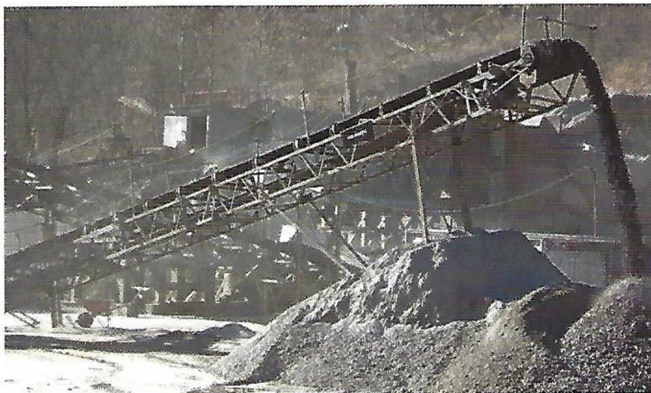
What is Your Company Worth?

For Any Private Business Owner, Change Is Inevitable And A Good Valuation Can Help You Better Respond To That Change.

By Chuck Eaton



You've put years into building a quality aggregates business, but the economy and markets have been on a roller coaster ride the past 6-8 years. Are you curious about what your company is worth now? Do you want to know how to maximize that value?

For any private business owner, change is inevitable and a good valuation can help you better respond to that change. For example, are you:

- Thinking about selling or retiring?
- Looking for funds to expand?
- Considering ownership restructuring or succession?
- Wanting to convert or reallocate assets (partner buy-out or divorce)?

There are many reasons for aggregates operations to be curious about value, but determining that value is not easy if the company is privately owned. If the company is publicly held, it is pretty easy to determine what the stock market thinks the company is worth by multiplying the number of shares outstanding by the market price per share. But a privately held company has no market price, so this method doesn't work. For private companies, there are three commonly used methods for determining value: asset values, profit multiples, and cash flow modeling.

Asset Value

One potential way to value a company is to total the value of all the company's assets. For tangible assets, this is fairly straightforward, with values for equipment and real estate relatively easy to determine by looking at recent sales of similar assets. Other assets such as aggregate reserves can be more difficult to value because the location and quality of the material differs, and there may be large differences in the costs of extracting, processing and transporting the aggregate.

And the value of some intangible assets like customer and community relationships may be very difficult to measure. Plus, simply adding together the value of all the assets ignores the value of the business as a going-concern, generally a significant contributor to overall value. So valuing a company by adding together asset values is generally not very useful.

Moreover, just owning a bunch of assets does not necessarily make a business worth a bunch of money. To create real value, assets must be used to earn profit and cash flows, which can be returned to the owners of the assets. And an important part of estimating value is judging the risk of whether the expected profit will actually occur. That is, if there is substantial risk that expected profit may not be realized, a higher rate of return will be required to compensate for that risk, so the business will have a lower value.

Profits and cash flows in the construction materials industry have historically been relatively predictable, which indicates relatively low risk and therefore requires relatively low rates of return. This is not to say that the industry is without risk – there can still be substantial market, management, environmental and other risks for specific companies in the industry.

Thus, there are three primary issues a useful valuation method must address – profitability, risk and rate of return. In the construction materials industry there are two widely used methods of addressing these issues. The first method uses historical profit and knowledge of prices paid on recent transactions of similar risk to determine value – the "profit multiple" method. The second method estimates future cash flows and required rates of return for similar risks to determine value – the "cash flow modeling" method.

Profit Multiple

To use the profit multiple method, you must know what prices have been paid for companies of similar risk and you must know the profitability of those companies. Knowing

these numbers enables you to calculate the profit multiple for each of those transactions by dividing the price by the annual profit. By looking at profit multiples on numerous transactions, you can begin to estimate the "market" multiple, and therefore estimate value of a company by multiplying that company's annual profit by the market multiple.

Unfortunately, this process is not as easy as it sounds, for several reasons. First, it is not always easy or even possible to obtain the pertinent numbers. In most transactions for privately held companies, neither buyer nor seller divulge the details of the transaction.

Sometimes there is an announcement about the cash price paid, but there is often little detail about debt assumed, deferred payments, employment contracts and other details which can be significant components of actual value. And it is often very difficult to determine the profitability of the acquired company, especially in enough detail to compare profit figures from different companies.

Most analysts use EBITDA (earnings before interest, taxes, depreciation and amortization) to calculate profit multiples because this figure "normalizes" many company-specific variables, but often details about interest, taxes and depreciation are not available.

The second problem with profit multiples is that it is difficult to compare companies with different risk profiles. For example, companies may face different product pricing, cost structures, growth rates or competition, and therefore have different risk profiles. If risks between companies are not comparable, the profit multiples are also not comparable.

Another reason the profit multiple approach can be difficult is that the circumstances of the specific buyer must be considered. For instance, two very rational and well-informed buyers might be willing to pay very different prices for the same company because the company is a great "fit" for one buyer, but not for the other.

Despite these drawbacks, the profit multiple approach is widely used within the industry, at least for initial rough estimates of the value of a company. For example, by spending an afternoon with a company owner and asking the right questions, a competent investment banker should be able to give a reasonable estimate of value. However, few transactions actually get done using just these rough estimates.

Most large companies who acquire smaller companies use some form of the "cash flow modeling" method to confirm their initial estimates of value. And many owners want more than just a profit multiple estimate before they make decisions about selling, borrowing, etc.

Cash Flow Modeling

The cash flow modeling method of estimating value involves predicting the future cash flows the company will generate, then estimating what a potential buyer will pay for those future cash flows. This method necessarily requires a thorough investigation of the company and its market in order to enable detailed modeling of every operation of the company (each aggregate operation, each ready-mix plant, each asphalt plant, etc.), along with the corporate overhead structure.

Projected revenue and expense of each of these separate operations is modeled, then the separate operations are combined into a company model. For a small company, this can be a pretty simple exercise. For a larger company with multiple operations, the model becomes more complex, and if the company is fully integrated, with multiple aggregate, ready-mix, asphalt and construction operations, and internal transfers of products between operations, the model can get pretty complicated.

The process of developing such a model generally involves considerable interaction between the analyst and company management, as well as independent investigation of the market by the analyst. This leads to comprehensive understanding of the company's operations, market, competitors, risks and opportunities, which enables the analyst to complete the modeling, make appropriate assumptions about the future of the company's operations and develop well-founded estimates of future cash flows.

Once estimates of future cash flows are obtained, the analyst must then estimate how the market would value those cash flows. This involves "discounting" the cash flows to a "present value," a standard financial analysis technique. The judgment and experience of the analyst is critical in selecting the "market" discount rate for that specific company, and is dependent on the perceived risk of the company. Generally, the higher the perceived risk, the higher the discount rate and therefore the lower the present value.

Maximizing Value

Of course, estimating value is not the same as actually realizing that value. For owners of small- and medium-sized companies, especially family-owned companies, the process of realizing value generally means selling their business, and selling a company can be a challenging, complex task.

And maximizing the value of the company is almost always achieved through competition among prospective purchasers. Few owners have the transaction experience or broad market knowledge required to properly manage such a competition, whereas an experienced investment banker can implement a competitive bidding strategy while minimizing the impact on the owners and company. ▲

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