Business and Real Estate Success Planning Summit

Valuing Your Assets

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Business Owners Typically Consider One of the Following:

- Selling company to outside third-party (will require preparation to do so, including cleaning up financial statements)
- Gifting or selling to family
- Selling to a management group
- Starting an ESOP (which is expensive and takes time)

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Business Valuation in 10 Minutes or Less

Standards of Value

- The standard of value used in a business valuation depends upon the purpose for which the valuation is used. A brief discussion of a few of the value concepts follows.

Business Valuation in 10 Minutes or Less

Reason for Valuation	Purpose of Valuation
Sale of business	Fair market value
Loan application	Loan value
Insurance coverage	Insurance value
Estate valuation	Fair market value
Divorce settlement	Legal standard of state (In MN – Fair Market Value)
Accounting Value	Book Value
Bankruptcy	Liquidation Value

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Business Valuation in 10 Minutes or Less

Standards of Value: Fair Market Value

- The fair market value standard assumes the hypothetical buyer is a "*financial buyer*" and not a "*strategic buyer*". Financial buyers are primarily interested in a company's cash flow and generally contribute capital and management equivalent to the current owner and management. This standard excludes strategic buyers, those who "know" the company or operate in its industry and have unique attributes (for example, the ability to increase revenue, reduce costs, and manage well) and buyers willing to acquire an interest due to considerations not typical of an arms-length buyer (for example, related parties, creditors).
- In addition, fair market value assumes the assets are installed, in place, ready for continued use, and are part of a going concern business entity.

Business Valuation in 10 Minutes or Less

Selecting a Valuation Method

- There are three broad approaches in business valuation (income, market and asset-based approaches)

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Income Approach

- The primary methods under this approach are the multiple period discounting and single period capitalization methods.
- The single period capitalization method provides an indication of value by applying a capitalization rate to a company’s normalized earnings. This method is most appropriate when the following criteria are present in the subject entity: a relatively stable level of income or cash flow, increasing at a relatively constant rate, for a relatively long period. When these criteria are not present the multiple period discounting method is most appropriate.

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Market Approach

- The primary methods under this approach are the guideline public company or private transactions.
- Where adequate private data is available, data from transactions can provide very useful guidance as to value. However, the vast amount of data about publicly traded stocks that is available for the valuation of other types of businesses often does not exist for closely held companies. Therefore, market transaction methods largely depend on the availability of relevant private transaction data (merger and acquisition method).

Asset-Based Approach

- The adjusted book value method in business valuation analysis is based on the proposition that the informed purchaser would pay no more than the cost of producing a substitute business with the same utility as the subject. Specifically, this particular method values a business by adding the tangible net worth of the subject company at market to the goodwill value resulting from capitalizing excess earnings.

What Makes Up a Business Valuation

- Internal company information/site visit
- Economic information
- Industry data
- Financial statement analysis
- Adjustments to financial statements
- Approaches to value: Income, Market, Asset (with excess earnings)
- Transaction data – sales of closely-held businesses