

# Selling your company: what is it worth?

Just as beauty is in the eye of the beholder, so a company's value is determined by the interest it generates in the market. While there are numerous quantitative methods you can employ to estimate the value of your business, its true value can only be determined by the market. By definition, fair market value is the price that a commodity can bring in an open exchange between knowledgeable buyers and sellers in an unfettered market.

## **Key points to remember in understanding what your company is worth**

The asset approach considers the underlying tangible assets of an enterprise individually. The sum of the fair values of each asset, after netting out the aggregate total of the company's tangible liabilities, represents the asset value of a company. This approach is most appropriate for companies with significant tangible assets, such as real estate holding companies or natural resource companies.

The market comparison approach compares your company's operations and financial performance with that of:

- similar publicly traded companies
- recent sales transactions involving like private companies.

Since you are estimating the value of your company for acquisition purposes, the merger markets will generally provide a more accurate benchmark than a comparison with publicly traded companies.

The income capitalization approach (or 'discounted cash-flow model') is based on the present worth of the future economic benefits to be derived by an acquirer. This approach attempts to determine the net present value of a company's expected future earnings stream over a certain 'payback' period. Most prospective buyers will tend to use some form of this model in assessing the value of your company.

The key to the value of most businesses is their ability to generate earnings. And yet, in order to minimize income tax, many private company owners seek to suppress reported profits. In order to provide a true economic view of these companies, it is imperative that their financial statements are recast to eliminate direct and indirect owner-related expenses, as well as expenses of an extraordinary, discretionary or non-recurring nature.

Many business owners ignore conventional methods of valuation, and base their 'asking price' on a number of myths and misconceptions about value:

- The value of their company should be directly related to the amount of work that they put into it (the labor theory of value).
- Extraordinary growth should command an above-market value. This is only the case if the growth is achieved with a commensurate increase in profitability (the revenue theory of value)
- A few owners start the valuation process by first determining what they want from the deal, and then work backwards to justify that number (the 'just gimme my price' theory of value).

### **Pitfalls to avoid**

- Do not place an unrealistically high value on your business: you will only end up hurting yourself with unrealistic or insupportable expectations. Potential suitors may not even consider buying your business if they assume that a high asking price means that you are not serious about selling.
- The market comparison approach assumes that a few recent deals are appropriate indicators of value. However, firms often pay a premium' to gain a foothold in a particular field, setting standards that no other parties in the field will subsequently match.
- The weakness of the income capitalization approach is that its reliability depends on the quality and credibility of the projections. Sellers tend to be overly optimistic; buyers tend to be overly cautious.

### **Best practice**

Before going to market, you should first go through the process of estimating a range of potential values for your business. It is always advisable to have a complete and detailed understanding of possible values at the outset, so selling shareholders and advisers alike are clear as to expectations and realistic goals.

When using the market comparison approach it is important to choose a universe of comparative companies that are similar in size, capitalization and industry.

In every comparison, you must be certain that you have enough facts on each company and its operation to make a sound judgement. For instance, you

may know that your competitor sold for £15 million, but without any more information than that you are in no position to judge comparative value.

### **Hints and tips**

- At its best, a valuation can give you some idea of what range of prices you might expect to realize in the market. However, you need to recognize a valuation for what it is: merely one opinion of the ultimate worth of your business.
- Most sophisticated acquirers will understand and accept the concept of re-stating your financial statements to reflect the 'true' profitability of your company.

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