

Valuing a Business

Determining the value of a business remains one of the most important and complex steps when buying or merging with a business. How do you determine the value of a business? According to the booklet *Business Valuation Strategies*, business valuation is “as much art as science.”

Value is derived by a complicated set of factors. So, it is imperative that the methodology used fits the needs of the business and is correctly applied in order to reach an accurate value. This requires someone with both experience and skill – a professional valuator.

Professional Valuators

Professional valuators are individuals trained to “use professionally accepted methods to arrive at well-reasoned and defensible estimates of value.” They help define the value, gather, sort and analyze tremendous amounts of data, and determine which method(s) will provide the most accurate value for the business.

Common Valuation Methods

Three common valuation methods are the income approach, market approach and cost approach. The valuator selects the appropriate method based on 1) the type of property and 2) the purpose of the valuation. Traditionally, one primary method is chosen to determine the property’s value, and one or two others serve as checks and balances of that value. The process remains somewhat subjective. Here is a brief look at these valuation methods:

Income Approach

In the “income approach,” a valuator forecasts the net cash flows or business earnings for a specific time period and then discounts them to adjust for growth, inflation and risk. When utilizing this approach, the valuator first establishes a starting point – typically the current year. Next, he/she predicts future business projections and the forecast time period (typically three, five or 10 years). Lastly, the valuator determines the appropriate discount rate. This final step requires careful analysis and can greatly affect the valuation.

Market Approach

In the “market approach,” a valuator compares valuation multiples from similar business acquisitions. The data is then adjusted to account for differences between the target business and similar businesses.

A valuator must be able to justify his/her business selections and show how they are similar to the business under consideration. In addition, he/she must demonstrate how

the fair market value was adjusted to reflect any differences, such as location, size, structure, growth, profitability and financing.

Cost Approach

In the “cost approach” (otherwise known as the adjusted book value method), the value of all assets and liabilities are established to determine the value of the entire business. The most difficult part of this approach is identifying and valuing the intangible assets.

Acquiring/Merging With a Business

Many issues are involved in buying or merging with a business. Valuers can help you through the process and may even save you from buying a “lemon.” For example, professional valuers can help you locate a good acquisition candidate by utilizing a personalized screening process. If you are buying a business, they can provide insight into its financial picture and shed light on potential problems that could affect the deal.

In addition, valuers can make sure that business financial statements and disclosures are in order, discover unrecorded liabilities, assess the reasonableness of projections, and structure purchase agreements.

The word “value” is defined in Webster’s Collegiate Dictionary as “the monetary worth of something...marketable price.” When determining the “value” of a potential business venture, make sure you are paying what it is worth. Enlist the help of a professional valuator.