

A middle-aged man with grey hair and a friendly smile stands in a grocery store aisle. He is wearing a light-colored checkered shirt and a green apron, with his arms crossed. The background is filled with white shelves stocked with various grocery items, including jars, boxes, and bags of food. A green rectangular box with white text is overlaid on the center of the image.

A Taste of Business Brokerage

A man with short dark hair, wearing a light blue button-down shirt and a tan apron, stands behind a wooden counter in a cafe. He is looking towards a woman with long, curly brown hair who is wearing a light blue denim shirt. The man is holding a small notepad and a pen. The background shows shelves with various jars and kitchen items. A chalkboard menu is visible, listing smoothie options like 'STRAWBERRY HONEY &', 'RASPBERRY YOGURT, MINT & HONEY', and 'BLUEBERRY, PEACH & HONEY'. Another chalkboard to the right lists 'FRESHLY' options like 'ORANGE, APPLE', 'BEETROOT, APPLE & CARROT', and 'POMEGRANATE APPLE'. In the foreground, there are some pastries and a jar labeled 'CHOC CHIP COOKIE'.

Part One *Essentials*

The BIG Impact of Small Business



"In America, a small business is a big deal." - Bob Beuprez

The BIG Impact of Small Business



SMALL BUSINESSES are independently owned and operated.

- Fewer than 500 employees
- Less than \$20 million revenue
- A powerful punch!
 - ✓ Economic
 - ✓ Social
 - ✓ Political

The BIG Impact of Small Business

ECONOMIC ENGINE

- 57% of the workforce (77 million workers)
- 64% of new jobs
- 44% of private U.S. payroll
- 80% at a single location
- 97% of exporters, 29% of export volume



The BIG Impact of Small Business



Small business owners are INNOVATIVE.

The BIG Impact of Small Business



Many big businesses
OUTSOURCE parts and
services to smaller, local
businesses.



The BIG Impact of Small Business

SOCIAL HUBS

The importance of small business to local communities is EMOTIONALLY rooted in buying, selling, working, sharing with friends and neighbors.



Community Roots



The BIG Impact of Small Business



behind
EVERY
small
business
is a
FAMILY

WHEN YOU BUY FROM A
SMALL BUSINESS AN
ACTUAL PERSON DOES
A LITTLE
HAPPY DANCE



The BIG Impact of Small Business

UNIQUE OR SPECIALIZED

In big cities, small businesses offer more *diverse* inventory... or provide *unique*, personalized customer experiences.



The BIG Impact of Small Business

Many small businesses
become **BIG**
businesses.

*And stay in the old
neighborhood.*



The BIG Impact of Small Business



Integral to neighborhood revitalization

The BIG Impact of Small Business



In many areas, a small business is the **ONLY** type that can survive while serving a reduced or less wealthy population.

Why small businesses fail?



“There’s no such thing as bad business, only bad management.”

ACCORDING TO SBA. . .

- 50% of businesses fail in first year.
- 95% fail within the first five years.
- It’s rarely because of the market.
- Rather, it’s insufficient capital, ineffective management, or both.

Why small businesses fail?



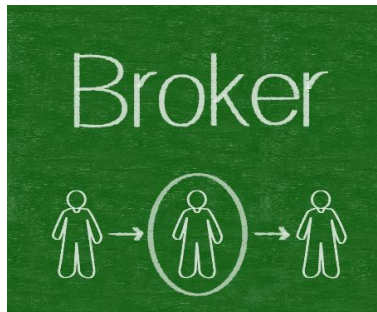
PRESCRIPTION FOR FAILURE?

- | | |
|--|---|
| <ul style="list-style-type: none">■ Not profitable■ Poor location■ Lack of business experience■ No planning■ Too many fixed assets■ Poor inventory management■ Inadequate financing■ Insufficient cash reserves | <ul style="list-style-type: none">■ Sketchy market■ Bad pricing and service■ Not enough cash flow■ Ill-prepared or inflexible■ Grew too fast■ Relying on a single customer■ Failure to delegate■ Personalities vs. systems |
|--|---|



PART OF your role as business broker is to offer guidance on becoming more “business-like,” addressing both financial and operational issues.

What is Business Brokerage?



BUSINESS BROKERS act as *intermediaries* in the sale of small to medium-sized businesses.

