalization rate.

Many business owners don't realize that they actually do have a profit from a valuation point of view, even though they may show a loss on their books. Once discretionary and non-cash adjustments are made to the net profit, most businesses will have positive earnings.

Market Approach

The Market Approach is based on comparable sales of other businesses that have sold with similar earnings in a comparable geographic area. In some instances, comparable data is difficult to find and other valuation approaches must be used.

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 and the total values are then offset against the liabilities.

The book value considers the figures from the balance sheet, as depreciated at the time of the sale. This method can pose some tax issues for sellers.

The liquidation value is the amount that could be realized if all assets were sold separately. This value is typically much lower as it only factors the tangible assets of the business.

The best way to find out the current value of your business is to find a licensed business broker who actively sells businesses. A competent broker will show how to maximize value and will not charge you to determine the value of your business or push you into putting it on the market.

In truth, the real value of a business is worth what a ready, willing, and able buyer will pay for it.

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