VALUE APPROACHES

Asset Approach: An asset-based approach to valuation is typically used with businesses that have substantial tangible assets, usually in the form of inventory and equipment. This approach is most appropriate for businesses with a substantial amount of fixed assets.

Income approach: Uses prior earnings to estimate company value based on income potential. This type of valuation approach is most appropriate for businesses with consistently strong earnings. The income approach is calculated using various methods. These methods include:

- Capitalization of earnings method – Applicable for consulting-type businesses and/or those with few or no tangible assets.

- Excess of earnings method – generally for manufacturing-based firms with significant assets

- Discounted cash flow method – This method uses projected values. Projected future earnings are then forecasted, then discounted using an appropriate rate representative of the "next best investment opportunity: with a comparable level of risk. The discount rate used is influenced by internal factors (e.g., dependency on the owner) and external market factors (overall industry stability/growth, interest rates). Used mainly for emerger and acquisition purposes.

- Multiple of discretionary earnings method – applicable for more service-oriented firms, (e.g., legal, accounting, healthcare systems, dental, engineering, etc.; the goodwill of the owner(s) has a significant impact on the value.

Market Value Approach: Based on the prices of similar or comparable businesses that have recently sold. This data is more challenging to find for the sale of small business and professional practice, rather than for large businesses.

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