PROTEGRITY Advisors™

How Much Is My Business Worth?

By Kenneth B. Collins

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 and all of the risks and opportunities associated with achieving those projections.

So how much is my business worth? That depends on the many financial and non-financial factors that drive enterprise value. Here are the most important:

- Past Financial Performance – sales and growth, profit or EBITDA, margins, and ROI
- Projected Future Financial Performance
- Cost Savings and Revenue Opportunities
- Management and Culture
- Industry and Served Market
- Share of Market – Competition – Entry Barriers
- Intellectual Property
- Impact of Technological Change

Except in competitive bidding situations, buyers prefer not to credit their valuation with any of the synergy benefits they expect to realize as a result of integrating the acquired business with an existing business. They will insist on professionally prepared financial statements from a CPA, but buyers will normally permit the *pro forma* exclusion of non-operating and extraordinary expenses from the financial statements.

Basically, there are just two valuation methodologies:

***Market* Method** – based on actual private/public company comparable transactions using multiples of EBITDA and/or Revenue as the appropriate metrics. Knowledge of the market and access to a database of transactions are key to using the Market Method.

***Income* Method** – analyzing the value of a business by using one or more methods through which anticipated future financial benefits 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. A terminal or end value is also calculated – based on 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. Financial investors use this approach.

Whichever method of valuation is employed, a number of adjustments are made at Closing 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.

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