BUSINESS VALUATION

Key Concepts

How are businesses valued?

This is one of the more commonly asked questions when somebody is looking to sell their business.

In this article we'll look at the basics which should hopefully answer your question, and it is focused on sectors such as engineering, manufacturing, packaging, fabrication, warehousing and general industry that are typical of the B2B sector.

The answer is that there are several ways to value a business, at least as far as the textbooks go, but in practice as far as the business owner is concerned, usually the answer revolves around a single basis of valuation.

The essential metrics you need to know that apply to the vast majority of private company sales are:

EBITDA – This stands for "Earnings before interest, tax, depreciation and amortisation" and adjusts your earnings to make comparison easier with other businesses and understand the pure trading aspects of your business. In practice non-business and discretionary items are also added back, such as charitable donations and money taken out by the directors as they have no impact on the business's ability to earn or profits.

Multiple – This is usually expressed as 3.5x or 5x and is the figure used to multiple the EBITDA and arrive at what a buyer would pay for business. The multiple may differ according to the business sector and the state of the market but it tends to be between 3 and 5 times EBITDA in the B2B sector but there are many factors that can reduce or increase it dramatically. These will become apparent during the sales process once prospective buyers appear.

Although the above is relatively straightforward let's look at other factors that could influence the value of your business: -

- Intellectual property rights such as trademarks or patents
- A very strong online presence as an expert in your industry
- The strength of long term contracts
- Adverse publicity
- Safety concerns surrounding your product
- Dependence on owners
- Political risk
- Fundamental changes in the marketplace
- Recent takeovers for public companies (used as a benchmark but subject to a discount)
- Sector consolidation

The above list is not exhaustive but is intended to give you an idea and get you thinking about your own industrial sector and more specifically your own business circumstances.

How such events and issues impact is impossible to gauge and depending on the strategic or tactical needs of a potential buyer the valuation could move substantially in your favour. Put two buyers in the room and things can become very interesting indeed.

One of the major differences between private companies and publicly listed ones is that in the former the sale of shares takes place rarely if ever, whereas in a publicly traded company there is a readily known value for the shares at any given moment.

Obviously if a private company had seen a movement of shares between shareholders, perhaps in a third-generation family owned business with a wider shareholder base, there is a starting point to refer to. However, even this needs to be taken with caution for the following reasons: -

- Was the seller a minority shareholder with little or no say in how the business was run?
- Was the sale a distressed sale?
- Was the buyer seeking to gain a majority stake?
- Was the seller an inheritor who had no interest in holding the shares?
- Did the shares carry voting rights?
- Did the shares carry different income or capital rights to other shares?

Some industries have a basis for valuation that are not in line with the norm and some buyers have their own preferred methods to put a figure on the worth of a business such as asset values or discounted cash flows.

The important take-away from this article is that nothing is cast in stone and while it is nice to dream of vast riches from selling your business, it pays to be realistic and understand that markets don't always behave the way you would like them to, nor do other businesspeople place the same value on your business that you do.