

# VALUING A BUSINESS

Our firm can provide expertise advice on the value of your business. We have listed below some approaches that we are likely to use. The approach we use is dependent on your circumstances.

There are many methods for valuing business, due to

(1) The unique nature of each business, and

(2) The purpose of the valuation. Here is a rundown of the most common approaches to value:

**Market Comparison Approach** - Compares the market value of the subject business with that of similar businesses. While this may seem similar to the market data approach used in real estate valuation, the business valuation process is much more difficult since there is no common yardstick for measurement, such as dollars per apartment unit or dollars per square foot of retail office building, shopping center, or warehouse space. Instead, you only have the equity (net worth) of the businesses, and the concomitant problems of variations in levels of equity, relative size of the businesses, location and market differences, and other unique features of each business that require prudent adjustments in order to result in meaningful value numbers.

**Replacement Value Approach** - Measures value by determining what it would cost to replace the assets and business processes used by the business today. Differs from the Market Comparison Approach in that this approach deals with acquiring the parts that make up the whole business rather than looking at prices for the entire business, as does the Market Comparison. Often used in settling insurance claims.

**Future Net Operating Income Approach** - Uses the present value of reasonable future net operating income. Useful for a prospective purchaser whose chief interest is the business's future net income. Due to the speculative nature of this approach, great attention must be given to the bases for the projections of future revenues and expenses. Likewise, the rate at which those future earnings are discounted to a present value must be sound. **Historical Net Operating Income Approach** - Takes the actual net income figures for the last few years and capitalizes them into a value figure. Any factor that cause any year to have higher or lower than typical earnings must be considered and adjusted.

**Going-Concern Value** - Basically the value of a company as an operating entity. Often used in conjunction with other approaches in order to determine a residual goodwill amount (i.e., organizational value).

**Liquidation Approach** - The reasonable prices for the various assets that make up the business are calculated and totaled. Assumes that the entity is ceasing to carry on business and is selling its parts in the most advantageous manner. Often applied to businesses that have a strong underlying asset value but a poor earnings performance record.

**Formula Approach** - Earnings, dividends, and book value - are considered in this approach and weighted in accordance to their appropriateness to the particular company under consideration and their importance to the acquirer.

**Capitalization of Dividends Approach** - Looks upon an acquisition more as an acquisition of an investment security that will be held indefinitely. While it is a unique and limited approach, it is

appropriate for some circumstances, and can be used as an indicator of value for consideration in some difficult evaluation cases.

**Debt-Free Approach** - Permits an analysis of the company's operations without consideration to the present debt structure. Allows a prospective purchaser who might acquire the business and pay off the existing debt to see what the business might be worth under those circumstances.

**Reconstructed Capital Structure Approach** - Similarly to the Debt-Free Approach, this methodology allows a prospective purchaser to see what a company would be worth with different capital and debt structures.

**Capitalization of Future Cash Flow Approach** - When there are large non-cash deductions from income and when the owner or acquirer is more interested in long-term growth of their investment, this approach might be more meaningful than the capitalization of past or anticipated net income.

**Capitalization of Historical Cash Flow Approach** - Actual cash flows over the most recent years are capitalized. Assumes that the business will continue to operate in the future as it has in the past.

**Adjusted Book Value Approach** - Starts with the company's most recent financial statement. Then the values of the assets and liabilities are adjusted to reflect current values rather than historical values that may be inaccurate from a market value standpoint due to depreciation deductions, collectibility, payment terms, etc.

**Tax Value Approach** - In valuing a business's taxable real and personal properties for ad valorem tax purposes, it is typical to rely more heavily upon the assessed values of other similar properties than you would otherwise consider. Real estate is part of a business, but generally is not valued separately - except in special circumstances such as where a business, but generally is not valued separately - except in special circumstances such as where a business has excess real estate that has a significant market value and is capable of being sold separately without negatively impacting the remaining operations of the business.