



How Much is Your Business Worth?

A Comprehensive Guide to Business Valuations



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Unless you're a publicly traded company, it's unlikely you know the exact value of your business. As a private company, you don't track the value of your business on a day-to-day basis. It's a figure that isn't of particular importance – until it is.

All business owners should understand, at least in rough terms, what their business is worth, and how that value is calculated. It's only with that knowledge that you can take steps to grow the value of your business, meaning that when you do eventually exit, you'll achieve the best reward possible for your years of hard work.

There's no question this is an important issue. **55% of business owners in the U.S. are 55 or older, and in the coming years**, trillions of dollars will change hands as these entrepreneurs transition to retirement.

However, there are all kinds of reasons to obtain a valuation for your business. These range from the extremely positive, like the sale of your business after a successful career, to far less positive situations, such as litigation or tax disputes. And when it does come time to obtain a valuation, there are different methods that can be used to calculate value depending on the situation.



In this guide, we'll explain the complex and sometimes unclear world of business valuations in clear, practical terms that business owners can understand.

By learning about the key elements that contribute to the value of a business, you'll gain a better understanding of how to manage your business with a focus on long-term success. Plus, if you have a more urgent business valuation need, you'll learn exactly who to contact to get the ball rolling.

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Hogan Taylor: Experienced Business Valuation Professionals

At Hogan Taylor, our business advisory professionals bring a wealth of experience in the field of business valuations. Our **Forensic, Valuation & Litigation Support practice** provides objective analysis in life's uncertain moments, helping business owners move forward with increased confidence.

Our nationally recognized team works closely with small to mid-sized businesses in Arkansas, Oklahoma, and beyond, taking a rigorous, data-backed approach to calculate the true value of your business. We also work closely with a range of private equity groups and attorneys, providing support on a wide variety of complex financial matters.



To learn more about how Hogan Taylor can support you, talk to one of our experts today.

When Might You Need to Value Your Business?

When it comes time to sell your business, having an idea of its value is important to ensure you're well-informed throughout the negotiation process. However, as we'll explore below, the sale of your business is far from the only occasion that might cause an entrepreneur to obtain a valuation for their business.



Succession Planning

Planning for the future is important for all business owners. If you'd like to retire and transfer your business to someone else, whether that's your children or a strategic acquirer in your industry, it's important you take the time to plan. Depending on your **succession plan**, you can take slightly different approaches here.

If you plan to pass your business down to family members, maximizing the value of the business, and therefore the price they'll pay you to acquire it, might be less important to you. You do, however, still have to assign a value to your business before you transfer ownership of it to a family member. This valuation forms an essential component of your **estate and gift tax planning**.

On the other hand, if you plan to sell your business to the highest bidder, working to understand and maximize its value is key to realizing the highest possible price. Optimizing the value of your business is a years-long process: you may want to pivot into a new revenue model, optimize your costs, and expand your capabilities into growing markets. In this case, it's important to understand the value of your business well in advance and identify the key areas you need to improve before you start sounding out potential acquirers.

Estate Planning

Planning to hand your business down to the next generation is one area where business valuations are important, but there are additional estate planning issues that should also be addressed.

If your business is growing fast, it's often beneficial to have this appreciation in value occur outside of your personal estate using a freeze technique. Entrepreneurs transfer their ownership position in a business to a **trust**, often retaining voting control while ensuring that the value of the business grows outside of their personal estate. When the business owner passes, ownership passes to the beneficiaries of the trust, avoiding federal estate taxes.

This strategy offers significant long-term tax advantages for successful business owners who'd like to keep ownership in the family, but does typically require a business valuation before the ownership interest in the business is transferred to the trust.

Business Expansion

All ambitious entrepreneurs are constantly coming up with creative new ways to grow their business. Whether it's bringing in a partner, seeking external financing, or engaging in M&A activity, there's no shortage of options for driven business owners.

Often, these growth strategies require business owners to seek a business valuation – either for their own business or for an acquisition target.

Take the example of an ambitious start-up founder with visions of building the next great technology company. Businesses in this space tend to raise a significant amount of capital, often operating at a loss for years as they prioritize rapid revenue growth. Raising institutional capital demands businesses assign a value to their business and outline tangible plans to grow this exponentially in years to come. A business valuation professional plays an important role in determining this value and advising founders on their fundraising asks.

Alternatively, consider a successful **construction business** that plans to expand into a neighboring state. To do so, they plan to acquire an existing business in that state, taking on their office, vehicles, equipment, employees, and book of business. They apply for an **SBA loan** to fund this expansion. As part of the approval process, the SBA typically requires businesses to present an independent business valuation that calculates the fair market value of the business they plan to acquire, and will only provide funding up to this amount.



