Valuing Your Business

The valuation of one's business is probably the main obstacle when it comes to negotiating a sale between a buyer and a seller. One is looking to sell at the highest possible price, while the other wants to buy at the lowest. So, how to evaluate a price that will be fair for both parties and representative of the fair value of the company? Despite the impossibility of finding a price that will be 100% accurate, we will nevertheless try to outline the main criteria and methods of evaluation to establish an adequate value for your business.

FACTORS INFLUENCING THE VALUE OF YOUR COMPANY

⏩ Financial

To determine a company's value, we start by looking at its finances. Most of the time, we look at the income statement and the net profit generated by the company to conclude whether it is profitable or not. This analysis is important, but we must not forget to look at the cash flow statement and the cash flow generated. Indeed, it is these that demonstrate if the company will be able to meet its financial obligations and avoid debt. The company can have a positive net profit, but if it is not able to generate liquidity, it will not be profitable. Therefore, the creation of wealth is based on the profits, however the funds generated by the company also come into play.

⏩ Assets and Liabilities

In addition, the asset market value must also be taken into account, as it may differ greatly from the book value. The equipment or fixed asset in question may be obsolete, in poor condition or only useful in the company's operations and not elsewhere. The asset may also be the backlog of orders already taken or prepaid expenses. It is also important to compare the total value of assets to liabilities to determine the company's level of debt. The higher the assets compared to the liabilities, the more likely the company is in a good financial position. We can also calculate the ratio of current assets to current liabilities to know if the company is able to meet its financial obligations during the next year. These points should be considered when evaluating your business to establish a representative portrait of your financial situation.

⏩ Intangible Assets

To continue, a company's intangible assets can have a significant impact on its value. This factor is very broad and can include many important aspects. For example, if the company has good relationships with its customers and suppliers and these relationships allow it to get contracts and better prices for its goods, it will be able to create wealth without even making a sale. Moreover, if it possesses intellectual property, patents, a strong reputation in its field, these are all aspects that can influence its value and must be taken into consideration.

⏩ Staff

Next, one must look at the company's human resources. The lack of manpower is an important problem nowadays; companies that can counter it are certainly in a stronger position as compared to others. Therefore, one can evaluate employee turnover, experience and qualifications, management achievements and any other involvement of the staff. These points can have a considerable impact when evaluating one's company.

⏩ External Factors

Finally, it is important to situate your company in the overall economic conditions as well as those favourable to your business sector. For example, is your country's economy going well? If you operate a restaurant, is the restaurant business doing well? These types of questions are important to ask yourself. Indeed, during an economic crisis, most industries can be affected and the value of all businesses will decrease accordingly, even if they are profitable. However, when an industry-specific event occurs, only the businesses in that industry may be affected. On the other hand, if economic conditions are favourable, a business may have a higher value. It is therefore important to know the market in which one is in order to establish a value that is consistent with it and not disproportionate.

BUSINESS VALUATION METHOD

⏩ Times-Revenue (Multiple des Revenue)

First, you can use the multiples of revenue method. Usually, you determine earnings before interest, taxes, depreciation and amortization (EBITDA) and multiply it by a factor. The multiple will depend on your business sector. Each sector can have a different multiple depending on its activities. However, this method is based on EBITDA only and does not take into account all the aspects mentioned above. We must therefore use it with caution. It may give an approximate value, but it should not be relied upon solely as an indicator.

⏩ Discounted cash flow value

Secondly, the discounted cash flow method is based on the future cash flows that the company projects. These are discounted using a required rate of return and a value can then be established in this way. The discount rate will depend on the industry and the requirements of the managers for their business. Once again, although these financial forecasts may be more realistic than EBITDA multiplied by a factor, they do not take into consideration the intangible elements that are related to the business. Judgment is therefore required with this valuation method as well.

⏩Valuation of assets

Finally, the third method of valuing a business is based on the valuation of its assets. We take the net book value of all its assets and we add them up. This method is probably the least effective of the three. Indeed, it can be useful for real estate companies or large stable companies, but otherwise it is better to use the other methods. A business may have a building or equipment with a significant value, but when the time comes to value the business itself, it is not necessarily worth that price because of its operations and revenue generated. Therefore, one must be careful with this method.

Conclusion

In conclusion, we can see that evaluating one's business is not an easy task. There are many aspects to consider, and among them, most are intangible or qualitative. This means that their impact is not visible when you only look at the financial statements of your company. Despite the many valuation methods that have been put in place, one must depend on these alone to establish the value of one's business. You must look deeper. For all these reasons, it is preferable to surround yourself with the right people to evaluate your business or simply leave it up to the professionals.

Keep in mind that SADC advisors will support you at every step of your business evaluation process. They will do their utmost to assist you and will refer you to any specialists that you may require.

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