How to Value Your Company - The Asset-Based Approach

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Highly valued startups like Uber, Airbnb and Snapchat have many entrepreneurs like you wondering: what exactly is my company worth? Even if your product or service is not in the tech field, chances are, at some point, you've wondered how to go about valuing your business. This question may come up as you plan on applying for a bank loan, contemplate a potential merger, develop a succession plan or draft a buy-sell agreement.

The realistic answer – and a not so scientific one – is that a business is worth exactly what a buyer is willing to pay for it. But how would you know if the offer is fair, or if it even makes sense? That's why we created this three-part series that gives an overview of the different generally-accepted valuation methods a business owner can use to determine their company's business value, as well as which approach is best suited for what type of business.

Part one in the series, presented below, discusses the asset based approach. Part two will discuss the income method, and part three will discuss the market approach.

Knowing the basics of these methods will equip you to start a meaningful conversation when or if a potential buyer should arise. The series is intended to be an overview and has been simplified for illustrative purposes.

Asset-Based Approach – Adjusted Net Asset Method

The asset-based approach is best suited for a company whose business focus is to hold investments or real estate. The company is typically either a non-operating company or one that has been generating losses. A widely-used method under the asset-based approach is the "adjusted net asset method," where the estimated value of your company is the difference between the fair market value of your total assets and the fair market value of your total liabilities.

This method starts with a financial "snap shot" of your business by using information culled directly from your balance sheet. The key for business owners is to recognize that current asset values can be dramatically different from the assets' original acquisition cost. While your balance sheet presents your assets and liabilities at historical cost, an accurate use of this method hinges upon a business owner's ability to recast those costs and capture the current value (also known as "fair market value").

How does this work? First, all assets are reviewed and the fair value of each asset is obtained. A landowner, for example, can work with a real estate appraiser to obtain the land's fair market value. The business owner may find that land purchased for $1 million ten years ago, and the amount carried in the balance sheet, is now worth $3 million. In this example, the land would be restated at $3 million for the purposes of applying the net asset value method. This process is then repeated for every business asset.

Liabilities, meanwhile, are usually already stated at fair market value so usually no additional calculations are required.

The next step is to sum up the fair market values of your assets and, from the total, deduct your total liabilities. The difference is the estimated value of your business using the net asset value method.

In the end, a potential purchaser will have their own ideas for measuring the offer price and might use a valuation method that suits their perception of the value of your business. In part two of this series, we discuss the income method, and in part three the market approach.

Regardless of the factors in play, being knowledgeable about the basic valuation approaches can help you be prepared to vet potential suitors as they arrive on your doorstep with offers, or simply empower you to envision the future.

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