Beauty is not the only thing in the eye of the beholder..... so is valuation

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A business owner is looking to exit her business and is curious to know the real worth of her treasured operation. For an entrepreneur, the subject of business valuation can seem like a complete enigma. However, there is a method to the madness.

Business valuation can be simply put as the present economic value of a business. To fully understand business valuation, one needs to understand why the buyer could see value in your company. The value an investor may perceive from a business can change from buyer to buyer as each of them have their own objectives.

For instance, a strategic buyer, generally a larger player in the same industry as your business, could want to buy out the competition to gain as much market share as possible. For such a strategic buyer, your revenues, or topline, hold more value than your profits or bottom line. Conversely, a PE fund would be more focused on your annual profits and growth potential with new management.

A venture capital fund might consider investing even if you are not making revenues, but all the emphasis then focuses on the proprietary technology owned and future value that could be derived from commercialization of that technology. Apart from understanding the intent of different buyers, business owners must also understand that companies in different sectors are valued on different metrics. Each sector has its own set of dynamics and the valuation method should complement these dynamics.

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For example, a Discounted Cash Flow valuation method – discounting future cash flows into current time period - works well for industries operating with predictable cash flows due to fixed assets such as plant and machinery. However, the same approach will not work well in valuing a tech start-up as most of them have longer gestation periods and have very volatile cash flows in their initial years. Valuing such businesses will require a more holistic approach that considers the growth potential, which is often quantified using comparable ratios on revenues or EBITDA from either listed competitors or from past transactions in the pace.

Business valuation is a key part of the deal process, and almost always the first question on the table. If not done wisely, it can either dissuade potential buyers by being too high or, under reward a business owner by being too low. As M&A advisors, our aim is to safeguard our clients from under or over valuing their business. Hence the first part of our engagement as advisors on a sell-side mandate is to spend time working with our clients to arrive at the correct valuation of their business and help decode the enigma.