One Page Business Valuation Overview

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Small Business owners are usually too busy making sales; paying the bills; and growing their business to worry about valuation. Nevertheless, determining the value of the business can be important.

What is a Business Valuation and how does it differ from an appraisal?

- Business valuations determine the fair market value, the standard of value, and purpose of the valuation.
- Valuations focus on operations (cash flow) and appraisals focus on assets (land, inventory, etc).

Why would a business owner need a business valuation?

- Valuations are a useful tool for ***business acquisitions***. The business owner (or buyer) may be acquiring a business; taking on or buying out a partner; or selling the business.
- Valuations are an aid in ***litigation*****.** In divorces, the business is part of the marital estate. A valuation may help a spouse get (or keep) the fair market value of their interest in the business.
- The IRS may require a valuation to support reported amounts on an **estate or gift *tax return***.

How does the business owner (or prospective buyer) provide value?

- Valuations help a buyer/seller see beyond financial statements and tax returns.
- Financial statements (Balance Sheet, Profit & Loss, and Statement of Cash Flows) focus on historical cost; however, valuations consider fair market value.
- Valuations consider management discretionary decisions (owner's salary & fringe benefits, etc).

Who can perform a business valuation?

- Valuators should be certified by a recognized society of valuation professionals. These include:
  - **National Association of Certified Valuation Analysts** (Certified Valuation Analyst, Accredited Valuation Analyst)
  - **American Institute of Certified Public** Accountants (Accredited in Business Valuation)
  - **American Society of Appraisers** (Accredited Member, Accredited Senior Appraiser)
- Trained business valuators have: a code of ethics; training standards; and reporting standards.

How does a business valuator determine the value of the business?

- The **Asset Approach** concentrates on tangible assets (real estate, inventory). This method is well suited for businesses with low cash flow when compared to their assets (cattle ranch).
- The **Income Approach** calculates the present values of future cash flows. The valuator calculates a capitalization rate (rate of return) and applies it to estimated future cash flows. This is best suited where the business operations are worth more than the tangible assets (pool cleaning service).
- The **Market Approach** compares the business being valued against actual business sales. This method works best for similar in businesses (franchise restaurants in similar towns).
- The business valuator considers all three approaches and recommends the one best suited to the business being valued.