How to benchmark the value of a business

BVR
What It's Worth

What is this company worth?

It's a question that arises frequently for business owners, business intermediaries, and a wide spectrum of tax and financial professionals.

Of course, every business is unique and therefore there are no formulaic one-size-fits-all models to determine value, and an appraiser utilizes his or her professional judgment, experience, and analysis to reach a valuation conclusion.

But what if you want a general ballpark value of what a specific business is worth? One way to determine this is to look at how much others have paid for similar businesses relative to different earnings measures.

Let's consider three financial metrics:

- **Revenues:** The total amount of money that is brought into a company by its business activities. Sometimes referred to as the "top line" and is prior to any expense deduction, including materials.

- **EBITDA:** An acronym for earnings before interest, taxes, depreciation, and amortization. These are the earnings of the business before the aforementioned expenses.

- **Seller's discretionary earnings (SDE):** One measure of earnings to an owner/operator of a business. This figure is calculated by adding owner's salary to EBITDA.

When benchmarking the value of a business...

we compare the above earnings measures to selling prices of a similar business to create a ratio, also known as a business selling price multiple or valuation multiple.

Selling price to revenue (or selling price/revenue) is the selling price of the sold business divided by that business's revenue. If a benchmark company sold for $1,000,000 and it had yearly revenues of $2,000,000, we would say it sold for 0.50 times revenue ($1,000,000/$2,000,000). Said another way, the selling price/revenue business valuation multiple is 0.50.

You can use this metric as an estimate or benchmark for a specific business's worth. For example, if a business had $3,000,000 in revenue and a 0.50 selling price/revenue business valuation multiple was selected from a benchmark company, you could estimate that business's worth to be $1,500,000 ($3,000,000 × 0.50). But we don't typically look at one business sale in isolation. Rather, we consider a median valuation multiple for a group of businesses in an industry or part of an industry. A median is the middle number in a set, where half of the numbers are greater than the middle and half are lower than the middle. Many prefer the median to the average, as outliers can skew the average—the median is less susceptible to the effects of outliers.

Business appraisers use median (and sometimes average) selling price ratios for an industry to create a general ballpark value for the company of interest...

Using median selling price ratios
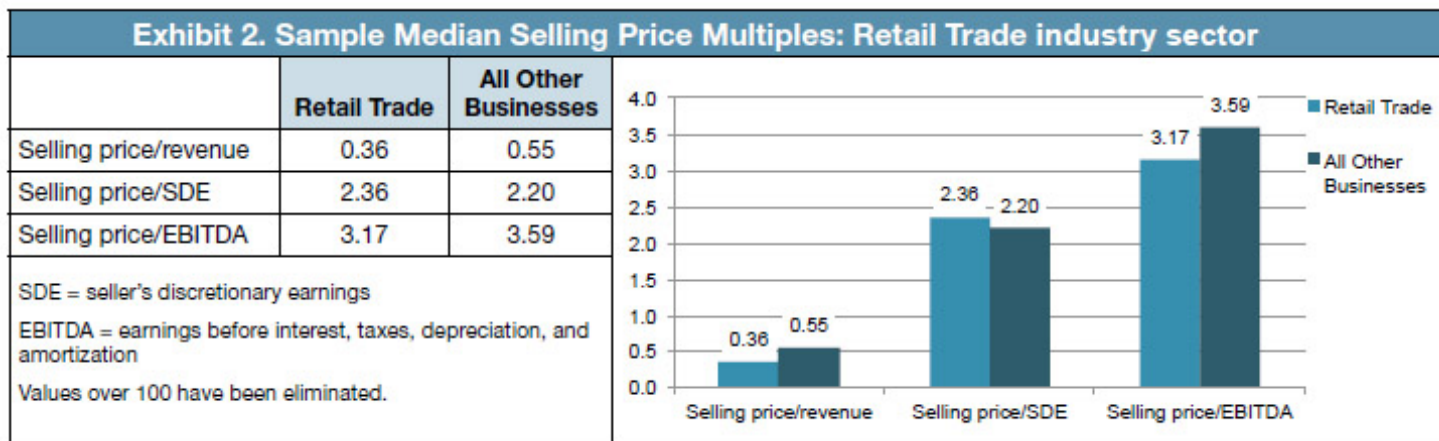
Business appraisers use median (and sometimes average) selling price ratios for an industry to create a general ballpark value for the company of interest. **Exhibit 1 below** shows how you can use the data to find a general ballpark value for a business. Some take an average of the results, some select the median value, and others select the specific value that is most meaningful given the industry and/or size of the business. Each multiple creates a unique estimated value.

You may then choose to apply a weight to each estimated value to determine a final value. For some circumstances, revenues or EBITDA of a business may be more important than either earnings measure so more weight may be applied to that value.

