Business Succession & Aquisition

Valuation Methods for Buying and Selling a Business

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NEWFOUNDLAND & LABRADOR ORGANIZATION OF WOMEN ENTREPRENEURS

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What is a business worth?

The answer can depend on perspective: buyer, seller or market valuator.

The Canadian Institute of Chartered Business Evaluators (cbvinstitute.com) defines fair market value as the highest price agreed to between a buyer and seller that are fully informed and free to choose. As a result, determining 'worth' of a business requires clear definitions and a subtle blend of financials, market conditions, and personal preferences. Warren Buffett puts it succinctly: "Price is what you pay; value is what you get."

Business value is calculated based on market predictions, activity of potential buyers, years of future operation, and other forecasts impacting business operations and income.

Once the price is accepted, any of these predictions or unforeseen circumstances could affect the value of the business. As a result, price and value may not be the same number.

Valuation is usually based on one of three key elements:

- Income
- Market
- Assets

Income-based valuation projects the future cash flow of a business and analyzes the potential of the company to meet that prediction. This approach is often used for software or other companies rich in intellectual property, where their value rests in future performance.

Asset-based valuation examines the value of a company's assets minus its liabilities. This considers the value of cash and other assets left over if all bills, debts and taxes were paid. This approach is often used for companies with most or all 'tangible' assets, such as construction companies or real estate holding companies.

Market-based valuation determines a company's value using data from comparable companies and recent transactions. This method is often used with an income-based approach, due to the variability of public information on company activities and relevant market metrics.

All of these methods will provide a value number for a company.

The price will be determined by the open market and potential buyers.

For this reason, the value assigned to your company may not be the price you receive, or if you are a buyer, the purchase price may be different from the valuation.

Sources:

https://cbvinstitute.com/wp-content/uploads/2010/10/Practice-Bulletin-No-2-E-2001.pdf

https://www.bdc.ca/en/articles-tools/blog/value-vs-price-understanding-difference-buying-selling-business