



How Much Is Your Business Worth?

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Why Do People Go Into Business?

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Why Do People Go Into Business?

- Create Current
Cash Flow
- Create Future **Value**

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Reasons For A Business Valuation

- Mergers & Acquisitions
- Sale of Stock (Private Company)
- Gifting of Stock
- Buy/Sell Agreements
- Fairness Opinions

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Reasons For A Business Valuation

- Litigation
 - Partner disputes
 - Divorce
 - Bankruptcy
- ESOP
- Business in Estate

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Who Are The Business Owners?

- 31% over age 55
- 60% over age 45
- In the next 5 to 10 years there will be a huge transfer of business ownership

SOURCE: US Census Bureau

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Steps to Valuing A Business

- Gather Information
 - Financial Statements / Tax Returns
 - Balance Sheet & Income Statements
 - Last 3 to 5 years

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Steps to Valuing A Business

- Gather Information
 - Forecasts
 - Next 3 to 5 years
 - Why was the forecast created?
 - How accurate have they been on past forecasts?
 - Growth Company – future cash issues?

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Steps to Valuing A Business

- Gather Information
 - Intangibles
 - Patents / Technology
 - Management knowledge / experience
 - Location
 - Brand

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Steps to Valuing A Business

- Gather Information
 - Intangibles
 - Customer lists
 - Workforce – Knowledge / Experience
 - Recipes
 - Goodwill (Personal????)

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Steps to Valuing A Business

- Gather Information
 - SWOT Analysis
 - Strengths
 - Weaknesses
 - Opportunities
 - Threats

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Steps to Valuing A Business

- Site Visit
 - Interview key personnel
 - Observations
 - Neat & Orderly or
 - Disorganized & Messy
 - Processes
 - Data recording

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Steps to Valuing A Business

- Compare this Business to Others of Same Size and Industry
 - Ratios
 - Growth

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Steps to Valuing A Business

- Normalize Financials
 - Add back non-cash expenses
 - depreciation / amortization
 - Adjust for fixed asset purchases

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Steps to Valuing A Business

- Normalize Financials
 - Owner Expenses
 - Salaries
 - Meals & Entertainment
 - Travel
 - Auto

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Steps to Valuing A Business

- Gather Information
 - Ownership breakdown
 - Lawsuits
 - Business Evolution

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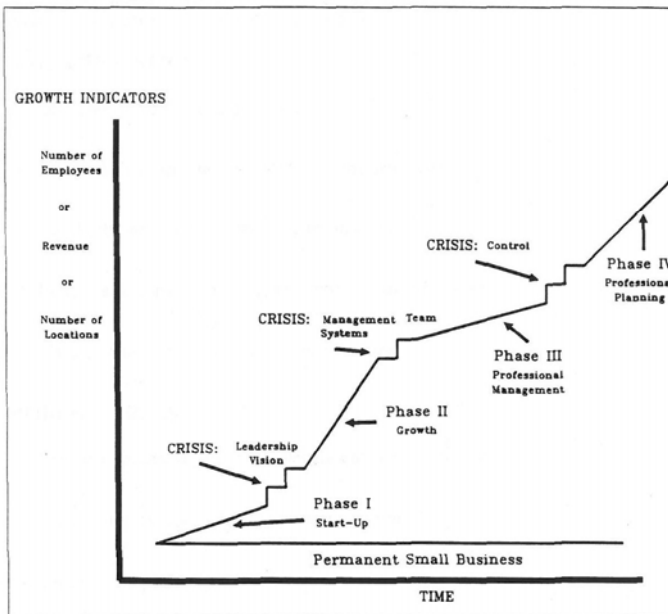
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Where Are You In The Evolution Of Your Business?

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Permanent Small Business

Businesses that will always be considered a small business.

