Valuing Your Business

Putting a numerical value on your business can be a difficult task. All too often, we at Cultura encounter business owners that have severely overestimated, or sometimes even underestimated, the value of their company.

When selling your business, it is important to have a realistic estimate of what your business is worth to potential buyers. Having a realistic range will help you field offers more easily as you will have a benchmark valuation range to negotiate from.

There are several different ways of valuing a software business, and there is no one valuation type that can be applied to all situations. The valuation methodology or methodologies will differ depending on various characteristics of your business. In addition, different buyer types are likely to assign different values to your business based on their own formulas and weighting of criteria they find important.

As such, you can expect various values and valuation methodologies from different acquirers. For example, a Private Equity firm will typically put a lower value on your business than a strategic acquirer, who bases part of their valuation on synergies and the savings that they plan on realizing post-integration. Below are four common valuation methodologies typically used in valuing software businesses:

1. Revenue Multiple

This is a quick way to estimate the value of the business based on the revenues that are generated. There are multiple ways to approach this type of valuation, such as last fiscal year, trailing twelve months, or even forecasted revenues if the business is stable or growing in a predictable fashion. This method is typically not used for businesses where revenues are in decline or have historically shown volatility.

2. Recurring (Maintenance) Revenue Multiple

This valuation methodology is also common, especially in valuing Software-as-a-Service (SaaS) businesses. Certain acquirers prefer this valuation approach as recurring revenue is relatively predictable, as opposed to valuing the business based on net new or incremental upsell revenues. Also, during economic downturns, recurring revenues tend to show greater stability.

3. Internal Rate of Return (IRR) Method

Also known as the Discounted Cash Flow method, the IRR approach is used to understand how desirable an investment is in terms of the rate of return on the invested capital. For this method to be used, the business will need to have shown profits over a number of years, or the financial modeling has to show future profitability.

4. Comparables

This is the least systematic method of the four. It relies upon the value that has been put on companies with similar characteristics. The difficulty with this is that no two companies are exactly the same, and in the case of private companies, reliable data is difficult to come by. This method should be treated a rule of thumb. However, on the other hand, it offers a point of comparison and “sanity check” to the other methodologies used.