FOCUS ON SUCCESSION PLANNING

Every succession plan needs third-party business valuation

By MICHAEL FEITE
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There are many reasons owners need a business valuation: estate planning, partnership splits, refinancing, recapitalization or divorce are just a handful of scenarios.

Feite

But no reason is more important than succession planning, whether transferring a business to an external buyer or to the next generation of the family.

A certified business valuation helps set an asking price and justifies the asking price to the buyer and to the bank financing the acquisition.

A certified business valuation by an accredited firm is the only way to accurately determine true market value. The benefits are obvious: it helps set an asking price and justifies the asking price to the buyer and to the bank that is financing the acquisition.

For a seller, the lack of a valuation will leave one in the dark about the proper asking price. Specifically, if the asking price is too low, the seller leaves money on the table. Conversely, if the business is overpriced, it won't sell and can compromise the confidentiality of the transaction by causing the business to be on the market too long.

However, there are other often overlooked disadvantages for the lack of a valuation. Most importantly, the lack of a valuation will render any offer suspect, since the owner would never know if it's a fair offer.

Moreover, a qualified valuation will allow the owner's experts to plan for before the sale to maximize after-tax net receipts.

Finally, the lack of a third-party valuation is negatively viewed by investors, who could conclude the business is as poorly prepared operationally for a transition as it is in its financial presentation. Without a business valuation, a potential buyer may not take the seller seriously and likely won't make a fair offer.

ADDS CREDIBILITY

From a buyer's point of view, a valuation provides multiple benefits.

First, it provides a qualified valuation of the business by an accredited third party. Its mere existence allows the buyer to conclude there was at least some degree of due diligence in compiling financial and operational information.

Secondly, a valuation lets the investor obtain a quick decision from the bank on financing. That's crucial because 80 percent of all acquisitions are at least partially financed by a lender.

Finally, a professionally prepared prospectus, consistent with an accredited valuation, will lead a buyer to conclude the business is well organized and professionally managed with a serious, motivated seller.

VALUATION METRICS

What drives the value of businesses? In general, valuation metrics consist of three methods:

- Asset based approach.
- Income based approach.
- Closed transaction comparative approach.

Each metric has subcategories addressing a company's operational environment. Single-ratio valuations, such as a "multiple of EBITDA (earnings before interest, taxes, depreciation and amortization)," are simply not good enough to determine true value.

Value drivers for such metrics build or protect the value of a business. These drivers are crucial in determining existing and future value, as well as the overall salability.

Buyers thoroughly analyze these drivers because they affect the buyer's risk, comfort and confidence. For example, a high dependence on a single customer, reliance on key employees and nonpredictable revenue streams all affect one or more value drivers.

A typical list of value drivers includes:

- Historic growth.
- Profit and margins.
- Customer diversity.
- Employee diversity.
- Product and service mix.
- Recurring revenue versus new business.
- Overall financial condition.
- Five- to 10-year projections.
- Outside risk exposure.
- Industry environment.

DEFINING GOODWILL

How, then, is "goodwill" defined in such a valuation? It's not as nebulous as often perceived.

With most valuations cash-flow-driven, the cash-flow-based enterprise value is determined first. Goodwill is simply the difference between the cash-flow-derived value and the value of net assets.

In sum, a comprehensive valuation should be the first step in succession planning, whether the business is to be transferred to family or to a third-party investor or buyer.

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TRUMP

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you'd think, sheer persistence is the difference between success and failure."

(Kind of sounds like the media's campaign against him, doesn't it?)

I've learned over the years – in developing communication strategies for numerous businesses and nonprofits – that it is often the small changes that make the biggest difference.

Trump's advice picked me off the floor and gave me the renewed confidence I needed to continue my work and grow a successful public relations company.

JOB CREATOR

America saw a miracle on Nov. 8. A miracle that our forefathers put into place when they created the Electoral College.

That system enabled the disenfranchised small-business owners throughout rural Pennsylvania and other parts of the country to have an equal voice.

During his lifetime, Donald Trump has created tens of thousands of jobs. While most candidates offer promises to create jobs, few have experience in doing so.

We have for the first time in history elected a president who has the proven experience and a plan to stimulate job growth. And for us in business, that means abolishing a foolishly constructed health care law, lowering taxes and making it more affordable to hire good people and to better market ourselves.

LOVE FOR THE NATION

President-elect Trump is a New Yorker through and through. He may not have the eloquent charm that Reagan possessed, but he has the same charisma and love for this country.

Trump believes in this nation and because of that will succeed in fixing a very broken system.

Let's work with our 45th president and give him the chance to do what he needs to do.

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