



## SWC Business Brief

# Obtaining the Best Valuation of Your Business

by Laura Stees, CPA

# TABLE OF CONTENTS

- Introduction: Obtaining the Best Valuation of Your Business ..... 3**
- Why You Need a Business Valuation..... 3**
  - Valuation for Business Sale or Merger..... 5
  - Valuation for Payout..... 5
  - Valuation for Financial Planning..... 5
  - Valuation for Benchmarking..... 6
- How Businesses Are Valued..... 6**
  - Historical Earnings Method..... 6
  - Rule of Thumb Method..... 6
  - Asset-Based Method..... 7
- Knowing What it is That Valuers Seek ..... 7**
- Knowing What Buyers Want to Know ..... 8**
- Keep the Value Perception High..... 8**

SWC (Stees, Walker & Company, LLP)  
16875 W. Bernardo Drive, Ste. 290 | San Diego, CA 92127  
p: (858) 487-4580 | f: (858) 487-8033 | e: admin@swc.cpa | w: SWC.cpa

©2022 SWC (Stees, Walker & Company, LLP). | All rights reserved. | No portion of this document may be used without the express and written permission of SWC





INTRODUCTION

# Obtaining The Best Valuation of Your Business

Do you have any idea how much your business is worth? If not, we can guide you through the process of securing an accurate *business valuation*.

A business valuation is just that: an analysis of how much money a business entity is worth. Knowing the fair value of a business is useful for many reasons, including selling or buying a business, establishing partner ownership, securing business loans, calculating taxes on gifted shares, and in the context of succession and estate planning or divorce proceedings.

Here at SWC, where we help entrepreneurs and business owners maximize their return on investment while achieving both their professional and personal goals, we encourage you to get up to speed on the basics of business valuation, which we cover in this SWC Business Brief:

- Why you should have a current valuation of your business
- Some common methods of valuing a business
- How to prepare so as to get the best valuation
- Some advice for improving business valuation prior to a sale or merger
- Next steps you can take with us to get a valuation done for your business

## Why You Need a Business Valuation

Business valuations are not exclusively for large corporations. Even small and midsize business (SMB) owners can benefit from

knowing the value of their business. For example, a business valuation:

- Reduces the likelihood of costly tax audits and penalties on your estate
- Improves the odds of being approved for a business loan, assuming the valuation supports the business's credit worthiness
- Reveals the true value of stock/shares
- Simplifies calculations during partner buyouts
- Save heirs from extreme tax liabilities

Not every business needs a valuation. If you are self-employed (meaning, you are the business) and not planning to ever sell your business, pass it down to heirs, or borrow against it, you probably won't benefit from undertaking a business valuation. (However, that may open the door to the more pressing discussion of *why* you are not building a business that you can eventually sell or pass down to your heirs.)

Here is a more detailed list of common reasons to get a business valuation:

- You are selling your business, planning to buy one, or merging with another business
- Your business is facing a change of ownership as part of your succession or estate planning
- You are gifting shares of your business to your heirs
- Your business is taking on a new partner, or a partner is leaving
- You are applying for a loan to grow or expand business
- You are issuing shares in your business to raise investment capital
- You are going through a divorce or facing other litigation that is threatening your business
- You are establishing or updating an employee stock ownership plan (ESOP)

In the following sections, we take a deeper dive into some of the more common scenarios that benefit from having a business valuation.



## *Valuation for Business Sale or Merger*

If you are preparing to sell your business or merge with another business, having a business valuation can facilitate the process and ensure that you receive fair compensation. In these instances, a business valuation:

- Facilitates retirement/succession planning
- Accelerates the sale process
- Provides the information you need to negotiate effectively

## *Valuation for Payout*

Whether you are selling your share in a business or buying out someone who is selling theirs, knowing the value of the business can simplify the transaction and ensure a fair settlement. In our experience at SWC, these situations occur unexpectedly, as in the following cases:

- Illness or death
- Divorce
- Sudden market change
- Problems with business partners
- Change in industry regulation, forcing the sale of the business

Any of these situations can impact the value of the business, so it is best to be prepared with a valuation in advance. Having a valuation in place, along with a plan for effectively dealing with unexpected events such as these, can help prevent business disruptions and any negative impact on the business's value.

## *Valuation for Financial Planning*

Having a business valuation can enhance financial planning by providing you with a clearer picture of how your business fits in with the rest of your assets. An accurate valuation can help significantly in the following areas of your business and personal financial planning:

- Buy-sell agreements
- Estate planning
- Gift tax
- Reorganization
- Employee share participation schemes



## ***Valuation for Benchmarking***

Among the oft-overlooked benefits of a business valuation is its usefulness in serving as a benchmark to measure overall success, where it functions like an individual's net worth. When used as a benchmarking tool, a business valuation provides the following insights:

- How successful or unsuccessful the business is financially
- The relative performance of the business compared to the industry overall or to specific competitors

## **How Businesses Are Valued**

Several different methods are used to complete a business valuation, including the following:

- Historical earnings
- Rule of thumb
- Asset-based

The following sections describe these three methods.

