Seven Reasons for a Business Valuation

By John Nardozzi, CPA, CVA, MST

There is an old joke about an eager young accountant applying for his first job. In an effort to test the young man's basic accounting knowledge, the interviewer asked him, "How much is two plus two?" Immediately, the young CPA shot back, "How much do you want it to be?"

He got the job.

The same sort of logic applies to business valuations. How much your business is worth depends on who is asking, and why. And while you should always have a "ballpark" idea of how much your business is worth, there are times when you need to know its value more precisely.

A business valuation puts a price tag on your company's assets, both tangible (trucks, real estate, bulk plant, parts inventory, equipment, computer system, oil inventory) and intangible (customer list, logo, web site, the "good will" generated by your reputation). The value of each part of your company can be influenced by a number of factors, including your location, competitors, oil prices — even the political stability of the Middle East.

But in all cases the value assigned by a professional valuation analyst is an opinion, and can vary widely. Ask five different valuation analysts to examine the same business and you are likely to get five different valuations.

Similarly, there are seven basic reasons to have a valuation conducted, and the purpose of each will affect the outcome of the valuation process.

1. ***You are selling the business**. If you are about to put your oilheat company on the market, you must first know what it is worth so that you can set an asking price. In such a case, you want the valuation to be as high as possible, rating your assets at their maximum value. Although the market will eventually set the true value of the business (which is what someone is willing to pay for it!) you want to start the bidding as high as you can.*

2. ***You are buying another business**. Conversely, if you are looking to expand and grow by acquiring a competitor's company, you want to have it valued as low as possible. Do not rely on the valuation given by the seller (see #1 above for the reason why), but pay to have your own valuation done. You will be surprised by the difference in asking price and true value.*

3. ***You are seeking financing****. Banks and other lenders will peg the amount they will lend and the interest rate they will charge to the security you can provide them. The higher the value of your business, the more comfortable a lender will be in providing capital. Time to crank the valuation knob "up" again.*

4. ***You are getting divorced****. When it comes time to divide assets with your soon to be ex-spouse, you will once again want to minimize the value of your business. Of course, he or she will do just the opposite, and present an analysis that maximizes the value of the company. That's why lawyers make so much money.*

5. ***Succession planning****. It's time to give the next generation a chance to own and run the business. This could be in a planned and organized gifting / transfer strategy or a complete succession plan. Whether gifting or selling or some of both, a valuation is critical to the success of the plan.*

6. ***Shareholder and Partner agreements****. What happens if you or your partner dies, becomes disable or wants to retire? First, you need an agreement. Second, the agreement will require an "agreed to valuation." This can be by formula or by an outside appraiser. Either way, you will need to agree to a starting value to get the ball rolling and avoid disputes when the time comes.*

7. ***You die****. Not that you will be directly affected, but your heirs have a keen interest in the value of your business once you pass on. So does Uncle Sam. For estate tax purposes, your spouse, children and other heirs will want to minimize the value of the company. This will be particularly important if Congress and the Obama administration allow the current estate tax laws to lapse in 2010, which will bring back a much higher estate tax rate.*

As you can see, the young accountant had the right attitude. When it comes to a business valuation, you really can make "two plus two" add up to almost anything you want, depending on the situation in which you find yourself.

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