

## Maximising business goodwill

*Have you ever thought about selling your business or thinking about the value of your business as part of an overall succession plan?*

Many small-to-medium business owners see their business as a part of the asset base that will go towards their retirement capital. For some, the statement "my business is my retirement income" may not be uncommon.

The question is: how much is your business worth and what can you do to improve the value?

Ultimately your business is worth only what someone else is willing to pay. There are, however, a number of different ways in which businesses are valued. These include:

- A capitalisation of future maintainable earnings. This method assesses the annual sustainable profit the business is achieving and then applies a multiple that takes into account opportunity and risk.
- A discounted cash flow method. This focuses on future cash flows and the expectation of realising those cash flows over time.
- The net asset backing method. This simply values the business at the net worth of the assets less the liabilities.
- Industry formulas. These tend to be specific to certain industries and may value at a multiple of revenue or profits.

Today's trend is to focus on the profitability of the business.

In most cases the lower the profits, the lower the valuation. Where there are no profits there is a very real question about the value of the business beyond any break-up value.

When you look at the typical small business it is made up of a series of assets. These typically include plant and equipment, trading stock, debtors and goodwill. All of these assets are relatively easy to value, with the exception of goodwill. Hard assets such as plant or stock can generally be assigned an agreed value without too much argument. Goodwill, on the other hand, is much more difficult to value. Its inherent nature is that it is an intangible asset. You can't necessarily touch or see it, yet often it is the most valuable component of your business - and the component that sellers and buyers will most often argue about.

If you are looking to maximise your goodwill in any possible sale you need to ensure that you have the components in place that reflect its value. Maximising goodwill value is to some extent about making the intangible tangible.

When someone buys your goodwill, what are they paying for? The answer is your future profits and free cash flow. Goodwill in effect is a premium paid in excess of the hard asset value.

*Continued page 2*

## Clothe your naked PC

Connecting your naked PC to the internet is like leaving your house unlocked – eventually someone will wander in, rifle through your underwear drawer and empty the jewellery case. How do you prevent this from happening? Here are a few simple rules:

### Use antivirus software

The recent Mydoom virus was the fastest spreading email virus ever. Security experts MessageLabs said, at its peak, one in 12 emails carried the worm. How do you combat this sort of attack? Buy a well known antivirus product and keep the signatures (how the software detects a virus) up to date. Symantec's Norton AntiVirus and Network Associates' McAfee VirusScan are both reliable products that are able to automatically update their signatures, although Norton AntiVirus is highly recommended for its ease of use. An antivirus application will scan your incoming email before it reaches your Inbox and will scan any files that you attempt to open from a floppy disk or CD.

### To firewall, or not to firewall, that is the question

If you're using a high-speed, always on internet connection (e.g. wireless or Broad band) then the answer is definitely "yes"! Two reasons:

1. The connection is always on, meaning that your PC is connected to the internet 24/7 regardless of whether you have your email client or internet browser open; and
2. These types of connection usually require that your PC use a fixed IP address. An IP address is how your PC is recognised on the internet, therefore if someone discovers that your PC is unprotected and takes note of your IP address they will always be able to find and attack your PC again.

*Continued page 2*

## Clothe your naked PC

*Continued from page 1*

If you're using a dial-up connection the answer is it is up to you, depending on how you weigh up speed over security. Two reasons that you may not need a firewall (and they're both the flip-side of the high-speed internet coin):

1. The connection is not always on. Once you close your email client or internet browser and disconnect from the internet (this usually happens automatically) a potential hacker can no longer see your PC because it simply isn't on the internet; and
2. These types of connection usually (depending on your ISP) require a "server assigned" IP address, which means that your ISP will issue your PC with a different IP address each time you connect to the internet. Should a hacker have previously obtained your IP address they won't automatically be able to access your PC again.

The only downside of a firewall is that your speed slows because your internet traffic will be passed to the firewall to be checked, then, assuming all is well, passed from the firewall to your email client or internet browser. Hardware firewalls are quicker than software firewalls because they use their own processor and memory rather than using your PC's, however they are not easy to configure. Software firewalls are easy to install but will require a brief training period for them to learn which applications you want to allow access to the internet. There are several good, free software firewalls available:

- Kerio Personal Firewall 2 – for power users, [www.kerio.com](http://www.kerio.com)
- Outpost Firewall Free – brims with extra features including ad and popup blockers, [www.agnitum.com/download/](http://www.agnitum.com/download/)
- Sygate Personal Firewall 5.1 – offers fine-grained control over how and when applications can connect to remote servers, [www.simtel.net](http://www.simtel.net)
- ZoneAlarm 4.5 – novice-friendly, [www.zonelabs.com](http://www.zonelabs.com)

### Patch your software?

A patch is a small piece of software designed to plug a hole in a big piece of software. It's not a temporary solution, but a permanent one.

In theory it's a great idea to keep your email client, operating system and internet browser patched. However, sometimes the patches themselves are buggy or have security holes! Again, you have to weigh this up – do you install a patch immediately it's released, or do you wait a couple of weeks to ensure that the patch you're installing is good and, in the meantime, run the risk that a virus may be written that will exploit the hole that the patch is designed to fix?

- To patch Windows, Internet Explorer and Outlook Express (not Outlook) go to [www.windowsupdate.com](http://www.windowsupdate.com)
- To patch Office go to [www.officeupdate.com](http://www.officeupdate.com) and click on the Office Update link
- If you're using other applications the developer will have any necessary patches available for download from their website

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*Continued from page 1*

It is an amount that a buyer willingly spends to access your established and future profits and cash flow. Depending on the business, a buyer may be prepared to pay somewhere in the range of one to three times your future profits in goodwill. Some of the components that can make your goodwill more tangible include: an identifiable brand; customer lists; annuity income streams; documented operating systems; supply agreements; location leases; marketing materials; and advertising presence and websites. And above all, a history of operating profits. Too many small businesses operate their business simply with a tax focus.

A part of the objective is to ensure that taxable profits are as low as possible. Then, when they come to sell their business, they are trying to explain why it is so valuable. The reality is that in many cases they have invested years of their life in a business asset which they have progressively diluted.

If you are contemplating the future sale of your business you need to start building the business not simply with a focus on profits or lowering your taxable income, but with a view to maximising the value of your business asset.

Preparing a business for sale may be a three to five-year project. Failure to take the necessary steps three years prior to sale may cost you many tens of thousands of dollars in business value forgone.

*For information and advice on maximising the value of your business prior to sale, contact us today.*