

COMMUNITY FUTURES NORTH OKANAGAN

# Small Business Valuation

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AN OVERVIEW & SUCCESSION PLANNING TOOL

# Workshop Agenda

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- Why prepare and plan for a successful succession event
- Why you need a valuation
- Evaluating your position
- Preparing for a business valuation
- Defining goodwill
- Valuation methods
- Post valuation - marketing
- Common mistakes to avoid

# Prepare and Plan

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WHAT DOES THE ENVIRONMENT TELL US?

# Why Prepare?

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- 2017 BDC Survey of Canadian entrepreneurs showed that:
  - 41% of businesses expected to exit their business within five years and not buy another
  - 8% expected to exit their business and acquire another
- That's **49%** that expect to **exit** within five years
- **1 in 8** said they are expecting to leave within **1 year**
- **5 out of 6** said they are exiting to **retire**

# Why Prepare?

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How do entrepreneurs plan to exit?

- 26% noted family succession
- 52% noted sale/transfer to a third party
- 22% expected to wind down their business and sell its assets <sup>(1)</sup>

(1) Business Development Bank of Canada – The Coming Wave of Business Transitions in Canada

# Why Prepare?

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What does this all mean?

- Large amount of businesses will come on market in near term
- Aging population and retirement means buyer pool will be limited
- Competition for buyers will be fierce
- Buyers don't wait for you to prepare – they find someone who is
- Given supply-demand imbalance in businesses for sale, maximizing value will require sound planning

# Why Plan?

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- Planning can take **2 to 5 years** depending on complexity of business in order to:
  - Minimize future tax liabilities
  - Minimize marketing costs and time to sale
  - Minimize impact on stakeholders
  - Maximize cash flow
  - Create and maximize goodwill
  - Maximize value and ultimately sale price
  - Identify the right purchaser and have a smooth transition

# Reasons for a Valuation

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WHY DO YOU NEED ONE AND WHEN?



# Why Obtain a Valuation?

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- Succession planning
- Sale of a business
- Purchase of a business
- Matrimonial settlements
- Partnership dissolution
- Admitting new partners
- Offer to buy or sell a minority interest
- Insurance claim
- Litigation and claim for business loss
- Re-financing or new financing
- Estate planning or death of owner
- Tax restructuring and corporate restructuring

# Why Obtain a Valuation?

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## **Purchaser:**

- Minimize purchase price – don't overpay
- Want to obtain ROI within a reasonable time and at a reasonable threshold
- Want to add value to business – to make money
- Assess the 'future' potential of the business
- To negotiate with seller

# Why Obtain a Valuation?

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## **Seller:**

- Maximize purchase price – determine worth
- Make sure hard work is not lost in business (goodwill)
- To develop competitive and reasonable asking price for business
- To be competitive with other investments
- To address negotiating points from purchaser

# Evaluating your Position

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WHERE DO YOU STAND NOW?

# Evaluating Your Position

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## What is working for your business?

- Strong market
- Niche
- Customer base
- Experience, knowledge
- Price, value, quality
- Processes, systems, IT, communications
- Low expenses, solid profits

# Evaluating Your Position

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## What needs improvement?

- Customer or supplier concentration
- Gaps in capabilities, manpower, knowledge, technology
- Financing or cash flow issues
- Expense control
- Processes, systems, IT, communications
- Location, geography
- Barriers to entry

# Evaluating Your Position

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## What are the Opportunities?

- What trends do you see in your industry?
- What external changes present opportunities?
- What technologies could present opportunity?
- What new markets exist – customer segments or geographical?
- Any favorable government policy changes?
- Social patterns, population profiles, lifestyle changes, trends?
- Partnerships, agencies, product distribution points?
- Volumes, production, economies of scale, cost control?

