

FEATURE ARTICLE:

WHAT IS A BUSINESS WORTH? DETERMINING ITS VALUE

Whether you are looking to buy, looking to sell, or are currently operating a business, there are many reasons for knowing its value.

All said and done, in the end a business is worth what someone else is willing to pay for it. There are always several factors that influence the perceived value **on both sides, and the buyer's ability to access the funding needed to pay once a deal has been reached.**

For a fair estimate of worth on a very basic level, a business is worth the amount that is listed on the balance sheet as assets, plus a calculation involving the earnings of the business.

There are several valuation methods commonly used to determine the value of a business, all of which depend heavily on the financial records of the business in question.

Formulas are used such as:

- Price to earnings (P/E) x current or average earnings
- P/Ebitda x current or average or projected Ebitda
- Price to free cash flow x current or average free cash flow
- Price to sales (P/S) x current or av-

erage sales

- Price to Book (P/B) industry average x book value
- Enterprise value to Ebit multiple x current ebit

There are also "Cash Flow Based Valuations" which use 5 years of historical cash flow with compounded interest, Discounted Cash Flow (DCF) with Terminal value (Perpetuity of EBIT) etc.

Another valuation method is the "Asset Based Valuation" which takes into account, among other things, replacement costs of assets, liquidation value of assets and valuation of revenue generating assets based on best use.

"Hybrid" or "Other" valuations take into account the things like: market value of assets plus one year of cash flow, and critical factors including: % down payment, interest rate, industry, chance of survival, desirability, other use

Sellers are often under the impression that their businesses are worth more than what they in fact are. In the end, most sell for 25% to 40% off asking price. It is understandable that sellers overvalue their businesses; they have potentially spent most of their life building the business to what it is, and there is an emotional factor that comes into

play.

A common issue that arises when looking at a business purchase / sale is that often times the revenues of the business and its profitability are downplayed on the books for income tax purposes (*if acceptable records are kept at all*). This then impacts the end-value of the business.

Two identical businesses can sell for different prices depending on who is buying and what their resources are, along with **how the business is "packaged for sale".**

From day one, it is important to develop a good plan. This is especially so if the **owner's intention is to eventually sell the business and use the money to retire.**

Not only will a plan help you to achieve success in business, it will also help you to sell the business for a maximum return in the end. Plan an exit strategy to ensure that not only do you get a fair price for the business, but by being prepared, the transaction will go smoothly. Probably most important, your business will end up in the hands of someone who **will maintain what you've built.**

~ Ian Wiebe, BDO

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- 8 Small Business Tax Strategies to Reduce Income Tax Part 2:
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“Women own and operate more than a third of our small businesses, helping to raise our small business growth rate to three times the national average.”

The BC Government Releases the 2008 Budget

~From BC's 2008 Budget Speech Pertaining to BC Businesses:

"Today we are announcing further reductions in both our corporate and small business income tax rates.

Effective July 1st, 2008, the general corporate income tax rate will be reduced from 12 per cent to 11 per cent and, over the next three years, we expect it to fall to 10 per cent — on par with the lowest corporate tax rates in the country, and a long way from the 16.5 per cent rate seen through most of the 1990's.

That puts B.C. on track, by 2012, for a total combined corporate tax rate — the federal plus the B.C. rate — of 25 per cent... the lowest among the world's major industrialized economies, and 10 points lower than the U.S. federal rate.

This meets a challenge set for us by the federal government. And we are happy to rise to this challenge. Because we agree that competitive taxes are crucial to a strong, diverse economy.

To that end, we are also reducing taxes for small businesses — the cornerstone of B.C.'s economy, and one of many areas that benefits greatly from the ingenuity of women. Women own and operate more than a third of our small businesses, helping to raise our small business growth rate to three times the

national average. Small businesses now provide more than one million jobs in B.C., and contribute more than a quarter of our gross domestic product.

To help support continued growth, effective July 1st, we are reducing the small business tax rate to 3.5 per cent. And we expect it will fall to 2.5 per cent by 2011.

I say "we expect" because — as part of our commitment — we will review personal and business tax rates every year and provide a plan for keeping the carbon tax revenue neutral. We are introducing legislation to support specific rate reductions for 2008 and 2009. Future rate cuts will be confirmed as we update the revenue neutral plan through the annual budget process. One thing is certain: every dollar raised by the carbon tax will be returned to British Columbians in the form of tax reductions."

M&A: Souled out

~ Calvin Leung — From the March 3, 2008 issue of Canadian Business Magazine :

Selling your business might seem like a joyous occasion to an outsider. After all, it's a chance to reap the financial rewards from the countless hours of hard work and sacrifices you've made over the years. Yet nearly half of Canadians who sell their business experience "mixed emotions" following the deal, according to a recent survey

by Newport Partners, a Toronto-based consulting firm for entrepreneurs .

