



## THE TRUE VALUE OF A BUSINESS VALUATION



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**A**lthough valuations are particularly important for contractors considering an ownership transition or business sale, they serve many other purposes as well. You should seriously consider a valuation when seeking loans, establishing an employee stock option plan, creating a buy-sell agreement, contemplating a merger or acquisition; or engaging in estate planning or gift taxation.

Factors that can enhance the value of your company include a seasoned management team, trained and established workforce, viable business plan, effective management information systems, stable revenues and profits; and well maintained equipment and facilities.

Estimating the value of a closely-held business is much more complex than merely guessing at a dollar amount a potential buyer may be willing to pay for the business. The value placed on a business is related to the purpose for which the value is being determined. For example, a business valuation for estate and gift tax purposes differs from one for a partnership dissolution. Regardless of the purpose however, in most cases, the valuation of an on-going business is determined from the economic benefit derived by the use of its tangible and intangible assets.

There is an array of internal and external factors which affect the value of a business, making the valuation process multifaceted. Each valuation is unique and requires conscientious deliberation of the facts, a detailed analysis of the financial data specific to the business, comprehensive research, and a complete understanding of the state of the industry and its economic outlook.

Benchmarking your company against those of other construction businesses is important in determining the true value of your business. The *Annual Valuation Survey of Construction Companies* published by industry consultants ZweigWhite or the *Annual Financial Survey* published by the Construction Financial Management Association (CFMA) can be particularly helpful in this regard. The CFMA survey provides twenty key financial ratios for liquidity, profitability, leverage, and efficiency, as well as financial statements categorized and compiled by specialty, region, and revenue.

### STANDARDS OF VALUE

The value of your business will depend on which sector of the construction industry you do business in and the standards used. It defines the “value to whom.” Among the most common standards are:

***Fair Market Value*** – The price at which a business would change hands between a willing buyer and a willing seller.

***Fair Value*** – Typically defined by state statute. It is commonly used in dissenting shareholder actions without application of discounts for lack of control and for lack of marketability.

***Investment Value*** – The value to an investor based on his individual investment requirements. The value can differ among investors because of perceived differences in risk, growth, earning power or tax status.

***Liquidation Value*** – The net amount that an owner could realize if a business is terminated and the individual assets are sold off.

#### **APPROACHES TO DETERMINING VALUE**

An appraiser will likely rely on one of several commonly used approaches to determine your construction company's value:

***Asset-based approach*** – Is the cost to replace or replicate your business. With this method, the valuator adjusts your business assets and liabilities to their fair market value equivalents. The sum of those assets, less the liabilities, yields your company's overall fair market value. Each component of the business entity is valued individually and aggregated.

The asset-based approach is often favored for capital-intensive enterprises in which revenue and earnings are difficult to forecast. As you might suspect, that includes many construction companies, which are often heavily invested in equipment and follow an uncertain pattern of one-time projects.

***Income-based approach*** – Estimates the value of your business based on its future earnings. Here the valuator develops a forecast of the rate of return on an investment in your company. In other words, this method looks at the present value of your construction company's future economic worth, discounting that prospective value at a rate commensurate with alternative investments of similar quality and risk. This is done by projecting net cash flow as a percentage of equity. It is considered appropriate for valuing a closely-held business because they tend to be earnings or cash flow driven. This approach estimates the value of the entity as a whole, including tangible and intangible asset values.

***Market-based approach*** – A valuator using this method compares your business to similar construction companies. The ratios used will generally center on your business's earning power, assets or both.

No matter what method a valuator uses, certain factors are bound to play key roles. These include management quality, annual profit margins, historical growth, future revenue projections,



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and your company's name and reputation. In addition, expect your valuator to look at bonding capacity, union contracts, insurance coverage and any environmental disputes in which you may have been involved.

### **THE BOTTOM LINE**

Ultimately, your construction business is worth only what an independent, objective party would pay for it. In other words, the bottom line on valuations is, in fact, your bottom line. It is recommended that you engage a professional with the proper credentials to ensure that your valuation represents the actual net worth of your business. These credentials include a Certified Public Accountant (CPA), Accredited in Business Valuations (ABV), Certified Business Appraiser (CBA) or Certified Valuation Analyst (CVA).

As one of the leading accounting and consulting firms for the construction industry, Cowan, Guteski & Co., P.A. understands the complexities impacting the value of your business and how to estimate the value of your construction company that most nearly represents its actual worth. Contact Bill McNamara, CPA - Director of the Construction Services Group at 732-349-6880 extension 116 or [bmcnamara@cowanguteski.com](mailto:bmcnamara@cowanguteski.com) for more information.

### ***About Cowan, Guteski & Company, P.A.***

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