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Jan Odai, YSTOP Student (Summer 2006), Toronto, Ontario

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SMALL BUSINESS WEEK

How much is your business worth?

Imagine a Montreal boardroom. On one side of the conference table sits the founder and operator of a small manufacturing company; he is the seller. Opposite him sits a man who represents a potential buyer. All that is left to discuss is price.

The seller names a figure. The buyer nods and says okay. The seller changes his mind and names a higher figure. The buyer sighs and says okay once again. The seller once more raises the price.

"The upshot is the would-be buyer just walked away," says Roger Giraldeau, Vice President of Subordinate Financing at BDC, Canada's business development bank.

"When it comes to valuing a business, owners often have an optimistic idea of what their company is worth," he says. "One of the reasons sales fall apart is that the owner wants far more than a buyer can pay."

In short, proper valuation is key to business transition issues in businesses.

"Valuation and then negotiation with third parties should be handled by external business advisers, who provide an objective perspective," he says. "There is just too much emotion involved for an owner/operator to be fair and reasonable with either."

"It is not like selling your house," says Robert Shoniker, president of Courage Capital Corp. "For men and women who founded businesses there is enormous emotional content."

The challenge most vendors have to grapple with is that valuation is a moving point, according to Mel Margolese, managing director of Crosbie & Company Inc., Toronto-based investment bankers.

"There are the hard facts of today, what might be achieved tomorrow and then there is the plan to get from today to a better value tomorrow," he says.

To determine the value of a business, valuators will look at a combination of factors: the earnings multiple, the earnings before interest, taxes, depreciation and amortization multiple (EBITDA) or the discounted future cash flow method. But all calculations aim at evaluating the business on its ability to generate cash flow.

At the same time, almost every business is different. A manufacturing company with $50 million in sales, for example, commands a premium over one doing $10 million a year.

"The reason is sustainability," says Mr. Shoniker. "One-man shows can probably manage up to $10 million a year; after that the business demands a solid management team and that team adds considerable value to a business."

Business conditions play a major role as well, adds Mr. Margolese. Today many companies sell for 1.5 times what they did three years ago simply because demand from buyers is stronger. At the same time, manufacturers exporting to the United States may find their companies are worth significantly less because the rising Canadian dollar has eaten into profit margins.

A bit of advice can sometimes mean hundreds of thousands of dollars more into the vendor's pockets. For example, Mr. Giraldeau suggests sellers separate any real estate from the sale of the business. Instead hold ownership of factory, warehouse or office space in a separate holding company and lease the property to the purchaser.

He also advises getting financial statements in shape – audited statements will be required by the buyer to obtain financing.

As to the best scenario, selling a company to family or management usually means a lower business value while selling to a competitor will usually bring in more money because of the potential synergy, says Mr. Giraldeau. When selling to family however, the vendor – who will most probably need to accept a vendor take back – should make sure to receive enough money from the transaction to allow the purchaser to manage operations with minimal interference.

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