- Similar listing and selling functions as real estate
- Similar legal responsibilities and agency laws
- **Sharply different valuation methods**
- Most businesses operate from *leased* locations.
- GA requires real estate license.

What is Business Brokerage?

BUSINESS BROKERAGE SERVICES

- Confidentiality
- Pricing
- Offering Memorandum
- Marketing



- Screen Buyers
- Facilitate Meetings
- Negotiate Offers
- Financing
- Due Diligence

What is Business Brokerage?

**GIVE NO
LEGAL ADVICE!**



What is Business Brokerage?

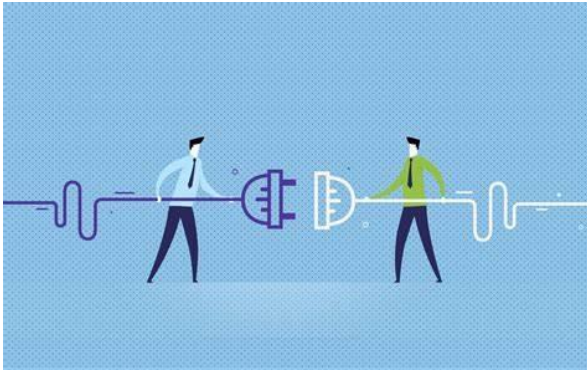


Approximately 90% of businesses in the U.S.

INDUSTRY SEGMENTS

- **MAIN STREET:** Businesses valued at less than \$2 million, usually owner-operated businesses and franchises; sold to an individual operator replacing an owner or an add-on to growing businesses.
- **LOWER MIDDLE MARKET:** Businesses valued between \$2 million and \$25 million, appealing to individuals escaping the corporate grind, or strategic or private equity buyers.

What is Business Brokerage?



INDUSTRY SEGMENTS

- **MIDDLE MARKET:** Businesses valued between \$25 million and \$50; targets of similarly sized or larger companies or private equity groups.
- **UPPER MIDDLE MARKET:** Transactions for businesses over \$50 million that involve corporate M&A firms and investment bankers.



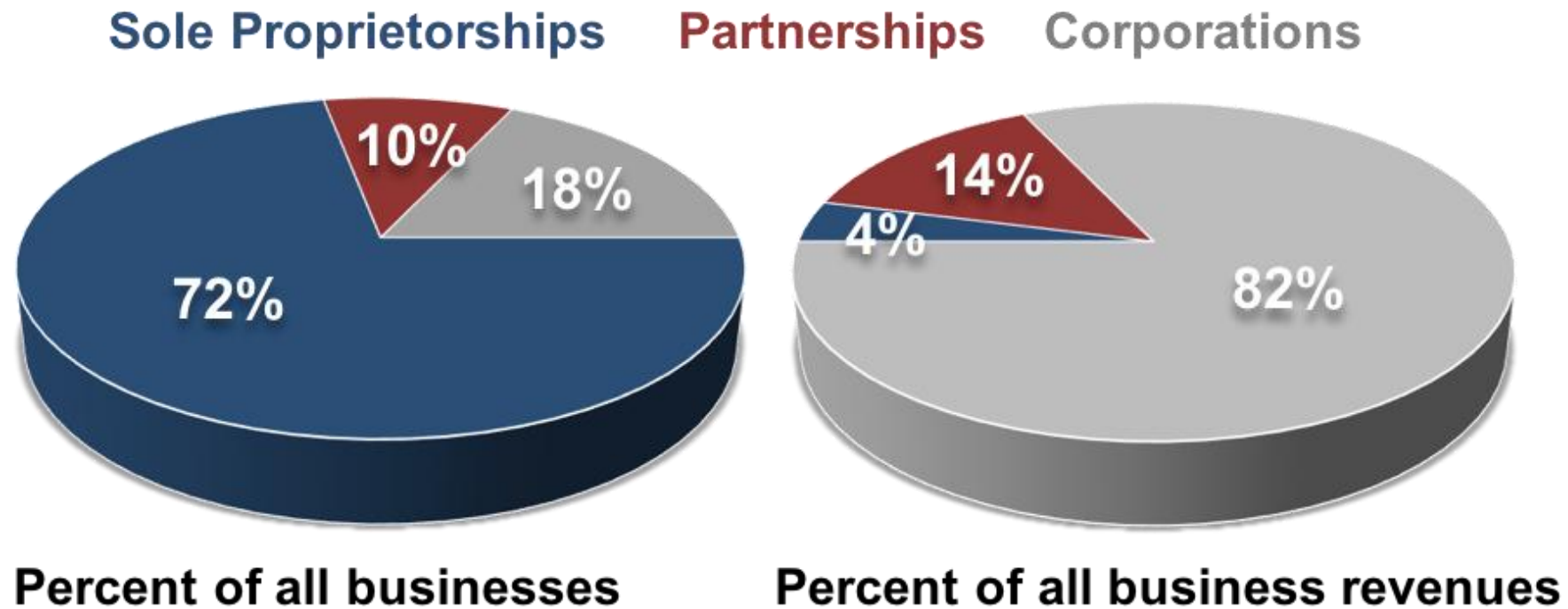
72% of U.S.
businesses are sole
proprietorships.