Characteristics:

- Operated in effect as a proprietorship
- Owner is task-oriented (vs. management oriented)
- Rarely the need for formal systems and procedures
- Few, if any, long-term employees other than the owner

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Permanent Small Business

Characteristics (continued)

- Usually retail, service, or brokerage business

Problem Areas:

- Business success and survival dependent on one person
- Financial data not understood when available
- Little or no planning

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Permanent Small Business

Crisis:

Continuity

- The business cannot perpetuate itself beyond the founders

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Phase I – Start-Up Phase

Characteristics:

- Founder(s) often still there and running the business
- Founder(s) are technical or entrepreneurial; they dislike management functions
- Emphasis is on creativity producing products or services and selling them
- Minimal emphasis on management, systems, planning, etc.

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Phase I – Start-Up Phase

Characteristics (continued)

- Organization and communication informal
- Long work hours – modest salaries
- Management reacts mostly to customers rather than employees
- Growth greater than inflation but moderate

Problem Areas:

- Market is not clearly understood or inherently limited
- Conflicts between new and old workers

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Phase I – Start-Up Phase

Problem Areas (continued)

- New employees not motivated by dedication
- Poor accounting and cash control
- Working capital shortages
- If multiple founders, conflict about who is in charge
- Temptation to diversify into unrelated businesses

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Phase I – Start-Up Phase

Crisis:

Leadership/Vision

- The business does not have a leader with a clear vision of a growth-oriented product or service

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Phase II – Growth Phase

Characteristics:

- Faster growth experienced
- Often multiple locations such as sales branches or warehouses
- More attention given to areas other than producing and selling
 - Marketing
 - Personnel
 - Accounting, budgeting, and finance

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Phase II – Growth Phase

Characteristics (continued)

- Employee duties become more specialized and formally defined
- Business becomes more impersonal

Problem Areas:

- Direction becomes cumbersome. Founder/Leader has difficulty organizing, planning, motivating and delegating
- Access to leader becomes difficult

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Phase II – Growth Phase

Problem Areas (continued)

- Mgrs. are technically oriented and not accustomed to making their own decisions
- Financial and information systems lag behind growth
- Some key employees grow disenchanted and leave
- Profits sacrificed to fund growth
- Temptation to diversify into unrelated businesses

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Phase II – Growth Phase

Crisis:

Management Team

- The business lacks a cohesive management team

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Phase III – Professional Management

Characteristics:

- Organization begins to decentralize by:
 - Function
 - Product or service
 - Geographic location
- Management by exception
- Managers do more managing than technical work

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Phase III – Professional Management

Characteristics (continued)

- Profit centers established
- Growth rate is moderate – usually slower than Phase II

Problem Areas:

- Coordination becomes difficult and insufficient
- Sr. Mgmt. has less contact with day-to-day operations and feels they are losing control

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Phase III – Professional Management

Problem Areas (continued)

- Increased vulnerability to outside factors such as govt., unions and competition
- Increased vulnerability to office politics, corporate culture and bureaucracy
- New business opportunities are continually identified but decisions are cumbersome
- Systems not adequate to handle larger organization

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Phase III – Professional Management

Crisis:

Control

- The business lacks the proper systems to stay in control

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Phase IV – Professional Planning Phase

Characteristics:

- Business has a well-defined mission and long-range strategy
- Formal business planning procedures are in place
- Line and staff balance is achieved
- Employees have a strong identification with the business
- Operations are decentralized

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Phase IV – Professional Planning Phase

Characteristics (continued)

- Support functions are centralized
- Managerial accountability is strongly emphasized
- Growth rate is usually faster than in Phase III

Problem Areas:

- Conflict evolves between line and staff
- Systems and procedures become cumbersome and time consuming, producing a bureaucracy

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Phase IV – Professional Planning Phase

Problem Areas (continued)

- Innovation is inhibited
- Entrepreneurial-oriented employees grow disenchanted and leave
- Attempts made to balance business cycle through major diversification
- Different leadership styles are needed depending on economic, business and industry trends

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Phase IV – Professional Planning Phase

Crisis:

Bureaucracy

- The business becomes entangled in red tape

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Why Is Understanding the Phase Your Business Is In Important To Its Value?

