What is my technology business worth? Factors that impact value

As a business owner it's interesting to track the potential value of your business, but by understanding what drives this value will help you make key decisions about its strategy and direction.

Whether or not you are actively considering a sale, understanding what makes your company valuable to buyers can inform your strategy, guide your plans around growth, and help you make informed decisions on where to invest in your business. When you know and understand the value drivers of your business, you can steer future transformation.

Alongside this, it's important to define your ambitions. As a business owner you have plenty of options available to you in terms of raising money and realising value. However, unless you understand your goals, you cannot set the strategic direction for achieving these aspirations.

For most people, selling their business is the biggest business deal they will ever do, and it's often a life-changing event. It's the point at which you realise the value of many years' work and investment. Post-sale, you may want to retire and secure the financial future of you and your family for many decades. Or maybe you want to liberate funds to start a new business.

Whatever your goal, the role of your professional adviser is to understand where you want to get to and advise you on the best way of getting there to achieve your objectives.

At Knight Corporate Finance, we tend to start at the end. We ask our clients about their goals and aspirations - often this is a number that achieves financial independence for the business owner. We work in the technology and telecoms sector and have access to unique insights and trends. As such, we are able to advise our clients on whether they can realise their financial ambitions now, or alternatively help them construct a roadmap which aims to achieve this in the future.

By understanding the value of your business today and how this compares to shareholder aspirations will help define the strategy, timing and nature of the work ahead of you.

This leads us on to the next point...

How do buyers and investors value a business?

In today's market, the most common way for buyers and investors to value a business is based on a multiple of EBITDA - on earnings before interest, taxes, depreciation, and amortisation. Essentially, this calculation is a proxy for the cash generation of the business.

What do buyers consider valuable when assessing a business?

Clearly profit is a major driver of value, but not the only one. Other key drivers include:

• **Customers** – it may sound obvious, but customers validate your strategy and proposition and are proof that your business has value.

• **Intellectual Property** – unique assets that you have developed in house. For a software company this is the code that drives the product, but it can equally relate to operations, processes and know-how that you have created over the life of your business.

• **Product proposition** – the ability to create or sell products in hot or high growth market sectors tend to be in demand from acquirers and investors.

• **Growth** – growth is the result of all the above, and in general a strong management team and an engine for growth is a prized asset.

How do buyers work out how much to pay for your business?

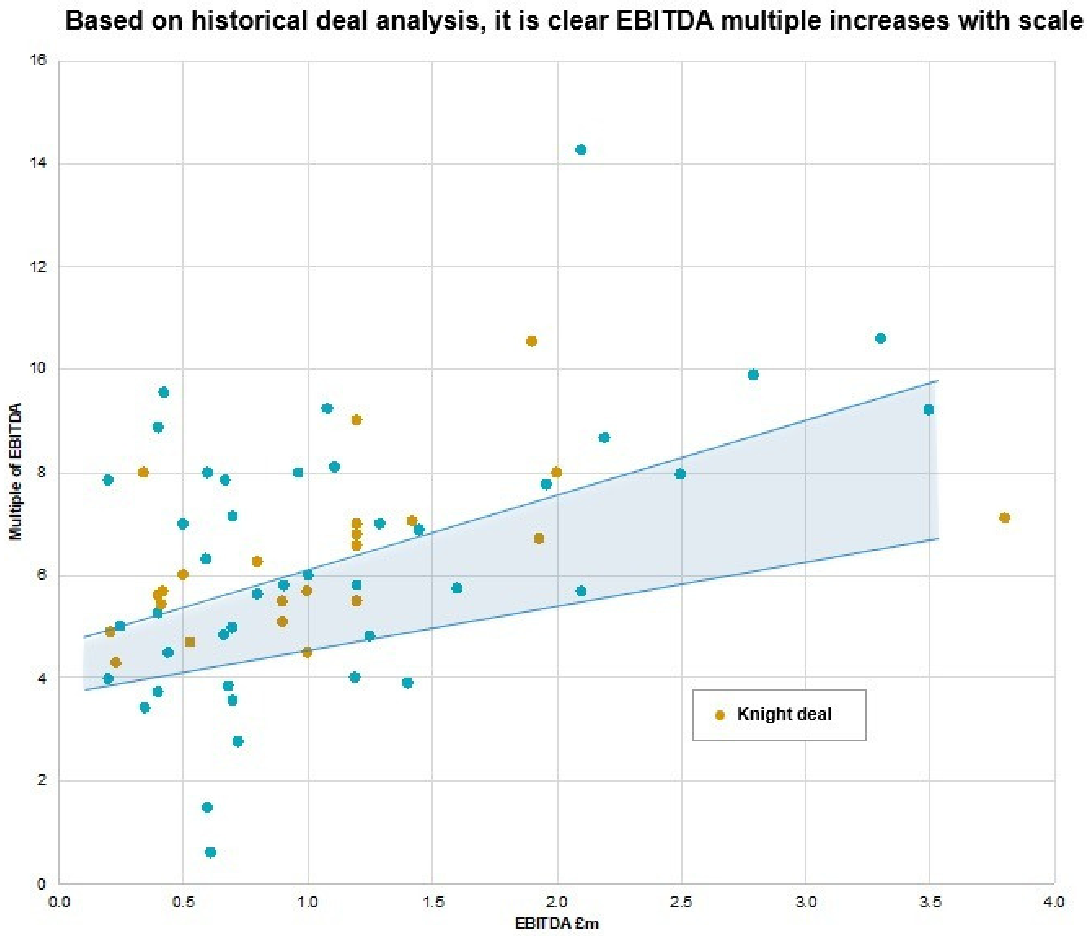
Having calculated the EBITDA of your businesses, buyers and sellers then determine what multiple to apply. Two key metrics here are size and growth.