### ***Historical Earnings Method***

The historical earnings method relies on past performance and future projections to establish the business's present value. Specifically, it relies on:

- Three- to five-year financial track record as a basis
- Estimates of future earnings and value
- The ability to repay debt, reinvest, and pay dividends
- Free cash flow:
  - Net after-tax earnings or *earnings before interest, tax, depreciation, and amortization (EBITDA)*
  - Adjustments for debt payments and capital improvements
  - Adjustments from capitalization or discount rate

### ***Rule of Thumb Method***

The rule of thumb method is a simple approach that provides a ballpark estimate of what a business is worth. Here are some of its pros and cons:

- Based on multiples of sales/earnings
- Industry specific



## Obtaining the Best Valuation of Your Business *(cont'd)*

- Easy to apply
- Not necessarily the most accurate estimate – it is based on averages and does not account for a business's unique strengths or growth opportunities

### **Asset-Based Method**

As its name suggests, the asset-based method of business valuation looks at what a business is worth based solely on the value of its assets. The asset-based method:

- Usually used when a business has negative earnings or is being broken up or liquidated
- Best for asset-intensive firms, not service companies
- Provides rock bottom value for the business

Now that you have a basic understanding of the common methods used to place a value on a business, let's turn our focus to what valuers are looking for.

### **Knowing What it is That Valuers Seek**

As a business owner, you usually want to maximize your business valuation, especially if you're planning to sell your business or are negotiating a merger. If you're valuing it for tax purposes on the other hand, a lower valuation can be to your benefit. Regardless of your reason for seeking a valuation, knowing what the person or firm performing the valuation is looking for can help you achieve your objectives. For instance:

- The most common methods for valuation rely primarily on earnings history
- Past earnings are used as a predictor of future profitability of the business

**Pro Tip:** *Prior to a valuation and with your CPA there for guidance, review your books with a focus on earnings. You may even want to prepare an earnings history report to summarize your earnings growth over the years you have been in business.*



### Knowing What Buyers Want to Know

If you're selling a business or negotiating a merger, knowing what the other party will be interested in seeing in terms of your business's value can help you gain a more advantageous position.

Here's what buyers want to know:

- How long the business has been operating successfully
- Whether the business can continue to operate successfully under new ownership after the takeover
- Whether you'll provide training for the new owner
- The quality, price, and reputation of the business's goods/services
- Whether existing employees are skilled and knowledgeable and whether they will stay with the business after the sale
- Whether the plant and equipment are in good condition
- Whether the financial records are accurate and well maintained
- The amount of any business debt and how much of it, if any, the buyer will assume
- The workload (*time, effort, and aggravation*) involved in running the business
- Whether the business is worth the asking price – this is where the business valuation can have the greatest impact
- Why the business is being sold



### Keep the Value Perception High

If you are planning a sale or merger, one of your objectives is to keep the *value perception* among prospective buyers as high as possible. Here are some key do's and don'ts for improving (and not damaging) the perception of your business's value:

- Don't convey the impression that you need to sell
- Consider approaching individuals instead of engaging in a widespread advertising campaign that might convey a sense of urgency or desperation
- Maintain confidentiality – especially avoid leaking any information that could be interpreted as a mark against the value of your business

- Use your knowledge of the buyer's circumstances to leverage the price (*i.e., what is it in your business that is particularly appealing to them?*)

You may think of SWC as just an accounting firm, but don't be fooled – we have expertise in starting, running, building, and selling businesses; business acquisitions; and estate and succession planning. Our focus is on your financial success – both personal and business. In fact, we measure our success by how financially successful *you* are.

If you own a business and have concluded that a business valuation might benefit you or your family, [contact us](#) to schedule an appointment. It's never too early. And for certain, you don't want to wait until it's too late.

---

**About the Author:** *Laura Stees, CPA*, is a founding partner of SWC – Southern California's independently owned tax planning and financial strategy advisory firm for small-business owners, real estate investors, and high-net-worth individuals. The driving force behind SWC's brand and operations, Laura advises the firm's clients on several fronts, including tax planning, estates and trusts, investment vehicles, legacy planning, and other net-worth-generating strategies.

---

**Disclaimer:** *The information in this SWC Business Brief about business valuation is provided for general informational purposes only and may not reflect current financial thinking or practices. No information contained in this SWC Business Brief should be construed as financial advice from the staff at SWC (Steas, Walker & Company, LLP), nor is this the information contained in this SWC Business Brief intended to be a substitute for financial counsel on any subject matter or intended to take the place of hiring a Certified Public Accountant in your jurisdiction. No reader of this SWC Business Brief should act or refrain from acting on the basis of any information included in, or accessible through, this SWC Business Brief without seeking the appropriate financial planning advice on the particular facts and circumstances at issue from a licensed financial professional in the recipient's state, country or other appropriate licensing jurisdiction.*

---

