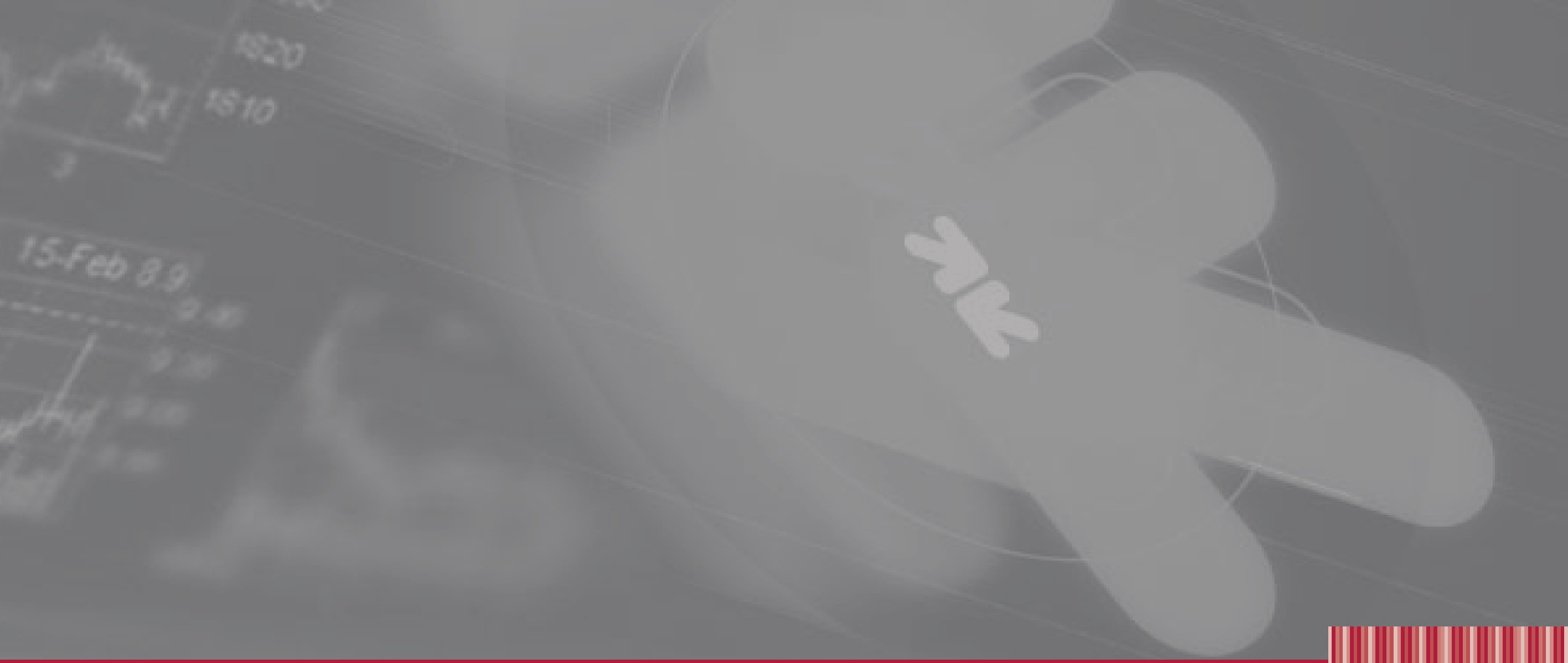

Valuation:
Getting the Right Price For Your Business

Value is related to risk and to the ability of the business to generate an income stream that is comfortable for the buyer. The value of a business depends on the needs and perspectives of each individual buyer.

To accurately assess the value of your business, you and your Broker will start with these basic steps:

- *Review and evaluate hard assets*
- *Recast, normalize, confirm, and review financial statements*
- *Identify factors that can impact future earnings*
- *Select the appropriate valuation method*
- *Calculate and apply external factor discounts*

VALUATION METHODS

While there are many different valuation methods, most fall into one of the following categories. Your Morgan & Westfield Business Broker can help you determine which method is most beneficial for you:

- COST OF ASSETS: this method bases the value according to the value of its assets: all equipment, furniture, fixtures, inventory, supplies, etc.
- INCOME/EARNINGS: this method is predicated on the amount of income the business can produce for the potential buyer
- MARKET/COMPARABLE SALES: this method looks at sales of comparable businesses based on gross revenue and net profit and other rules of thumb

