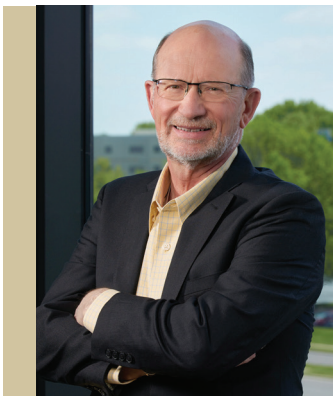
Call us:
317-849-9559

Email us:
gary.pittsford@creativeplanning.com

Visit us online:
www.creativeplanning.com

JULY 2021

SIX REASONS FOR A BUSINESS VALUATION



Gary Pittsford, CFP®
Partner / Chief Valuation Officer

And Why You Should Work with an Experienced Valuation Team

Undergoing the business valuation process for your company is a bit like having a thorough physical examination with x-rays and blood tests. A business valuation, when performed correctly by qualified valuation professionals who know your industry, can be an excellent way to gain perspective on the overall "health" of your company, compared to national industry averages.

There are many reasons to have a business valuation prepared for your company. Following are the top six situations in which a business valuation may be beneficial.

#1 – Selling to family or key employees

If you are planning on selling your business to a family member or key employee, it's absolutely vital to start the process with an accurate business valuation, for several reasons:

- **To clarify which assets are being sold and which assets will be retained by the seller.** For example, if the seller is part of an older generation, he or she may wish to keep some of the business' excess cash for income in retirement. If a business being sold is part of a national purchasing cooperative, the seller may wish to keep the value of any patronage stock.
- **To identify EBITDA.** The usable cash flow, or EBITDA, of a business is one of the most important calculations in any valuation. This number illustrates how much cash flow the new owner will have to work with should he or she decide to:
  1. Look for financing for part of the purchase price; or
  2. Pay on a promissory note to the seller for the purchase of stock.

A valuation provides perspective to both the buyer and seller, depending on how the buyer intends to finance the purchase.

Over many years of working with business owners, I have always stressed that, while the assets of the company are very important, the ***usable*** cash flow is ***more*** important. A business valuation can help you gain a better understanding of your usable cash flow.

- **To plan the transition.** Part of the business valuation process is determining the details of the sale. If the usable cash flow changes during the three- to five-year transition period, those changes could potentially impact the business valuation.

For example, is the seller going to reduce his or her salary and bonuses to zero, or take a reduction in pay as he or she gradually transitions out of the business? What is the timeframe in which the ownership transition will take place? Taking time to identify a transition plan through the business valuation process helps ensure a smooth transfer.

#2 – Selling to an outside party

When selling to another company within your industry, it is again important to know what assets are being sold and to have an idea about the amount of usable cash flow. EBITDA calculations for an outside sale are different than those used for a sale to family or key employees. When a seller plans to leave the business immediately, the EBITDA is typically higher, resulting in a higher overall company value.

The seller can also use the information from a business valuation to determine a selling price. The buyer will be interested in reviewing all assets and will likely want to thoroughly analyze the amount of usable cash flow the company can produce.

A well-prepared business valuation can be a valuable tool for both the buyer and the seller as they discuss the terms and conditions of the sale.

#3 – Improving value

If you plan to sell your business several years down the road, a business valuation can be used as a tool to increase the value of your company and monitor the progress of your transition plan.

For example, the business valuation may identify an opportunity to enhance the value of the company by increasing gross margins by 1% to 2% each year during the three to five years leading up to the sale. Or, it may highlight opportunities to lower expenses or get rid of obsolete or slow-moving inventory.

Preparing a business valuation three to five years prior to the anticipated sale allows the business owner to gain a sense of the company's current "health" and identify opportunities to improve upon it. Going forward, the business valuation can be easily updated on an annual basis by the valuation professionals using the same formulas and methods, allowing the business owner to see the impact of any changes and adjust his or her transition plan accordingly leading up to the sale.

This annual checkup can serve as a valuable resource, not only by improving the health of the company, but also by increasing the company's ultimate selling price.

phone: 317-849-9559
gary.pittsford@creativeplanning.com

#4 – Estate/probate

A business valuation is typically required when an owner of a privately held company dies. The business valuation is necessary for the estate transfer and probate process. It may also be required by the company's buy-sell or stock redemption agreement. In addition, if the owner is in the process of getting a divorce, the attorneys and both spouses will likely need a business valuation to use in negotiations and property settlements.

#5 – Buy-sell agreements

If the business has two or more owners, it is generally a good idea to have a business valuation prepared when stock redemption agreements or buy-sell agreements are first signed. The valuation can then be revised every year or two to provide an updated valuation for the stock and update the stock redemption agreement. This allows all owners to know the value of the stock and how it was calculated.

#6 – Retirement and contingency planning

A valuation can also help value shares when one owner retires from the company, as it's important to know the stock's current value when buying out a retiring owner. A business valuation is also important when an owner becomes disabled and is unable to perform his or her duties. Another situation in which is business valuation is important is when an owner wishes to sell a few shares to access cash.

A well-written business valuation that thoroughly analyzes the true value of the company can be a valuable tool for business owners. Just as it's important to schedule an annual check-up with your doctor, so is it important to conduct a regular health check on your business.

Castle Valuation, a Division of Creative Planning, is a team of experienced professionals that develops comprehensive business valuations across a wide range of industries. Creative Planning is a nationally recognized wealth advisory firm comprised of credentialed, educated, experienced and action-oriented advisors, including CERTIFIED FINANCIAL PLANNER™ practitioners, certified public accountants, insurance specialists, attorneys and other professionals dedicated to helping you achieve your goals. We work together to help ensure all aspects of your business and personal finances are well cared for. If you're ready to initiate the business valuation process, or for any other financial concerns, please schedule a call.

phone: 317-849-9559
gary.pittsford@creativeplanning.com