



How Much Is Your Client's Business Worth?

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Why Do People Go Into Business?



Why Do People Go Into Business?

- Create Current
Cash Flow
- Create Future **Value**



Reasons For A Business Valuation

- Mergers & Acquisitions
- Sale of Stock (Private Company)
- Gifting of Stock
- Buy/Sell Agreements
- Fairness Opinions



Reasons For A Business Valuation

- Litigation
 - Partner disputes
 - Divorce
 - Bankruptcy
- ESOP
- Business in Estate



Who Are The Business Owners?

- 31% over age 55
- 60% over age 45
- In the next 5 to 10 years there will continue to be a huge transfer of business ownership

SOURCE: US Census Bureau



Steps to Valuing A Business

- Gather Information
 - Financial Statements / Tax Returns
 - Balance Sheet & Income Statements
 - Last 3 to 5 years



Steps to Valuing A Business

- Gather Information
 - Forecasts
 - Next 3 to 5 years
 - Why was the forecast created?
 - How accurate have they been on past forecasts?
 - Growth Company – future cash issues?



Steps to Valuing A Business

- Gather Information
 - Intangibles
 - Patents / Technology
 - Management knowledge / experience
 - Location
 - Brand Name



Steps to Valuing A Business

- Gather Information
 - Intangibles
 - Customer List
 - Workforce – Knowledge / Experience
 - Recipes
 - Goodwill (Personal????)



Steps to Valuing A Business

- Gather Informaton
 - SWOT Analysis
 - Strengths
 - Weaknesses
 - Opportunities
 - Threats



Steps to Valuing A Business

- Site Visit
 - Interview key personnel
 - Observations
 - Neat & Orderly *or*
 - Disorganized & Messy
 - Processes
 - Data recording