Franchising

44% of small business are franchised.



Types of business entities





Part Two

Evaluating/Pricing

Accounting



ACCOUNTING FUNDAMENTALS

Basic concepts, assumptions, policies, methods and practices used by a business for maintaining the books of account and summarization into financial statements.

Accounting



GAAP

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

A common set of accounting principles, standards and procedures that almost all companies follow when compiling their financial statements.

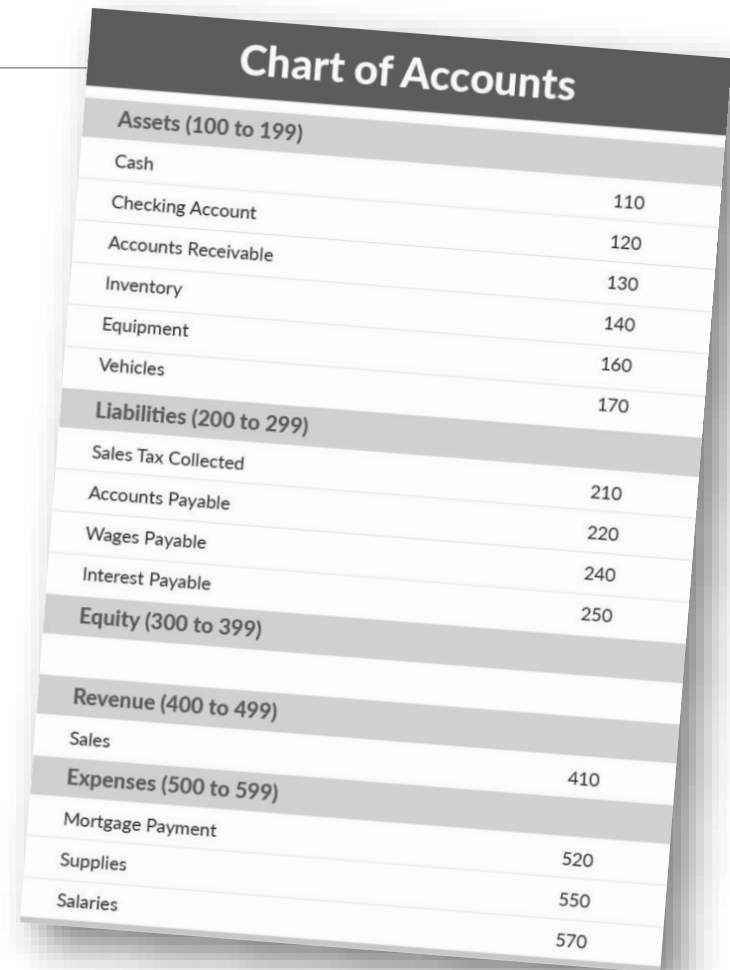
Accounting

	CASH-BASIS	MODIFIED CASH-BASIS	ACCRUAL BASIS
Available Accounts	Cash Accounts Only	Cash & Accrual Accounts	Cash & Accrual Accounts
Record Income	When Paid	When Paid	When Invoiced
Record Expenses	When Paid	When Paid	When Billed

