The Advisor – Winter 2017

What is Your Business Worth?

We often get asked by friends, associates and potential clients what we think their business is worth. The answer we usually provide is "It depends."

You should always have an idea as to what your business is worth even if you're not planning on selling in the foreseeable future. An unexpected event may cause circumstances to change, forcing an immediate sale. Having an idea of what you're going to get if you're forced to sell unexpectedly eliminates any surprises.

By the same token, you should have an idea of the value of your business if you're planning on selling in the near term. This should be determined prior to commencing the sales process. If you have great expectations that don't mesh with reality, the sales process will be a major disappointment and will result in offers that are significantly lower than expected.

Below are some rules of thumb you can use to value a business and some of the pitfalls that arise if used incorrectly.

1. **Publicly Traded Companies.**

   If your business is in an industry with publicly traded companies, it is easy to calculate the value of your company based on publicly traded stock prices. The two main caveats to using this as a valuation approach are:

   a) Size. Publicly traded companies are usually significantly larger than a comparable privately owned company. The larger the company, the lower the risk and the higher its value when compared to a smaller company.

   b) Liquidity. The ability to sell shares in an open market whenever you want has significant value. Privately held companies usually have little or no liquidity in their shares so its equity value will be worth less when compared to a publicly traded company.

2. **Sales of Similar Companies.**

   A sale of a similar business may be a good indicator of what your business is worth. The main issues with using this valuation method is making sure that you're comparing apples to apples i.e. is the business you're comparing your business to:

a) In the exact same industry/market or a complementary one?
b) Of a similar size? Smaller? Larger?
c) Have similar revenue streams i.e. recurring revenues under contract vs. project (one-off) type revenues? or
d) Have assets that are approximately the same age or are they relatively new?

Any significant variances in the above between your business and the one you're comparing it to could result in a material difference between what offers you'll get for your business vs. what the comparable business sold for.

3. Generic Valuation Multiples

If you're a business owner who has attended conferences where topics covered include succession planning and business valuations, subject matter experts will quote generic multiples of recent sales of businesses. Owners will then use these multiples to arrive at a value for their business. But if applied incorrectly, you may end up with a value that's significantly higher or lower than what the true value is.

An example of this is the use of EBITDA multiples. You may use this number and multiply it by your company's EBITDA to generate a value for your business. A few of the issues with this method are provided below:

a) Most owners don't realize that an EBITDA multiple generates a value for both the equity and debt of the business. If your company has a lot of debt on its balance sheet, the debt must be subtracted from the above number to arrive at an equity value for your business;
b) EBITDA must be "normalized" for one-time or non-recurring items before applying the multiplier; and
c) If your business is undercapitalized, then any additional working capital required to support the business would be deducted from the valuation since a buyer would have to invest this amount in order to generate their expected returns.

Rules of thumb can be useful to provide you with a general idea of the value of your business, especially when more than one rule generates similar values. However, we strongly suggest that you consult with a corporate finance expert to ensure that your methods and assumptions are correct and reasonable so that there are no surprises when it comes time to sell.

Aries Advisory Group has extensive experience in assisting owners with the valuations of their businesses. If you're looking to sell your business or just want to get an idea of what your business is worth, please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.