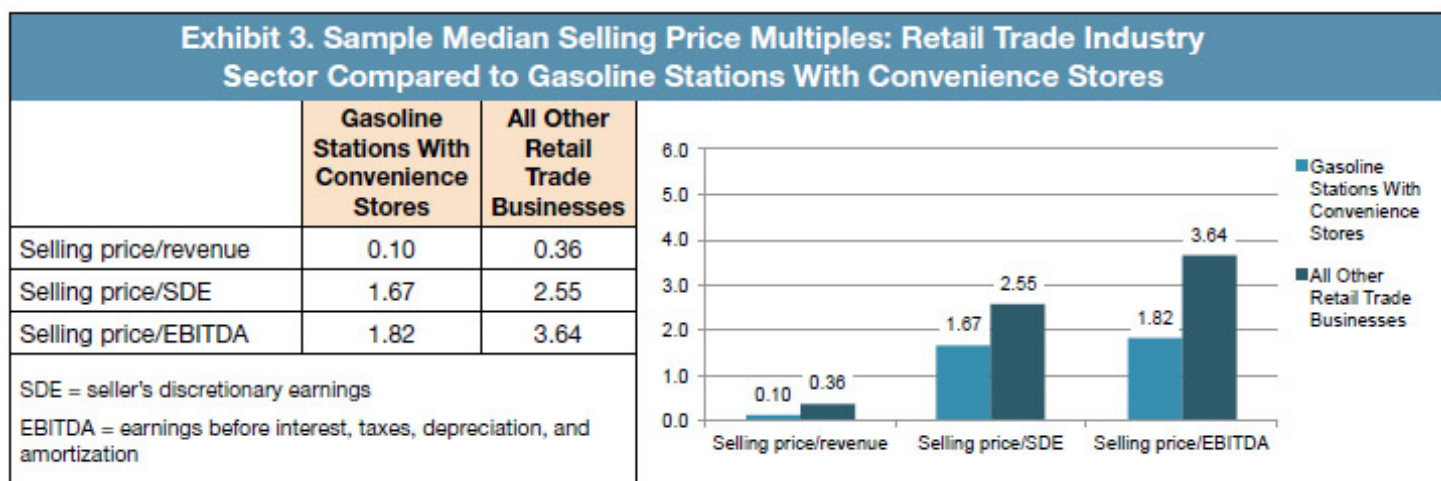| Exhibit 1. Example Business						
	Median Multiple		Business Earnings		Estimated Value	
Selling price/revenue	0.70	×	$2,000,000	=	$1,400,000	
Selling price/SDE	3.00	×	$450,000	=	$1,350,000	
Selling price/EBITDA	5.70	×	$325,000	=	$1,852,500	

Industry median price multiples

The data in **Exhibit 2 below** is derived from the DealStats (formerly Pratt's Stats) platform, which contains financial details on sold private businesses, organized by industry. We examine business sales to find median selling price multiples for various industries.

Exhibit 2. Sample Median Selling Price Multiples: Retail Trade industry sector

	Retail Trade	All Other Businesses
Selling price/revenue	0.36	0.55
Selling price/SDE	2.36	2.20
Selling price/EBITDA	3.17	3.59

SDE = seller's discretionary earnings

EBITDA = earnings before interest, taxes, depreciation, and amortization

Values over 100 have been eliminated.

In addition, we compare the selling price ratios of specific business types to other businesses in the same industry. For example, we can look at benchmark data for general industries (retail trade, for example) compared to all other general industries but also benchmark data for specific business types

(such as gasoline stations with convenience stores) to all other businesses in that business's general industry (retail trade excluding gasoline stations with convenience stores). See **Exhibit 3 below** for an example.

Exhibit 3. Sample Median Selling Price Multiples: Retail Trade Industry Sector Compared to Gasoline Stations With Convenience Stores		
	Gasoline Stations With Convenience Stores	All Other Retail Trade Businesses
Selling price/revenue	0.10	0.36
Selling price/SDE	1.67	2.55
Selling price/EBITDA	1.82	3.64

SDE = seller's discretionary earnings

EBITDA = earnings before interest, taxes, depreciation, and amortization

Selling price multiples by sector

In **Exhibit 4 below**, the table compares the median selling price multiples across major industry groups as of 1Q2018. MVIC represents the selling price of actual businesses, based on thousands of private deals listed in DealStats (formerly Pratt's Stats).

Exhibit 4: Selling Price Multiples (Valuation Multiples) By Industry Sector							
SIC	Industry Sector	Count	MVIC/ Revenues	MVIC/Gross Profit	MVIC/ EBIT	MVIC/ EBITDA	MVIC/ SDE
0139-0971	Agriculture, Forestry, & Fishing	841	0.57	0.73	2.85	2.65	1.87
1011-1499	Mining	212	1.74	3.44	11.04	8.17	3.91
1521-1799	Construction	1,410	0.43	0.97	4.31	4.08	2.41
2011-3999	Manufacturing	4,553	0.76	1.97	7.86	6.79	3.02
4011-4971	Transportation, Communications, Electric, Gas & Sanitary	1,497	0.76	1.28	5.72	5.17	2.45
5012-5199	Wholesale Trade	1,688	0.45	1.30	5.83	5.54	3.05
5211-5999	Retail Trade	7,780	0.36	0.69	3.00	3.07	2.16
6011-6799	Finance, Insurance, & Real Estate	1,157	1.09	1.46	5.99	5.28	2.33
7011-9999	Services	10,240	0.66	0.93	4.59	4.63	2.17
0139-9999	All Industries	29,158	0.55	0.98	4.50	4.43	2.33

While the selling price multiples in this table serve as a rough benchmark for broad industry categories, the multiples vary when you look at a more specific industry code and take into account factors like company size and profit margins. Business appraisers and business intermediaries use DealStats (formerly Pratt's Stats) to view a custom set of deals and access a multiple that reflects their client's business, based on actual deals for similar companies. Explore a wide range of useful resources for valuing and benchmarking businesses, including guides, training webinars, transaction databases, and more at **bvresources.com**.

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