It can help you to identify factors contributing to increased and decreased value of your business!

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How Is A Business Valued?

An appraiser will analyze the business from three approaches using various methods:

- Asset Approach
- Market Approach
- Income Approach

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How Is A Business Valued?

Asset Approach:

- Essentially the fair market value of all the company assets reduced for all it's debts
- Often the liquidation value
- Some exceptions – particularly if the company has intangible assets

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How Is A Business Valued?

Market Approach:

- What have companies in similar industries, similar size and/or similar sales sold for recently?
- Uses ratios or “multiples”
- Information from various data bases
- Public companies are used too – but their size makes comparison difficult

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How Is A Business Valued?

Income Approach:

- Investors buy into companies based on their expectations of returns vs. risk
- Cash flows (potential dividends) projected using historical data (usually established companies) or future forecasts (usually startup companies)

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How Is A Business Valued?

Some approaches will not produce a result

- Company may be specialized and finding comparable companies may be difficult
- Company may have had recent losses, so an income approach using historical data may not provide a value

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How Is A Business Valued?

Appraisers makes judgments on the resulting data using their knowledge and experience:

- Weighting of approaches
- Reconciling differences – why are the values different?
- What is going on with the industry?

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How Is A Business Valued?

As one would expect, the effects of the national economy over the last few years has wrecked havoc with valuations and created greater difficulties and challenges for both appraisers and investors.



How Is A Business Valued?

Valuing businesses has always been an art and a science. The introduction of new data bases and models are always moving appraisals closer to a science.

However, since there is no one correct value, there will always be some subjectivity involved.



What Is Your Business Worth?

Personal Goodwill:

Often a business loses value because the owner is such an intricate part of the business that separating him/her from it will be detrimental to its performance, and as a result, its value.

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What Is Your Business Worth?

Using An Income Approach:

- 1) Determine the cash flows of your business:
 - Starting with net income, add back non-cash expenses such as depreciation
 - Determine if there are overly high owner salaries and/or expenses and adjust

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What Is Your Business Worth?

- 2) Determine the capitalization rate (expected rate of return an investor would expect based for your business)
 - Large profitable public company: 8 to 13%
 - Other profitable public company: 12 to 17%
 - Unprofitable public company: 15%+

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What Is Your Business Worth?

- Healthy private company: 11 to 19%
- Typical private company: 17 to 27%
- Start-up (VC-type investment): 35 to 60%
- Really risky company: the sky's the limit!

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What Is Your Business Worth?

- 3) Divide the cash flows by the capitalization rate:

Annual cash flows - \$100,000

Capitalization rate – 20%

$$\$100,000 / .20 = \$500,000 \text{ value}$$

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What Is Your Business Worth?

- 4) Is this a controlling (50% or more) or non-controlling interest?

Income Approach calculates a minority interest

- Controlling – take value and multiply by 10 to 50% (average is 35%) - premium

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What Is Your Business Worth?

- Controlling –
 $\$500,000 \times 1.35 = \mathbf{\$675,000}$
- Non-controlling – **\\$500,000**

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What Is Your Business Worth?

- 5) Take value from #4 and multiply by Marketability/Liquidity Discount (typically 30 to 45 percent – average is 35%)

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What Is Your Business Worth?

- Controlling –
 $\$675,000 \times (1 - .35 = .65) =$
\$438,750
- Non-controlling –
 $\$500,000 \times (1 - .35 = .65) =$
\$325,000

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Importance of Knowing the Value of Your Business

- Exit Planning should begin with a Business Valuation
 - If your plan assumes the business is worth \$1,000,000, but it is actually only worth \$500,000, it's better to know now than when you are ready to exit
 - Ideally, an exit plan should be made and started at least 5 years before you plan to do so
 - If you need to increase the value of your business, starting early gives you time to do so

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What Is Your Business Worth?

Disclaimer:

The examples shown in this presentation are to provide the viewers with some very general guidelines as to how a business is valued. It is not meant to be used to determine the actual value of a specific business or what a buyer would pay for it

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