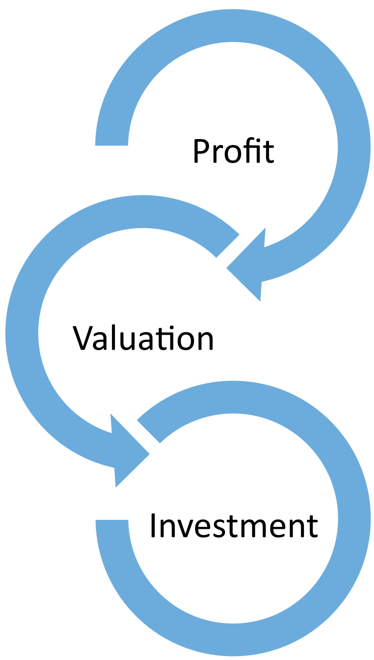
Jim's Profit Accelerator 51:
Is Valuation Your Rocket Fuel for Growth?

There's confusion about where valuation fits in daily operation of a privately held business. Here's the answer:

SPEED BUMP: Measure profit until it's consistent, then measure valuation.

Okay, some explanation. Here are the three power paths to success:



Profit
Like all clichés, it's partly true. Actually you always measure profit, but you may change how it's viewed and applied. Until you're consistently profitable, profit is the monthly measure of progress, success, and motivation. No change there. Once you're consistently profitable, shift the light to valuation. Consistently profitable means five out of six months, with no major sign of abrupt change.

Think of profit as the cheap seats: you need it to get into the game, but it's a lousy value. It biases you against the risk that will make you successful, and it forces short-term leadership. It's necessary to pick up speed, but wasteful thereafter.

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Valuation
Once you're profitable, build quickly on what you have. Your competitors are sprinting toward your niche and your customers, and unless you invest wisely and aggressively they'll beat you.

Valuation tracks the strength of your business in the market, including profit, growth potential, niche strength, management capability, ability to grow as needed, and so forth. It places your business in full context with your markets, your suppliers, and your competitors. Because valuation is broader than just a financial measure, it's reality on steroids. But these steroids are good for you, if you'll use them.

Valuation can be estimated well enough to provide powerful guidance. Valuation's three elements are profit, EBITDA, and market multiple.

- Profit is your monthly summary of results as framed by your income statement.
- EBITDA is self-defining, and should be part of monthly financial reports (earnings before interest, taxes, depreciation, and amortization).
- Market multiple is an informed estimate of the risk of future profitability. Risk estimation is a critical skill when you sell, but your estimate will suffice for growth planning. For most planning, a multiple of 4 will suffice, even if you believe your company multiple will be different.

A sample calculation of valuation:

Annual Profit: $1,000,000

EBITDA: $1,200,000

Multiple: 4

Valuation: $4,800,000 (Multiple x EBITDA)

Investment
Once we're profitable, we've just entered the game. Much of the outcome depends on clever investment. Investments take many forms (people, information, equipment, marketing, etc.), but their purpose is to drive valuation.

Here's the investment trap: Imagine a $3.5 million investment. It seems promising, so bring on the ROI to help decide whether to move on it. How you calculate the "R" often determines whether you'll move or not. The risk is that when your return ("R") seems too low, you'll skip the investment, and drift behind in the game. Here's the math:

- Annual Profit: $1,000,000
- EBITDA: $1,200,000
- Multiple: 4
- Valuation: $4,800,000

Evaluate the opportunity:

Formula for ROI: Return/Investment

- Profit: $1,000,000 /$3,500,000 = 28.6%
- Valuation: $4,800,000/$3,500,000 = 137%

Bonus measure: Return OF Investment (Value of time)

Profit: $3,500,000/$1,000,000 = 3.5 years

Valuation: $3,500,000/$4,800,000 = .73 years

SPEED BUMP: Money sooner is better than money later; speed matters.

No, this isn't a shortcut. It's the actual return, because every major investment should be building your valuation. Period.

For most private businesses, the difference between 3.5 and .7 years is the difference between action and losing sleep (and rewards!).

SPEED BUMP: Measure investments against valuation, not profit.

ACCELERANT: What is your valuation goal in 48 months?

For more information on how you can accelerate revenues and profits in your business, please call or email me.

For more information, visit www.grewco.com.
Jim Grew is an expert in CEO-level strategy and executive leadership whose clients refer to him as the Business Defogger and Accelerator. Jim helps leaders swiftly discover the hidden opportunities within their businesses and exploit them for dramatic results. Nearly three decades of success as a COO and CEO coupled with his experience running nine thriving businesses provide the foundation for his consulting work as president of the Grew Company. He presents regularly to industry groups, mentors business leaders, and shares insights on his blog, BizBursts.com: http://bizbursts.com/. He holds BA and MBA degrees from Stanford University.