# Business Valuation Guide

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***TIP:*** *Ultimately your business is only worth what someone is willing to pay for it at any given moment in time. Use this document to help you value & negotiate different aspects of your business.*

# Valuing Hard Assets

**Factoring Depreciation into the Value of Business Assets**

Depreciation allows you to recover the cost of certain property over the time. It is an allowance for the wear and tear, deterioration, or obsolescence of the property. In general:

- You must use the property to generate income in your business
- The property must have a determinable useful life
- It must last more than one year

**Straight depreciation**

Straight line depreciation incrementally reduces the value of the property each year it is used by a business for #X of years. You can easily calculate depreciation by asking two simple questions:

- At the end of it's useful life how much could I sell this property for?
- How old is the property?

You can estimate the current value by reducing the purchase price of the item $X for each year it has been in service. The 'total depreciation' + 'final sale price' = 'original purchase price'.

**Accelerated Depreciation**

Business Tax returns do not always reflect market conditions. Accelerated Depreciation are tax tricks CPAs use to frontload the depreciation of an asset which artificially generates losses to save money on this year's taxes.

- Only available on certain assets like vehicles, buildings, and equipment you plan to own for a minimum (and reasonable) number of years.
- If you sell the property within X years or close your business before a certain date you will owe back taxes.

# Valuing Soft Assets

**Intangible 'soft' assets**

Intangible 'soft' assets are usually invisible unless someone goes through the effort of writing them down to make them more visible. The 'value' of a soft asset is also subjective and will be different from one buyer to the next. So expect a negotiation between the buyer and seller to occur.

As a seller you want to list all soft assets and ascribe a value you are willing to negotiate towards. Keep in mind the buyer will be looking to depreciate these assets so help them justify your valuation. So list the soft asset values in the following format:

- Name of the asset
- Your valuation & justification
- Example: $X over X years

By suggesting a soft asset has a lifespan and dividing the asset over time, you will help make the buyers decision easier.

## <u>Here are common soft assets:</u>

**Phone Number**
Make sure your phone carrier will allow you to transfer the number to a new owner. Sometimes an area code adds value. Easy to dial numbers like 444-TUNE don't matter as much in the age of cell phones but do help reduce friction for new customers. The number of business cards you have sitting out in the community DOES matter so estimate this for the buyer "I have 10,000 business cards out in the community with this phone number on it...."

**Web Domain & Email**
As .com domains become harder to find this is important. But only if you have something short, easy to remember, and easy to spell. Also, estimate the number of business cards out in the community that have this domain & email listed. Also include things like the current website ranking on Google and SEO positioning. If it helps your case.

**Customer Aging & Activity**

List the total size of your database & then break it down into no more than 3 big groups of people using metrics like '# of of active clients who service their piano every X number of months'. You can also highlight the number of clients for whom you have FULL contact data vs. partial contact data.

**Estimating Active Clients**

If your data is really messy estimate your 'Active' clients using a breakdown like this:

- 99% of clients who haven't serviced in 25 years are inactive
- 90% of clients who haven't serviced in 20 years are inactive
- 70% of clients who haven't serviced in 10 years are inactive
- 50% of clients who haven't serviced in 5 years are inactive
- 30% of clients who haven't serviced in 3 years are inactive
- 20% of clients who serviced within the past 1 year are inactive
- 10% of clients who serviced within the past 6mo are inactive

**Estimate Business Growth**

Divide your total number of clients by the number of years you have been in business. This gives you the avg # of clients per year you are growing. Also highlight "I added X number of new clients last year". Usually your new client count from last year is higher than your average. This demonstrates an ongoing concern for the potential buyer.

