IT'S YOUR LIFE

Understanding the Value of Your Business

If someone were to ask you what the value of your business is, would you know the answer?

There are different methods that can be used to value a business: book value, adjusted book value, Earnings Before Interest Taxes Depreciation & Amortization (EBIDTA), multiplier of sales, and straight capitalized earnings, to name a few. Which method makes the most sense for your business will depend on the type of business – it might be based on the things that you have, such as assets or liabilities, or maybe the profits that the business produces.

Let's take a closer look at some of the most common methods:

- **Adjusted book method** – This method looks at the fair market value, rather than the lower, depreciated value, of a company's assets and the total amount of debt (liabilities) that the business has. This can be a good method to use when the assets, rather than future earnings, more accurately reflect the value of the business.
- **Book value and goodwill** – This method allows for an adjustment to book value for intangible assets, such as customer relationships, employees, name recognition, and location. Those things represent the goodwill of the company. Goodwill isn't listed on the financial statement, so a multiplier is used try to determine this value compared to other businesses with a comparable adjusted book value.
- **Straight capitalized earnings** – This method solely looks at the historical profitability or stream of income the business produced in a given year, and how reliable that stream of income is. The value is determined by identifying the amount of capital that needs to be invested at an expected fair rate of return in order to generate income equal to the company's average historical income. This method is often preferred when the earnings, rather than the assets, are a better reflection of the business value.

Why is knowing the value of your business so important? Knowing the value of your business is the first step to any kind of planning you many need to do. Usually, this is the largest asset you own, and a value is needed when drafting a buy-sell agreement, estimating your future retirement income needs, and/or creating an estate plan. Knowing the value can help ensure you receive a fair price and the full value of the business that you spent a lifetime building in the event of an owner's voluntary or involuntary departure, and can also help avoid conflict with other owners, family members, and the IRS.

Business valuations can be expensive, costing anywhere from $1,000 to $10,000 or more, depending on the complexity of the business. Talk to your Federated marketing representative for more information about our value estimator service, which, while not a replacement of a formal business valuation, can provide you with a general idea of the value of your business that may be used as a starting point with your attorney and other advisors for business succession or estate planning discussions.