What Is Your Business Really Worth?

For many owners, the answer to one question determines their ability to leave their companies: “How much money will I get when I sell?”

This question is indeed critical, and answering it is the second step of The Seven Step Exit Planning Process™. Realistically, you can’t exit your business unless you achieve financial independence, and the primary source of that independence is likely to be the funds you receive for your business when you leave.

Let’s look at fictional owner Ron Nee, the owner of Landscaping Supply Company, to see why a valuation—well before your exit date—is so important.

For years Ron figured he could sell his business for more than enough money to retire comfortably. He based that belief on his understanding of his industry’s valuation rule of thumb—a percentage of gross revenue. Using that rule, Ron calculated his company was worth about $2 million—more than enough to finance his post-exit life.

When Ron decided that it was time to sell and met with a transaction intermediary, he learned that the rule-of-thumb approach didn’t apply. Ron discovered that buyers for the company would base their offers on cash flow rather than on revenues (the basis for Ron’s estimate).

Because Ron relied on an incorrect assumption about the value of his business, he had wasted valuable time coasting along to his exit date. Had he retained a professional to estimate value or provide a range of likely sales prices before he was ready to exit, he could have spent his time focused on increasing the value of his business.

How can you avoid Ron’s predicament?

Ron Nee failed in a critical aspect of ownership: knowing the worth of his business. By not getting a professional valuation or estimate of value, he never knew how far away he was from exiting. He had no accurate information on which to base a plan to grow value.

Benefits

An accurate valuation of your current business resources:

• Tells you—objectively—how much value you need to add to the business.
Provides you the ability to monitor your progress toward your ultimate financial objective. For example, if Ron had discovered that his business was worth $1.5 million (pre-tax) instead of $2 million, he could have created and implemented a plan to increase value to $2 million by the time he wanted to exit. His plan could have included interim goals and laid out strategies to achieve each interim goal.

- Determines whether and when you can reach your Exit Objectives.
- Provides a basis for estimating, and minimizing, tax consequences of exit path alternatives.

If you are ready to exit your business today, tomorrow or in ten years, you need more than a thumbnail sketch of (or “rule of thumb” approach to) value. An experienced appraiser should be able to answer the question, “Can your company be sold today for enough money, after-tax, to allow you to reach all of your exit objectives?” If the answer is no, you can use that knowledge as the basis for a plan to build business value.

**Cost**

The cost of hiring an appraiser or business intermediary varies substantially. For example, if you and your business are several years away from a transfer of ownership, a full-blown valuation may well be unnecessary. Instead, you need a value approximation (or range of likely sales prices).

If you are ready to exit and plan to sell to a third party, a transaction intermediary can prepare a range of likely sale price. If you plan instead to transfer your company to employees or family members, a certified business appraiser can prepare a “calculation of value.”

Estimates of value, thorough valuations, and marketability appraisals all have their places. Don't skimp on obtaining the valuation you need, but don't secure a more precise valuation before you need it.

**What If?**

Finally, let's return to Ron's situation: what might have happened had Ron obtained a business appraisal and learned—well before his target exit date—that his company would likely sell for a price that would meet his financial objective? Should he have taken immediate action to sell? What would you do if today you learned that you could exit for an amount of after-tax cash that would meet all of your financial objectives?

How would the knowledge that your business is 60%, 75% or 110% of what it needs to be worth affect your actions? Life offers no guarantees regarding your health or longevity and today's volatile economy provides an excellent reminder that there are plenty of circumstances beyond an owner’s control. For all these reasons, knowing the value of your company is a fundamental, indispensable element of sound decision making.

*The information contained in this article is general in nature and is not legal, tax or financial advice. For information regarding your particular situation, contact an attorney or a tax or financial advisor. The information in this newsletter is provided with the understanding that it does not render legal, accounting, tax or financial advice. In specific cases, clients should consult their legal, accounting, tax or financial advisor. This article is not intended to give advice or to represent our firm as being qualified to give advice in all areas of professional services. Exit Planning is a discipline that typically requires the collaboration of multiple professional advisors. To the extent that our firm does not have the expertise required on a*
particular matter, we will always work closely with you to help you gain access to the resources and professional advice that you need.

This is an opt-in newsletter published by Business Enterprise Institute, Inc., and presented to you by our firm. We appreciate your interest.

Any examples provided are hypothetical and for illustrative purposes only. Examples include fictitious names and do not represent any particular person or entity.

©2016 Business Enterprise Institute, Inc. All rights reserved.