Employee Stock Ownership Plans (ESOPs)

Awarding employees with stock in your business is a tried-and-tested method to incentivize your team to give their all in support of your business's goals. Establishing an **Employee Stock Ownership Plan (ESOP)** transfers equity in your business to employees on a gradual basis, rewarding performance with shares of the company's stock.

However, for employees of private companies, valuing this stock is impossible without a business valuation. That's why **Section 409A of the Internal Revenue Code** requires private companies with ESOPs to obtain a 409A valuation each year.

Legal Action

Unfortunately, not all business valuations are a cause for celebration. If your business faces legal action, whether it's litigation, a tax issue, or bankruptcy proceedings, you are often required to obtain a formal business valuation as part of the process.

In these instances, business owners are required to obtain a comprehensive business valuation report from an accredited third party such as an **accounting firm**. These rigorous reports combine best-practice valuation methods that use empirical evidence to present a credible business valuation that stands up to the scrutiny of attorneys and other litigation professionals.

Divorce

If you're in the process of a divorce, it's likely your ownership stake in any business will be included in the division of assets. This is often one of the most complex areas of a divorce and family law attorneys tend to engage a qualified business appraiser to assign a value to any equity positions in businesses.

If the divorce case results in litigation, it's important to have a business appraisal firm with experience serving as an expert witness. At **Hogan Taylor**, our team has years of experience producing valuation reports that stand up to the scrutiny of a court, and are happy to provide **expert witness testimony in Arkansas and Oklahoma**.



Business Valuation Methods

When it comes time to value your business, there are a wide variety of methods that can be applied. In general, these are grouped into three key categories:

- Income Approach
- Market Approach
- Asset Approach

Below, we explain each of these approaches in detail, outlining how they calculate the value of your business and exploring which business valuation methods are best suited to different situations.

Income Approach

The income-based method of business valuation, which is sometimes referred to as the earnings-based method, analyzes the financial performance of your business to determine a value. This approach considers the net income of your business, focusing on the future cash flows you expect the business to generate.

This is perhaps the most complex way of calculating the value of your business, relying on many assumptions and complicated analysis models. However, taking an income-based approach to valuing a business allows appraisers to account for different scenarios and perform sensitivity analysis on their calculations. In many instances, appraisers will use a combination of income-based methods and an asset-based approach.



Income-based approaches to valuing businesses typically use one of the following methods:

Discounted Cash Flow (DCF) Method

Using this method, it is assumed that the value of a business is equivalent to the present value of its **projected future benefits**, including its annual cash flow and any terminal value. This method involves significant calculations and some assumptions. Business appraisers must calculate the value of future cash flows, the terminal or residual value of the business at the end of the period, and a discount rate that is based on the risks of the business. The DCF method offers more flexibility than the capitalization of cash flow method and is well suited to businesses that do not anticipate having stability in their margins, growth, and expenses in coming years.

Capitalization of Cash Flow Method

If your business has stable, relatively predictable cash flows over several years, and expects these to continue, the capitalization of cash flow method may be a good fit. This method takes these future cash flows and applies a discount rate to them to assign a value to those cash flows in today's dollars.



Market Approach

The market approach assigns a value to a business based on a comprehensive analysis of the completed sales of other, similar assets in the recent past.

When determining the value of a business, valuation professionals will look at other businesses in your industry and determine their selling price. Several factors will be considered here; among the most important is the revenue or earnings multiple an acquirer paid for a business similar to yours.

An accurate appraisal demands the right choice of comparisons. The market-based approach works well when valuation professionals have detailed information on the sale of comparable businesses to yours. In the private markets, this can be difficult since many businesses do not disclose the price of their transactions to the public.

However, the market-based approach does have several flaws. It does not account for many of the factors that make a business unique: its Intellectual Property (IP), technology, and so on. It's also reliant on the right choice of comparables, and it's unlikely that many businesses out there have identical financial performance, growth rates, and assets to your business. Finally, it does not account for the irrationality of the market: regardless of what the valuation says, many businesses overpay for an asset to beat out competition or for strategic reasons.

These factors mean that the market-based approach is largely viewed as a less precise business valuation method. It can be helpful in understanding general market sentiment and identifying common EBITDA multiples, but should not be used in isolation to calculate the value of a business.

Asset Approach

The asset-based approach to business valuation assigns a value to a business based on its assets and liabilities, otherwise known as the company's book value. These figures are often similar to what a company presents on its balance sheet, but valuation professionals have the ability to assign values to intangible assets if they see fit.

Business valuation professionals often use the adjusted asset-based approach, which seeks to adjust the value of a business's assets to match their fair market value, rather than their book value, which includes depreciation. This adjustment process also includes the addition of intangible assets including trade secrets and other IP. Unrecorded liabilities, such as leases, are also included in this calculation.

If a company is entering bankruptcy, valuation professionals may assign a liquidation value as part of this process. This value simply considers the value of the company once all assets have been sold and all liabilities have been paid off.

