How Much is Your Company Worth?

Virtually every manufacturing firm can benefit from a determination of its own value. Such an undertaking can easily become a necessity, in fact — one that arises for various reasons.

Obviously, a sale, purchase or merger requires an objective calculation of the value of a company. Many other questions — involving taxation, insurance, financing, litigation, succession, joint ventures or employee stock plans, for example — also call for valuation.

Because some of these questions can arise suddenly, performing a complete valuation and periodic updates is a healthy practice for any manufacturing concern. Just as a successful company strives to understand its markets, competition and supply chain, so should it strive to understand its own culture, processes and value.

The very concept of value, especially to the owners of a privately held company, often carries strong emotional connotations. They built it, after all, and it’s their mark upon the world. But in the marketplace, where the final determination is made, arithmetic holds sway: A company’s assets, minus its liabilities — all measured by objective standards — constitute its value.

The arithmetic, however, isn’t simple.

Assets, Tangible and Intangible

Among your assets are tangible and intangible ones. The easiest to value are tangible assets like cash and accounts receivable. (Most liabilities can be valued in such a straightforward way, too.

Fixed assets, though tangible, are more complicated. One turret lathe is shiny and new, while another has put in serious mule time. One spacious warehouse is fifteen feet from a Burlington-Northern main, while another stands on a quiet prairie, close to nature, far from highway or railhead.

Other assets aren't tangible at all, and determining the value of intangible assets is an even more complex undertaking. Customer lists, solid business plans and well-ordered financial books all have value — but what is it? And what about the heart of your company — how can a price be put on the untouchable reputation for integrity that you've achieved?

Straightforward or complex, all of these things are judged using the same underlying concepts. One is called fair market value, or FMV. This can be defined as *the price at which the property could change hands if buyer and seller both were willing, free of compulsion, and possessed of all relevant facts*.

"Present Worth of Future Benefits"

Rational buyers, of course, would attach no value at all to a company unless the benefits they could anticipate from ownership — more precisely, the value of those anticipated benefits *today* — were greater than the purchase price. In other words, the value of a business is equal to the present worth of the future benefits of ownership.

That's a fundamental premise, and it's why the components of the valuation equation are calculated with reference to their potential to increase earnings. Business valuators look at other factors, too: a company's history, the nature of the business, prevailing economic conditions, general outlook for the industry, prior stock transactions and — often most decisive — the real-world purchase prices of comparable companies.

Proportion of interest also has weight in a calculation of value. A majority interest is not only worth more than a minority interest, but *disproportionately* more. That's because, in addition to a mathematical entitlement to the lion's share of earnings, the majority interest can direct the entire company in the direction of its choosing.

Three approaches to valuation are commonly used.

- *Market approach*. This method looks primarily at comparable companies — the market price of stocks, if the companies are publicly traded, as well as merger and acquisition data. The biggest challenge in this approach is finding true comparables.
- *Asset-based approach*. This method is most appropriate when current returns to shareholders don't adequately reflect fair market value. It relies upon the tangible asset and book values, express earnings calculation and liquidation value.
- *Income approach*. This method weighs cash flows, earnings capitalization (adjusted for external conditions and internal risk factors), price earnings multiples, discounted future earnings and so on.

To learn more, contact us — our experts in manufacturing and valuation can show you some options for getting started.