



## How Much is Your VAR Practice Worth?

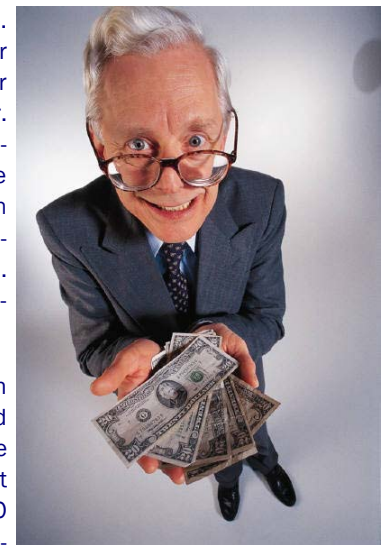
There are many reasons to know the value of your VAR practice. One of the more frequent motives is to build an exit strategy for one or more principals. Several popular strategies include selling the business to a partner, to the employees, or to another organization. By understanding the factors that determine value, a plan can be designed to maximize the business worth.

Although there are an infinite number of variables and methods to determine business valuation, a simple but relatively accurate formula can be used to value a VAR practice. The Magic Formula is shown below.

The key component of business value is EBIT, earnings before interest and taxes. Generally, EBIT is evaluated by looking at the current year, the prior two years, and a forward projection of one to two years. The largest weight is the current year but looking back and forward determines consistency of earnings and growth. A

VAR with consistent, growing, and predictable earnings achieves the highest valuation. Determine your EBIT by taking a three-year average. Use the prior year, current year, and next year estimate. If there is no estimate for next year than assume it is the same as the current year. When calculating EBIT it is important to normalize for owner compensation. For example, if one or more principals are paid less compensation than the industry average, EBIT must be adjusted to reflect industry normal compensation. The reverse is also true if owners are over compensated. The same is true with special perks.

CASH represents on hand cash and any cash equivalents such as CDs, bonds, equity, and other liquid instruments. Accounts Receivable (A/R) is all outstanding customer invoices that are not beyond 60 days old. A/R beyond 60 days is considered questionable. Doubtful Accounts are monies that may be returned to customers or uncollectible invoices within the 60-day A/R window. (Continued ...)



## The Magic Formula

**BUSINESS VALUE = FACTOR \* EBIT + ASSETS - LIABILITIES**

**ASSETS = Cash + (Accounts Receivable - Doubtful Accounts)  
+ Prepaid Expenses**

**LIABILITIES = Accounts Payable + Long Term Debt +  
Customer Deposits**

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Prepaid Expenses are any items such as insurance, taxes, or trade vendors that have been prepaid. Accounts Payable represents all outstanding liabilities including vendors, banks, and employees. Long-term debt is any obligations to banks, shareholders, and other sources that the business is obligated to pay. Customer Deposits include all deposits for undelivered products, services, or service contracts.

Physical assets such as furniture, office equipment, computers, automobiles, and inventory are not included in the valuation formula. These assets are considered to have little or no value when purchasing a business. They do have value, however, if the business were liquidated.

The big variable in the valuation formula is the **FACTOR**. Factor takes on a value between 0 and 6, based upon a variety of considerations. For example, a business that is very dependent upon the principal has a smaller factor and value than

a business capable of sustaining itself on its staff. To get a close approximation of the Factor to use for your own business valuation, take the SDbT “VAR Success Test Challenge”. Calculate your score and use it in the table below to determine your Factor.

SDbT Score	Factor
<25	0 to 1
25 to 29	1 to 2
30 to 39	2 to 3
40 to 45	4 to 5
46 to 50	5 to 6



To receive a free copy of the “VAR Success Test Challenge” simply email your request to Sheldon Kralstein at [Skralstein@sdbt.com](mailto:Skralstein@sdbt.com).

## Myths About Business Valuation

A well-run business achieves a healthy EBIT while having investment capital to propel growth. Many VARs tell me that their EBIT is low because they made an investment in growing their business. Although this may be a fact, it is not an acceptable reason for a higher business valuation. Business growth should be ongoing and must always be funded. High valuations are achieved through a balance of consistent EBIT and growth. Both are achievable with a sound business plan and accounting principals. Investments, where acceptable, should be amortized and not expensed. This spreads out the cost of the investment over time and properly reflects revenue and expense. EBIT is the critical factor in VAR valuation and there is no acceptable way to explain it away.

Risk is another important criterion in valuation. The higher the business risk the lower the Factor. Risks include issues such as challenged projects, past due accounts receivable, dependency upon the principal, low customer satisfaction, high employee turnover, ineffective marketing, and inconsistent sales revenue. The highest valua-

tions are awarded to companies that are well run, have happy customers, happy employees, and generate their own sales.

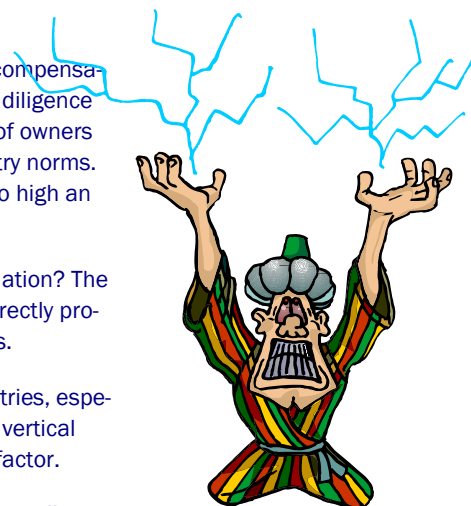
Can I inflate EBIT by taking little or no compensation? The answer is no! During the due diligence phase of valuation, the compensation of owners and employees are compared to industry norms. If compensation is either too little or too high an adjustment is made to EBIT.

What factor does potential have in valuation? The answer is very little or none. Value is directly proportional to results not potential results.

VARs targeted at specific vertical industries, especially those that have created and own vertical software command a higher valuation factor.

Valuation is a complex issue. By understanding the components that affect it permit you to design a business plan and strategy to maximize it.

Send your comments to [skralstein@sdbt.com](mailto:skralstein@sdbt.com).



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## Who is Success Driven By Technology

**S**uccess Driven By Technology, LLC (SDbT) focuses on helping Resellers and VARs grow their business. In fact we are so confident that we can make a dramatic contribution to your practice that we back it up with a no questions asked **money-back guarantee**.

Principals, Sheldon Kralstein and Mark Chinsky have 30+ years of experience and a stellar track record in the industry. Both Sheldon and Mark have built practices from the ground floor up, successfully sold their business, and were part of the national management teams of the Aston Group and ePartners respectively. They are dynamic individuals with the knowledge and skill set to help your business be more successful. Our areas of expertise include:

- Marketing
- Business Positioning
- Lead Generation
- Sales Team Development
- Sales Methodology that works
- Sales Training

- Sales Prospecting
- Effective Product Demos
- Compensation and Hiring
- Pricing
- Software Deployment
- Project Management
- Delivery Methodology
- Business Analysis and how to get paid for it
- Business Development
- Mergers and Acquisitions

Success in today's economy requires solid business practices coupled with creativity, innovation, and methodologies that drive business success. SDbT can analyze your current practice and help you implement proven strategies and methods that are guaranteed to work. We welcome the opportunity to speak with you about your business operation to explore how a relationship with SDbT can benefit your organization.