Strategic Advisors, LLC
PO Box 41200 | Greensboro, NC 27404
(336) 854-9006 | strategicadvisorsnc.com

STRATEGIC
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BUSINESS VALUATION METHODOLOGIES

Accurately valuing a small (under $5,000,000 in sales) or lower mid-size ($5,000,000 to 50,000,000 in sales) business can be extremely challenging to both a buyer and a seller. Above all, everyone should realize that valuing a business is an art, and not a science.

There are several ways to calculate the value of a business: For the purpose of business and transition issues. The most common methodologies are:

- **ASSET VALUATION:** Calculate the value of all of the assets of a business and arrive at the appropriate price.

- **COMPARABLE SALES:** The selling prices of other "like" businesses are determined. Typically, this is for smaller businesses and involves a multiple of cash flows or percentages of revenue.

- **CAPITALIZATION OF EARNINGS:** This approach depicts how an investor would value the business based upon an expected and / or required "Rate of Return".

- **PROFIT, EBIT, EBITDA, AND SDE MUTIPLE:** This is the most frequently used approach for small to mid-size businesses. A buyer will want to know (and project) how much he/she can make from businesses and this methodology provides the answer to that question.

The one common denominator of all these methodologies is the determination and identification of "Risk Factors" that are specific to each business. If these “Risk Factors” are identified and mitigated, the valuation is higher. If the “Risk Factors” are not mitigated or eliminated, the valuation is lower. In many situations, the elimination or mitigation of “Risk Factors” takes months if not years to complete.

In addition to these methodologies, a business seller will want to be familiar with the type of potential buyers in the market place, and how these buyers affect the valuation. These valuation types are.

- **FAIR MARKET VALUE:** These values are most commonly used in an Internal Transfer where the business is sold or gifted to family members, sold to management, or sold to an ESOP.

- **INVESTOR VALUE:** This valuation anticipates that an investor will buy and operate the business with intent of building equity.

- **STRATEGIC OR SYNERGISTIC VALUE:** This valuation anticipates that a strategic buyer will acquire the business, and use the acquired company’s capabilities or unique niche to drive synergies throughout their entire organization. Strategic Buyers might be Public Companies, Private Equity Groups implementing an add-on strategy, or a Private Equity Group acquiring a platform for growing similar businesses.

Prepared By: Bob Biggerstaff
Strategic Advisors, Inc