ONYX PARTNERS GROUP

Business Valuation

How do you put a price tag on a company? They aren't the type of thing bought and sold off a supermarket shelf. Is a company worth only the property it owns? Or is it the work the owner and staff have put into it?

The complex process used to determine a company's official value is known as "business valuation." Having a professional valuation can be inconvenient, but knowing a company's formal value is extremely important when planning or transferring ownership.

There are any number of reasons business owners need to know the value of their company. Some of the most common include:

- **Estate planning purposes**
- **Sale of the company**
- **Succession planning**
- **Liquidation of the company**
- **Establishing personal net worth**
- **Property division in a divorce**
- **Preparation for initial public offering**

Why Value a Business?

For public companies, business valuations are not often needed; the owners are the shareholders, their stake in the company is determined by market value of their shares. This is not to say the company's total value is determined by the trading price of the stock, but that the value of each person's ownership is easily found through the selling price of their shares. For private business owners, however, a full business valuation is needed before the value of their ownership can be calculated.

What Affects a Business's Value?

From the day a business opens, its fair value becomes more and more difficult to determine. Profits start to come in, wages must be paid out, machines begin to wear down and the company establishes a reputation. After a few years, trying to find a dollar value for everything a business does can seem impossible.

The value of business is more than just the equipment it owns or the income it generates. There are numerous factors that affect value—some have nothing to do the company's operations. Some of the factors include:

- Corporate earnings, historical and current
- Growth potential
- Economic outlook for the industry as a whole
- Success of similar businesses
- Book value of all physical and intellectual property
- Outstanding liabilities
- Asset liquidity (how easily the company can be converted into cash)
- Controlling shares of the company
- Value of company stock (if any)

Some or all of these factors (as well as others) may be used during the valuation of a company. Which factors get the most attention depends on valuation approach used during an appraisal.

Approaches to Valuation

Appraisers can use a number of different approaches when determining where a company's value lies. The most common approaches to valuation are the asset-based approach, the income approach and the market approach.

Asset-based approach – This method predominantly looks at the utility and value of the physical property that a company owns. It suggests that a company's full value is held in the things it owns.

Income approach – The income approach focuses on how much money a company produces through its operations. For companies that rely heavily on services, this approach tends to make more sense. (Future income must be adjusted to a present value.)

Market approach – Perhaps the most obvious means to determine a business's value, the market approach simply looks at the previous values of similar companies. Since no two businesses are the same, an appraiser can use industry-standard multipliers to adjust the value of the business up or down to better reflect its unique situation.

Different approaches suit different businesses and transitions. For instance, a bookstore's value is best reflected by the asset-based approach; its value comes from the items in stock and the building it is in. Similarly, companies going out of business may also be evaluated this way; their value comes from selling off all of the equipment, inventory and real estate.

A company focused on service is more likely to be evaluated by the income approach because they have few physical goods and generate value through skilled labor. Accounting firms are an excellent example of this; an office is not worth much by itself, but a firm can have high value through its client list and the high demand for its expertise.

When a company is acquired by another business or decides to go public, the market approach might be best method for valuation. The market approach will allow a business to use historical information to get the "big picture" of its value. Private equity companies will often use market value to determine the purchase price of a company they intend to grow and keep.

Because each method has different strengths, most valuations will incorporate more than one approach. Using a blend of valuation techniques, an appraiser can reach a value that best represents the company's worth.

Standard and Premise of Value

Much like any other product sold at a price, a company's value changes with the circumstances surrounding its sale. The "standard of value" and "premise of value" make up the hypothetical climate under which a company is valued.

Standard of Value – This reflects the relationship between an owner, the would-be buyer and the desire to close the sale. The standard of value typically used is "fair market value"—the value a random willing buyer and a random willing seller would reach if neither were anxious to buy or sell and both parties were fully aware of all the business's details.

Premise of Value – These are the assumptions made about accessibility of the business's value. If the company is considered capable of operating indefinitely and producing value, appraisers calculate its "going concern value." If the business's value comes from it being dismantled and sold off, the premise of value is through "liquidation."

Valuable Information

Business valuation can be a lengthy process with a vast number of shifting factors, only some of which are looked at here. Business owners should not attempt to evaluate their own company, it should be left to a professional, objective third-party. Valuations should be done regularly, especially if the value is suspected of potential tax implications for estate or succession planning. Valuations can also be particularly important for partnerships where surviving parties may be required to purchase a deceased partner's share in a company.

If you are considering a business valuation or are hoping to get more information on how your company's value affects you, contact Onyx Partners Group, LLC for guidance and professional advice.