



# KNOW YOUR BUSINESS VALUE

The benefits of assessing your SME

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## Introduction

Life as an SME owner can be really challenging, with cash flow, marketing, innovation, technology, competition and staff to worry about, among the rest. According to the Australian Bureau of Statistics, [less than 6% of all Australian businesses reach annual revenue of \\$2m or more](#), so the hard slog doesn't necessarily mean financial buoyancy.

There are nearly 2.1 million businesses in Australia, spread out across 20 industry segments. There is a lot of competition for the hard-fought revenue you need to sustain a commercial return. So the real question most business owners should ask is, 'Is my business generating sufficient value?'.

As an SME owner-operator, it's also important to always have your long-term exit strategy in mind, which is why knowing the true value of your business really matters.

This *SmartCompany* eBook, sponsored by SMART Valuations, uncovers why it's important to understand the value of your SME.

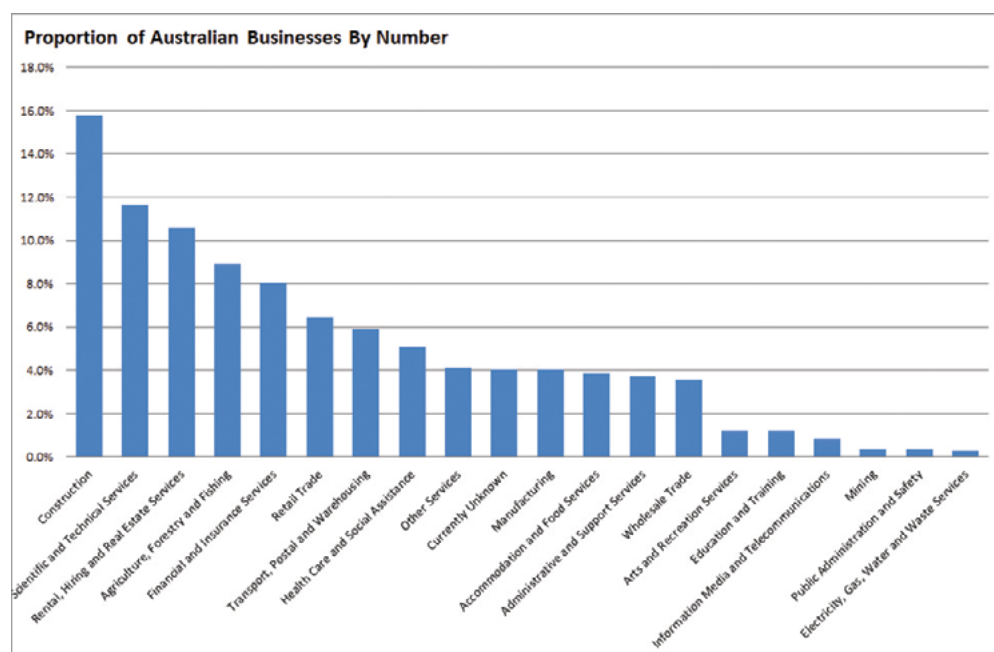
A valuation is critical for all sorts of eventualities, including succession planning, selling the business, preparing to float, partnering up, acquiring other businesses, looking to get investors, or ensuring that the business will support a retirement lifestyle.

However of the SMEs that do undertake a valuation, many are inconsistent or wrong as a result of substandard documentation and inconsistencies in analysis. If a valuation is done incorrectly, an SME can lose money in the long run from higher taxes, a lower sale price or a negative dispute outcome because the valuation report did not sufficiently support their case.

Through this eBook, we'll explore the fundamentals of an SME business valuation – looking at key issues such as why it matters, what it involves, how to get it right and how you can plan ahead to boost the value of your business in the future.

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Andrew Bethune, a principal from Daniel Allison & Associates with 25 years' experience in taxation and accounting says:

"Most SMEs are focused on day-to-day business operations and there's less value placed on strategic operations over time. I suspect a lot of SMEs have a gut instinct as to the value of their business, but if they're in it for the long haul it's less of a priority to know the 'down the line' value of their business until a critical event occurs. For example, they may need to obtain finance, or there's a sale event, succession or death, or they may be about to admit a new shareholder or principal. Sometimes they need their head turned as to when is a good time to sell."

According to SMART Valuation's [Top 5 reasons a valuation creates wealth](#) report, the need for valuations can be divided into two categories:

1. *Discretionary events*: The planned sale or purchase of a business or proactive succession planning.