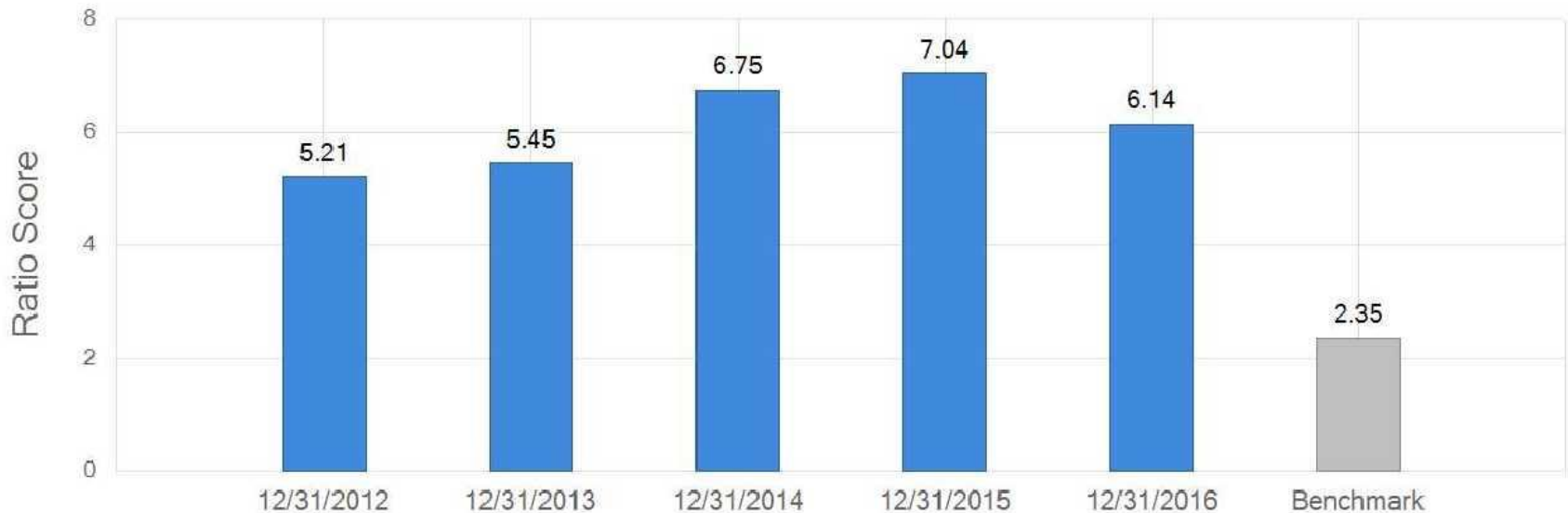


Steps to Valuing A Business

- Compare this Business to Others of Same Size and Industry
 - Ratios
 - Growth

Steps to Valuing A Business

Current Ratio



Generally, this metric measures the overall liquidity position of a company. It is certainly not a perfect barometer, but it is a good one. Watch for big decreases in this number over time. Make sure the accounts listed in "current assets" are collectible. The higher the ratio, the more liquid the company is.



Steps to Valuing A Business

Industry Scorecard

Financial Indicator	Current Period	Industry Range	Distance from Industry
Current Ratio = Total Current Assets / Total Current Liabilities Explanation: Generally, this metric measures the overall liquidity position of a company. It is certainly not a perfect barometer, but it is a good one. Watch for big decreases in this number over time. Make sure the accounts listed in "current assets" are collectible. The higher the ratio, the more liquid the company is.	6.14	1.80 to 2.90	+111.72%
Quick Ratio = (Cash + Accounts Receivable) / Total Current Liabilities Explanation: This is another good indicator of liquidity, although by itself, it is not a perfect one. If there are receivable accounts included in the numerator, they should be collectible. Look at the length of time the company has to pay the amount listed in the denominator (current liabilities). The higher the number, the stronger the company.	6.14	1.00 to 1.80	+241.11%
Net Profit Margin = Adjusted Net Profit before Taxes / Sales Explanation: This is an important metric. In fact, over time, it is one of the more important barometers that we look at. It measures how many cents of profit the company is generating for every dollar it sells. Track it carefully against industry competitors. This is a very important number in preparing forecasts. The higher the better.	15.21%	1.00% to 7.00%	+117.29%



Steps to Valuing A Business

- **Normalize Financials**
 - Add back non-cash expenses
 - depreciation / amortization
 - Adjust for fixed asset purchases



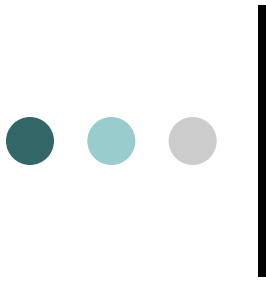
Steps to Valuing A Business

- **Normalize Financials**
 - **Owner Expenses**
 - **Salaries**
 - **Meals & Entertainment**
 - **Travel**
 - **Auto**
 - **Health Insurance**