1. Size – As illustrated in the diagram below, size has a significant impact on valuation. There are a number of reasons for this:

Track record – a larger company is likely to have established a track record that can provide greater certainty for a buyer or investor in projecting future growth and performance. Also, a larger business is more likely to have a business structure and processes in place that will provide a smooth operation post-completion.

Risk – Usually, a larger company is perceived as a lower risk investment. For example, larger companies don't tend to be reliant on any single customer, supplier or member of staff and are more able to sustain itself in times of economic uncertainty.

Competition – In any given sector, there a fewer large companies than there are smaller companies (see diagram below). This is likely to increase competition for these assets, which is typically reflected in an increased value.



2. Growth

– If your business is not growing then the multiple won't be as high as a business that is growing at a healthy rate. Equally, if your business growth is in decline then then the multiple will be less again. If your business is growing this will increase the multiple.

The growth point of your business shows buyers and investors how attractive you are to your customers and whether they are choosing to buy from you rather than your competitors. A healthy growth rate is always good news for your multiple.

Who is going to want to buy or invest in my business?

If you wanted to sell a six-bedroom house in the countryside, it is probably not going to be of interest to a young couple starting out on their careers. Its important to consider who would benefit most from buying or investing in your business.

Here are three factors to help you identify who this might be:

1. Are you strong in a specific sector or client type?

A potential buyer may be interested in vertical integration. Does your business have strengths in their specialist sector that would add value to their business? In our experience, if your client base is aligned in a vertical this will be of value to certain buyers and investors.

2. Size of your typical customers

Alongside vertical expertise, the size and volume of your customers base is something that buyers and investors are attracted to. For example, if an investor or buyer is targeting enterprise level companies, the likes of Coca-Cola and BMW, and your business has loyal enterprise level customers then this is likely to be valuable to them.

As a general rule having a narrowly defined customer size or type will enhance the perceived value of your business to potential buyers.

3. Do you have a differentiator?

A differentiator could be your technical expertise, your products or services or a particular aspect of your customer proposition that is unique and different.

If your business produces a fairly commoditised product and you don't have any particular expertise or Intellectual Property Rights, then this will have an impact on value. Low barriers to entry and ease of copying are factors that will impact the value of your business to a potential buyer.

However, if you are working in a commoditised market, but you may have a particular platform or solution that makes it easy and cost effective to sell your products and services then this could be interesting and valuable to potential buyers or investors.

Maybe your business is operating in a brand-new sector, or maybe you have developed new technology or software that no other business has. All these differentiators represent inherent value to potential buyers.

In summary, it's important to understand and identify what buyers are looking for and what parts of your business they will value most highly.

So, what does all this mean for taking the next step?

Rule number one - don't start out on this process until you are pretty confident you can complete your transaction that meets your expectations. The process could last nine months, will require a significant amount of time and resources and in parts can be an intense and emotional process.

Rule Number two – focus on the value not the multiple. Multiples can become meaningless as EBITDA can be manipulated or presented in any number of ways.

A private equity investor may pay a higher multiple than a strategic buyer, but they will base the multiple on a fully costed business with a full management team and a business that is geared up for growth. Conversely, a trade buyer will seek to realise synergies or cost savings and can factor these into their EBITDA calculations.

[Click here to view the webinar recording]

And so, you may have a higher multiple of a smaller number or vice versa, but neither are important compared to the value and whether the deal is the right one for you.

In conclusion

To understand the value of your business, you really need to understand where the value lies within your business, who this will be of greatest value to, and what approach will achieve the optimum outcome for you.

Knight Corporate Finance are one of the UK's most active advisors working solely in the telecoms and IT sector. We benefit from unique insights into the trends and metrics for the sector.

If you'd like to discuss how to leverage value within your business to optimise your value upon sale, whether it's this year, next year or in ten years' time we would be delighted to talk to you so please do get in touch.

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About Knight Corporate Finance

Knight Corporate Finance was founded by Adam Zoldan and Paul Billingham in December 2008 with the specific aim of providing industry-leading advice and outcomes to businesses and entrepreneurs in the technology and telecoms sector. Since then, Knight Corporate Finance has built a reputation for excellence, and has completed over 120 transactions from its offices in London and Warrington.

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