Do The **Math!**

What's Your Business Worth?

By Jay Goltz

At some point, many business owners decide to sell their business. Since this is frequently a once in a lifetime event, many are not familiar with how businesses are valuated. A common way many people attempt this is by taking the value of all of the assets including inventory and equipment and adding on a number for "goodwill." This will result in a number, but one that might be unrealistic. There are two problems with this methodology. First of all, what you paid for moulding, glass, matboard, and equipment is a far cry from what it is worth on the open market. Actually, you might cry. Maybe 20 cents on the dollar? Or 10? Or nothing? It's not like selling a used car that there is a big market for.

That's the bad news. The good news is that it doesn't really matter. When someone buys a business, they are essentially buying a profit stream. Profit, mind you, not revenue. A company that makes no profit is going to be a hard sell. Other considerations are how much the owner took out in compensation and other "perks." The other selling point might be "then there is the cash I take in" and possibly a wink-wink. Tough luck. Nobody wants to take your word for how much money you have skimmed off the top, and it doesn't put your integrity or business in a very good light. It could very well work to your disadvantage.

So what is the formula? In most businesses, it is some multiple of earnings. What multiple? Probably somewhere between four and six times earnings. Why do the numbers make sense? Because it replicates the appropriate return on investment, which should be high considering the risk. Let's do the math!

Let's say the business has a $50,000 profit. If it sold for four times earnings, that means it would sell for $200,000. Five times would be $250,000; six times, $300,000. This affects the return on investment. If someone paid $200,000 and had the $50,000 profit, they would realize a 25 percent return on investment. At $250,000, it's a 20 percent return. At $300,000, it's a 17 percent return. For the risk involved, most people are not going to be happy with a 17 percent return. They are also buying potential as well as downside risk.

There are many factors that will affect the multiple used for valuation like:

- Have sales been trending up or down?
- Do things look better or worse for the future?
- What is the status and value of the lease?
- How connected to the owner are the customers?
- Are key employees going to stay around?
- What is the health of the customers?
- Are there any untapped sources of new customers that could be easily gained?
- Is the facility in need of any updating or repair?
- What is the demand for your kind of business?

Profit and Selling Price Scenarios

Annual Profit	Sales Multiple	Selling Price	Return%
$50,000	4 X profit	$200,000	25 %
$50,000	5 X profit	$250,000	20 %
$50,000	6 X profit	$300,000	17 %

This is not an exact science, and one could argue that the business is worth whatever someone will pay for it. This formula does, however, give you an idea of what someone will be willing to pay. If this methodology determines that your business is worth $50,000 but you feel that the assets are worth $200,000, an option would be to sell the assets and close the business. In reality, I have found that many businesses are worth half or less than what the owner wants to believe. The problem then becomes an unrealistic sales price that leads to no sale. The saying "nothing to lose by trying" is not true. Having an unrealistic asking price can scare off potential buyers and result in a liquidation sale. Do the math, price accordingly. Then it probably makes sense to hire a broker. ■

Jay Goltz owns Artists' Frame Service in Chicago, IL, which employs over 50 people at its main framing operation. He has received many business honors and is known for his straight talk on succeeding in business.