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How to Value an SME – Part 2

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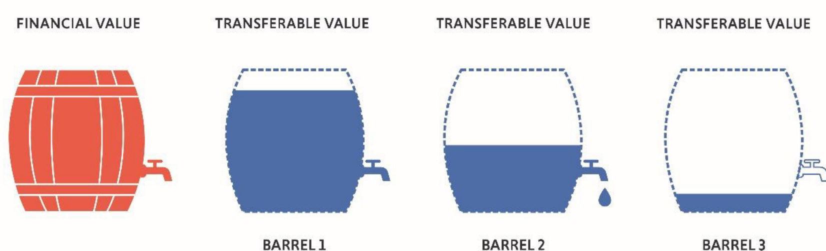
There Are Two Elements to Consider When Valuing an SME:
• Transferable Value
• Financial Value

Financial Value



In order to value your business, you must find a way of cutting through all the emotion and differing requirements to determine a value of your business based solely on facts, facts that no one can argue or dispute over. Before looking at some fact-based valuation methods, you should also be aware of the two basic needs of all buyers.

Your business must satisfy two basic needs every buyer has:

1. The buyer must receive a return on their investment.
2. The business must be able to pay off its debts.

Does your business allow a buyer to do that?

If it does, then you're well on your way to having a business that you can sell.

If it does not, then you need to take a step back, reassess, and recognise that you need to make changes now to ensure that those buyer needs can be met.

By ensuring your business meets the two basic needs of a buyer, you'll naturally increase not only the value of your business but its saleability, and should the worst-case happen where you have to sell quickly, you'll be in a much better position to appeal to as many buyers as possible.

Let's return to fact-based business valuations. Valuing a business can be complex, and there are several ways in which you can value a business. In most of these methods there is going to be an element of negotiation with differing views between buyer and seller, which makes negotiations so fascinating.

Financial Valuation Methods:
The seven methods I tend to use to determine the value of a business are:

- Balance Sheet Valuation
- Discounted Cash Flow (DCF)
- Multiple of EBITDA (earnings before interest, tax, depreciation, and amortization)
- Multiple of Recurring Revenue
- Return on Investment
- Cash Payback
- Cash Flow Valuation

In order to achieve a balanced valuation, I always use and would encourage you to use at least three methods to value a business. This gives you a good all-round picture of the business and creates a balanced view.

Looking at this practically: at a very minimum your business needs to generate sufficient cash flow, which ideally should be the same as your net profit, to provide a buyer with a return on any capital they invest in the business as well as service any debt required to purchase or run the business. This could be in the form of asset finance, debt finance, deferred payments, etc. If your business is unable to do that, then it is very possible that your business valuation is too high based upon the cash flow generated by the business.

To find out more about how to value a business please read part 3 of this series or visit **www.businessbydesign.co.uk**.

In the hustle and bustle of running a business it is very easy to take your eye off the ultimate end goal—successfully exiting your business. Keep focused and do not be afraid to ask for help.

Would you like to make sure your business is ready for sale? Learn more about how we can assist you. Please contact Cliff at Business By Design for a free confidential phone call to see how we can assist you.

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