How Much Is My Business Worth?

PLACING a value on company is a critical step in the acquisition process. It is even more important for private companies because they are frequently the product of a life's work. Entrepreneurs often invest their family's savings and time into their business in order to grow it into a thriving enterprise. Often the vast majority of an owner's wealth may be contained in the value of their business. When an owner decides to sell the business the objective typically is to maximize the final purchase price.

Although there are five or six commonly accepted valuation methods used to value a company, understanding why the buyer is interested in the acquisition shapes the negotiation. Some of the reasons why acquisitions are made include:

1. Reconstructed earnings (improved bottom-line performance)
2. A desire to distribute products or services in buyer's own established marketing network
3. A desire on the buyer's behalf to sell its own products or services to the seller's customers
4. Eliminate competition
5. Distribute the expenses over a number of locations to achieve economies of scale
6. Enter into the U.S. market (for the case of a non-US buyer)

Buyers value a company based on a variety of methods and the final pricing of the transaction may depend on timing, recent transactions, size complexity and structure of the deal, and the availability of financing. The final price is typically measured as a multiple of the company's EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization), multiple of EBIT (Earnings Before Interest And Income tax) and sometimes multiple of Revenues or Pre/After tax profits. Multiples of EBITDA are the most popular benchmark used by buyers and sellers - particularly the Investment Groups or Private Equity Groups. Public Companies and Non-US buyers are discussed shortly. Fortunately for owners, the average multiple for middle-market transactions has increased considerably since 2002 as seen in Figure 1.

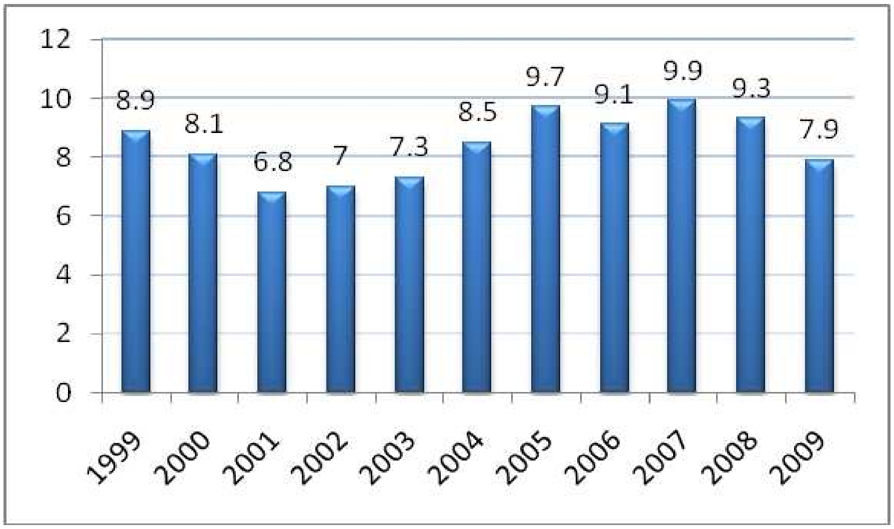
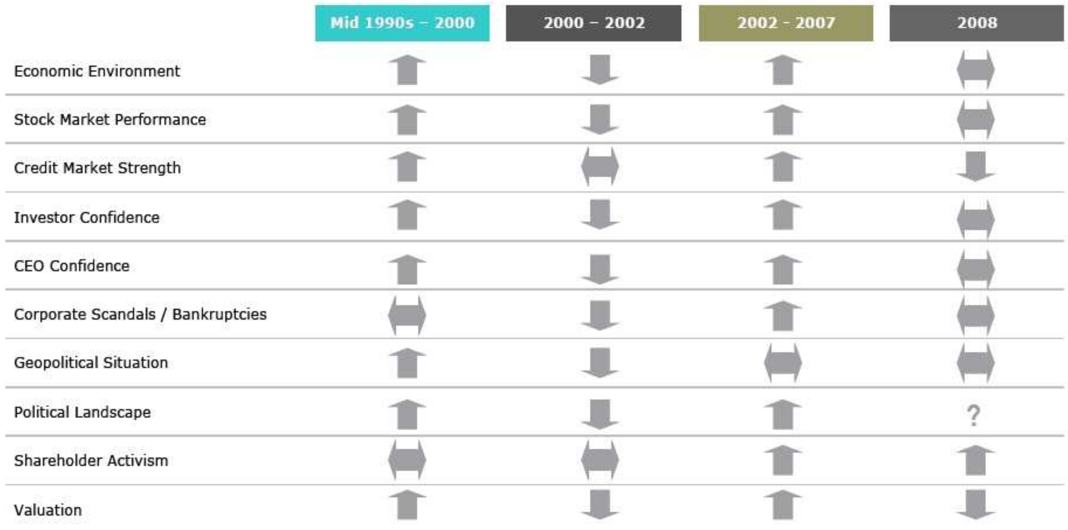