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In many cases, we see some common averages of what businesses sell for, for example:

- Two to three times annual discretionary cash flow/earnings*
- Fair market value of equipment and inventory, plus 18 months of discretionary cash flow
- A percentage of annual gross sales (25%-100%)

TURNAROUND OPPORTUNITIES

Businesses with a negative cash flow may not pass the sanity test, but may be a good acquisition for the right buyer. These types of opportunities make the most sense for an industry buyer or someone who has experience in your industry. Novice buyers will be too intimidated and lack the experience to buy a turnaround opportunity. Expect the acquirer to offer you an "earn out," or a percentage of future sales.

THE VALUATION "SANITY TEST"

The figure you set must answer these questions:

- Does it adequately cover debt service?
- Does it provide a reasonable income for the buyer?
- Does it allow for working capital fluctuations?

(*Discretionary Earnings is defined as the owner's total compensation. This includes owner salary, net profit, deducted interest, depreciation plus other benefits, such as luxury automobiles, excessive insurance, exotic travel and family bonuses that have been charged off as business expenses.)

HOW BUSINESS ASSETS INFLUENCE
BUSINESS VALUE

(excerpted from Business Broker press, 2008)

Many courts and the Internal Revenue Service have defined fair market value as: "The amount at which property would exchange between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts." You may have to read this several times to get the gist and depth of this definition.

The problem with this definition is that the conditions cited rarely exist in the real world of selling or buying a business. For example, the definition states that the sale of the business cannot be conducted under any duress, and neither the buyer nor the seller can be pushed into the transaction. Such factors as emotion and sentimental value cannot be a part of the sale. Surprisingly, under this definition, no actual sale or purchase has to take place to establish fair market value. That's probably because one could never take place using the definition.

So what does make up the value of a privately-held business? A business consists of tangible and intangible assets. The tangible assets are the most visible and the ones on which buyers too often base a judgment on the value of a business. As factors of value, fixtures, equipment and leasehold improvements are often valued first by the buyer. Well maintained equipment and attractive interior surroundings are the first things a buyer sees when visiting a business for sale. Make no mistake, regardless of what prospective buyers may say, the emotional impact of a physically well-maintained business can be a very positive factor. In addition, it is much easier to finance tangible assets than intangible ones.

However, buyers have to consider what is really behind those well-maintained tangible assets. There are many businesses, especially today, in which physical assets play a very small part in the success of the business. These intangible factors include: the business' reputation with its customer or client base, and within its industry; mailing lists and customer/client lists; quality of product or service; reputation with its vendors and suppliers; strength of the business' technology and other systems; plus many other factors that can add a lot more value to the price of the business than can shiny equipment.

Although the intangible assets listed above cannot be seen, they are certainly an important part of the business - and purchase price. Businesses that don't need expensive fixtures and equipment can, in many cases, be expanded more quickly and inexpensively because they do not require cash-intensive equipment purchases. Buyers, to their own detriment, do not want to pay the same price for equivalent cash flow for businesses that do not have lots of equipment. They want to buy tangible assets.

Business brokers and intermediaries know how to point out to prospective buyers the advantages of businesses that may not require lots of equipment but have those all-important intangible assets that create steady cash flow. Business owners who have a service or other type of business that does not rely on the heavy use of tangible assets and are considering selling, should talk to their professional business broker/intermediary who can point out the pluses and the hidden assets of the business.

VALUE DRIVERS
Factors that can affect value and selling price

It is critical to consider all of the value drivers. In valuing a business it is important to take all of the factors below into account.

