BOCKUS CONSULTING
BUSINESS BROKERAGE

HOW MUCH IS MY BUSINESS WORTH?

By Hank Bockus | August 23, 2021

If you wonder, “How much is my business worth?” or “What is the actual value of my business?” We will help provide some guidelines for how companies are valued.

We provide business valuation to the companies we help sell. Our years of experience selling businesses for their optimal value have allowed us to develop various information and industry indicators we use to value businesses. More information can be found on our website under the Services section.

If you consider buying a business, this article will also provide information on how companies are valued. Knowing how businesses are valued can help guide the process of selling or buying a business.

There are a lot of factors that go into valuations. We outline some of the criteria that can affect the valuation of a company. We do not provide a business valuation calculator because we find these overlook many business valuation factors. We do not use blanket industry rules to determine valuation multiples. There may not be a perfect business valuation formula, but the characteristics and methods below are all things you should consider when valuing a business.

HOW MUCH CAN YOU SELL YOUR BUSINESS FOR?

If you are looking to sell your business, it’s crucial to get a business valuation. Getting a business valuation helps to market your business effectively. Contact us to sell your business and get a business valuation. When we take your business on as a client, we utilize our business valuation methods to determine your business’s worth so we can effectively sell it.

NET INCOME AS A FACTOR IN A BUSINESS VALUATION

Your Company's financial health will play a significant role in the value of your Company. It will also be an essential factor in potential buyers' decisions on what they will pay for a company.

There are different terms for income, such as Cash Flow, Net Income, EBITDA, Seller's Discretionary Earnings, and more. First, we'll discuss Annual Cash Flow. This is essentially what the owner makes from the business, including their salary, perks, benefits, and net income. There may also be additions to this, such as one-time expenses. For example, if there was a flood and the business had to be cleaned up, this expense would typically be added into Cash Flow as a one-time expense incurred that a new owner would not expect to incur.

EBITDA (Earnings before interest, taxes, depreciation, and amortization) is similar to cash flow. Still, it subtracts what it would cost to pay a typical CEO in this industry to run the business. This may differ from the salary that the current owner makes. EBITDA is what the business would make for an investor after paying the average salary to a president who would run the Company.

Cash Flow and EBITDA are essential because what people are willing to pay is often based on a multiple of annual cash flow or EBITDA. These multiples can vary greatly depending on many factors. For example, if two companies' net incomes are both $500,000, one Company might sell for three times the annual cash flow ($1,500,000), and another might sell for five times the yearly cash flow ($2,500,000). Risk and multiples work opposite of each other. The less risky a business, the higher the multiple.

As soon as a business has a negative cash flow – the valuation reverts to the hard asset value; property, buildings, equipment, vehicles, and machinery.

We will explore some factors that can affect what type of multiple a buyer will use to determine what they will offer for a business and other factors other than Net Income buyers might use to determine a company's sale price.

YOUR INDUSTRY PLAYS A ROLE IN THE VALUE

The industry that a company is in certainly plays a part in multiples potential buyers' willingness to pay for a business. For example, a technology company will typically sell for a higher multiple than a construction company. Even within technology, a company that sells its proprietary software will usually sell for more than a company that sells IT Services or acts as a reseller of other companies' technology.

I wrote a recent article titled High-Risk NAICS Codes and How It Can Affect You. For more information here – please request this article.

Not to worry, though. There are still many factors that go into what someone will pay. The industry is just one of them. Depending on other factors, a profitable construction company might sell for a lot more than a software company.

HOW YOUR COMPANY'S SIZE IMPACTS VALUE

In general, the larger and more profitable a business is, the higher the multiple of price to earnings is. For example, a company with an annual net cash flow of $200,000 might sell for 2.5 times Cash flow

($500,000). Depending on the details, a company with a cash flow of $5 Million might sell for 7 X Cash flow ($35 Million). This is a prominent factor in determining the value of a business.

There are many more factors to your Company's size and the value of your business, but this illustrates the amount of the earnings also factoring into the multiple buyers will pay for a business. Valuing a business is part art and part science to combine all of the factors into a company's potential sale price. We'll continue with other factors that will go into it.

