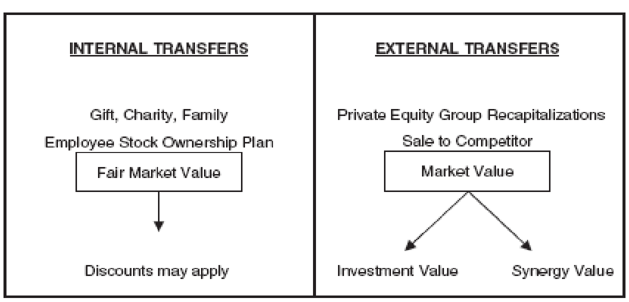
January 2013

What is My Business Worth?

The answer is…it depends. Many business owners ask this question in the form of a statement or even a conviction; "I need to get $X" being the most common. However, the reality is that although you may be able to influence the price someone will pay by the way you operate it and prepare your business for transfer, what you can get for your business depends on the type of transition you chose.

At Owner's Edge, we like to look at what you can get as a 'range of values' - there is no single value for the shares of your privately held business. The easiest way to understand this range of values concept is to begin with the differences between an internal transfer and an external transfer of your business - *see the chart below*.



When looking at the internal option, the lowest value in the range is in play. Transfers such as gifting programs, charitable contributions and Employee Stock Ownership Plans (ESOPs) are all governed by Fair Market Valuation standards. Each of these options require an appraisal by an accredited professional evaluator, usually a CPA, who render a single 'point in time' value for your company.

External transfers normally include transactions that will occur in the intermediate and upper end of the value range. Those values are measured by what different types of market players are willing to pay you for your business.

For example, a financial buyer such as a private equity group may be willing to pay you the 'investment value' for your business – this is the value to them as an investor in your enterprise. This valuation is the intermediate value in the value range you can expect to receive. Management buyouts also fall within the investment value classification.

A competitor or a market-buyer who is in a similar line of business may be willing to pay you 'synergy value,' which is the highest value you can expect to receive. This type of buyer may be able to reduce certain costs or take advantage of certain efficiencies achieved by acquiring your business.

For example, selling your business to a competitor may allow that buyer to reduce overhead associated with financial and sales operations because they already have their own systems and people in place to handle those aspects of the business. These types of cost cuts or efficiencies are called 'synergies', hence the term 'synergy value'.

Although synergy value is theoretically the highest value that you can receive for your business, only 5% of businesses will successfully sell to an outside buyer. So we see that an understanding of the 'range of values' concept becomes relevant to the majority of transitioning business owners.

There are advantages and disadvantages to both internal and external transition strategy plans. In short, a sale to a synergistic buyer generally causes you to lose control of the business as well as forfeit any future value in the business.

A sale to a financial buyer, such as a private equity group, will generally cause you to sell strategic and financial control, but may leave you the opportunity to continue running the day-to-day operations (operational control), whereby your salary and benefits continue. And, you may also be able to maintain a minority stake in the ownership of the business, thereby participating in the future value of the company that you continue to build. Participating in future value and receiving continued income should be included in the 'value' of the transition strategy plan that you design.

A sale to an ESOP or a gift to a charity or to family is measured under the Fair Market Value standard. I won't go into much detail here other than to reiterate that this Fair Market Value standard is lower than the market values of both investment and synergy value. It is the only valuation used by the tax courts and the IRS when evaluating a 'stated' value for a business.

So again, the fair market value does not necessarily reflect the premiums that can be achieved hwhen a transitioning owner decides to sell to an outside buyer such as a competitor or a private equity group. But even though the overall value may be lower, the exiting owner may experience much more flexibility and continued control with an internal transfer using the fair market value standard.

In short, internal transfers do not include an 'outside' party. Therefore, the exiting owner has the ability to construct a plan for their transition that is customized. Whether that transitioning owner is selling shares to an ESOP, or transferring a portion of their wealth to family members or charities, their ability to control the transaction is increased. The trade-off for this increased control is a lower value for the business.

In conclusion, when formulating your transition strategy plan a few very important points can be highlighted for your consideration:

- Most businesses will not successfully sell to an outside party so it makes sense to begin to understand 'internal' transfer strategies and their values.

- The internal valuation of Fair Market Value will generally produce a lower overall value for the business, but the ability to control the transaction, as well as potential savings on taxes and professional fees may more than make up for this diminished value.

- Professional appraisers are used to determine Fair Market Value whereas Market Value is determined by whatever the marketplace is willing to pay you for your business.

A final point is that a transitioning owner is well served in understanding that the 'value' that they receive for their business may not be the most important factor to consider in their transition strategy planning. Beyond the entrepreneur who knows that they want to sell to a competitor for the highest price, there are millions of other business owners who have strong incentives to pass their businesses to managers, co-owners, family, and charities of their choosing. Although these transfers may not yield the highest sales price, they may ultimately produce an outcome that is much more favorable to that exiting owner's personal goals.

Owner's Edge can help you determine your business's range of values. This is one of the first steps you need when you begin thinking about a business transition. You owe it to yourself to call us today. We are ready to assist you with your journey through developing your transition strategy plan and its successful execution.

Regards,

Tom Stocker
Managing Director
tstocker@OwnersEdgeLLC.com

Where should you start?

Owner's Edge can help in 3 major ways:

- **Are you ready personally?** We will help you articulate your personal and family goals, assess your emotional readiness for a change and estimate your family's financial needs for the future. To understand how much your business may be worth today, we will compute a range of values as a financial guide.
- **Is your business ready?** Owner's Edge is experienced in getting businesses ready for a sale or transfer. Our Operational Assessment™ will identify and prioritize what your business needs to change in order to be saleable, transferable or to grow to a higher level of performance.
- **Is your business poised for growth?** Our strategic CFO services help you focus on the strategies and actions that provide the highest return on investment and get you to a higher level of performance We help you create and act on the metrics that really drive business performance.

Call Owner's Edge for a no obligation consultation today.

About Owner's Edge: Owner's Edge is a business advisory and consulting firm specializing in helping business owners articulate their vision into measurable strategies and operational actions needed to make their profits sustainable and their business transferable. We are one of the few advisor firms in the nation that can provide a formal and comprehensive Transition Strategy Planning service for business owners. Call us for a no-obligation consultation today.