Accounting

CHART OF ACCOUNTS

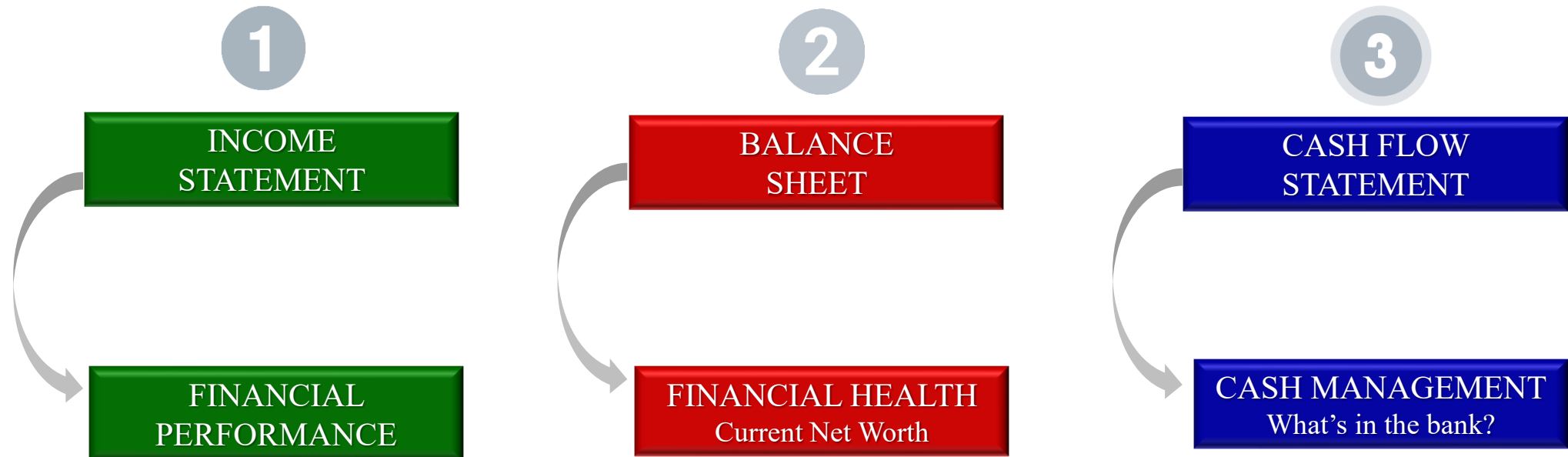
- Defines each category for which money is spent or received.
- Separates revenue and expenditures; assets and liabilities.
- Organizes company finances. Allows for analysis and comparisons.
- Keep it simple, but useful for analysis.



Assets (100 to 199)	
Cash	110
Checking Account	120
Accounts Receivable	130
Inventory	140
Equipment	160
Vehicles	170
Liabilities (200 to 299)	
Sales Tax Collected	210
Accounts Payable	220
Wages Payable	240
Interest Payable	250
Equity (300 to 399)	
Revenue (400 to 499)	
Sales	410
Expenses (500 to 599)	
Mortgage Payment	520
Supplies	550
Salaries	570

	A	B	C	D	E	F
1	Small Business Chart of Accounts					
2	Account Name	Code	Financial Statement	Group	Sub-Group	Normally
3	Bank checking account	1000	Balance sheet	Current assets	Cash and cash equivalents	Debit
4	Bank savings account	1010	Balance sheet	Current assets	Cash and cash equivalents	Debit
5	Online savings account	1020	Balance sheet	Current assets	Cash and cash equivalents	Debit
6	Petty cash account	1030	Balance sheet	Current assets	Cash and cash equivalents	Debit
7	Paypal account	1040	Balance sheet	Current assets	Cash and cash equivalents	Debit
8	Accounts receivable	1200	Balance sheet	Current assets	Accounts receivable	Debit
9	Allowance for doubtful debts account	1210	Balance sheet	Current assets	Accounts receivable	Credit
10	Inventory	1400	Balance sheet	Current assets	Inventory	Debit
11	Prepayments	1600	Balance sheet	Current assets	Other current assets	Debit
12	Property	1800	Balance sheet	Long term assets	Property, plant and equipment	Debit
13	Property Depreciation	1810	Balance sheet	Long term assets	Property, plant and equipment	Credit
14	Plant	1820	Balance sheet	Long term assets	Property, plant and equipment	Debit
15	Plant depreciation	1830	Balance sheet	Long term assets	Property, plant and equipment	Credit
16	Equipment	1840	Balance sheet	Long term assets	Property, plant and equipment	Debit
17	Equipment depreciation	1850	Balance sheet	Long term assets	Property, plant and equipment	Credit
18	Accounts payable	2000	Balance sheet	Current liabilities	Accounts payable	Credit
19	Payroll payable	2200	Balance sheet	Current liabilities	Other current liabilities	Credit
20	Interest payable	2210	Balance sheet	Current liabilities	Other current liabilities	Credit
21	Accrued expenses	2220	Balance sheet	Current liabilities	Other current liabilities	Credit
22	Unearned revenue	2230	Balance sheet	Current liabilities	Other current liabilities	Credit
23	Sales Tax payable	2240	Balance sheet	Current liabilities	Other current liabilities	Credit
24	Purchase Tax payable	2250	Balance sheet	Current liabilities	Other current liabilities	Credit
25	Payroll tax payable	2260	Balance sheet	Current liabilities	Other current liabilities	Credit
26	Income tax payable	2270	Balance sheet	Current liabilities	Other current liabilities	Credit
27	Mortgage loan	2400	Balance sheet	Long-term liabilities	Mortgages	Credit
28	Other loans	2600	Balance sheet	Long-term liabilities	Loans	Credit
29	Owners contributions	3000	Balance sheet	Equity	Capital	Credit

