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What's It Worth?
Understanding Your Company's Market Value

By David L. Walker

Selling a business without knowing its market value is like playing poker without looking at your cards—only a lifetime of hard work and sweat equity is at stake.

Picture this scenario: On the same day, the owners of two different private companies complete transactions to sell their respective companies to two separate buyers. The companies have similar products and services, serve similar markets, and have similar revenues and profitability. Yet one sells for $11 million while the other sells for $17.5 million. Why such a difference?

Despite surface similarities, there are probably hundreds of factors that increase or reduce these companies' respective values to a buyer. Understanding what makes a company more or less attractive to a buyer is important for any home builder or remodeler planning to sell his or her business.

However, it's good to know your company's true market value even if you aren't planning to sell your company anytime soon. The information comes in handy when you're seeking a loan from a bank, looking for investors, want to take on a partner, want to know how your company compares to the competition, or want to see if that new handyman or custom home division is adding value to your company.

Many business owners don't want to spend the time or money to learn their company's true value in the market. Some believe it's too difficult or they don't have the right skills or resources; others think they already have a pretty good idea of what their companies are worth—but they're usually wrong.

Find an Advisor

Determining market value requires extensive market research and financial analysis to reveal a company's future potential under new ownership. Since most business owners sell only one business in their lifetime, a professional, experienced mergers and acquisitions advisor can help by providing a valuation that gives an owner confidence when approaching and negotiating with prospective buyers—or talking to a lender.

If you do less than $1 million in volume, look for a business broker or an accountant who specializes in mergers and acquisitions. (You can find them by consulting the International Business Brokers Association's Web site at http://www.ibba.com/.) In addition, you'll want a good investment banker and an attorney who handles mergers and acquisition on your team. Your advisor can probably give you referrals to locate these professionals

Once you've located an advisor, broker, or accountant, don't expect him or her to do all the work. The key to obtaining a "full" valuation is to understand everything good and bad about your business, and to anticipate how this information will be received in the marketplace.

Study Your Financials

The process usually begins with recasting the business' financial statements; typically the past three years' balance sheets, income statements, and statements of cash flow. Recasting includes extracting information that lenders, investors, and potential buyers want to see, eliminating certain expenses and extraordinary items legally used by private, owner-managed companies to define tax benefits, and making other adjustments to conform to Generally Accepted Accounting Principles (GAAP).

These adjusted financial statements offer potential buyers a normalized view of the company's past performance; that is, they provide a basis for judging credibility by showing how the company operated in a given period.

Remember, however, that buyers buy the *future,* not the past. Adjusted historical financials help you build pro forma financials, which look five years into the future and are the foundation of market value. Pro forma financials require extensive market research to determine reasonable, supportable assumptions regarding revenue and profitability trends, growth rates, market dynamics, and other factors.

Study the Market

If it isn't economically feasible to hire a market research firm, do your own research by examining trends in the industry, studying your competition, and reading industry publications as well as general business-related periodicals.

Identifying and examining intangible assets is also integral to the valuation process. These are attributes like a loyal customer base, patents and licenses, supplier contracts, trade secrets, and many others that contribute value to the company but aren't necessarily represented in the financial statements.

Combining all of these elements—adjusted historical financials, reasonable pro forma financials, and intangible assets—reveals a company's future potential and establishes a valuation range that informed buyers will likely be willing to pay for the company.

Armed with a perceptive, comprehensive valuation of his or her business, an owner can then enhance the value by increasing sales and marketing efforts, investing in cutting-edge technology, divesting an under-performing division, or adjusting the capital structure. That in turn provides leverage at the negotiating table and increases the likelihood of receiving an attractive value for the company—or funding for future ventures—regardless of market conditions.

David L. Walker is president of RSM EquiCo's Professional Services Group, which conducts research and analysis for client companies to determine accurate valuation ranges. Based in Costa Mesa, CA, RSM EquiCo specializes in *mergers and acquisitions, divestitures, and corporate finance for private middle-market businesses and is part of RSM McGladrey Business Services, a business segment of H&R, Block Inc. For more information, visit the company's Web site at www.rsmequico.com/association or contact Gerry Gacek, senior vice president, at 888-900-0411.*

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