Simple Question - Complex Answer

The valuation method used most often by business owners is, "What do I need to retire on?" Unfortunately, buyers never use that method to determine your business' worth.

Most business owners don't have a good idea of what their business is worth, and understandably so. In fact, there are multiple answers to the question at the same time.

Is it the worth of your business in the condition it is in today, the worth that it could be if you made changes to improve operations, or the worth to a synergistic buyer such as another company in your industry or a private equity firm? Could a buyer realize efficiencies, fill in geographic gaps in their market, broaden their product portfolio, improve margins, or achieve other improvements? In one instance, we have seen a business sell to a synergistic buyer for 2.5 times what it was worth to the seller.

Your business' worth is determined by two main factors: The condition of your business at the time of sale and the buyer.

Estimate the Value of Your Business

A simplified way to estimate the value of a business is to first calculate what is commonly called "adjusted EBITDA." EBITDA is "earnings before interest, taxes, depreciation, and amortization," which is a short-hand way to estimate cash flow from the operations of your business. Start with the pre-tax income on your income statement and add back depreciation (and amortization, if you have it) and interest expense.

Next, identify expenses that you do not think a new owner would continue. For example, if you have family members on the payroll purely as an act of kindness, and they do not contribute to the business, add back their salary and benefits. Do this for all reasonable add-backs. The net result is adjusted EBITDA.

Now, multiply your adjusted EBITDA by an appropriate multiple to arrive at your worth. But wait. Which multiple do you use? Here is where it gets more complex. Multiples vary greatly based on several factors, such as your industry, your growth rate, general economic conditions, synergies realized by the buyer, and how well your transaction is negotiated on your behalf. For example, in the logistics industry, a distribution company that simply brings goods in the back door and ships them out of the front door could sell for an EBITDA multiple as low as 3.5X.

However, a value-added distributor that has a highly attractive product line, that does sub-assemblies, provides other specialty services, or that is run extremely well, could sell for a multiple of 6X, or even higher. Thus, two companies each making $5 million in adjusted EBITDA could sell for $17.5 million to $30.0 million, or an adjusted EBITDA multiple of 3.5X to 6X.

Insurance related companies, medical device companies, software and other technology companies could sell for adjusted EBITDA multiples of 10X, 12X, or more. This could push the value of the $5.0 million EBITDA company to $50 million, $60 million, or higher.

Enterprise Value

Another key point is that EBITDA multiples estimate what is called "enterprise value." Enterprise value is the total value of your business without deducting any interest-bearing debt the

business has. Most sales of businesses are done on a "cash free, debt free" basis, meaning that you keep any cash the company has on its balance sheet, but you are responsible for paying off the company's interest-bearing debt out of sale proceeds.

Equity Value

The number you are ultimately interested in is "equity value," or the value of your equity ownership interest in the business. Equity value is the amount you would` receive personally if you sell your business before taking into account transaction costs and income or capital gains taxes on the transaction.

The easiest way to think of this is with your house. Let's say your house is worth $1 million, and you have a mortgage of $600 thousand. The enterprise value of your house is $1 million, and the equity value is $400 thousand ($1 million - $600 thousand).

So, the ultimate answer to the original question is "It depends." Contrary to what you may hear, there is no simple rule of thumb, even within an industry. Beware of those who tell you your business is worth X times adjusted EBITDA without doing a thorough analysis.

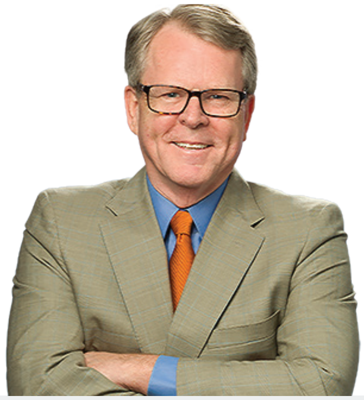
Discounted Cash Flow

Heritage builds detailed financial models of our clients' businesses using a valuation method called "discounted cash flow" (DCF) and our own proprietary software. DCF is specific and considers the individual nature of your business. We also look at the value of the business as you operate it currently, what it could be worth if you make changes to increase profitability, and what it is likely to be worth to a buyer. For example, a strategic buyer (one in your industry) may be able to cut out duplicate expenses, increase sales growth because of additional marketing resources, or buy raw materials more cheaply that you can. All these factors, and many others, can make your business worth more to a buyer than it is to you currently. We calculate the possible value to a buyer, so that you have the knowledge to be in a stronger negotiating position. This is a hidden value in your business, and we use this information when we are negotiating on your behalf with buyers to achieve a better price for you.

Market Comparables

We also look in depth at other similar transactions that have taken place in the market recently to corroborate the values we develop using DCF. Since all businesses have their own unique combination of characteristics, finding nearly identical comparable transactions is difficult, but similar transaction data add insight and reason to the process. The result is a comprehensive, reliable value based on the specifics and reality of your business.

If you have any questions on this article or ***would like to explore what your business is worth, get in touch.*** We can have a no pressure, no obligation discussion.



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