

# Buying or selling a business: finding true market value

Understanding the factors that determine the value of any business will pay tangible dividends whether you intend to sell or buy a business.

If selling, the objective will be to increase your business's short- and long-term profitability, and positioning to receive the highest price.

Similarly, if considering the purchase of a business, such knowledge will ensure that the value of the business is truly understood. A business valuation can be defined as "a process, and a set of procedures used to estimate the economic value of an owner's interest in a business."

A meaningful evaluation therefore needs to be based on a set of procedures and through a valuation process that reflects the economic value of an owner's interest in the business. Factors such as owner experience in the industry, current market conditions and future growth and opportunity should also be considered.

So, a meaningful valuation is not derived through simple multiples.

Multiples almost never reflect the true value of a specific company, but rather reflect an often assumed median or average for a specific industry.

To help demystify the valuation process, I first want to identify a few myths about valuing private business so that you can avoid the pitfalls these myths present.

## Myth busters

### Valuing a private business



By ARTHUR KLEIN

**should only be done when it is ready to be sold.**

When preparing to sell a home, the first thing owners typically do is fix up the landscaping, add a coat of fresh paint and make necessary repairs. Likewise, when you are getting ready to sell a business, you will want to make the necessary investments (financial, management, systems and procedures, etc.) to improve the performance and appearance of your track record in order to maximize the value you receive for all you have invested over the years.

Knowing the value of your business will assist in determining the relationship between an owner's expected value, and a market or buyer value, and afford the ability to properly plan for growth and maximum value.

Ideally, you will start this process at least two to three years in advance so that you can disclose a solid set of financials,

but you also need to tidy up your balance sheet, which could mean moving around certain assets or removing bad debt.

If a business is to have a life beyond that of its current owner, then realistic knowledge of value and effective planning for ownership transition requires a regular valuation of your business.

**Businesses in my industry sell for X times annual revenue or X times earnings so why get a business valuation?**

The short answer is that these are simply erroneous numbers, reflective of industry or transaction medians without consideration of the subject company's specific performance, efficiency and many other valuation factors. What happened last year is not really relevant to what something is worth today.

What your business is worth now is largely dependent on various factors including:

- How much does the business generate today?
- How much cash can the business generate in the future?
- How predictable and sustainable are those cash flow earnings?
- What is a buyer's required return on investment in your business, based on relevant risk and time factors?

Additionally, consider the many value drivers that apply:

- Historical profits
- Income risk

- Business growth
- Competition
- Location of the facility
- Marketability

The value of a business is its fair market value.

The **International Business Brokers Association** defines fair market value as that price paid for a business by a willing buyer to a willing seller when each is fully informed and neither is under pressure to act.

The value of your business however, may or may not be reflected in the transacting price.

So price and value are not necessarily congruent, since value is perceived and driven by assumptions and perception, while price is a reality, driven by the market and compulsion.

Though we often ask, "if a business is not making money then what are we selling?", it can also be stated that another myth could be "the business financials show it losing money so it is not worth much."

*There are many value drivers that you should consider beyond just numbers when valuing a business*



## True earnings

Many private businesses appear to lose money. Appearances, however, are often misleading.

The separation between ownership and management does not really exist in a private business. Often owners, upon directing their accountants, may reflect various levels of discretion over how much money the enterprise is generating, since the more they show, the more taxes they will need to pay.

So recasting or normalizing the financials to reflect the true earnings of a business is a critical activity to accurately reflect the value of a business for purchase or sale purposes.

There are many value drivers that you should consider beyond just numbers when valuing a business for purchase or sale.

By understanding the basics, you can successfully plan your financial future by understanding the value of your most important asset: the business. ■

*Arthur Klein is a business broker with Vancouver-based Pacific Business Brokers Inc. As an experienced intermediary, Klein endeavours to assist buyers and sellers in the process to value and transact privately held enterprises. Klein can be reached at 604-696-6111, or through www.pacific-businessbrokers.com.*

Knowing how to evaluate a business the key to a successful transaction



**Join Canada's Fastest Growing Candy Retailer**

- Nostalgic, Old-Fashioned
- 17 Stores Open, 18<sup>th</sup> in Feb !!
- Turnkey Franchises \$165K
- New Franchises \$125K
- B.C. Territories Available

**3,000 unique products**  
**100 Soda Pops**  
**16 Ice Cream Flavours**

**Franchises Available in Victoria, Comox Valley, Nanaimo, Burnaby, Downtown Vancouver & Richmond**

Michael Anderson  
604.374.1171

michael@stickyscandy.ca  
www.stickyscandy.ca



**NAI Commercial**  
BUSINESS ADVISORY PRACTICE

**RESORT, MARINA & LAND (COMOX) NEW LISTING \$21,200,000**  
28.3 ac resort with RV campground, 20 cottages and 140 moorage slip marina. 73.6 ac of development land with residential zoning.

**BC INTERIORS RESORT LODGE.....\$10,900,000**  
Strong cash flow. 8% cap rate.

**OUTDOOR GEAR RETAILER (AB) NEW LISTING \$1,000,000 inc wc**  
Well established franchise. Low royalty fees. Approx \$2m revenue.

**FLOOR COVERING RETAILER NEW LISTING.....\$790,000 inc wc**  
Successful franchise business located in Northern BC. Suitable for BC PNP.

**CNC MACHINE SHOP (Lower Mainland).....\$890,000 inc equip**  
CNC and manual machining. Revenue \$1.5 m.

**SENIOR CARE SERVICE PROVIDER NEW LISTING.....\$495,000**  
Located in the Okanagan this franchise provides non medical in-home services to seniors. 5 yrs of continuous growth. SDE approx \$200K.

**MENCHIES FROZEN YOGURT NEW LISTING .....\$350,000**  
Great opportunity for an owner opportunity to join North America's fastest growing food franchise. Located in Fraser Valley.

**AUTO REPAIR BUSINESS (L. Mainland) REDUCED.....\$245,000**  
More than 20 yrs in business. Loyal customer base.

**RESTAURANT & NIGHTCLUB (Kootenays) .....\$389,000**  
Awarding winning business suitable for BCPNP.

**U-BREWING BUSINESS (Fraser Valley) REDUCED.....\$125,000**  
Customers have been making quality wine & beer here for over 20 yrs.

**ALF SANDERSON or DELON CHEUNG**

604 691 6646

604 691 6654

**BUSINESS FOR SALE**

604 683 7535

www.naibusinesses.ca

**SCRAP METAL RECYCLER**

(Thompson/Okanagan)

- Same location for 32 years
- \$1.45 mil sales (4-yr average)
- New 25 year lease
- Price includes approx. \$798,000 Equipment, Machinery & Inventory..... \$698,000

**DOLLAR STORE FRANCHISE**

(Abbotsford/Mission)

Established in 1999. Excellent exposure in a large mall.  
\$1.4 mil annual sales.....**NEW PRICE: \$159,000 + Inventory**

**TED STELLAKIS**

604 691 6692 stellakis@naicommercial.ca



**MERGERS & ACQUISITIONS TEAM**

Do you have a profitable business?

Are you considering disposition or succession of your business within the next five years?

Our experienced, licensed professionals are available to review your business to help formulate the ideal strategy for succession, valuation and disposition.

**Call today to speak to one of our mergers and acquisitions specialists!**