International Acquisition Group

The Advisor

IAG

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Finding the Worth of Your Business

Fair Pricing for Buyers and Sellers

Whether you are planning to buy an existing business or expect to sell one you currently own, one of the biggest challenges involves deciding on a fair price. As the buyer, if you pay too much, you risk damaging future profit by digging too deep a hole early in your ownership cycle. As the seller, asking too little unfairly discounts the investments you made that created a successful business. Additionally, an improperly priced company sends the wrong message to potential buyers. If a business is being sold for significantly less than its true value, potential owners will immediately sense that something is wrong. This is hardly the way to attract a group of qualified buyers.

Abandon the Dartboard

Believe it or not, one of the most common ways people price a business for sale is by guessing. “Well, I paid X dollars ten years ago and made Y dollars a year in profit, so I’ll figure a 10 percent annual increase in value and sell it for Z dollars.” Good luck convincing a savvy buyer that the price tag you

posted is an accurate one. One of the dangers of putting the wrong value on a business involves a concept called “shelf life.” The longer your business remains unsold, the likelier it is you will sell it for far less than its true worth. Let’s say you guess that your business is worth $1 million. Maybe it is -maybe it’s not. But because you have no facts to back up your claim, your company stays on the market for months and months. As you get more anxious to sell, you keep dropping the price until a buyer surfaces. That is neither a profitable nor a sensible exit strategy.

Revenue Versus Profit

A popular way to put a price on an existing business involves looking at its annual revenue. Lots of so-called experts tout this as the most accurate method to decide if a price is fair. Every industry supposedly has its own “multiple.” For example, a manufacturing company would sell for “three times annual revenue,” with a real estate brokerage at 1.5 times revenue, and so on. This metric is so ingrained in the American business psyche that reference materials quoting the proper multiple for a particular field are abundant. But anyone familiar with Internet companies will tell you that sales do not equal profits. Look at how many dot-com’s logged millions of dollars of revenue each year and still went belly-up because they were spending more than they took in. If you

> “The vast majority of businesses really have no idea how much their business is actually worth until they sell it.”

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insist on using a linear measure like this, at least consider multiples of earnings, not gross sales.

Cash-Flow Projections

Applying standard accounting methods can create a more accurate assessment of a company's valuation. Begin with annual earnings (revenue minus expenses) and project that figure into the future as a function of growth. Let's assume your target company earned $50,000 last year and $52,000 this year, so an additional two-grand-per-year bump is not out of the question. In five years, the business would earn $270,000, which is $50K (Year 1) + $52K (Year 2) + $54K (Year 3) + $56K (Year 4) + $58K (Year 5). Then take a look at current T-Bill interest rates. If these instruments are paying a two percent dividend, it means you have to start with $2.7 million in cash to earn the same $270,000 over five years at two percent. No one is likely to put that kind of money of risk if they can get an equal or better return from a safe, and fully guaranteed vehicle like Treasuries. Under these conditions, an asking price of $2.7 million or more is high. If this sounds too complicated, ask your accountant for clarification.

* Here is the math: $270,000 ÷ 2 percent = $13.5 million ÷ 5 years = $2.7 million invested.

This Equals That

For decades, the home real estate industry has flourished by using something called "comps," which is short for comparables. In simple terms, if I own a three-bedroom house in a similar neighborhood to yours that has roughly equivalent amenities - square footage, number of bathrooms, yard size, attached versus detached garage, and so on - and it recently sold for X dollars, then your home should be reasonably close to the same value. Cities use this formula all the time to help determine valuation for property tax purposes. But because businesses change hands far less frequently than do homes, and with so many intangibles involved - location, clientele, staff, and the skills of each respective owner - business comparables may only give you the barest sense of a company's valuation. Still, it can be a worthwhile tool, especially when paired with the cash-flow method described above.

Ask an Expert

Business brokers, bankers and accountants (especially CPAs) are excellent sources of advice when trying to place a value on a business. Whether you are the buyer or the seller, the moneylenders engaged in the process - plus the people who buy and sell companies all day long - have their fingers on the pulse of business valuation. Don't hesitate to get them involved as well.

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Please let us know if you have any questions or would like to discuss the above articles with one of our trained Business Analyst.

You can reach us at 1-866-498-6445 or visit us on line at www.intlag.com

IAG Is Here For You!

***International Acquisition Group** (IAG) is North America's largest M&A Company of its kind -- working with small to medium business owners. Since 1983, using their proprietary processes, IAG brings qualified business buyers and sellers together in such a way that helps those businesses get sold profitably.*

IAG has an impressive average success rate of 74% matching North American business sellers with a global business buyer network – regionally, nationally and internationally! The company's goal is to empower every small-to-medium size business owner to sell their businesses profitably, without the risk of the wrong people finding out which could reduce the value or damage the business.

This is accomplished utilizing IAG's proprietary M & A processes so they capitalize on all of their hard work and effort.