Finance New Mexico

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Business Valuation – Beauty is in the Eye of the Beholder

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Every business owner asks the question – What's my company worth?

While that question may be on the top of your mind, perhaps the right question to ask is: What is my company worth . . . to a buyer, to a banker, to an investor, or to any specific person or entity. Besides you, who will care about the valuation?

Does it make a difference? Doesn't a company have some definitive, intrinsic value?

An academic will tell you that a company does have a definitive value, while a skilled investment banker will say your business value depends on who is setting it. Both are right. The key is to understand the context in which the business is being valued.

For example, if you want to sell or finance your business, you are likely looking for the highest value; but if you're trying to settle a tax bill, you will probably want to find a legitimate valuation method that minimizes the company's worth. Different parties can have very different motivations in setting or perceiving the value of a business.

If you are looking to sell or finance a business, the best advice is to spend time and effort finding those buyers or financing sources that are most likely to pay the highest price. Seek out those with a strategic reason to buy or invest in the business. Perhaps your company presents an attractive product line extension or it compliments other parts of the buyer's business. Maybe the buyer believes he or she can bring marketing or distribution synergies to grow the business more rapidly. Or perhaps the financing source has committed to making investments and this investment will satisfy promises made to public markets. By finding the buyer or financing source that "needs" to do the deal, you will usually find the highest value.

Once a buyer or financing source is found, use typical valuation techniques to set the value range. It's okay to put the business in the high end of the range, but be prepared to justify it.

How do you find typical valuation techniques that are appropriate for your business? A good place to start is to identify public companies that have similar characteristics to those of your company, and then look at the valuation metrics they have used. Public company comparables might be metrics such as a range of eight to nine times operating cash flow – or EBITDA – or two to four times revenue, or 15 to 20 times earnings. Then find the arguments that position your business at the higher end of those ranges. By so doing, you will make it easier for the business buying yours, or the financing sources funding you, to justify paying a higher price.

Similarly, do research on recent business sale or financing transactions of businesses similar to yours. Determine the valuation metrics and the range of those metrics. For example, maybe the companies all traded in a range of 6 to 7.5 times EBITDA and two to three times revenue. Then determine which characteristics of your company you believe should position you in the higher end of the valuation ranges. Again, you will make it easier for the business buying yours, or the financing sources funding you, to justify paying a higher price.

Finally, find an investment banker or skilled corporate financial analyst who knows how to model the historical and projected financial performance of your business using models typically employed by professionals in the field. Although these modeling exercises are very precise mathematically, all use a series of assumptions that encompass ranges – such as the proper discount rate, or the proper exit valuation. Again, make the case to position your business in the higher end of the range and find the buyer most likely and willing to accept your relative valuation arguments.

Business valuation is an art, not a science. As in most arts, beauty is in the eye of the beholder!

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