Figure 1: Median U.S. Middle-Market Enterprise Value to EBITDA Multiples

It is important to note that these multiples use the much lower reported, rather than reconstructed, earnings. The multiples would also be lowered if real estate transactions were not included in the calculation. While the trend in EBITDA multiples can be used as a generic benchmark, sellers should not take this as sole determinant of value. True valuation of a firm at any given time is influenced by specific industry segment of the firm, access to financing, economic environment and M&A Activity in the market among other factors. Recent trends in valuations and various factors influencing the results are shown in Figure 2.

Valuation of a specific firm does not always follow the generic trends. Other factors that are more specific to a firm influence the valuation and frequently take the value against the trends. For example, companies that are paid an above average multiple often have one or more of the following characteristics:

1. Earnings that exceed the industry average or earnings that show consistent and significant growth
2. Well-maintained and up-to-date machinery, computers, and inventory control systems
3. Absence of excessively late accounts receivable or payable and little dilution of receivables
4. Diverse group of customers and suppliers with no entity representing more than 10-20% of annual business



Source: Thomson Financial and Robert W. Baird & Co. Incorporated M&A Market Analysis.

Figure 2: Trends in Factors Affecting Acquisitions

5. Reasonable levels of inventory with high turnover and little obsolescence or spoilage
6. A position of strength among its supplier base
7. Strong credit history including up-to-date payment on loans
8. Strong, non-unionized labor force
9. Assignable leases at or below market rates
10. High barrier to entry in the industry
11. Solutions offered for large problems
12. Patented or proprietary products or business knowhow
13. Growing industry or untapped opportunities for growth
14. Strong line and staff management
15. Attractive facilities
16. No environmental problems or liabilities

Additionally, the price paid may be substantially higher depending on the timing and structure of the sale. The demand for companies in a particular industry, and consequently the multiple paid, fluctuates over time, as does the economy in general. Some industries have also commanded a higher premium over time. Average EBITDA Multiples for various industry sectors during 2007 are shown in Figure 3.

