ASK THE ACCOUNTANT

EDITORS' NOTE *Paul Goodman, MBA, PFCI, and Derrick Myers, CPA, CFP, PFCI, love a good financial management challenge, however big or small. Send your questions to fmeditor@safnow.org, and we'll challenge the experts to tackle them in an upcoming article.*

SHUTTERSTOCK/AURIELAKI

WHAT'S YOUR BUSINESS WORTH?

Calculating the value of a business involves many factors — and in most cases, professional help. Here's a breakdown of what the experts consider to determine what a business is worth.

BY PAUL GOODMAN, MBA, PFCI

"How Much Is My Business Worth?"

That's the question I am most frequently asked by retail florists.

The reasons they want to know are varied. A sale. A purchase. Buyout of a partner. An estate valuation. Whatever the driving force, at some point almost every florist needs to place a value on the shop they own or one they want to buy.

There's a lot of money involved in the value of your floral business — and the biggest risk is not doing it correctly. You don't want to set the price too low or too high, and usually professional help is needed.

But even with outside help, there are a few key points you should understand about determining the value of your business.

Evaluating Assets

There are two things you have to sell: assets and the ability to generate an annual profit.

A quick look at the balance sheet shows the assets of the business. Each asset should be viewed individually. What is the real "fair market" value of each? Fair market value simply means what a person would pay for it in its present condition. It's not unusual for most assets to sell for significantly less than they originally cost. Most buyers will be selective about the specific assets they want to purchase.

Accounts receivable is a very valuable asset; however, you must weed out all questionable accounts, such as an account that is past due and may not be paid. Similarly, inventory should be examined to identify anything that is obsolete or of no value.

Fixed assets such as furniture, fixtures, office equipment, and vehicles will generally need to be appraised to determine their fair market value. The depreciated value on the balance sheet may or may not reflect their actual fair market value.

Some shops own real estate — the building and land. Real estate is quite different from the operating assets of the business and should be valued separately from the rest of the business.

The fair market value of the assets being purchased will set one of the two numbers you need. The next number is the value of the business itself; how much profit can it earn each year and what is that worth?

Finding the 'True' Profit

Sales levels and profitability are the basis for determining the value of the business. Sales represent the opportunity for profit. The higher the sales, the greater the opportunity. The greater the opportunity, the more the business is worth.

Rarely is a retail flower business worth more than 40 percent of its annual sales volume, and that amount requires a net profit of 10 percent before taxes. Consequently, 40 percent of annual sales volume usually sets the top price for the business portion of the total valuation. Of course, in using these figures, sales and net profit must be defined properly.

Even if a shop has no profit, the sales volume is worth something. You'd clearly prefer to have a shop doing a million dollars a year over one doing half that much, even if it showed no profit. At a minimum, a shop is worth 10 percent of its sales volume.

There will be a fair market value for the assets alone and the value of the profit-generating ability of the business. The minimum value for the profit-generating value is 10 percent of sales; the maximum will be around 40 percent of sales.

Where you land in that range is a function of bottom line profit before taxes.

Determine Net Profit

Sales must include all product and non-product sales minus any discounts. Outgoing wire orders need to be included at the 20 percent sending commission, and incoming wire orders need to be netted to the 73 percent that the florist receives from the wire service.

Once sales have been properly calculated, cost of goods sold and expenses need to be checked. In order for cost of goods sold to be correct, take a physical inventory at the end of the fiscal year. This will ensure that the inventory is neither understated nor overstated.

Next, look at five items closely:

- **Depreciation**. Check depreciation for any item that was written off quickly. Change the accelerated amount to a normal annual amount of depreciation.
- **Interest**. Take interest off the expenses. A properly capitalized shop does not need to pay interest.
- **Facilities expenses**. If the shop or the shop owner owns the building, you need to make sure a fair market value is being charged for rent. Adjust the rent up or down to match the fair market value.
- **Owner/manager compensation.** The way in which the owner is compensated can have a significant effect on the profit of the business. Some shops pay the owner a salary. In others, the owner only takes a draw, depending on the profitability of the business. Salaries show up as an expense, but draws don't. Your goal is to get the owner compensation reflected at a standard level — not too high and not too low. Start by identifying all expenses that are directly related to compensation to the owner. Look for salary, payroll taxes, and benefits such as cars, health insurance, life insurance, club memberships, etc. Back all of these out of the expenses of the shop. Next, add back a proper amount for owner compensation. The industry standard for an owner/manager's compensation package (including payroll taxes and benefits) is $50,000 for the first $500,000 in annual sales plus 5 percent of the annual sales over $500,000.
- **Extraordinary expenses**. Look over all the expenses for any item that was a large purchase and unusual and was expensed all at once. It needs to be taken out of normal operational expenses.

After making these adjustments, the net profit will reflect how the business is really doing for valuation purposes.

GO DEEPER

Paul Goodman goes deeper into valuations in a video available to watch on demand in SAF's learning hub. Visit safnow.org/ondemand23.

What a Buyer Expects

Buyers expect a reasonable salary for the work they will perform as the new owner/manager. In addition, they will want a reasonable return on the money invested to buy the business. The salary is an expense of the business, and the return on the investment is the net profit produced.

Today, most investors can get a 3 to 5 percent or higher return on an investment at virtually no risk or trouble by depositing money in savings accounts, or purchasing certificates of deposit (CDs). It stands to reason, therefore, that most potential buyers will want a higher return for investing in something that has considerably more risk and trouble. Buying a flower shop certainly fits that description.

Most buyers of flower shops and other small businesses expect a minimum return of 25 percent on their investment. That means, from an earnings perspective, you could expect to sell a flower business for approximately four times its net profit (after making the five adjustments reviewed previously). This assumes the new buyer will continue to operate the business in the same manner that the previous owner did.

Getting Professional Help

While this column is intended to give you a basic understanding of what goes into a business valuation, I don't advise undertaking an evaluation yourself unless you are very comfortable handling numbers. Seek professional assistance from your CPA or an industry expert.

Paul Goodman, MBA, PFCI, is a former CPA and the founder of Floral Finance Business Services in Tulsa, Oklahoma, editor of Floral Finance and author of "The Profit-Minded Florist."