ValuCompass

Understanding Enterprise Value

The biggest advantage of the Discover assessment and its subsequent report is that it is actionable - displaying 3 important pieces of information after only a few minutes. It's the combination of these 3 that gets a business owners attention and makes them beg for more:

1. The enterprise value;
2. The business's potential value;
3. At least three Drivers that light the path to closing much of that value "gap".

		1	2				
Revenue $4.75M	EBITDA $567K	Enterprise Value $5.95M	Potential Value $8.97M	Value Gap $3.02M	Flags 2	CoreValue 63	Diligence C+
			Objective Create sustainable growth	3	Driver 1 Marketing	Driver 2 Growth	Driver 3 Operations

But many business owners will ask, "How are those values created?" Let's start with #2, "Potential Value".

The "<u>Potential Value</u>" is a multiple of EBITA. That multiple will change based on your client's industry. You can actually determine what that multiple is by dividing the Potential Value by your client's EBITA.

This is a traditional and simple formula that many buyers of businesses use to judge the profitability of the business.

BUT - most businesses do not sell for their Potential Value. As a buyer completes the due diligence process, they'll undoubtedly run into areas within the business that could be better.

These areas represent "risks" they must overcome should they buy the business. In the Discover assessment, those risks are measured for 18 areas of the business, called Drivers, and are tallied based on how the business owner answers the 18 multiple choice questions. The difference between "best practice" for each question and the owner's actual answer measures those risks.

In a transition situation, in exchange for taking on those risks, the buyer will discount the Potential Value and make an offer more in line with #2, the "<u>Enterprise Value</u>". This creates a Value Gap.

Of course, the business owner who sees this will want to know how to close that gap. The top 3 answers are shown in #3. Those are <u>the top 3 Drivers</u> that make up the most of the value gap, and conversely represent the fastest way to close much of it through business planning. Those 3 out of the 18 measured generally represent 1/3rd to almost half entire gap. This is shown in the pie chart in the Discover Report.

What do you do with a business owner that isn't ready to sell - who wants to grow their business? Simply explain that the difference between #1, Enterprise Value and #2, Potential Value demonstrates there is plenty of room to run, and the quickest way to get to where you want to be is #3, through optimizing the top 3 Drivers.