SYNERGIES IN SELLING TO STRATEGIC BUYERS

Getting a buyer or buyers who have good synergies with an acquiring company can be an excellent way to increase value in the sale of a company and lead to a higher price. There are a lot of different ways in which you can have a synergistic buyer. We'll outline synergistic possibilities from buyers in the same industry and buyers in various industries.

1. **Cost Reduction:** A buyer within the same industry can reduce costs by combining some of the overhead. Whether that overhead is the investment in underutilized equipment, space, or personnel, when underutilized assets are more fully utilized, there can be an increase in the combined profits by reducing costs without reducing revenue.
2. **More Services to Cross-Sell:** More common than cost reduction is synergies resulting in a profit increase through increased combined revenue. An example of this is where a civil engineering firm acquires a Land Surveyor firm. Now they can cross-sell their existing customer base to provide more services to each other's customers and increase the combined revenue. Also, they can win larger jobs where the bid involves both areas of expertise of the combined companies so that they don't need to use subcontractors and can better control the quality and costs of the project.
3. **Taking Full Advantage of each other's strengths:** An example of this would be acquiring a small software company that has developed great new technology but doesn't have a large sales force. This could be achieved by either an IT Services or Software Company with a large sales force and relationships with IT Departments at their customers, but perhaps their products have become dated over time. Combining these two firms would be able to sell the new technology more quickly and allow the more established firm a growth path that it wouldn't have otherwise.
4. **Investor's Contacts and Strategy:** Synergistic mergers don't necessarily need to combine two companies. In some cases, you can have a wealthy entrepreneur or private equity firm that can acquire a company in an industry where they have contacts that they can use to introduce an acquired firm and get them into some large customers that they wouldn't have access to. An experienced investor's knowledge of an industry may also lead to invaluable advice on how a company should grow profitably.

BUSINESS TRENDS IMPACT A BUSINESS'S VALUE

The trends in your business will affect the valuation of your Company. For example, is the revenue going up, down, or stable? They will also look at the trends in net income as well as the movements of the costs. On average, they will pay a higher multiple for a company trending up compared to one trending down. Ultimately business buyers are paying for future cash flow based on our experience.

Also, the net income and revenue might vary a lot from year to year. In this case, some potential buyers might average the last three or four years' net income to apply a multiple, or they may use a weighted average where more weight is given to the most recent financial results.

Buyers will try to assess a reasonable forecast for a company's future earnings based on its trends and other factors, such as the industry's overall trends and external factors.

CUSTOMER CONCENTRATION AFFECTS VALUATION

Another thing that positively affects value is having many different customers, with no one customer making up more than 10% of your revenue. For example, if two companies are both making a net income of $1 Million and Company A has 150 customers with no one customer making up 10% of their revenue and company B has ten customers with their top customer making up 40% of their revenue, typically Company A will sell for more than company B.

Company B can still be sold; however, in some cases, they will have to decide between a lower sale price and a higher sale price that includes an earn-out. An earn-out is a general term for a part of the sales price paid to be reliant on the future revenue and/or earnings. It is a way for the buyer to pay more and assume part of the risk if their largest customer doesn't continue with them. In many cases, the seller may stay on to ensure that the ownership transition is seamless and their large customers are retained.

RECURRING REVENUE INCREASES A BUSINESS'S VALUE

If a company has recurring revenue, this will typically make it more valuable. Recurring revenue can occur in many different industries. An example would be two Landscaping companies.

Company A mostly does new construction landscaping. When new developments are being built, they do the landscaping for these developments. Company B has long-term customers that they have ongoing relationships with and bill them every month.

Suppose their customer retention is high and both Company A and Company B make the same amount of net income. In that case, typically, company B will sell for more because they have recurring revenue with long-term customers that they have retained. This reduces the risk in a buyer's mind that the revenue will decline.