FINANCIAL STATEMENTS

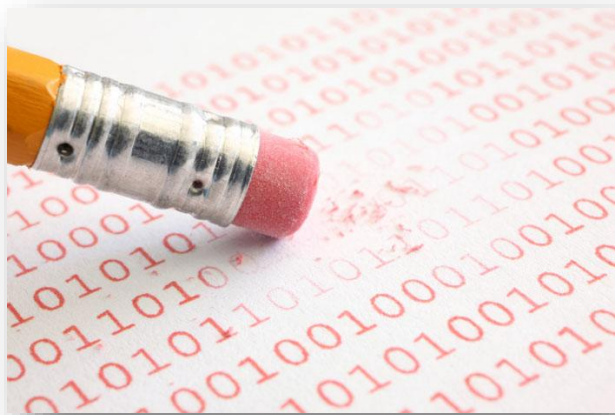


*Complete * Accurate * Warranted*

**Income statement for XYZ business
for the period ending 31st of December 2010**

	Budgeted	Actual
INCOME	\$	\$
Services rendered	100,000	94,600
EXPENSES		
Salaries	25,000	25,000
Telephone & internet	6,500	6,500
Water & electricity	14,000	16,000
Property rates and taxes	1,000	1,000
Insurance	7,300	7,300
Advertising costs	1,000	1,000
Fuel	1,800	2,500
Stationery	500	412
Bank charges / interest paid	600	654
Tax expense	3,000	3,414
NET PROFIT	<u>39,300</u>	<u>30,820</u>

Accounting



ADJUSTING INCOME STATEMENT

Compensates for unusual spending or accounting practices.

Should be clearly identified as “adjusted.”

Accounting

ADJUSTMENTS TO INCOME STATEMENT

- Salaries
- Cars
- Life Insurance
- T&E
- Relatives on payroll
- Cost of Goods Sold
- Equipment Leases
- Discretionary expenses
- Depreciation
- Interest expenses
- Non-recurring items
- Others



Accounting



INCOME STATEMENT covers a specific period of time (quarterly, annually, etc.).

BALANCE SHEET is a snapshot of one particular point on time (e.g. 12/31/25).

Accounting



THE BALANCE SHEET



OWN

Assets



OWE

Liabilities



NET WORTH

Equity

WEBSTER COMPANY
Balance Sheet
March 31, 20X6

Assets

Current assets

Cash	\$160,000	
Accounts receivable	75,000	
Inventories	200,000	
Prepaid insurance	<u>25,000</u>	\$460,000

Long-term investments

Available-for-sale debt securities	45,000	
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Property, plant, & equipment

Land	\$ 25,000	
Buildings and equipment	\$150,000	
Less: Accum. depreciation	<u>(50,000)</u>	<u>100,000</u>
		125,000

Intangible assets

Goodwill	275,000	
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Other assets

	<u>10,000</u>	
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Total assets	<u>\$915,000</u>	
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Liabilities

Current liabilities

Accounts payable	\$ 80,000	
Salaries payable	10,000	
Interest payable	20,000	
Current portion of notes payable	<u>40,000</u>	\$150,000

Long-term liabilities

Notes payable	\$190,000	
Mortgage liability	<u>110,000</u>	<u>300,000</u>

Total liabilities		\$450,000
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Stockholders' equity

