How Much My Business Is Worth?

What is the value of your business, what drives it, and how to maximize it?

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Estimating the value of your business

As the famous quote says, beauty is in the eye of the beholder. A company's "value" is the amount a buyer pays upfront, which the seller accepts under normal circumstances. Often in middle-market M&A deals, a buyer pays a specific price depending on how desperately (age, health, retirement) the seller wants to sell their business or how competitive a sale process is (other bidders involved, exclusivity). Unfortunately, many business owners fail to prepare, are unaware of their business' worth, or know how to maximize it.

Most people often ask themselves whether their businesses are worth what they are today or what they will be tomorrow. Do Private Equity or "PE" groups, and strategic companies value a business differently? What if I do not have to sell it today but need the valuation for other needs, such as raising capital through equity financing? Or I do not want to sell now, but I want a few chips off the table. Whatever the case, you should know the value!

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When buying a business, buyers value the company based on several factors, including the company's current situation and the buyer's characteristics. But yes, it is negotiable!

Let us dive into the key points and methods to estimate a valuation range. Many factors are considered, primarily your business' unique attributes.

Approach

You often hear the word Enterprise Value ("EV"), which is the total value of your business including the interest-bearing debt and cash on the balance sheet. Most M&A transactions are "cash and debt-free," which means sellers keep the cash and pay the debt on the company.

The first step is to find out the EBITDA, or earnings before interest, taxes, depreciation, and amortization. Your firm's EBITDA is Net Income plus Interest, Taxes, Depreciation, and Amortization. Next, you identify any non-recurring expenses and excess salary to owners / family and add them back to get the adjusted EBITDA. This number becomes the basis of all the *market-based* valuations. This is frequently used to the EBITDA multiples to derive the of the company's Enterprise Value. For example, your firm's adjusted EBITDA is $10 million, and the EBITDA multiple is 6x, your firm's value will be six times $10 million or $60 million.

For the *cash-flow or intrinsic valuation* method, like Discounted Cash Flow or "DCF," we calculate the EV of the firm by calculating the present value of all unlevered free cash flow (FCFF) the company will generate in the future. FCFF is the net cash flow available to the company after paying off its working capital and capital expenses and calculated as EBIT (Earnings Before Interest and Tax) plus taxes and D&A, minus Capital Expenditure or "CapEx" and change in working capital.

Although EBITDA is widely used to compare companies and is a good proxy for the operating cash flow, it does not capture the CapEx and working capital changes. For DCF, FCFF is a better matrix because it has the highest correlation of the firm's economic value without leverage.

Considering that every company is unique, we use a practical methodology that incorporates industry and sector-specific data and company-specific assumptions into calculating Enterprise Value.

We will briefly explain the various methods of valuing companies. Is one method better than another? Is it fair to apply multiples of large transactions and public companies to small and midsize companies?

Valuation Methods

There are many methods available to perform the business valuation of a company in general. However, for M&A purposes, we use these three methods:

- Discounted Cash Flow
- Precedent Transactions
- Public Comps

Intrinsic value of a company
The DCF valuation method is specific to your company and considers your business's individual nature, such as the growth rate, CapEx, and cost of capital. We calculate the values based on (i) current management estimates, (ii) assuming a haircut on the above estimates, and (iii) what is likely to be worth to a buyer who will consider post-acquisition synergies.

Market-based approach
Precedent Transactions considers the prices paid for comparable assets relative to sales and EBITDA in your sub-industry over recent years. We analyze the past M&A deals, find the mean and average valuation multiples, and apply your firm's sales and EBITDA to find the EV. For example, if your firm's adjusted EBITDA is $10 million and the median multiples buyers have paid is 10x EBITDA, your firm would be ten times $10 million or $100 million.

Public "comps" or comparable analysis involves comparing sales and EBITDA multiples of public companies in the comparable universe to those of your company. For example, if your firm has $10 million in sales and the median sales multiple of the peer group is 5x, your firm's value will be five times $10 million or $50 million. Note that, we discount the derived EV since public companies are more marketable and less risky. Also, there is no right or wrong method but knowing which applies to your company is essential.

The Perspective

Regardless of whether you are preparing to sell your business or not, thinking as if you are, will help you identify the real drivers of value in your company. Consider these points below as if you were selling today and compare your feedback to your current situation.

- What type of buyer would be an ideal match for my company?
- How can my business add value to that company?
- Where can I invest or focus to make my company look more attractive to the buyer?

So even if you do not intend to sell your business sooner, you can maximize your business's value by setting priorities and executing them effectively. The value of a business changes over time and is affected by many factors, including growth rate, unique expertise, human resources, digitalization, and competition, among others. In order to increase your company's value, you set goals and do your best, but it's hard to achieve them without knowing where to start. The business owner should be aware of its value, understand what drives it, and recognize when to reap the rewards.

Every business has its own set of unique characteristics. Contact us if you have any questions or want to know "how much your business is worth." We can have a confidential conversation without any commitment or pressure.

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