PUBLICATION

So You Want To Sell Your Business… PART 3 of 4 – Valuing Your Business for Sale

May 11, 2016

If you have read and acted upon the first two installments of this Client Alert series, you know the reasons why you have decided to sell your business, and you have positioned your business to be as attractive as possible to potential buyers. Now that you are at the brink of devoting significant time and money to the prospective sale, it is time to consider how your business will be valued.

There are two widely used methods for valuing a business. The first method is based on a multiple of annual sales. The second method is based on a multiple of earnings – either earnings before interest and tax (EBIT) or earnings before interest, tax, depreciation and amortization (EBITDA). It is likely that most businesses in your particular industry are valued using one of these methods rather than the other. Whichever method is used, the multiple typically falls within a range that has developed over time with respect to your particular industry.

There are, in essence, two types of buyers, financial and strategic, and they use valuation information in different ways. Financial buyers intend to finance a significant portion of the purchase price, so they value businesses that will generate sufficient cash flow to pay off such debt. Financial buyers may or may not know your industry well, and may rely on outside advisors regarding aspects of your industry that are new to them. Strategic buyers typically are your current competitors, or businesses that are interested in an expansion of their operations that would make them your competitors. As a result, they generally place greater value on operating synergies and other intangible aspects of your business.

Certain factors will affect whether the multiple to be applied to your business will be above or below the average for your industry, and strategic and financial buyers will assess such factors differently when valuing your business. These factors include the following:

- Do you have a diversified customer base or are you heavily reliant on just a few customers?
- Do you offer a variety of products and/or services, or are you mostly reliant on relatively few?
- Do you have proprietary interests in the products or services you offer? In other words, how similar are your products and services to those of your competition?
- Are any of the products or services you offer near the end of their life cycle?
- Is a major investment in a new plant or equipment needed in the near future?
- How strong is your market share? Is your competition weak or strong with regard to financial wherewithal, research and development, geographic reach, personnel or other factors?
- How strong and stable is your management team?
- Are your employee relationships stable? Is your business or industry subject to union activity?
- Is your business currently involved in any significant litigation or the subject of an investigation?
- Do you have assets that are not of value to the buyer? For example, do you own land currently used in your operations, but the buyer intends to re-locate those operations?

The best course of action is to make your business appear as attractive as possible when viewed by either a financial or a strategic buyer. So learn the valuation method and range of multiples typically employed in your industry, and consider what unique facts about your company may increase or decrease its value. Improve what factors you can, and be prepared to answer questions from potential buyers about factors that will influence pricing.

In our final installment of this series, we will discuss the outside advisors typically engaged by the seller of a business and the benefits such advisors can provide.