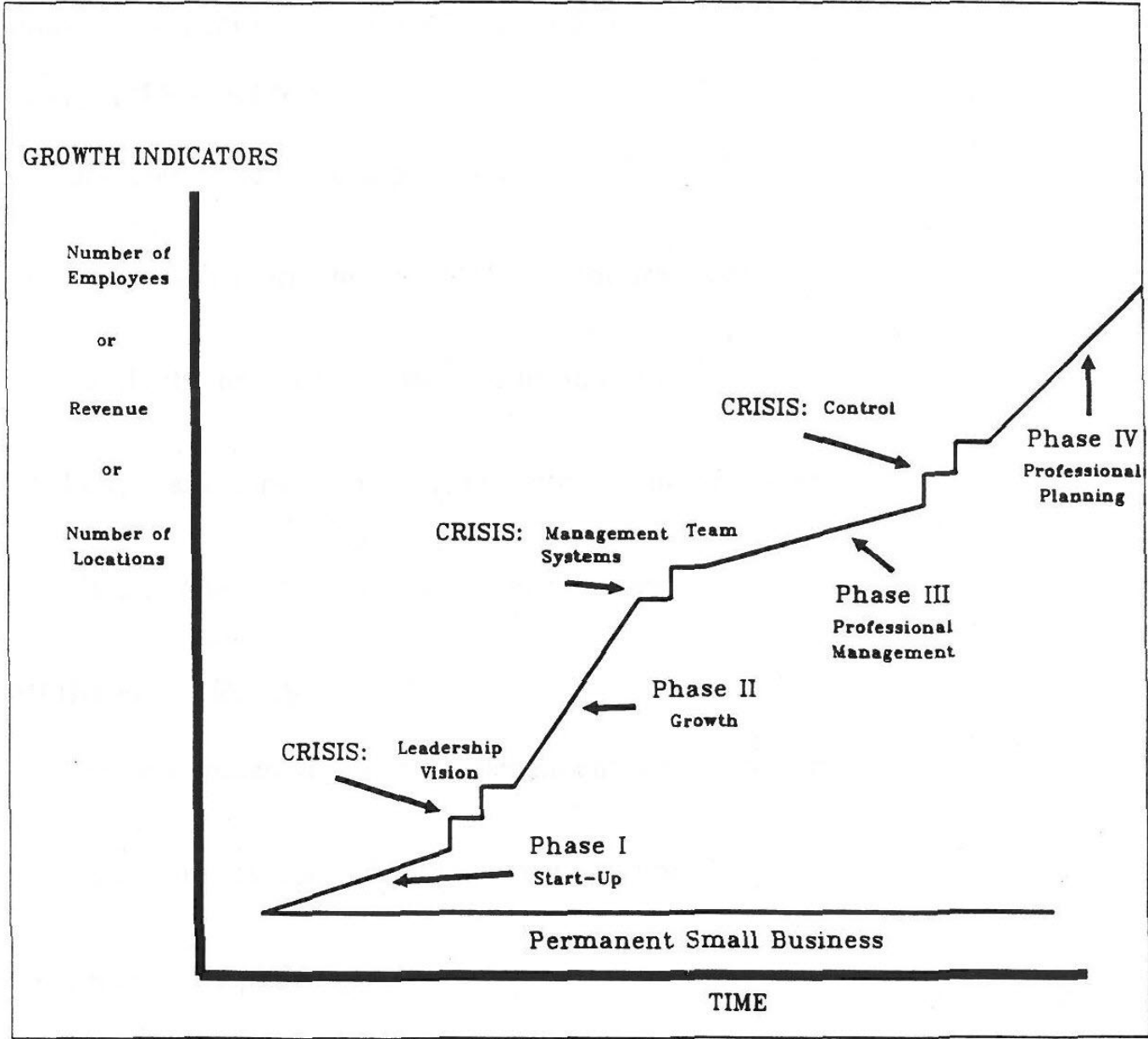


Steps to Valuing A Business

- Gather Information
 - Ownership breakdown
 - Lawsuits
 - Business Evolution



Where Are You In The Evolution Of Your Business?





Permanent Small Business

Businesses that will always be considered a small business.

Characteristics:

- Operated in effect as a proprietorship
- Owner is task-oriented (vs. management oriented)
- Rarely the need for formal systems and procedures
- Few, if any, long-term employees other than the owner



Permanent Small Business

Characteristics (continued)

- Usually retail, service, or brokerage business



Phase I – Start-Up Phase

Characteristics:

- Founder(s) often still there and running the business
- Founder(s) are technical or entrepreneurial; they dislike management functions
- Emphasis is on creativity producing products or services and selling them
- Minimal emphasis on management, systems, planning, etc.



Phase I – Start-Up Phase

Characteristics (continued)

- Organization and communication informal
- Long work hours – modest salaries
- Management reacts mostly to customers rather than employees
- Growth greater than inflation but moderate



Phase II – Growth Phase

Characteristics:

- Faster growth experienced
- Often multiple locations such as sales branches or warehouses
- More attention given to areas other than producing and selling
 - Marketing
 - Personnel
 - Accounting, budgeting, and finance



Phase II – Growth Phase

Characteristics (continued)

- Employee duties become more specialized and formally defined
- Business becomes more impersonal



Phase III – Professional Management

Characteristics:

- Organization begins to decentralize by:
 - Function
 - Product or service
 - Geographic location
- Management by exception
- Managers do more managing than technical work



Phase III – Professional Management

Characteristics (continued)

- Profit centers established
- Growth rate is moderate – usually slower than Phase II



Phase IV – Professional Planning Phase

Characteristics:

- Business has a well-defined mission and long-range strategy
- Formal business planning procedures are in place
- Line and staff balance is achieved
- Employees have a strong identification with the business
- Operations are decentralized



Phase IV – Professional Planning Phase

Characteristics (continued)

- Support functions are centralized
- Managerial accountability is strongly emphasized
- Growth rate is usually faster than in Phase III



Why Is Understanding the Phase Your Business Is In Important To Its Value?

It can help you to identify factors contributing to increased and decreased value of your business!



How Is A Business Valued?

An appraiser will analyze the business from three approaches using various methods:

- **Asset Approach**
- **Market Approach**
- **Income Approach**



How Is A Business Valued?

Asset Approach:

- Essentially the ***fair market value*** of all the company assets reduced for all it's debts
- Often the liquidation value
- Some exceptions – particularly if the company has intangible assets



How Is A Business Valued?

Market Approach:

- What have companies in similar industries, similar size and/or similar sales sold for recently?
- Uses ratios or “multiples”
- Information from various data bases
- Public companies are used too – but their size makes comparison difficult

How Is A Business Valued?

SIC	Business Description	Sales 000's	DE 000's	Price 000's	State	Sale Date	Price / Sales	Price / DE
3089	Custom Plastic Injection Molding	4,358	497	860	IN	09/09/10	0.20	1.73
3089	Plastic Fabrication Company	1,308	287	750	CA	02/02/15	0.57	2.61
3089	Plastic Injection Molding	2,138	369	600	NC	07/01/09	0.28	1.63
3089	Plastic Mfg	1,200	215	350	CA	02/04/13	0.29	1.63
3089	Plastic Park Furniture Mfger	1,776	250	975	MI	04/26/10	0.55	3.90
3089	Plastic Parts Manufacturer	890	255	475	CA	01/07/10	0.53	1.86
3089	Plastic Parts Manufacturer	886	213	285	WA	05/28/10	0.32	1.34
3089	Plastic Parts Manufacturer	3,216	483	800	TX	01/23/09	0.25	1.66
3089	Plastic Parts Manufacturer	3,898	537	625	MD	01/23/09	0.16	1.16
3089	Plastic Parts Manufacturer	1,886	364	450	CA	07/29/09	0.24	1.24
3089	Plastic Parts Manufacturer	3,086	356	375	TX	03/30/10	0.12	1.05
3089	Plastic Parts Manufacturer	2,132	408	435	TX	12/02/09	0.20	1.07
3089	Plastics Fabrication	680	127	515	CA	12/31/12	0.76	4.06
AVERAGE		2,112	335	577			0.34	1.92
MEDIAN		1,886	356	515			0.28	1.63



How Is A Business Valued?

Income Approach:

- Investors buy into companies based on their expectations of returns vs. risk
- Cash flows (potential dividends) projected using historical data (usually established companies) or future forecasts (usually startup companies)



How Is A Business Valued?

Some approaches will not produce a result

- Company may be specialized and finding comparable companies may be difficult
- Company may have had recent losses, so an income approach using historical data may not provide a value



How Is A Business Valued?

Appraisers makes judgments on the resulting data using their knowledge and experience:

- Weighting of approaches
- Reconciling differences – why are the values different?
- What is going on with the industry?



How Is A Business Valued?

As one would expect, the effects of crash of the national economy from 2008 to 2010 wrecked havoc with valuations and created greater difficulties and challenges for both appraisers and investors.



How Is A Business Valued?

Valuing businesses has always been an art and a science. The introduction of new data bases and models are always moving appraisals closer to a science.

However, since there is no one correct value, there will always be some subjectivity involved.



What Is Your Business Worth?