2. *Non-discretionary events*: Compliance with taxation audits, family estate matters, dealing with financial stress.

### The benefits of valuing your SME

Bethune believes a valuation can provide a reality check by bringing an external set of eyes in and, if the valuation's done properly, it can highlight risk areas to the business, as well as strategic areas that the owners should be focusing on, in respect to:

- Distribution channels
- Customer mix
- Supply chain
- Cashflow management
- Long-term contracts
- The presence of a strong management team to take over from you

As explained in SMART Valuation's Valuation-ready checklist, a valuation protects wealth by facilitating better decisions on buying or selling a business, growing the business, developing and implementing succession plans, managing your tax liability or addressing disputes.

It can also help you create wealth – by giving you the answers to such issues as whether a particular investment or acquisition will increase the value of the business, securing finance, investors or new partners, or restructuring the ownership of the business.

### A valuation gives you options

Peter Gandolfo, a lawyer working with SMEs and the managing partner of Partners Wealth, believes that getting your business valued is the only true indicator that you can rely on as you go through your business stages.

"A valuation gives you options. Not to necessarily sell by a certain date, but to have the opportunity to choose what to do. A lot of owner-operators are not investor- or market-ready to sell or to attract key personnel. Whatever will make their business stronger or more sustainable is typically ignored."

Having your business valued gives you context and understanding for your business planning.

"You can keep referring back to it and measuring against it – it gives you the ability, at any stage, to say whether the business is healthy or not," Gandolfo adds.

### Timing is critical

Mike Williams, CEO of SMART Valuations, says timing for a valuation is critical.

"Getting a valuation too early can be misleading, especially when revenue or cost trends change as the business matures. If you have just started a business a valuation will be too speculative, but as you gather more history the valuation becomes more reliable and informative. If planning to exit the business, it pays to get a valuation at least one to two years before, to give time to make improvements."

A valuation well in advance of selling gives an owner-operator time to assess what the value of their business should really be.

For example, if an owner-operator plans to leave in five years' time, a valuation will inform them of whether the business will sell for anywhere near the price they're looking for. They can then make any necessary changes or implement strategies in order to get where they want the business to be.



**[Click here to read more on How to sell your business for 10 times its worth.](#)**

"A valuation is all about communication – everyone's got to be open, upfront, communicate effectively and accept that no one is going to get things 100% their way."

*Andrew Bethune, principal at  
Daniel Allison & Associates*



When it comes to measuring the value of your SME, Peter Gandolfo believes it's best to bring in an external advisor who specialises in that space.

"Engagement is key, a valuation will get your advisors to understand what the variables are – to work on the positives and eliminate the negatives."

Williams explains that essentially the price of a business is based on the normalised cash flow (adjusted Operating Profit) and the attractiveness and risk of the business (the Earnings Multiple).

"The multiple should represent a mix between the cost of equity [the cost of the owner's money that's been put in] and the cost of debt. And what's the multiple figure? That's determined by the attractiveness and risk of the business. The more systems that are in place and the better the competitive advantage is, the higher the multiple. On the downside, the more risky the business is, and

the more uncertain future cashflow is, the lower the multiple will be."

Valuers also take into account the business profits, adjusted to reflect normal operating conditions. It is critical to understand what is included in this profit measure and what is excluded. This allows a valuer to give an enterprise value by working out the minimum operating assets you'd need to buy to run the business. The value of the equity of the business is the enterprise value less the debt.

"The key in valuation is to pull all these different pieces together in a reasoned way," explains Williams.

Measuring value can be very subjective. The price they are willing to pay will depend on the purpose of the acquisition. They might be looking to bolt it on to their own existing business, or they might want to run it as a strategic niche investment. What they're willing to pay can differ dramatically based on the purpose they want the business for.

### Geography and valuations

"Some people don't buy businesses in WA because it's too far from the east coast. On the other hand, a certain business in a particular area might have a lot of potential for a prospective purchaser or competitor so it might be worth more," says Bethune.

"If you're a business who's weak in Victoria and an opportunity comes up there, that niche acquisition may be worth more to you than to another party. Depending on the circumstances, geography can play a critical role in values."

### Business operation without the owner

If the business relies on the owner or key staff then you should be asking a host of questions, including:

- Can the business operate going forward?
- Will it achieve the same level of profitability?
- Will there be the same level of relationships with customers and suppliers?
- Is there a strong management team and what is the succession plan?
- Who's going to run the business and run it as well as it's been run historically?

### Exit strategies

It's also important to bear in mind that a profitable exit strategy takes time to create.