Other Valuation Methods

While the majority of business valuation techniques fall under one of the three categories outlined above, there are other business valuation methods. They include:

- **Market Capitalization:** used for public companies, this method multiplies the share price by the total number of shares outstanding.
- **Revenue Multiple Method:** a simplified version of the market approach, this method applies a revenue multiple (typically set at industry level) to a company's revenue over a certain period.
- **Earnings Multiple:** this method works similarly to the revenue multiple method, but multiplies the business's net earnings, rather than its revenue.
- **Cost Valuation Method:** this approach is based on the principle of substitution: what a potential acquirer would have to pay to reproduce or replace the existing assets of a business.

Business valuation professionals use a blend of the methods outlined above to assign a value to your business. They will perform rigorous analysis in line with accepted best practices to determine an accurate valuation for your business.



Types of Business Valuation Report

Business valuation professionals typically offer a variety of services. The level of service you require is typically driven by the situation that has caused you to seek a valuation for your business.

Below, we outline the differences between several common types of business valuation reports:

- **Verbal Estimate of Value:** this is a quick, back-of-the-envelope valuation conducted by an **accredited business valuation professional**. They will quickly assess your financial performance and use their knowledge of similar transactions to provide you with an approximate verbal estimate.
- **Calculation of Value:** this provides businesses with a basic written report that assigns an approximate value to the business based on limited calculations. These valuations typically do not stand up to legal scrutiny and should be used for internal purposes only.
- **Summary Appraisal:** these reports feature more rigorous analysis, and importantly, a conclusion of value. A summary appraisal only contains an abbreviated version of the analysis completed and is most helpful for succession planning, estate planning, and stock transactions.
- **Comprehensive Opinion of Value or Complete Appraisal:** these more detailed reports assess every component of a business and include the calculations performed to arrive at the opinion of value. They are best suited to situations where the business value is likely to be under close scrutiny or included in legal proceedings.

A business valuation professional will work with you to evaluate your situation and help you determine which type of report you need.



The Role of Business Valuation Professionals: What to Expect

If you're considering obtaining a valuation for your business, it's normal to feel apprehensive. After all, your business will effectively be under the microscope, with someone else assigning a dollar value to your life's work. Often, the business valuation process occurs in parallel to a watershed moment in your life, whether that's the sale of a company you've operated for decades or a divorce.

With such high stakes, we believe it's important you know what to expect from the business valuation professionals you'll be working with. The level of depth and rigor of the process is driven by your choice of valuation report and methodology, but in general, the process follows the following steps:

- 1. Document Review:** business valuation professionals will conduct a thorough review of your business's financial statements, research acquisitions of businesses in the same industry, and create a comprehensive plan to accurately assign a value to your business.
- 2. In-Person Review:** depending on the scope of the report, the business valuation professionals will tour your facilities and interview key executives to discover the story behind the numbers.
- 3. Analysis:** following the conclusion of the information-gathering process, the business valuation team will conduct a variety of analyses to determine the value of your business.
- 4. Production of Report:** finally, the analysis will be compiled into a report which will be shared with all relevant parties.



It's worth noting that there may be additional steps depending on the scope of the engagement. For example, some business valuation professionals (including the team at Hogan Taylor) can also provide expert witness testimony to support the business valuation in a court of law.

Business Valuations vs. Reality: An Important Distinction

Ultimately, any business is worth as much as someone is willing to pay for it.

Much like homes with beautiful ocean views sell for a significantly higher price than those with no view, businesses with special qualities, whether that's innovative technology or an extremely profitable business model, tend to sell for more than those with no unique points of difference.

This goes both ways, and also applies to businesses with weaknesses that may surface in the due diligence process during a potential acquisition. If you were considering purchasing a house, but found out at the last minute it needed a new foundation, you would likely lower your offer. The same is true for businesses: meaning that potential bids from acquirers may come in lower than your business's appraised value.



Business valuations do not typically take these factors into account. Nor do they consider the potential for a business to be fought over by multiple potential acquirers, driving the price up, or struggling to find an acquirer, driving the price down.

Consider a business valuation to be a helpful indicator of your business's potential value; not a guaranteed figure you should rely on to fund your retirement.

Partner with Hogan Taylor: Trusted Business Valuation Professionals

Obtaining a valuation for your business can be a daunting task. There are many decisions to be made, from the choice of valuation method to the report needed to adequately support the valuation.

Throughout this process, the experience and guidance of seasoned business valuation professionals is invaluable. At Hogan Taylor, our business valuation professionals are nationally recognized. We bring experience valuing businesses across a wide variety of industries and growth stages and use a data-driven approach to deliver precise business valuations backed by a wealth of empirical evidence.

Ready to take the first step towards obtaining a business valuation?
Reach out to our experts today.



Meet Members of the Forensic, Valuation, & Litigation Team

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