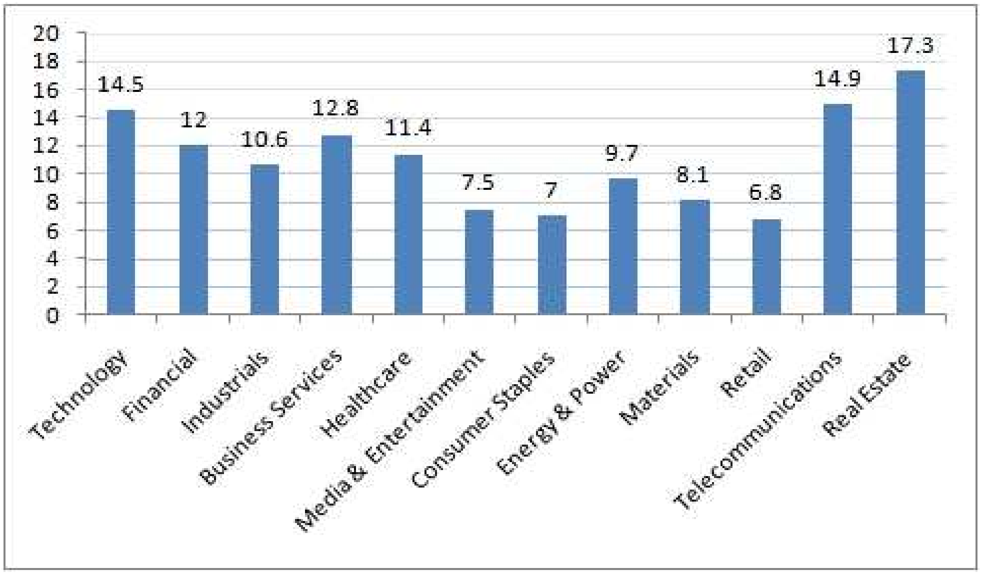


Figure 3: 2007 EBITDA Multiples by Industry

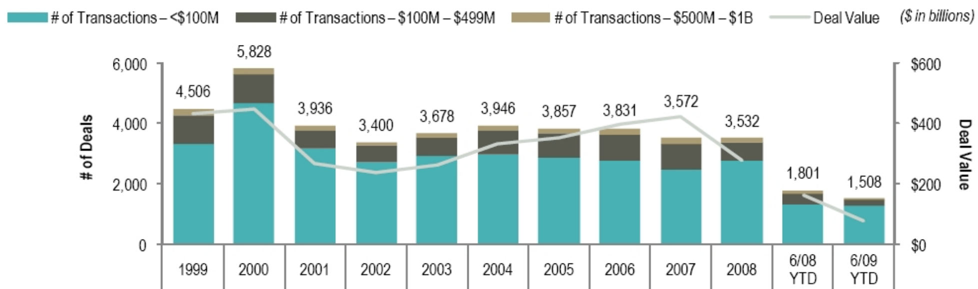
Companies that have not fully matured and still have substantial growth are often more valuable. The structure of the sale may also affect the price paid, and the ability to be flexible may create additional value for the seller. Oftentimes the most important negotiating points to the owner are less important to the acquirer, and armed with this information, skilled investment bankers will create more after-tax dollars for the owner. For example, structuring a sale where the owner stays for a transitional period of time while receiving a percentage of sales or profits may dramatically increase the final price paid. At the same time this will provide greater assurance to the buyer that the owner has been forthright in presenting the company in an accurate manner.

Finding the right buyer is also important in a sale. An acquirer who is a good strategic fit for the company is more likely to pay a higher price and the continued operation of the firm may be more successful frequently. Buyers look for target companies that feature:

1. Very strong brand or product line
2. A strong distribution network

3. A strong management team
4. Proprietary information or legal rights including patents, customer lists, or licenses
5. An opportunity to vertically integrate their operations to achieve lower costs or a more efficient way of distributing fixed costs
6. Expanding the acquirer's customer base, creating greater market share, or gaining penetration into new markets

Public Companies and other corporate buyers who are looking for a strategic fit are more likely to pay a higher price compared to Private Equity or Investment Groups looking for a value buy. The absolute number of deals involving corporate acquirers has increased over the last four straight years not with-standing corporate activity as a percent of total (U.S.) deals was reduced slightly due to the continued increase in the number of deals involving Private Equity acquirers. Buyer's activity from 1997-2007 is provided in Figure 4.

