



FRAZEE IVY DAVIS

Briefing: Business Valuation – How?

“What is your business worth?” That is a question much debated, and is one with which we are quite familiar. It’s at the heart of every purchase and sale negotiation. It drives tax consequences. It can be the subject of disagreement and controversy. The question can be posed by family, employees, executives, charities, and trustees, to name a few. It affects financial statements, compensation, retirement plans, buy-outs, buy-ins, and other circumstances. If you own or operate a private business, “what’s it worth?” could be one of the most difficult and essential questions you’ll ever ask.

There is a science and an art to business valuation. As part of the professional science, valuers think in terms of three principal categories of computations – assets, income, and market comparisons.

- Assets

An asset approach is a straightforward accumulation of assets minus liabilities. Occasionally, computation is simple. At other times, there are subjective realities like loyalty, opportunity, wear-and-tear, obsolescence, goodwill, and the like, which introduce the need to analyze profit, persistence, and comparisons.

- Income

An income approach reduces future income to its net present value. It accounts for the time value of money, investment risk, and the amount, timing, growth, and other patterns of cash flow. Past results sometimes help to estimate a likely future, but business plans, competitive conditions, trends, and capacities can require much study.

- Market

A market approach measures value by observation of prices paid for like investments. The methodology ordinarily capitalizes profit metrics by application of guideline multiples from either comparable publicly traded companies or comparable mergers and acquisitions. Because no business is identical to another, the definition of comparable is not prescriptive, but similarities should be sufficient to make reasonable judgments concerning relative value.

An average analyst can tell you what you own, what you owe, how much money you make, the prices paid for similar investments, and the like. But the professional art of business valuation is judgment of risk, prioritization of facts, and development of assumptions that are worthy of belief. Experience is the key.

Don’t doubt that the valuation question will arise in your business. Sometimes it requires merely intuitive rationalization and do-it-yourself application of anecdotal formulas. However, when realities call for close questioning, call us. We’ve been giving informed and useful guidance on valuation issues and transaction arrangements for many years.

If you would like to know more, then please contact any of us here at Frazee Ivy Davis.