Personal Goodwill:

Often a business loses value because the owner is such an intricate part of the business that separating him/her from it will be detrimental to its performance, and as a result, its value.



What Is Your Business Worth?

Using An Income Approach:

- 1) Determine the cash flows of your business:
 - Starting with net income, add back non-cash expenses such as depreciation
 - Determine if there are overly high owner salaries and/or expenses and adjust



What Is Your Business Worth?

- 2) Determine the capitalization rate (expected rate of return an investor would expect based for your business)
 - Large profitable public company: 5 to 10%
 - Other profitable public company: 9 to 14%
 - Unprofitable public company: 12%+



What Is Your Business Worth?

- Healthy private company: 8 to 16%
- Typical private company: 14 to 24%
- Start-up (VC-type investment): 35 to 60%
- Really risky company: the sky's the limit!



What Is Your Business Worth?

Risk-Free Rate of Return	(1)	3.50%
Risk Premium		
Equity Risk Premium	(2)	5.50%
Size Premium	(3)	8.64%
Specific Industry Risk	(4)	1.34%
Specific Company Risk	(5)	10.00%
Net Cash Flows Discount Rate		<u>28.98%</u>
Sustainable Average Growth Rate Adjustment	(6)	<u>(3.30%)</u>
Net Cash Flows Capitalization Rate		<u><u>32.28%</u></u>



What Is Your Business Worth?

- 3) Divide the cash flows by the capitalization rate:

Annual cash flows - \$100,000

Capitalization rate – 20%

$\$100,000 / .20 = \$500,000$ value



What Is Your Business Worth?

4) Is this a controlling (50% or more) or non-controlling interest?

Income Approach calculates a minority interest

- Controlling – take value and multiply by 1.10 to 1.50% (average is 1.35%) - **Premium**

What Is Your Business Worth?

Transaction Summary

Statistic	Count	Range	Mean	Median	Harmonic Mean	Coefficient of Variation
Effective Date	17	8/5/1998 - 8/11/2015	N/A	N/A	N/A	N/A
Net Sales LTM (USD)	17	\$9 - \$2,862	\$377	\$134	N/A	N/A
EBITDA CashFlow LTM (USD)	17	\$1 - \$343	\$49	\$16	N/A	N/A
Deal Value (\$mil-US)	17	\$2 - \$3,354	\$324	\$113	N/A	N/A
MergerStat Control Premium	17	-23.1% - 300.0%	44.7%	38.0%	N/A	N/A
Implied Minority Discount	17	-30.0% - 75.0%	22.0%	27.6%	N/A	N/A
Price/Sales	16	0.07 - 2.49	0.78	0.73	0.38	0.74
Price/Income	15	6.00 - 30.66	13.68	12.01	11.00	0.50



What Is Your Business Worth?

- Controlling –
 $\$500,000 \times 1.35 = \mathbf{\$675,000}$
- Non-controlling – **\$500,000**



What Is Your Business Worth?

- 5) Take value from #4 and multiply by **Marketability/Liquidity Discount** (typically 15 to 45 percent – average is 30%)



What Is Your Business Worth?

- Controlling –
 $\$675,000 \times (1 - .35 = .65) =$
\$438,750
- Non-controlling –
 $\$500,000 \times (1 - .35 = .65) =$
\$325,000



Importance of Knowing the Value of Your Business

- Exit Planning should begin with a Business Valuation
 - If your plan assumes the business is worth \$1,000,000, but it is actually only worth \$500,000, it's better to know now than when you are ready to exit
 - Ideally, an exit plan should be made and started at least 5 years before you plan to do so
 - If you need to increase the value of your business, starting early gives you time to do so



What Is Your Business Worth?

- There are several Valuation Credentials in the United States:
 - **ABV** (AICPA)
 - **CVA** (NACVA)
 - **ASA** (ASA)



What Is Your Business Worth?

Disclaimer:

The examples shown in this presentation are to provide the viewers with some very general guidelines as to how a business is valued. It is not meant to be used to determine the actual value of a specific business or what a buyer would pay for it



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