HOW MUCH IS YOUR BUSINESS WORTH?

By Kenneth B. Collins

How much is your business worth? In the end, the answer is simply this: "Exactly what someone will pay you for it." And that number depends on a host of factors that drive value.

If we were selling a house, we would be looking at a common set of factors such as its age and location, number of square feet, number of bedrooms, baths, etc. We would then simply ask, "What have comparable houses in the neighborhood sold for?"

Unlike real estate, however, selling a business means selling a going concern – i.e., projected cash flows based on the business's ability to produce profits in the future, with all of the risks associated with achieving those projections.

The key lies in identifying, understanding and assessing the many financial and non-financial factors that ultimately drive enterprise value. In my own experience, here are eight of the most important factors:

1. **Past Financial Performance** – sales and growth, profits or EBITDA, margins, and ROI
2. **Projected Future Financial Performance**
3. **Combined Cost Savings and Revenue Opportunities**
4. **Management and Culture**
5. **Industry and Served Market**
6. **Share of Market – Competition – and Barriers to Entry**
7. **Intellectual Property**
8. **Impact of Technological Change**

Except in competitive bidding situations, buyers prefer not to credit their valuation with synergy benefits that they expect to realize as a result of integrating the acquired business with their existing business. They will, however, normally allow the *pro forma* exclusion of non-operating and extraordinary expenses from the financial statements.

Fundamentally, there are just two valuation methodologies:

The *Market Approach* is based on actual comparable transactions and public company multiples, using EBITDA Multiples and/or Revenue Multiples as the appropriate metrics. Knowledge of the market and access to a database of transactions are key to using the Market Approach.

The *Income Approach* is a method of determining the value of a business by using one or more methods through which anticipated future financial results are converted to present value. A schedule is prepared which lays out current and projected earnings, taxes, investment requirements, and cash operating needs such as for working capital – resulting in projected cash flows over the plan period (typically five years). A terminal value or end value for the entity is also calculated – normally on the basis of an assumed exit multiple or a capitalization method.

The projected cash flows are then converted to today's value by applying a discount rate to reflect risk and target ROI, and using net present value (NPV) analysis. The result is what an investor should be willing to pay today for a business with future annual net cash flows as projected. Private Equity firms typically employ this approach.

At Closing, a number of adjustments are made based on the latest balance sheet of the Company – such as for working capital, deferred revenue and bank debt. Closing adjustments are standard practice in actual M&A transactions to determine the actual price paid to the seller for the equity or net assets of the business.

In the end, negotiations should be conducted with courtesy and professionalism, ideally through an experienced third-party. Ken Collins is Managing Partner of KBC & Associates, an M&A Advisory firm based in Huntington, New York. Visit: www.KBCandA.com.