- Quality and sustainability of earnings
- Controls and internal systems in place
- Industry trends — cyclicality, seasonality
- Customer concentration
- Growth rate
- Market — stability, potential
- Capital expenditures
- Barriers to entry
- Supplier concentration and dependability
- Employment contracts
- Profit margins
- Product differentiation
- Market share
- Cost advantages
- Business type — commodities, technical, competitive
- Repeat customers
- Quality of management
- Terms of sale
- Size
- Years in business
- Ability to finance the sale
- Requirements of franchisor or dealer
- The general economy
- License requirements and regulatory issues
- Financial results (sale, margins, net, supportable earnings, trends, working capital requirements)
- Key performance indicators — # inventory turns, A/R to sales
- Scalability/Upside potential and related additional investment required
- Facility lease (rate vs. market, renewal options, landlord reasonableness)
- Marketability, demand, availability of buyers with the necessary skill set
- Seller after sale issues (training/mentoring, consulting, non-compete)
- Competitive threats (internet, franchises, industry leaders)

RECASTING FINANCIAL STATEMENTS
Presenting an accurate picture of your company's actual earnings

If you're like most owners, you've operated your business in a way that's calculated to minimize taxes. You may have given yourself and family members as many perks and benefits as possible, kept offspring on the payroll, plowed profits back into capital improvements, etc. These and other common practices are designed to keep your profits (and your taxes) low, perhaps artificially so. But the need to "recast" or recalculate earnings arises when you decide to sell.

Removing owner-specific perks, benefits and expenses will make your company look as profitable as possible. If time does not permit (or in addition to) this step, you can have your broker adjust (recast) your past income statements to reflect your financial condition

if you removed from them:

- Your salary and perks, and those of family members you don't expect to remain with the company
- Expenses or income that would not be expected to recur or continue after the sale (for example, income or expenses associated with discontinued products, or gains or losses from the sale of any business assets)
- Investment or other non-operating expenses or income
- Interest payments on any business loans, since you'll be removing such liabilities from the balance sheet.
- Owner health insurance, life insurance, auto expenses, etc.

SAMPLE ADJUSTED INCOME STATEMENT
For the Year Ended December 2007

	STATEMENT	ADJUSTMENT	REVISED
Income	**$**	**$**	**$**
Gross Sales	5,090,578	0	5,090,578
Other Income	0	0	0
Total Income	**5,090,578**	**0**	**5,090,578**
Cost of Goods Sold	**3,840,899**	**250,470**[1]	**3,590,429**
Gross Profit	**1,249,679**	**250,470**	**1,500,149**
Expenses			
Advertising	22,045	2,510[2]	19,545
Auto	36,787	35,430[3]	1,357
Bad Debt	128	0	128
Computer Service	6,907	0	6,907
Contributions	1,697	1,697[4]	0
Dues & Subscriptions	3,845	3,845[5]	0
Fuel	4,992	4,992[6]	0
Insurance	35,104	6,321[7]	28,783
Licenses & Permits	2,680	0	2,680
Misc.	4,593	4,593[8]	0
Office Supplies	48,993	6,112[9]	42,881
Office Wages - 1099	10,237	0	10,237
Payroll Expenses	163,550	0	163,550
Payroll Taxes	96,890	13,600[10]	83,290
Payroll Wages - Office	258,802	136,000[11]	122,802
Postage & Delivery	1,102	0	1,102
Printing & Reproduction	4,637	0	4,637
Professional Fees	9,540	0	9,540
Rent	130,674	2,510[12]	97,146
Repairs & Maintenance	9,970	0	9,970
Depreciation	4,060	0	4,060
Taxes	7,069	0	7,069
Telephone	1,888	1,888[13]	0
Uniforms	6,244	6,244[14]	0
Utilities	4,208	0	4,208
Workers Compensation	3,042	0	3,042
Total Expenses	**879,694**		**622,934**
Net Profit/SDE (Before Taxes)	**169,985**	**476,212**	**646,197**

MORGAN & WESTFIELD

NOTES TO FINANCIAL STATEMENTS

1 $3800 – Installers no longer paid to measure, job now performed by salespeople.
COGS from another unrelated business.

2 Non–Business Expense.

3 Owner's personal vehicle.

4 Non–business expense.

5 Non–business expense.

6 Owner's personal vehicle expenses.

7 Dental insurance no longer provided for employees $2705. Owner's health insurance $3616.

8 Non–business expense.

9 Office supplies paid by salesmen $6,112.

10 Sales Manager's payroll taxes $4,800. Friend's payroll taxes $2,800.
Owner's payroll taxes $6,000.

11 Sales Manager duties assumed by owner $48,000. Excess wages paid to friend $28,000.
Owner's salary $60,000.

12 Rent reduction in new facilities by $2,790 per month.

13 Owner's personal cell phone.

14 Uniforms no longer paid for employees.