How are businesses valued?

There are lots of different ways of arriving at a business's value. They all largely boil down to the same thing — "**return on investment**". A buyer is asking him or herself, "what will I get back if I buy this business, and how quickly will I get it?"

Valuation multiplier and return on investment (ROI)

The Valuation Multiplier determines the sale price of your business. Buyers buy profits, so a potential buyer is willing to pay some multiple of your annual profits when purchasing your business. A multiplier of four means that the buyer will pay four times your annual profits, with the buyer reasoning that it will take four years to get their money back.

The Return on Investment is calculated as the potential annual profits of the business divided by the purchase price of the business. If annual profits are $50,000 and the business sale price is $200,000, then the ROI is 25% and the multiplier is 4x. In other words, the ROI is the inverse of the multiplier.

What determines the multiplier?

The size of the multiplier is a question of perceived risk and opportunity. Companies with lower risk tend to generate higher multiples – for example, McDonald's franchises with their stable revenue flow and household name recognition are perceived as very low risk, and routinely sell for a 10 multiplier. Similarly, companies with perceived high opportunity (even if risky) can sell for a high multiple, as is the case with many technology start-ups.

Let's start with risk.

The first risk a buyer wants to understand is the reason you are selling. Buyers are inherently suspicious. Is your industry or your product in the twilight of its life cycle? What major contract are you losing? What supplier is about to go direct?

What technology is about to wipe out your industry? Which staff are about to start up in opposition to you? It is imperative that, as a seller, you demonstrate a confident understanding of the risks your business faces. That you understand them, have planned for them, and that these factors represent opportunities for the business rather than downside risks.

The second factor is opportunity.

This is where it gets exciting. If we look at some public companies, they will trade shares at a multiplier of up to 100. That is a 1% return on investment for a buyer.

Why would a buyer be interested at such a low return? It is solely because of opportunity. Is the business on a trajectory to return higher profits in the future? Is there an opportunity to remodel the business? Are there economies of scale? Is it franchise-able? Are there new markets waiting to be tapped? The more opportunity you can prove, the better your multiplier will be.

Our goal is simple. EndVision is here to increase the multiplier in your business. Whether the market's starting multiplier for your business is 2x or 10x, we'll use our expertise and experience to move that number up.

EndVision exists to analyse your business, take away the risks, strategise on the future, and prove the opportunities.

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