# Preparing for a Valuation

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STAGING YOUR HOUSE



# Preparing for a Valuation

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- Customer, supplier and product diversity
- Management tools, handbooks, processes, documents
- Reliable revenue, contracts
- Innovate, differentiate and define
- Prepare facilities and property
- Prepare staff

# Preparing for a Valuation

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- Put yourself in your buyer's shoes – what are they looking for?
- Gather information
- Timing – seasonal, annual, market stage
- Consult with lawyer, accountant, insurance – is the house in order?
- Identify potential buyers
- Identify what is and what is not included in the sale
- Self-audit and manage your online profile, reputation and posts

# Preparing for a Valuation

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- Identify earnings power – continuation and growth
- Define barriers to entry
- Is financing available for the future purchase (external or vendor)
- Eliminate obsolete inventory, write off bad debts
- Strengthen legal matters (contracts, claims, compliance, ownership, filings)
- Turn-key tools and manuals
- Back up goodwill – is it transferable or is it personal

# Preparing for a Valuation

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## Keep in mind:

- Value relates to a specific point in time
- Value hinged on future expectations
- Circumstance of sale affects value
- Circumstance of buyer affects price
- Financing is a major hurdle in most purchases

# Goodwill Defined

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DO YOU HAVE IT?

# Goodwill Defined

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- Value of the business in excess of its tangible net assets
- Otherwise defined as “excess profits” – those profits above a market or usual rate of return on money invested in a business
- Otherwise defined as the intangible value of the business including items such as:
  - Brand name
  - Customer relationships
  - Employee relations
  - Patents or proprietary technology

# Goodwill Defined

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- Increase utilization of equipment
- Improve your brand/reputation
- Document customer lists and improve public relations
- Implement technology
- Negotiate terms with suppliers
- Improve operating methods
- Enhance employee relations
- Proven marketing strategies
- Acquire or create patents or proprietary products

# Valuation Methods

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WHAT YOU NEED TO KNOW



# Valuation Methods

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**Three main business valuation methods include:**

- Income approach
- Asset approach
- Market approach

# Valuation Methods

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## Income Method

If the time, money and effort were invested –  
what *income* would this provide me and when?

Key objective: to determine the business value as a function of its normalized income and return over time

# Valuation Methods

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## Asset Method

What will it cost to create this business and have it produce the same economic benefits as it does now?

Key objective: to determine the business value based on the fair market value of its assets less its liabilities.

# Valuation Methods

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## Market Method

What are other businesses worth that are similar to mine?

Key objective: to determine the value based on a relationship between the business' economic performance and its sales price on the open market.

# Post Valuation

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HOW WILL I MARKET AND SELL MY BUSINESS?

# Post Valuation

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## Market the Business

- Personally contact buyers
- Use your networks and contacts
- Utilize local business support organizations
- Advertise to intermediaries who may have interested clients
- Advertise in specialist trade journals and general press
- Advertise on business for sale websites

# Post Valuation

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## Online **business for sale** websites

- <https://www.ventureconnect.ca/business-listings>
- <https://www.business-trader.com/>
- <https://canada.businessesforsale.com/>
- <https://www.businesssellcanada.com/>

## **Opportunities BC**– foreign investment

- <https://www.britishcolumbia.ca/invest/opportunities/search/>

## **Provincial Nominee Program** – Entrepreneurial Immigration

- <https://www.welcomebc.ca/immigrate-to-b-c/b-c-provincial-nominee-program>

# Common Mistakes

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AVOID THESE COMMON PITFALS



# Common Mistakes to Avoid

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- Overpricing the business
- Providing inadequate documentation for revenues, expenses, assets and/or liabilities
- Trying to sell the past, not the future
- Skeletons in the closet
- Unreported income or expenses
- Limited vision of target market or inflated vision
- Inability to show potential for growth and/or improvements

# What's Next

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WHAT EVERY BUSINESS SHOULD DO FROM DAY ONE

# Next Steps

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- Decide where to start
- Set priorities – specific, measureable, attainable, relevant, time-bound (SMART)
- Access supports such as:
  - Accountant
  - Lawyer
  - Banker
  - Insurance specialists
  - Community Futures
  - Websites provided and own research

# Questions?