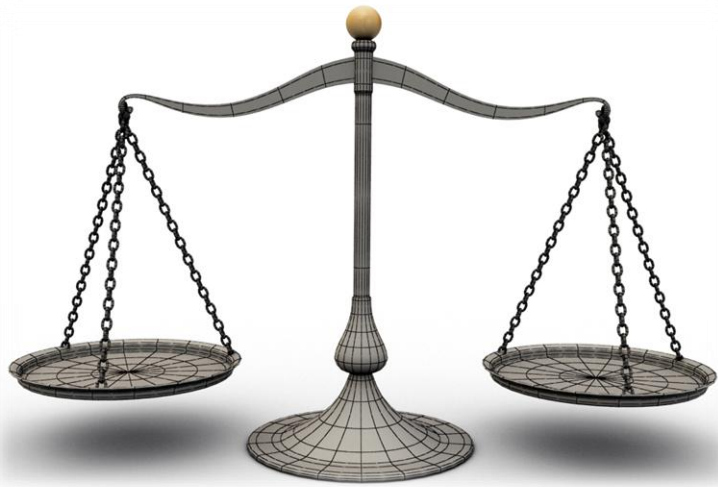
Capital stock	\$300,000	
Retained earnings	170,000	

Accumulated other comprehensive income/loss	<u>(5,000)</u>	
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Total stockholders' equity		<u>465,000</u>
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Total liabilities and equity		<u>\$915,000</u>
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Accounting



$\text{Assets} - \text{Liabilities} = \text{Equity}$

ASSETS

- Cash
- Marketable Securities
- Accounts Receivable
- Tangible or Fixed Assets
- Inventory
- Intangibles
- Other Asset Types

Accounting



Accounting



BALANCE SHEET

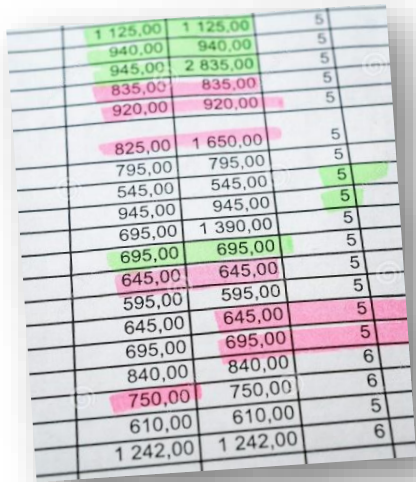
- Assets Tangible vs. intangible
 - Liabilities Short term vs. long term
 - Equity Distributed vs. retained
-
- ✓ *Too much or insufficient cash?*
 - ✓ *Sufficient liquidity to satisfy short-term obligations?*



The background image is a composite of financial and office-related elements. On the left, a portion of a black calculator is visible, showing keys for 'OFF', 'GT', '√', '%', '×', '3', and a decimal point. In the center, a green rectangular box with a slight 3D effect contains the title 'Reviewing the Numbers' in a white, serif font. To the right and below the box, a financial spreadsheet is visible. It features a monthly breakdown from January to December with various numerical values. A silver pen is positioned diagonally across the bottom of the spreadsheet, pointing towards the lower right. The overall image has a blue-tinted, slightly blurred aesthetic.

Reviewing the Numbers

Reviewing the Numbers



1 125,00	1 125,00	5
940,00	940,00	5
945,00	2 835,00	5
835,00	835,00	5
920,00	920,00	5
825,00	1 650,00	5
795,00	795,00	5
545,00	545,00	5
945,00	945,00	5
695,00	1 390,00	5
695,00	695,00	5
645,00	645,00	5
595,00	595,00	5
645,00	645,00	5
695,00	695,00	5
840,00	840,00	6
750,00	750,00	6
610,00	610,00	5
1 242,00	1 242,00	6

YOUR ROLE...

- In business brokerage, “numbers” matter.
- Clients expect you to gather numbers, sort them, explain them, and point out anomalies or deficiencies.
- You may not practice law or accountancy, but need to know enough about both professions to spot issues.

Reviewing the Numbers



NON-DISCLOSURE AGREEMENT (NDA)

Legal contract between at least two parties that outlines confidential material, knowledge, or information that the parties wish to share with one another for certain purposes, but wish to restrict access to by third parties.

Reviewing the Numbers



QUANTITATIVE ANALYSIS

- Business or financial analysis through mathematical calculations, statistical modeling and research.
- Uses financial statements to derive *financial ratios*, such as profit margins or liquidity rates.