EMPLOYEE SKILLS AND RESPONSIBILITIES HELP DETERMINE YOUR BUSINESS'S VALUE

Potential Buyers will consider the skills and responsibilities of the employees when determining the value of the Company. Suppose the business is based on the owner's capabilities and has all of the relationships with the customers. In that case, this will be a more significant risk factor when the owner moves on, and typically, the owner will need to stay on for a more extended transition period.

A plus is if there is a management structure under the owner where employees report to the departmental managers instead of everyone reporting to the owner. If there are salespeople that handle customer relations and other essential roles in the Company, this is also a plus.

YOUR COMPANY REPUTATION CAN IMPACT YOUR BUSINESS'S VALUE

If the Company is well thought of in the industry, this, of course, is a plus. A minus will be if there is a pending lawsuit against the Company from customers or employees. It doesn't mean that the Company can't be sold, but it may mean that it will sell for a lower valuation. If the Company's online reviews are good, this will also be a plus and put buyers more at ease.

CONTRACTS AND AGREEMENTS ARE MAJOR FACTORS IN YOUR BUSINESS'S VALUATION

Favorable long-term contracts with customers and employees are a plus. The length of the lease will also be a factor. If there is a short lease, if a new buyer can get a good long-term rental, this would also mitigate the short lease if the location is essential to the business.

They will also look at any contracts with suppliers that may be favorable or unfavorable as the term of the contract progresses. Having exclusive supplier contracts is good. Another critical item will be if the warranties are transferable with or without consent. In some cases, the buyer may have to buy the corporate stock to ensure the transferability of the contracts.

BUSINESS ASSETS

The business assets on your balance sheet will be a factor in a business valuation. When they are planning to sell, a business owner may have a good idea of the value. Still, buyers will determine the replacement cost and utility of your assets when deciding how much they are worth.

FINANCIAL TRANSPARENCY CAN HELP SELL YOUR BUSINESS

This is helpful if the business's financial information and other information are clearly laid out and easy to understand. It is beneficial to identify the owner's salary, perks, and benefits so the buyers can understand what the owner is making.

Also, in discussion with the buyer, it helps to be open and honest about the business to give potential buyers an understanding of the opportunities and challenges they might face. This builds trust. No company is perfect, so it's best, to be honest in answering any questions. Also, any problems your business faces may be growth opportunities for a new owner.

CHEMISTRY BETWEEN BUYER & SELLER

There is no accounting for the chemistry between buyer and seller until they meet and get to know one another. A Seller that is easy to get along with and work with makes it easier for potential buyers to pay a premium price for a business. It helps to be open to different styles and personality types during a sales process. At the end of it, though, a seller has to be comfortable with a buyer as well.

GET A BUSINESS VALUATION

If you consider buying or selling a business, it helps to work with our experienced firm that knows similar comparable sales. We can provide a clear and effective business valuation to help sell your business or to help you understand the Company you are purchasing.

The price for a selling is not based on a "financial retirement need" but a weighted approach between Cost, Market and Income. All valuations are 3rd party verified.

BUY A BUSINESS THROUGH BOCKUS CONSULTING BUSINESS BROKERS

If you consider purchasing a business, please fill out our online buyer profile found on our website at bockusconsulting.com.

SELL A BUSINESS WITH BOCKUS CONSULTING BUSINESS BROKERS

Hopefully, this article has provided an overview of some of the factors in the valuation of a company. If you are considering selling your business, we offer a confidential consultation to give you more specific information related to your business. After reviewing your financial information, we can provide you with a recommended plan.

We have a large pool of potential buyers and will aggressively market your business while maintaining your confidentiality. Having a large number of potential buyers competing for your Company will get you the best price.

Bockus Consulting specializes in selling companies with annual net incomes of $250,000 to $17 million in various industries. We offer a free, confidential consultation to learn more about you and your Company.

You will only sell your business once – so hire the best.

Bockus Consulting – Business Brokerage is an Oklahoma-owned, non-franchised firm that successfully matches sellers to prescreened prospective buyers. To learn more about buying and selling businesses in Oklahoma, visit our website at bockconsulting.com.