Why Do We Do What We Do? - Comparative Financial Analysis Edition

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Happy New Year!!

As Business Appraisers, we look at a lot of numbers. We examine financial statements and tax returns so we can identify historical trends, and help identify risk drivers, but I have noticed quite a few reports this last year where the appraiser omitted a comparative financial ratio analysis. I thought I'd start off this year's newsletter with a discussion on this basic analysis.

Revenue 59-60 lists as one of the eight factors we are to consider in the valuation of a privately held business as, "The book value of the stock and the financial condition of the business." If all we look at is the subject company's financial data, we are only going to see the part of the picture that the subject company portrays. If we also compare the subject company's data to industry averages, then we can really see how the Company has been performing amongst its peers. If a business' ratios indicate that it is underperforming, then we can draw the conclusion that the subject business may have higher operating risk. If the industry ratios are showing the subject business to be performing better than average, then we can use that to support the selection of a higher than average market multiple and also a lower discount rate.

We have several sources where we can pull data from for the ratios. The Risk Management Association (RMA) tracks financial data received by lenders as part of their customers' banking needs. Bizminer pulls data from a variety of public sources listed on their website and calculates the ratios we use from among those data sources. (https://support.bizminer.com/article/36-where-does-bizminer-get-its-data) There are several other sources, but I am much less familiar with them.