Reviewing the Numbers



Numbers matter but aren't everything!

Reviewing the Numbers



QUALITATIVE ANALYSIS seeks the “why” and “how” of business success or failure – using surveys and other narrative feedback.

- Narrative vs. numerical
- Anecdotal vs. scientific
- No less important than quantitative analysis, even if hard to measure.

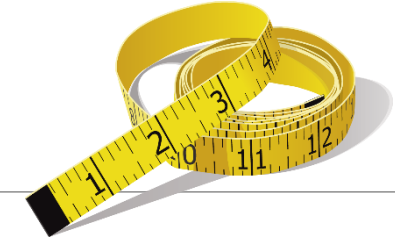
Reviewing the Numbers

QUALITATIVE ANALYSIS

- History (legacy)
- Leadership
- Market trade area/share
- Marketing positioning/competition
- Products and services (potential add-ons)
- Client profile (demographics)
- Systems (marketing, customer service, accounting, etc.)



Reviewing the Numbers



QUANTITATIVE ANALYSIS

- Review past performance.
- Measure financial flexibility.
- Estimate future cash flows.
- Assess efficiency in generating profits.
- Evaluate ability to meet its obligations.

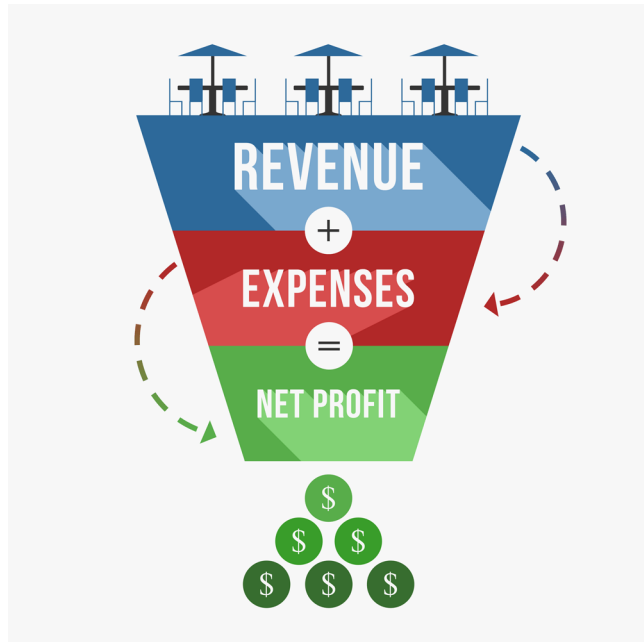
Reviewing the Numbers



FINANCIAL RATIOS

- Mathematical comparisons for analyzing strengths and weaknesses in companies.
- There are dozens of ratios that test a variety of financial criteria. Not all ratios are used by every company.

Reviewing the Numbers



PROFIT MARGINS

- Measure a company's profitability at various levels.
- Margins shrink as additional costs are taken into consideration, such as cost of goods sold, operating and other expenses, and taxes paid.

Reviewing the Numbers

GROSS PROFIT MARGIN is the difference between revenue and cost of goods sold (COGS), divided by revenue.

$$\text{Gross Profit Margin} = \frac{\text{Sales} - \text{Cost of Goods Sold}}{\text{Sales}}$$

