

A high-angle, slightly blurred photograph of three business professionals (two men and one woman) in a meeting. They are gathered around a table, looking at documents and a laptop. The image is semi-transparent, allowing the text to be overlaid.

# How to Accurately Value a Business

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David Nilssen

Founder, Guidant Financial Group

- 2007 SBA Young Entrepreneur of the Year
- 2007 Top 40 Entrepreneurs Under 40, Biz Journals
- 2008 & 2009 Ernst and Young Entrepreneur of the Year, Finalist



# Presenting

Richard Parker

Founder



[www.Diomo.com](http://www.Diomo.com)

- Author
- Broker
- Entrepreneur
- 20 years of Industry Experience



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# An Overview of Valuations



- Valuation is an art – not a science
- Businesses are living entities – generic assumptions cannot be made
- A business is not a property
- Target: 25% to 33% return on cash investment
- Price vs. value



# Asking Price vs. Value

- Most businesses are overpriced the day they are listed
- Sellers tie too much emotion to the business
- What a seller thinks it is worth, is not the value
- Business broker legacy mentality of “letting the market decide and then adjust” causes problems



# Assets vs. Profitability



- Assets are strictly a means to generate revenue
- They play a role in obtaining financing NOT valuing
- Most small businesses are “asset poor”
- Past and future profitability holds the value
- A money-losing asset rich business versus a no tangible profitable one – which is worth more?
- “Asset-buyers” never complete a deal
- Accountants look at the wrong statements



# Buying an Income Stream

- General objective is to replace or generate an income
- Need ample profit to pay yourself, service any debt, and invest to grow the business
- The more sustainable and scalable the profit - the greater the value



# Different Valuation Methods



- Rule of Thumb
- Asset Method
- Income Method
- Income Capitalization
- Owner Benefits Multiple Method



# General Objectives and Strategy



- Recommend using several to get a range
- Big business assumptions do not translate
- What method did the seller use? You may be surprised!



# Rule of Thumb

- Takes commonalities between like businesses and establishes generic rules and ratios
- Basis used often do not make sense nor can they be homogenous between two businesses
- Grossly overused & inappropriate basis
- Revenues must NEVER be the basis for a valuation



# Asset Method

- Inventory + 1 Year OB + Equipment + L/H = Value
- Doesn't give any weight to realistic profitability (i.e. which "1 Year OB" to use?)
- Lenders may use this as a litmus test
- Why your accountant may also use it



# Income Method

- OB - Manager salary/Cap Rate (25%) = Value
- Concept to weigh against other investment opportunities (i.e. hiring manager to run it)
- Good approach as a part of the exercise but you buy a business to run and grow



# Income Capitalization

- Present value of future earnings/cash flows
- Discounts future earnings or capitalized earnings
- MBAs like the exercise
- Classroom theory but this is the real world!



# Owner Benefit Multiple Method

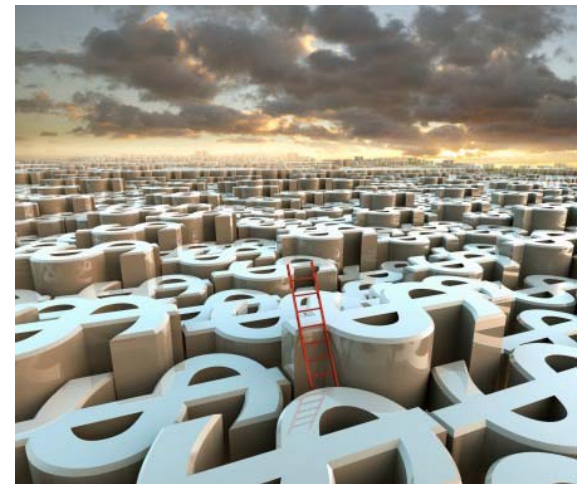


- “Owner Benefits” =  
PT Profit + Owner Salary/Perks +  
Interest + Depreciation - CapEx  
Allocation
- Why add back depreciation and interest?
- Why the CapEx reduction?



# What Multiple?

- Considerations to the financial history, competition, outlook, deal terms, employees, systems, condition of assets, customer concentration, threats, etc.
- As OB increases so does the multiple
- Industry impact on valuations – more than just supply and demand



# Historical Data – Isn't it History?



- Recent past is best indication of immediate future
- 12-month trailing statements are crucial
- Eliminates buyers hallucinations of growth areas – deals with reality
- Verifiable data is better than a crystal ball



# Sustainability or Growth or Both



- Need time to learn the business first before implementing new initiatives
- Are fundamentals in place to ensure status quo or only a marginal decline after takeover?
- Is it scalable – be realistic!
- Price to be paid for stability
- If low risk for decline; than a low chance for growth



# Common Issues and Challenges



- You need data to compile a valuation
- Useless to just make offers and then adjust the valuation
- Unreported income
- Concentration issues
- Is the seller “the business”?



# Industry Specific Issues



- Inventory
- Licensing
- Environmental
- Looming legislation
- Regardless of ingredients  
the recipe has to work



# Other Considerations



- Deal terms more important than price
- It's YOUR offer
- Insulting the seller
- Rationale trumps emotion
- It's okay to overpay.... sometimes  
– be flexible



# Thank you for Attending



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## Next Webinar

Investigate Small Business Financing Options

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March 3<sup>rd</sup> @ 10a PST