**Estimate New Client Conversions**

On average X% of people who inquire about my business schedule an appointment. Only list this if it is above 35%. If the number is above 66% you are bluffing or you don't have good data, or your business is priced too low. See our pricing webinar

**Types of Pianos**

Report on types of instruments in your active client roster:

- Grands = X% of my active clients
- Uprights = X% of my active clients
- Spinets = X% of my active clients
- Other = X% of my active clients

**Inactive pianos & clients don't matter.*

**Customer Contracts & Recurring Revenue**
If you have any contracts with institutional clients (or service contracts with residential clients) this will add considerable value to your book of business. Just make sure your contracts are transferable. Most institutions have an 'ownership transfer clause' that voids the contract if the company goes through a transfer of ownership.

**Online Reviews**
Transferring your digital business accounts to the new owner is usually easy. This is important especially if you have tons of positive online reviews. Sustained online reviews over time are better than a glut of fresh ones. Also, great responses to negative online reviews can be an asset. Poor responses are a detriment.

**Location, Location, Location**
Highlight anything of value about your location, zip code, etc... If you are in a particularly musical city, a tight knit community, or have notable clients who look to partner with you in the community; all of this adds potential value if you list it as a soft asset.

**Revenue & CRM**
Mention you use Gazelle and Break your 1-year & 5-year revenue down into these categories:

- General Service & Repairs (any invoice under $1,000)
- Repairs & Rebuilds (any invoice over $1,000)
- Moving & Storage (if applicable)
- Sales (If applicable)

Revenue over 5 years old isn't worth anything unless it is ongoing recurring revenue with a history of low churn.

**Customer Expectations & Behavior**
What have you done to prepare your customers for the sale of your business? List everything:

- I have trained them to pre-book every appointment
- They are expecting me to recommend my replacement
- My piano teachers expect me to give a presentation to their students once a year

- I require all my venues to provide me with a key/access codes.
- They are used to confirming appointments X weeks in advance
- I have been talking to them for the past X years about my need to retire.
- I have inactivated all kept detailed notes on bad clients
- I will do X, Y, Z once we have a signed deal.

**Business Name & Branding**
If you have a branded business this will only be valuable if the new owner will be keeping the brand. Highlight your company logo's, letterhead, advertising copy, samples of ads, business story positioning, etc...

**Email Lists & Sales Funnels**
If you use constant contact, mailchimp, etc... Highlight the size and activity of these lists. Facebook & Social media accounts are only as valuable as the activity you generate on each of your posts.

**Musical Exposure in the Community**
Highlight a list of all your piano teachers, professional musicians, and partnerships you have made in the past with people in the community. The ones of greatest value will be the ones that are predicted to occur again in the future. This helps add going concern to the business valuation.

**Financial Documentation**
Highlight the number of years you have used an outside accountant an offer to send them the financials for the past 5 years of your business (or as many years as you have data)

**Owner support**
I will be sending out 3 letters of support on X date, X date, and X date. I will also be offering to stay on (as an employee) for the next 18 months to help with the transition.

# Valuation Formulas & Factors

A 1x valuation means the buyer is paying a fair price for the asset. And if the asset is "$X/year" it means the buyer can recoup their costs in 12 months. Here are some rules of thumb:

**Valuing Profit**
3x Annual Profit is usually a fair valuation for profit. This means the buyer can expect to recoup all costs associated with a business within the next 3 years.

**Remember "Profit" is any money left after ALL expenses have been paid including the salary paid to the technician(s) for doing the work. Freelancers will probably calculate profit differently than business owners.*

**Hard Assets**
1x Depreciated Value of Assets is a fair valuation. Remember land and location do not depreciate. They add to the value of the tangible asset they surround. Cash in operating accounts usually gets valued at 1x.

**Soft Assets**
???x is a fair valuation. Soft assets are worthless if the company isn't profitable. Look at each soft asset and assign a value to it, then negotiate towards this number. Remember buyers need to be able to recoup these costs over time. Usually, the value of soft assets becomes the "supporting evidence" a buyer needs to accept a higher valuation.

**Ongoing Concern & Trademarks**
Going concern is a type of soft asset that the seller isn't usually aware of until a buyer reveals 'why' they want to buy this specific business. It is usually factored into the valuation of a branded company where the value of the brand is high. But this can extend to things beyond just "Brand".

