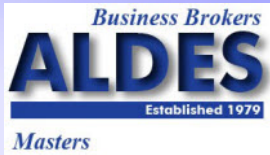


Valuing a Business



ALL THINGS FINANCIAL

Buyers and sellers are frequently at odds about the value of the business. Chris Fyfe, an Independent Property and Business Broker explores the standards for valuing a small business.

Setting A Value

Ask 20 experts to value a business and you get 20 different answers over an amazing range. You have the sellers accountant telling him he has a fabulous business with a fortune in goodwill and the value of stock and equipment. On the other hand, there is the buyer's accountant. He says it looks like a good business, but virtually non-existent goodwill and asset values which have been over inflated.

Value in a business is nothing more than what you as a buyer or seller perceive it is worth to you. Property traders can use the comparative property analysis, which records actual sale prices. These tend to be roughly similar for similar properties in similar locations.

With businesses, the variables are too great to make this type of comparison reliable. People buy businesses for many different reasons and sell them for as many. There are roughly 27 different ways to reach a value. Over the past 12 years, we have used the following three basic formulas very successfully and they are now the recommended procedure of the Institute of Realtors for small to medium size businesses.

Payback Method

Sometimes referred to as the Magic Multiplier, establishes value by multiplying the net profit by the period a purchaser would expect to recoup his investment. As a guide, an older, more established business with a high asset base, say 50%, would need 18 to 24 months to recoup the investment. A younger business with a low asset base and particularly businesses perceived to be higher risk because they are easier to start from scratch, would need 12 to 15 months.

Return on investment method

This method sets the value by dividing the net profit, after allowing for a owners salary, by an acceptable return on investment percentage.

Assess an acceptable percentage return before tax and how much one would pay a manager to run the business. The norm is 35% before tax for small to medium sized businesses with a realistic managers salary for that type of business per month.

Extra Earning Potential / Super Profits Method

Sets the value for the business based on the value of the assets, plus a goodwill figure calculated after deducting the owners salary,



plus interest from the net profit of the business.

To do this, calculate the income that would be earned from investing an amount equivalent to the asset worth of the company, its fixtures, fittings, machinery and stock, in the bank. Add to it an annual salary for managing the business, then deduct it from the net profit of the business over 12 months.

Although the result of each method may differ greatly, the average of the 3 methods is viewed as a realistic market value for the business.

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