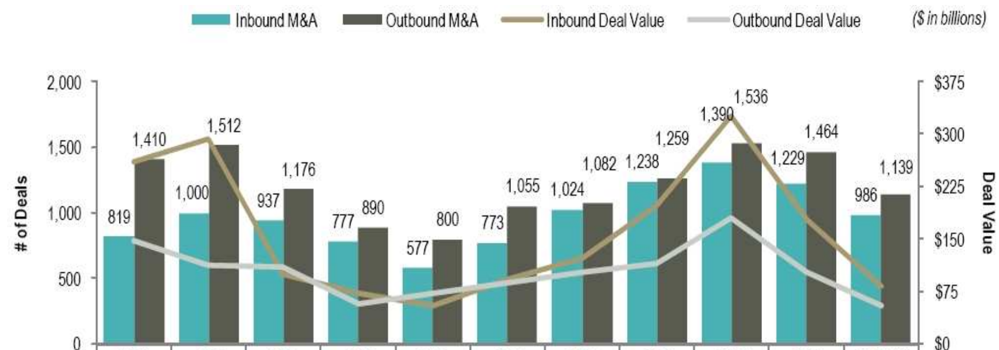


	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	6/08 YTD	6/09 YTD
# of Transactions – Middle-Market	4,506	5,828	3,936	3,400	3,678	3,946	3,857	3,831	3,572	3,532	1,801	1,508
# of Transactions – $500M – $1B	218	201	113	100	106	137	149	182	236	123	77	29
# of Transactions – $100M – $499M	935	950	622	545	626	795	806	871	842	612	352	178
# of Transactions – <$100M	3,353	4,677	3,201	2,755	2,946	3,014	2,902	2,778	2,494	2,797	1,372	1,301
Deal Value	$436	$450	$272	$240	$266	$336	$354	$401	$424	$280	$165	$80

Source: Dealogic and Robert W. Baird & Co. Incorporated M&A Market Analysis.
Note: Middle-market transactions defined as those with a disclosed transaction value of less than $1 billion. Figures exclude transactions involving minority stakes, stock repurchases, and spin-offs.

Figure 4: M&A Activity By Year

Another group of buyers that often pay a premium to affect an acquisition are non-U.S. buyers. These are the companies trying to enter into the U.S. market through an acquisition. Consequently, market share of the target company might be more important than after tax earnings for these non-U.S. buyers. Furthermore, tax laws in certain foreign countries do not penalize earnings due to goodwill that their U.S. counterparts' experience. Companies from such countries are able to pay premiums that are higher than those offered by strategic buyers from the U.S. Number of U.S. targets acquired by European companies increased steadily during past 5 years. This trend can be seen in Figure 5.



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	6/09 LTM
Inbound M&A	819	1,000	937	777	577	773	1,024	1,238	1,390	1,229	986
Outbound M&A	1,410	1,512	1,176	890	800	1,055	1,082	1,259	1,536	1,464	1,139
Inbound Deal Value	$261	$293	$101	$71	$55	$92	$122	$199	$325	$178	$83
Outbound Deal Value	$148	$112	$110	$57	$73	$88	$102	$114	$181	$101	$54

Source: Dealogic and Robert W. Baird & Co. Incorporated M&A Market Analysis.
Note: Inbound M&A represents U.S. target/non-U.S. acquiror; Outbound M&A represents non-U.S. target/U.S. acquiror. Figures exclude transactions involving minority stakes, stock repurchases, and spin-offs.

Figure 5: Global M&A Activity By Year

The selling price of a firm almost always increases when multiple acquirers are interested in the transaction. While a single firm may present a viable offer, competition for the acquisition will help ensure that the acquirer's bid is their best offer. Furthermore, with multiple offers, the owner may select the acquirer whose offer is the best fit. While a higher price is ideal, other important issues may include the structure and timing of payment and the acquirer's strategy for the target firm in the future.

A vital process completed by investment banker is the reconstruction of the earnings of a private company. This is where the financial statements are adjusted to reflect the capital structure and expenses as if it were run by the acquirer. These may include owner's compensation, consulting fees, pension and profit sharing items expensed rather than capitalized, unusual business expenses, relocation costs, or perquisites, and experienced advice may help a seller achieve a higher price in this manner.

Obtaining experienced advice regarding the sale of a private company is essential in obtaining an offer that best fits the owner's needs. Not only can the strengths of the company be highlighted, but the weaknesses can be presented in the best possible light. Additionally, an investment banking firm may have access to more possible acquirers, increasing the likelihood that a buyer will be interested, and also increasing the likelihood of a competitive bidding scenario. Seeking professional advice allows you to focus on your strength: running your company.

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