

Financial, Legal & Tax Advisory

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Valuing Your Business

Running your own business requires a lot of investment of your life, money, time, and effort. Endless hours have been spent operating, maintaining, and adjusting the business to stay competitive, profitable, and valuable. After all your hard work and dedication, you may ask yourself, how much is my business actually worth? While most business owners can estimate a ballpark value based on their income and assets, it is essential to follow the correct procedures and have an independent business valuation. Having an accurate value of your business is necessary for a plethora of reasons. In this article, we will break down those very reasons, such as the benefits of knowing your business's true value, how the true value is established, along with the importance of substantiating, defending, and explaining the said value to those in question.

When you look into buying or selling your business (M&A), business succession planning, estate planning, business loans, or even divorce, a proper valuation is vital for proper planning, execution, and structure of the transaction. Furthermore, a business valuation is more than just a number arrived at through various methods used to calculate value. The value arrived at is, in most cases, of secondary value to the actual methodology used in the calculation. As an example, two shareholders enter into a Buy/Sell Agreement (an agreement necessary for all businesses with two or more shareholders), and a shareholder looks to exit the business or passes away unexpectedly. What is the value of the business is the shareholder or the shareholder's estate owns?

How are we able to calculate a number that is sure to be ever-changing as business value increases or decreases based on a weekly, monthly, and yearly basis? The answer is the valuation methodology proposed and agreed upon by the shareholders in the executed Buy/Sell Agreement. This Buy/Sell Agreement can provide a valuation methodology that can be calculated upon the time of the shareholder's exit. Having this can avoid a battle of various methodologies, leading to different values more beneficial to one party over the other. How can we be sure we selected the right methodology to arrive at the true value? The true value of your business will reflect the value a willing buyer would agree to pay in an arm's-length transaction.

As the IRS states, "true value is the fair market value or the price at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy, and the latter is not under any compulsion to sell, with both parties having reasonable knowledge of the relevant facts." Rev. Rul. 59-60. The key to a credible valuation is the ability to obtain and substantiate the value at which the asset or stock will change hands between a willing buyer and seller. In order to do this properly, the business needs to hire an unbiased, qualified appraiser with experience and training in both the area of valuations and the industry in question.

Along with this, the qualified appraiser must understand and employ the various valuation methods, the discount and premium variables, while weighting the result accordingly. Finally, the value calculation must be defended by a qualified appraiser. A calculated value can only be as strong as the qualified appraiser's ability to defend it. Looking at it from an M&A standpoint, the value put forth to potential purchasers will undoubtedly be reviewed, scrutinized, and even potentially challenged to reduce the buyer's purchase price. The buyer will have a due diligence team that will dissect the business's internal financials to substantiate the numbers in the seller's most recent financial statements. Next, the buyer's due diligence team will then use their valuation methodology calculation to arrive at their proscribed value.

If the seller's value seems to be inflated or cannot be substantiated, a purchase price reduction may be sought, negotiation may ensue, and the transaction may be jeopardized. The above examples can highlight the necessity of not only a valuation, but also the necessity of obtaining a qualified appraiser who calculates, substantiates, and defends the value. At The Center for Financial, Legal & Tax Planning, Inc. (The Center), we have performed, defended, and substantiated our valuations for over 40 years. Our President, Senior Advisor, and Senior CPA have a combined sixty years of experience valuing closely held corporations for a myriad of reasons. If you have questions regarding the value of your business, please call The Center at (618)-997-3436 for a free consultation.

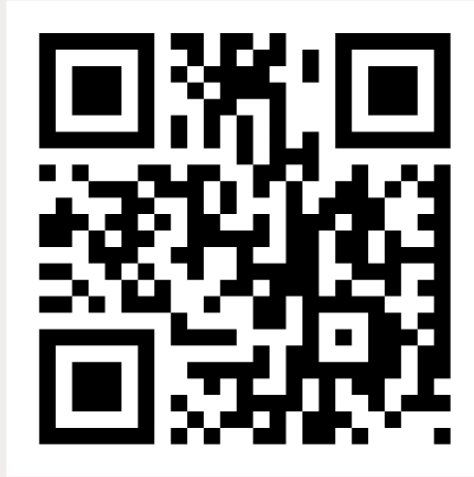
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