

SAGE *Solutions*

Determining Business Value: Step Two Of the Seven Step Exit Planning Process™

For many owners, the answer to one question determines their ability to leave their companies: “How much money will I get when I sell?”

This question is indeed critical, and answering it is the second step of The Seven Step Exit Planning Process™. Realistically, you can't exit your business unless you achieve financial independence, and the primary source of that independence is likely to be the funds you receive for your business when you leave.

Let's look at fictional owner Ron Nee, the owner of Landscaping Supply Company, to see why a valuation—well before your exit date—is so important.

For years Ron figured he could sell his business for more than enough money to retire comfortably. He based that belief on his understanding of his industry's valuation rule of thumb--a percentage of gross revenue. Using that rule, Ron calculated his company was worth about \$2 million—more than enough to finance his post-exit life.

When Ron decided that it was time to sell and met with a transaction intermediary, he learned that the rule-of-thumb approach didn't apply. Ron discovered that buyers for the company would base their offers on cash flow rather than on revenues (the basis for Ron's estimate).

Because Ron relied on an incorrect assumption about the value of his business, he had wasted valuable time coasting along to his exit date. Had he retained a professional to estimate value or provide a range of likely sale price before he was ready to exit, he could have spent his time focused on increasing the value of his business.

How can you avoid Ron's predicament?

Ron Nee failed in a critical aspect of ownership: knowing the worth of his business. By not getting a professional valuation or estimate of value, he never knew how far away he was from exiting. He had no accurate information on which to base a plan to grow value.

Benefits.

An accurate valuation of your current business resources:

- Tells you—objectively—how much value you need to add to the business.
- Provides you the ability to monitor your progress toward your ultimate financial objective. For example, if Ron had discovered that his business was worth \$1.5 million (pre-tax) instead of \$2 million, he could have created and implemented a plan to increase value to \$2 million by the time he wanted to exit. His plan could have included interim goals and laid out strategies to achieve each interim goal.
- Determines whether and when you can reach your Exit Objectives.
- Provides a basis for estimating, *and minimizing*, tax consequences of exit path alternatives.

SAGE *Solutions*

Cost.

The cost of hiring an appraiser or business intermediary varies substantially. For example, if you and your business are several years away from a transfer of ownership, a full-blown valuation may well be unnecessary. Instead, you need a value approximation (or range of likely sale price).

If you are ready to exit and plan to sell to a third party, a transaction intermediary can prepare a range of likely sale price. If you plan instead to transfer your company to employees or family members, a certified business appraiser can prepare a “calculation of value.”

Estimates of value, thorough valuations, and marketability appraisals all have their places. Don't skimp on obtaining the valuation you need, but don't secure a more precise valuation before you need it.

What If?

Finally, let's return to Ron's situation: what might have happened had Ron obtained a business appraisal and learned—well before his target exit date—that his company would likely sell for a price *that would meet his financial objective*? Should he have taken immediate action to sell? What would you do if today you learned that you could exit for an amount of after-tax cash that would meet all of your financial objectives?

How would the knowledge that your business is 60%, 75% or 110% of what it needs to worth affect your actions? Life offers no guarantees regarding your health or longevity and today's volatile economy provides an excellent reminder that there are plenty of circumstances beyond an owner's control. For all these reasons, *knowing* the value of your company is a fundamental, indispensable element of sound decision making.