

## Memorandum

To: Clients, Friends, Family & Associates of ProActive Advisory  
From: Mark Wyssbrod, Managing Member  
Date: February 25, 2015  
Re: How do I value my business?

In this memorandum you will receive information about the following:

- How do I value my business?
- How do I make my business worth more?

Please contact me should you have any questions. Keep adding value!

### How do I value my business?

Small businesses are recovering from what I consider their Depression. Owners are once again inquiring directly and indirectly about what their business is worth. Ten years ago most business owners overvalued their business (it's worth millions!); during the Great Recession, Small Business Depression, they undervalued their business (it's worth nothing; who would buy this?!). The true value is somewhere in the middle.

Some small business owners need a valuation in order to sell their business; others need it for estate planning or gifting purposes. We will focus on how a buyer might value a business in which there are at least a dozen ways; valuations can also depend on the type of industry. I have selected a two very generic ways:

- Owners discretionary cash flow
  - What is the owner actually receiving from the business?
    - Compensation\wages
    - Mileage reimbursement
    - Employee benefits
    - Meals and entertainment
    - Cell phone
    - Travel for owners meetings
    - Other items the owner benefited from
  - A potential purchaser will add these items to the profit (loss) of the business to calculate what the owner is benefiting from
    - Other items a buyer may consider adding are fixed assets and inventory
    - They will evaluate if they can financial the purchase price (make the debt payments) and still be able to make a living

- A bank will not finance the loan if the historical financial information does not support the loan payment and compensation of the potential buyer
- Multiple of forward earnings
  - Calculate current and/or forward EBITDA
    - Earnings Before Income Taxes, Depreciation and Amortization
    - Based on the current year projected earnings
      - Don't get too excited about making an aggressive or unrealistic forecast as there are adjustments to the purchase price if the earnings are not met
  - Some calculations add back owners compensation, employee benefits and mileage
    - If the future owner is purchasing a "job" they may add these items
    - If the future owner is investing in a company they may not add these items
      - As they will need someone in the current owners position to manage the company
  - The multiple can be 1 up to 8 is the highest I have seen

### How do I make my business worth more?

What can you do to make your business look more valuable to a potential purchaser? More than half the time I review a purchase document I can't do a calculation to find: purchase price less income taxes equals debt on books. This means they want you to purchase their debt. This is most likely a poor investment for you and you will not be able to earn any money as an employee since all of the purchaser's cash flow will be used to reduce debt; i.e. you are paying for their mistake. To avoid this in your business, keep after-tax profits in the business in order to build financial strength:

- Working capital
  - Have sufficient working capital (current assets less current liabilities)
    - Working capital needs to be a positive #
- Liquidity
  - Have enough liquidity (current assets / current liabilities)
    - Most small businesses need \$2 of current assets for every \$1 of current liabilities to be deemed healthy
- Debts
  - Reduce debts over time to be able to increase owners discretionary cash flow
- Equity
  - Have positive equity in the business
  - The lower the debt-to-equity ratio (debt/equity) the better!
    - Try to have this ratio equal to 1 or, preferably, less than 1

## Conclusion

Restructuring your business will take time, effort and resources. The time to reposition your business and increase its financial strength as well as valuation is now! Please contact me should you have any questions.

Keep focuses and keep on adding value!