

How Much Is Your Business Worth?

By

Craig W. Tower CFP®

There are many reasons why a business owner may want to know how much his or her business is worth. It may be for the purpose of acquisition, sale or merger, loan collateral, divorce, tax or estate planning or as part of a buy-sell agreement.

Greg and his brother, Jim decided to have their paper products distribution company valued when they first drew-up a buy-sell agreement. After consulting with their financial planner and accountant, they instructed their attorney to draw-up a cross-purchase buy-sell agreement. The contract would facilitate the smooth transfer of ownership interest when required.

As part of the planning process, it was necessary to establish the value of the business. Their attorney recommended a couple of appraisers. Both were Certified Valuation Analysts but as Greg and Jim required a full-scale valuation, they chose the more experienced, particularly as he had worked within their industry. They were impressed by the appraiser's willingness to listen and his common-sense approach.

Appraisers use various methods but the crucial issue is to choose a qualified appraiser who is experienced enough not only to appraise tangible assets but also intangible assets such as the "goodwill" the business has with its customers. A good appraiser should be able to deliver a written report, cost effectively and in a timely manner.

The appraiser's report identified the business assets to be valued and also the valuation formula to be used in the sale transaction at any given date. The buy-sell agreement also stated how those assets were to be divided between the owners. By agreeing to the method of valuation, Gregg and Jim reduced the chance of any future conflict between them or their heirs.

Greg and Jim made a wise decision in choosing not to simply include the current market value in their buy-sell agreement. Some buy-sell agreements use a dollar amount but obviously if the company prospers and the amount is not updated, that can be a recipe for disaster.

Their business was valued based on Fair Market Value (FMV). The Internal Revenue Service defines FMV as what a willing buyer will pay a willing seller when each is fully informed and under no pressure. It is possible that buy-sell agreements can include a valuation based upon another standard, e.g. Book Value (assets less liabilities) but the only standard accepted by the Internal Revenue Service is FMV. Usually, it is accepted by the IRS as a fair standard for calculating estates taxes. If the IRS believes the owners have undervalued their business, they will revalue it and the heirs will be responsible for any additional estate taxes.

Many business owners think that they know what their business is worth. Yet, surveys continually show that business owners often misjudge the value of their business. Make sure

your buy-sell agreement includes a valuation conducted by an expert appraiser. It is just plain good sense to protect what you have worked so hard to build for yourself and your family.

Craig W. Tower CFP® is a Certified Financial Planner with Mueller Financial Services, Inc. with three office locations: Elgin, St. Charles and Oakbrook Terrace. He is a registered representative with 1st Global Capital Corp. Securities offered through 1st Global Capital Corp., Member NASD/SIPC. The views expressed are solely those of the author and may not be those of 1st Global Capital Corp. This is not an offer to buy or sell any security. The preceding information is of a general nature and should not be construed as financial, legal, or tax advice. Please consult an appropriate professional about your specific situation.