"Some SMEs are in it for the long haul, they could run for 40 or 50 years and then the owner-operator will want to get out. Others may want to leave sooner to go on to do something else. Either way, it's easier to sell a business if it's well organised, if it's got a good track record, a demonstrable history of profit and future plans as to where to go from here," explains Bethune.

*What is the most a buyer would pay for your business?*



Call **1800 33 90 42** to uncover the hidden value in your business. For more details visit: <http://smartvaluations.com.au/selling-price-valuations/>



It's vital that your SME is prepared for future commercial valuation.

"To a degree, every business should be investor-ready," says Bethune. "Often an owner may decide to dispose of a business or a potential acquirer may make an enquiry about the business. It helps if you've maintained the appropriate records over time and you've got your processes in place. It helps you run your business smoothly anyway if you've got all that clearly established."

An SME should have its historical information available, key contracts identified and filed, and employment agreements up to date and readily accessed – after all, a potential purchaser might be willing to pay more for a well-organised business.

"Unfortunately, a lot of SMEs don't pay attention to detail. All of a sudden an opportunity to sell comes up, and they're madly racing to get all the info together. If it's already there, it's easy and creates comfort for the purchaser to know that it's a good business to invest in," says Bethune.

A valuer needs information on what's happened within the business in the past and what's most realistically likely to happen in the future.

"The most important thing to provide is accountant-prepared financial reports, for example a profit and loss statement and a balance sheet. You'll also need to offer information about depreciation that is being charged on the assets of the business, as well as information on the loans that are on the balance sheet, including director loans or related party loans," says Williams.

The company's business plan is also critical. A valuer needs to know the overall strategy, how it proposes to grow and what targets are being met for it to improve.

"Once all this information has been gathered, a valuer can ensure they're taking into account the right financial aspects of the business that contribute to its value," says Williams.



### Realistic timeframes

"Selling a business involves negotiation, verification that the assets are what you say they are, and due diligence that the business is run effectively. Questions go back and forth, each person involved in the chain takes extra time and the process tends to drag on. While we can do a valuation in one to two weeks, to actually implement a sale can take six to 12 months or sometimes two years."

*Mike Williams, CEO of SMART Valuations*

# A Valuation Is Not Just a Number in a Report

*It is an In-Depth Understanding of Your Business and How it Generates Wealth!*

At some stage most business owners will ask “how do I exit my business?” or “what is my succession plan?”.

Invariably they will then think of the price they want. However the question they often fail to ask is:

**Is my price the real value of the business?**

Knowing the existing value of your business is only half the picture:

- ✓ What is the highest value that could be achieved under the current circumstances?
- ✓ What is its strategic value?
- ✓ Who would pay a premium?

How can your succession plans or exit strategies benefit from a valuation and what information is required to start the valuation process?

**What does your business need to look like to achieve the value you want?**

## Current Situation

Existing Performance  
Under Current Strategies  
Current Valuation  
Key Value Drivers

## Vision

Best Valuation Under Current Model  
Strategic Valuation

What targets are required to achieve the Vision?

- Financial Targets
- Market and Operational Targets
- Investment Requirements

What are the strategies to achieve the Vision?

- Strategy 1
- Strategy 2
- Strategy 3

Action to be taken



for each strategy

**SMART Valuations works with your accountant and advisors to deliver the value-based action plans that increase the value of your business.**

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<http://smartvaluations.com.au/quick-start/>

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“Valuations are a subjective process,” explains Bethune, “the basic premise is what are your historical results and what are your future trading results – and are they deliverable? What you can demonstrate becomes the basis of how the business is valued.”

Williams agrees: “The one thing that always produces a good value is historical results that show a reasonable profit. It doesn’t have to be flash profit, it just needs to show the owner is taking a wage and there’s still profit leftover. Businesses with a history of consistent commercial profitability attract a higher value than businesses with a variable result.”

Businesses that rely on the owner or key staff often have a very low value, as no one is willing to pay for something that has a risk of disappearing when that person leaves.

But if a business has documented procedures and systems, and duplication of key roles – for example someone is trained to take the manager’s role – then it’s looked on favourably.

Systems should also be in place to generate leads and to report on what has happened in the business recently (rather than in the last two weeks) – these things give a buyer comfort and assurance that they’re buying something of real value.

And of course, businesses that have a well-defined, well-used competitive advantage will always be of more value than businesses that don’t.