For example: A buyer may see an opportunity to turn a failing company around. Which means there is hidden potential in your company that can be tapped if things are managed better.

# Creative Financing Structures

Owner financing is usually going to help increase the price you can get for your business. So get creative:

- $X today + $X over the next 5 years
- $X today + $X on the first appointment
- $X today + $X in a legal note where the seller becomes the bank
- $0 today + 100% of the first $X of revenue over the next X years, + X% interest in exchange for accepting payment over time
- $X for all hard assets + $X over time for soft assets

You want your deal to be simple, straight forward, and to have a defined amount of time. More than 5 years is probably too long to extend owner financing. Don't be afraid to tell a potential buyer they are simply not financially qualified to be considered a potential buyer.

# Continuation of Existing Legal Structures

Unless you have a C-Corp or publicly traded company; there is a high likelihood the buyer will simply take over all the soft assets, sign for ownership of the hard assets (including patents & trademarks) etc..., and then instruct you to quietly dissolve the shell of your old company and liquidate any cash reserves you had in your bank accounts. This provides legal separation and limits liability for the new buyer.

In some cases a new owner might want you to keep the legal structure in place (for instance: if they don't currently own a company and are purchasing a branded company). This saves the new owner time because they don't have to go through a bunch of paperwork to register a new company and create new vendor accounts.

## Listing a business for sale

Because customer relationships need stability you don't want to put a 'for sale' sign on top of your car and drive around town announcing you intend to sell your business. Be discrete so your potential clients don't know you are in the process of seeking a buyer.

**Using Business Brokers**

Business brokers (like real estate brokers) work on commission. Hiring a business broker is only going to make sense if you have the potential for a high-valuation and/or you don't want to deal with the hassle of finding & negotiating with potential buyers. If you don't hire a broker THEN YOU ARE THE BROKER. If you are going to broker your own business sign up for an anonymous email like MYCITYPianoBusiness4Sale@gmail.com

**Listing a Business for Sale**

Use the letter template below to promote your business. Keep it short & focused on the important data. Because our industry is small potential buyers will probably be able to figure out who is selling the business. However, the information in your listing should be vague enough that potential customers cannot identify you as the seller.

# Piano Service Business for Sale!
# $150,000

Revenue $200,000+, 3000 Active Clients, Great Online Reviews, and in a tightly knit local community in Central Virginia with limited competition. Owner financing available.

**Included:**

- Phone # w/ 30 years (25,000 business cards) out in the community
- Great location to raise a family
- Contracts with symphony & two local universities to service 75 pianos annually.
- Tools (optional for purchase valued at $8,000)
- Owner willing to stay on for up to 18 months to help you transition.

# Negotiating the sale of your Business

**Never make the first offer**
If you are asked to come off your list price, never make the first offer. Meet with the potential buyer personally to make the case for your valuation and then allow them to give you an offer and use this as the basis for future negotiations.

**Deny their first offer and provide a counter offer**
This is just a negotiation tactic and it helps you maintain your negotiating strength. The first person to offer to buy your business is probably your best ‘offerer’. Meaning you will probably get the best deal from this person so negotiate for a better deal.

**Set a time limit for yourself**
Don’t spend more than 1-hr with a non-qualified prospect; and never spend more than 5 hours with a qualified potential buyer before asking them to make you an offer.

**Be clear, firm, and patient**
This is your best negotiating leverage. Communicate with the buyer that you want to make a deal but you need to keep your options open if the offer isn’t strong enough.

**Qualify buyers quietly**
Don’t scare buyers off by asking them to fully qualify themselves immediately. Instead keep a running tab in your head and casually ask them to provide you with whatever information you need to qualify them as a lead. The more qualified they become, the more time you should invest in the relationship.

**Suggest a firm date for a transition**

“I would like to transition immediately and then work for the new owner for 18 months to help them maximize their value from the deal”

“I would like to have a signed deal by X date and a timeline for transition if you need time to get things in order.”

“If you are going to be financing the deal through a bank I need to know you are approved for the loan by X date”