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Small-business valuations: Beware of rules of thumb

As a small-business owner, do you know how much your business is worth? What if you're planning to sell the business; how do you determine what it should sell for? Or what if you're passing the business on to your children; what are they getting?

A lot of small-business owners don't have any idea of the true value of their company. Many may be so close to the operation that their emotional attachment to the company could provide a distorted view of the business' worth.

That's the view of professional business appraisers who work with small and mid-size businesses evaluating their worth.

"You have to have five years of financial statements and a business plan that contains projected financial statements," said **Charles Wulfing**, a partner in Fortune Group Corporate Finance Inc. "We need to look back five years and ahead at least two to three years.

"It's not that unusual for a small business not to have a plan," Wulfing said. "It's necessary to get it on paper or in a computer."

Bryan Goetz, president of Capital Advisors Inc., said businesses should start their planning at least three years prior to when they want to sell the business.

"Keep all your records organized and

have audited financial statements," Goetz said. "Potential buyers will feel a lot more comfortable if they can see what they will get."

Goetz also warns against some standard lines. "Beware of rules of thumb," Goetz said. "A lot of people will say you can sell for 1 1/2 times book value. It's an average; no one should rely on it."

"Cash flow is a principal methodology of valuation," Wulfing said. "Book value sometimes comes into play, but it's less important for a small, privately held business."

The Fortune Group works primarily with businesses in the \$5 million to \$100 million range. The company will do the valuation on its time for a business owner who intends to sell.

If the business likes the results, the company will charge a transaction fee — called a success fee — for the completion of the sell.

Wulfing has seen business owners who get too emotionally involved to see the true market value of the company.

"If a guy's been in business for 25 to 30 years, he has a different view than others," Wulfing said. "The real value is what the buyer will pay. The market determines the price — it's the ultimate arbitrator."



RON JANECKE
Small Talk

Goetz said the customer base of both the company and its competitors also is considered. He said two businesses in the same industry with identical sales and earnings could have very different values.

Wulfing and Goetz both advise small businesses to deal with a certified appraiser.

"Some people do it on the side," Goetz said. "You don't even need a license in Missouri. Anyone can call themselves a business appraiser."

According to Independent Business magazine, published by the National Federation of Independent Business, there are four approaches to determining the value of a business:

- Asset approach, based on the value of a company's assets;

- Market approach, based on what comparable businesses have sold for in the recent past;

- Income approach, based on the business' historical financial data; and

- Evaluation by a professional — like Wulfing and Goetz — to get a formal valuation.

Most small-business appraisals range from \$2,000 to \$15,000 depending on the purpose of the appraisals. A business that is being appraised for tax or litigation

purposes may be charged more because the appraiser must be extremely thorough.



Bryan Goetz

Books tell you how to start a small business

The American Institute of Small Business has published a two-volume set of books, "How to Set Up Your Own Small Business."

It is written especially for an individual who wishes to start his or her own business. The books are written in layman language and contain numerous examples and case studies.

The set covers where to obtain financing and financing alternatives, writing the business plan, advertising, public relations, selling, computer uses, site selection, franchising and legal aspects.

Included are chapters on how a person selects the right business, how to measure one's strengths and weaknesses and a comparison between buying a business or starting from scratch.

Other subjects covered are bookkeeping, accounting and tax from preparation, sources of supply, sales forecasting, market research and avoiding the pitfalls that lead to business failure.

The books are available with a study guide.

For information, call the American Institute of Small Business at (800) 328-2906.