Peter Gandolfo suggests the following measures to help increase the value of an SME:

- Register the brand and its logos as trademarks
- Extend the lease and obtain renewal options
- Appoint a CEO to run the business (allowing the owner to take a step back)
- Ask employees to sign restraints to protect the intellectual property of the business
- Lock in suppliers with long contracts, if possible
- Structure your business in a way to protect your assets
- Continue on profitable lines
- Geographically, consider which territorial areas to service



### SME Inspiration

Read [here to find out how Australian business Jobfit Health Group](#) had 20 global corporates fighting over it.



Knowing the value of your business is a key element in succession planning.

"There are two aspects to succession planning," says Williams, "either the owner-operator wants to retire or they want to move on to a new venture. To do either they should know how much money they need to meet their expectations. It is therefore important to know where the value of the business is in relation to their expectations. Being prepared defines the timeline and what actions you need to take for a smooth exit."



### **Why you should start planning to pass the baton now**

And find out more about [the importance of succession planning](#).

[Or consider 10 SMART ways to exit your business.](#)



"There's a lot of ATO audit activity regarding small business and capital gains tax concessions," reveals Bethune. "In particular, they're focusing on the net asset value test (which is currently \$6 million) and reviewing transfers of assets to ensure that test is satisfied."

Williams explains why capital gains tax is important when it comes to value: "If a father sells his business to his son but does so at a price below market value, then the tax office is missing out on capital gains tax."

In addition, in some states in Australia, when a business is transferred from one owner to another, there's stamp duty to be paid as a percentage of the value of the business.

"Also, if a company changes business from one structure to another – for example, from a trust to a private company – it's a transaction and the ATO want to know that transaction occurred at a market rate," says Williams.

The ATO want to ensure the price paid for the business was appropriate and therefore it's critical for a business owner to have an independent valuation in order to assure the ATO that it wasn't just a number pulled out of the air.



**Further reading:  
Five things your  
accountant should be  
doing for you besides  
your taxes.**

Stewart Koziora is cofounder of the Retail Savvy Group, which owns Asian Beer Café, Father's Office and Shaw Davey Slum. With more than 100 staff and an expected 2014 turnover of \$15 million, he's been doing valuations on his hospitality businesses for the last 15 years across different concepts (including chains and standalones) for various reasons.

"For example, you can get a valuation for mortgage purposes or for high net individuals who want to invest," Koziora explains.

Having faced both the challenges and benefits of valuations, he says: "The greatest frustration is valuers who don't understand the issues at play. They want to just cover their professional indemnity insurance so are always more conservative. They don't look at the differences between one particular style or type of business with sales evidence, and another type of business with no sales evidence."

### The one-size-fits-all model just doesn't work

"For example, I own and manage big bars, I move 200 kegs a week. I've used valuers the banks recognise who know nothing about retail and try to compare my business to a fish and chip shop that's not more than 30 or 50 square metres verses my 900 square metres and they try to say the sales evidence is this.

"The other frustration is if a valuer doesn't understand the business. I've got three venues and I'm turning over \$15m in sales, but there's massive economies of scale from a back office point of view which wouldn't exist if I only had one. Some valuers will put that into a valuation but some won't."

### The importance of being organised

"If a valuer asks for information, I can give them everything within six hours – and that should form part of the risk profile, that this owner-operator knows what they're doing. There's a lot of information to gather and everything's got to reconcile. There's got to be past historicals, future projections and tax returns. There's a whole process of getting things ready to make the valuer feel comfortable. It can be tricky if you're not organised, and means the valuer might have to make assumptions if you don't have the necessary information."

Ultimately, Koziora feels having your company valued is worth the effort.

"When you know the value of your business you can't undersell it to a potential investor. I recently didn't sell to a high net worth individual because the valuation of the business was higher than what they were offering. Having the valuation settled in my mind made me feel good about the business and gave me the confidence to try more things and take more risks to grow the business. If you get the right valuer, it's definitely worth it."



### What happens if buyers aren't interested?

"One challenge is, what do SMEs do if there aren't buyers interested in their business?"

Business owners may think: 'If there are no buyers, is there any value at all? And if this is the case, what do I do next?' One approach is to think about the employees – they want to maintain their employment and can act as a group to buy the business.

An alternative is to seek out businesses in a related industry to yours (not just competitors), who might see a business like yours as an advantage for them."

*Mike Williams, CEO of SMART Valuations*

*This holiday season, will you be thinking about the future of your business?*

Before you go on holidays and inevitably think about how you exit your business, get a professional business valuation so you can make better decisions.

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