
Business valuations key to growth

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How much is your business worth? It's a simple question with a complicated answer. Sean Black of the accounting firm LeMaster & Daniels' Spokane office provided some insight into the purpose and process of business valuations at the January meeting of the Three Rivers Entrepreneur Network in Richland.

According to Black, business valuation determines the price that a hypothetical buyer would pay for a business under a given set of circumstances. The value depends on an estimation of future benefits, such as cash flow or dividends, and the anticipated rate of return for a particular investment.

"Although the process is complex and time-consuming, an objective, professionally prepared business valuation is essential in many situations," Black said. Uses include:

- debt or equity financing
- stock ownership or option planning
- estate, gift or tax planning
- business sale, purchase or dissolution
- insurance, goal setting and compensation
- legal issues or divorce settlement.

Approaches to valuation

Most valuations are prepared by an appraiser, typically a person certified in the field of business valuation, Black said. Three approaches are considered in the valuation: income, cost (or asset) and market.

Income valuation considers future benefits associated with ownership. The appraiser evaluates the anticipated returns and risks associated with investing in the business and sets a value on the company.

Cost valuation examines the business as a collection of assets and liabilities without regard to their income generating capability.

Market valuation considers prices paid for publicly traded stock or transactions of entire companies in comparable industries. Although determining the differences between similar companies often requires significant analysis, this approach provides important information on verifiable market prices.

Valuing tech businesses

"Business valuation is more art than science," Black said, noting that appraisers rely on a combination of judgment, experience and an understanding of accepted valuation principles.

Jeff Lubeck, manager of Dade Moeller Business Consulting in Kennewick, formerly Strategic Business Solutions, likened valuing a business to pricing a home. "In

addition to hard facts, such as square footage and number of bedrooms, less tangible items like proximity to major roads and perceived quality of schools have a big effect on value," he said.

With tech businesses, the biggest intangible is intellectual property. "The value of patents, copyrights and other intellectual property is based on expectation, often for a product or service that isn't fully developed," Black said.

Since today's investors are pessimistic about promises made for new technologies, Black finds it useful to treat a piece of intellectual property as its own business, for which he forecasts such items as cash flow, royalties and market opportunity.

The purpose of a valuation also can influence value. "If the valuation is performed to establish a liquidation value for bankruptcy, the value is substantially lower than if you're doing a valuation because you are preparing to sell the business," Lubeck said.

"If a large company views you as a strategic fit, the valuation will be much higher. That's because a thriving enterprise is inherently more desirable than a defunct one," Lubeck said.

Other factors that can influence valuation in a purchase include the structure of the deal (cash, stock, or other options); the stage of the company in the business cycle (startup, growth or mature); and corporate culture.

First-hand experience

Business valuations were essential when Vivid Learning Systems, a subsidiary of Richland-based Nuvotec USA, acquired all or part of four other firms.

President and chief executive officer Kevin Smith explained that valuations of a prospective Vivid Learning Systems acquisition focus on the net present value of future earnings. Other considerations, such as the firm's past performance, strategic fit and the risk and volatility of the company's industry, are factored in to arrive at the valuation.

"The valuation gives both parties a range within which to conduct their negotiations," he said. "In the end, for private company transactions, the market value of the company is what ever price the buyer agrees to pay and the seller agrees to sell." Vivid Learning's most recent acquisition is ImageWorks Media Group of Pasco . In its 10-year history, ImageWorks commissioned two business valuations. The first provided information to a potential equity partner, while the second prepared for the company's sale.

"Both were very valuable to get a better understanding of what the company was worth and, coincidentally, what our insurance coverage should be," said ImageWorks president Matt Hammer.

To other entrepreneurs engaged in business valuations, Hammer advised, "Never underestimate the value of your gut feel. Usually, the business owner knows more about the value of his or her company than anyone else."