Understanding Business Valuation: Considerations for Potential Buyers

info@oaklynconsulting.com

https://oaklynconsulting.com

When a small or medium-sized business wants to grow, it has two options: either hiring more people or buying another business. Acquisition can increase a company's size much more quickly, but it's also a much bigger risk — especially if the buyer overpays.

For buyers who've never purchased a business before, it's hard to know where to start when it comes to determining a company's actual value. Sellers, understandably, think highly of their businesses and tend to overestimate how much they're worth. Many prospective buyers find that the wisest solution is to work with a M&A expert who can guide them through the process.

Explaining business valuation methods.

The truth is, there's no one correct way to determine the value of a business. A few of the most commonly used methods are:

- **The times-revenue method**, which multiplies revenue from a set period of time by an industry-specific multiplier;
- **An earnings-based technique**, which analyzes projected future profits against the interest that could be generated by cash flow over the same period of time; and
- **Liquidation value**, or the cash value of the business's total assets minus the cost of any current liabilities.

The problem with using any of these methods exclusively is that they give an incomplete picture of a business's true value, since they only show that company as it exists today, or recently. Depending on what the future holds, a company could be on the verge of having its best years ever — or its worst.

The impact of scenario analysis.

A smart way to take this range of possibilities into account and get a more accurate view of a business's resiliency — and along with that, its value — is to incorporate scenario analysis, a long-term planning method that involves examining the potential impact of several plausible scenarios, both positive and negative. Some examples could be changing economic conditions, industry advancements (such as a competitor introducing an innovative new product), or changes in a company's ability to continue operating at its current level (maybe due to the departure of a key employee).

A prospective buyer trying to understand the valuation of a target company should first consider what its future would look like in a base case, where the company continues on its current trajectory with no major positive or negative changes. Then, the buyer should build out models of 2-3 upside and 2-3 downside scenarios, where things go better or worse than planned, each in a specific way.

In each scenario, they should validate their assumptions about the target company as much as possible using concrete historical information about the company or about the market. Once they've established projections of how each scenario might affect the company's earnings over a set period of time, they'll have a range of numbers that can be factored into a final valuation based on the combined company's ability to respond to each scenario taking place.

Not only does scenario analysis can help buyers arrive at a more realistic valuation for a target business, it helps to identify areas of concern that can lead to a more focused list of due diligence questions. By verifying assumptions through due diligence, they can be certain of what they're getting into as they finalize the deal.

Alternatives to buying.

Even if all the signs look positive for a deal, nothing is certain until the final documents are signed. So, buyers should be considering actionable alternatives if their primary acquisition doesn't go through, which might mean not purchasing a business at all and growing through focused hiring.

If other companies are being legitimately considered as potential backups, buyers need to begin the process of business valuation with them as well. While it's possible to do all of this without the assistance of an M&A professional, few working business owners have the extra time to devote to what amounts to a second job.

How Oaklyn Consulting assists buyers with valuation.

Business valuation is often described as a combination of art and science. While the science might be understandable for those with a finance or accounting background, the art only comes through experience.

At Oaklyn Consulting, we bring more than 20 years of mergers and acquisitions experience to our business valuation work. We essentially function as a corporate development department for our clients, working on a fractional basis. From helping to identify potential acquisitions to closing a final transaction, we provide unbiased, expert guidance for every step in between: developing and evaluating scenarios, doing due diligence, negotiating the deal and much more.

If you're considering a business purchase and could use a sounding board to make sense of your options, we'd love to talk about how Oaklyn Consulting might be able to help.

info@oaklynconsulting.com https://oaklynconsulting.com

https://oaklynconsulting.com/

info@oaklynconsulting.com

888-983-1617

info@oaklynconsulting.com https://oaklynconsulting.com