Although 81% of the more than 100 entrepreneurs surveyed believed selling out was the best decision for them, 78% said the process was emotionally draining. Part of the

reason may be they're not prepared to cash out. About a quarter of business owners sell because they receive an attractive offer, and those often come unsolicited. For Clark, selling College Pro after devoting 18 years to it was one of the toughest times in his life. He felt uneasy about keeping the pending transaction a secret from his employees, and the legal bills and mountains of paperwork just added more stress. When the deal was finally done, "I felt as though the centre core of my being was gone," Clark says.

Clark tried to find another business to fill the void, likening the experience to a person desperate to meet someone new after a failed relationship. "I was for sure on the rebound," he says. But a close friend told him "to be rather than do," so Clark spent a year in France with his wife and four children, sipping wine and enjoying life. That was likely a wise choice. According to Newport, nearly half of the survey's respondents didn't feel they were in the right state of mind to make long-term decisions following the sale of their businesses. That's why Clark, who today is a managing partner of Horatio Enterprise Fund, a Toronto-based venture capital firm, recommends talking with others who have sold out to learn what to expect and realize the emotional toll it takes.

“My interest is in the future because I am going to spend the rest of my life there.”

-CF Kettering

Continued from Last Month: More Small Business Tax Strategies

What other small business tax strategies can you put into effect to reduce the amount of income tax you pay? Try one or more of these.

5) Maximize your Capital Cost Allowance (CCA) income tax claim.

Most Canadian small business owners know that instead of just deducting the cost of whatever depreciable property they've acquired to use in their business in a particular year, they need to deduct the cost of the depreciable property over a period of years, through a Capital Cost Allowance claim.

But many small business owners are not aware that they don't have claim Capital Cost Allowance in the year that it occurs – a tax strategy that you can use to reduce your income tax. The CCA is not a mandatory tax deduction so you can use as much or as little of your CCA claim in a particular tax year as you wish; you can carry any unused portion forward to help offset a larger income tax bill in the future. It doesn't make sense for you to take your full Capital Cost Allowance claim deduction in a year that you have little or no taxable income.

Another aspect of maximizing your Capital Cost Allowance claim is to buy (and sell) your assets at the right time. You want to buy new assets before the end of your fiscal year and sell old assets after the current fiscal year.

Be aware, too, of the 50% rule; in the year that you acquire an asset, you usually can only claim 50% of the Capital Cost Allowance that you

would normally be able to claim (and in some cases, the "available for use"

rule means that you can't claim Capital Cost Allowance until the second tax year after you acquired an asset).

6) Split your income

The income splitting tax strategy lets you take full advantage of the marginal tax rate disparities. The higher your income, the higher your marginal tax rate. By transferring a portion of your income to spouse or child, a person with a lower income, you can reduce the marginal tax rate on your income.

This is an especially powerful tax strategy for small business owners with children of post-secondary school age. Suppose that you employed your 19-year-old daughter in your business, paying her a salary totaling \$10,000. Because of the basic personal income tax exemption, she would pay very little income tax, and would have a nice nest-egg to help pay for her education. (If you paid her an income equaling the personal income tax exemption, she would pay no tax at all!) And meanwhile, you've "lopped" \$10,000 off your income for the year, decreasing the amount of income tax you personally owe.

7) Take full advantage of the income tax deductions available to home-based businesses.

Do you operate your business out of your home? If not, what's stopping you? While not every business is suitable for a home-based business, do have advantages when it comes to income tax. Besides the Business Use-Of-Home Deduction, home-based business

Owners can deduct a portion of many

many home-related expenses, such as heat, electricity, home maintenance, cleaning materials and home insurance. If you own your home, you can also deduct portions of your property tax and mortgage interest.

8) Incorporate your business?

One reason many sole proprietors and partners incorporate their businesses is because of the tax advantages of incorporation. The best known of these tax advantages is the Small Business Tax Deduction, whereby the income of qualifying Canadian-held corporations is taxed at a special "reduced" rate. For the 2005 tax year, these qualifying Canadian corporations generally paid tax of 16.5 percent on the first \$225,000 of active business income. (The corporate tax rate varies by province.)

However, incorporating your business as a tax strategy will only be effective if your business has a grown enough for incorporation to be worthwhile. You not only have to have a significant income already to offset the costs of incorporation, but need to be prepared to leave enough of your business earnings in the corporation to benefit for corporate tax deferral.

For instance, if you operate an incorporated business and the corporation's profit in a given year are \$60,000, but you take \$60,000 from the corporation in salary, your \$60,000 is then taxed just as your personal (T1) income would be now, making incorporation for this reason pointless.

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Community Futures Sun Country is a non-profit community economic revitalization organization in collaboration with Western Economic Diversification. Sun Country is governed by a volunteer board of directors and exists to assist rural areas experiencing slow economic growth.

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The Business Development Officer
meets with clients throughout the entire region.
Contact the office at 1-800-567-9911 to
book an appointment.

Current Scheduled Visits:

March 6, Hope

March 21, Lillooet

March 24 – 25, Hope