

Did You Just Ask Me What It's Worth?

By Patricia K. Fisher, M. A., CCC/SLP

At the OSLHA convention in March 2010, I was asked three times about determining the value of a business. It's a fact - small business owners will eventually need to calculate the worth of their business. It could be for the purpose of sale, loan application, estate planning, net worth calculation or a multitude of other reasons.

Valuation is also necessary to purchase a business. Valuation techniques range from simple "rule of thumb" methods to more complex ratios that include asset valuation and industry average valuations.

Rule of Thumb Valuation is a method that uses a multiplier to determine the worth of a business (considering cash flow and profitability). The multiplier is "Earnings Before Interest and Taxes," or EBIT. The term "Earnings" means profit, not gross income. The EBIT is multiplied by 3, 4 or 5 to determine the value of the business. Businesses expect to earn back an investment in 3 to 5 years, so the 3-times multiplier gives 33% per year, and the 5-times multiplier gives 20% per year.

Service businesses with few tangible assets would most likely be calculated by 3, whereas a business with substantial assets or other attractive features would be calculated by 5. The valuation of a small business has many variables. Tangible assets increase the valuation (land, buildings, equipment), but the value of these is debatable. The value of intangible assets is subjective, including location, goodwill, customer base, or length of time the business has been in operation.

Rarely do buyers and sellers have the same perspective, but these guidelines could help you organize before any important decision is necessary. Have a great spring and keep the questions coming!!