Reviewing the Numbers

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}}$$

$$\text{\$3,000,000} \div \text{\$5,000,000} = 0.6 \text{ or } 60\%$$

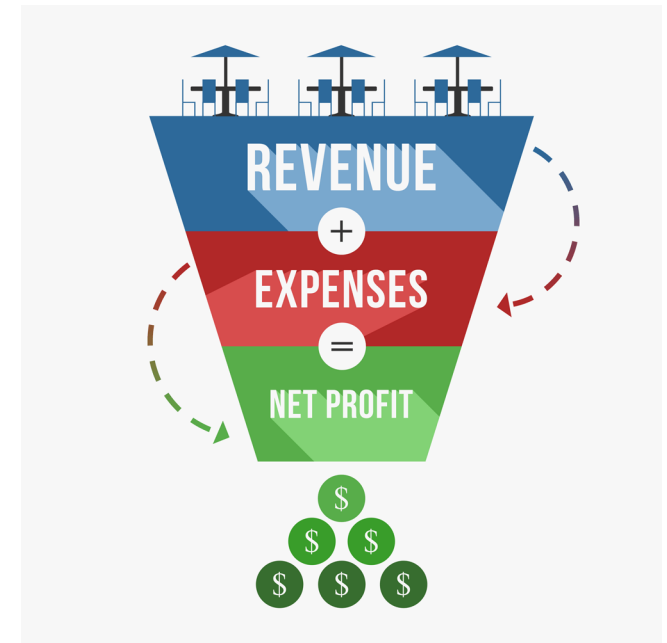
Gross profit

Revenue

Gross Profit Margin

Reviewing the Numbers

- Low margins may not cause immediate concern, but do require higher sales volume.
- Comparing gross profit margins with competitors helps you determine how much costs can you pass on to customers.
- Some companies tier their offerings to encourage customers to purchase products with better gross profit margins.



Reviewing the Numbers

OPERATING MARGIN

Business expenses usually exceed the cost to produce and sell goods (examples: sales staff, executives, marketing, facilities).

These expenses affect your operating margin calculation:

$$\text{Operating Margin} = (\text{Net Sales} - \text{COGS} - \text{Operating Expenses}) / \text{Net Sales}$$

Reviewing the Numbers

NET PROFIT MARGIN

Factors even more expenses into the equation, covering costs unrelated to the business' core operations. You must subtract taxes; gains or losses from investments and shareholders; and large, one-time transactions (e.g., acquiring/selling a part of the business's property or product lines).

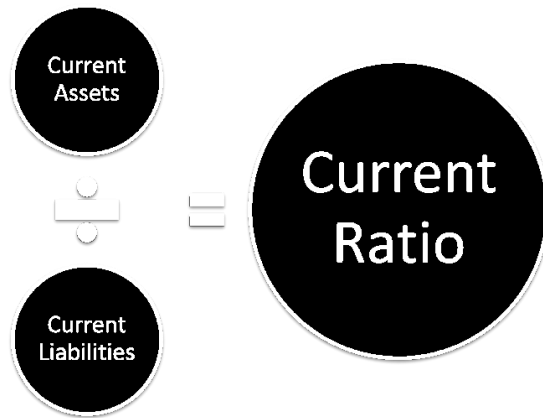
$$\text{Net Profit Margin} = (\text{Net Sales} - \text{COGS} - \text{Operating Expenses} - \text{Additional Gains or Losses}) / \text{Net Sales}$$

INDUSTRY	GROSS PROFIT MARGIN	NET PROFIT MARGIN
Advertising	23.99%	0.34%
Apparel	49.77%	-3.94%
Auto and Truck	9.04%	1.4%
Banks (Regional)	99.75%	23.79%
Building Materials	28.38%	5.06%
Computer Services	27.16%	3.62%
Home Furnishings	27.03%	4.63%
Healthcare Products	56.94%	10.91%
Household Products	50.87%	11.71%
Machinery	34.50%	6.58%
Packaging and Container	22.39%	2.98%
Precious Metals	50.17%	15.79%
Recreation	37.58%	-2.12%
Restaurants and Dining	27.60%	5.69%
Retail (General)	24.27%	2.79%
Retail (Online)	42.53%	4.95%
Software (Internet)	58.58%	-5.60%
Transportation	19.91%	3.88%
Total Market*	36.22%	5.05%

Reviewing the Numbers

CURRENT RATIO

How many times bigger are current assets compared to current liabilities?



- A ratio of 1.5 to 2.0 suggests efficient management of working capital.
- Low ratio (e.g. below 1.0) indicates cash problems.
- High ratio indicates too much working capital.
- Industry norms vary. Trends are more important.

Reviewing the Numbers

CURRENT ASSETS	AMOUNT
Cash	\$500
Checking Account	\$4,500
Inventory	\$15,000
Total	\$20,000

CURRENT LIABILITIES	AMOUNT
Line of Credit	\$10,000
Total	\$10,000

CURRENT RATIO is 2 to 1.

*\$20,000 current assets to \$10,000
current liabilities = 2 to 1*

2 to 1 ratio is healthy, as you have
twice as many assets as liabilities.

Reviewing the Numbers

QUICK RATIO

Can you meet your financial obligations should the unexpected occur?


$$\begin{array}{l} \text{Quick} \\ \text{Ratio} \\ \text{Formula} \end{array} = \frac{\text{(Cash + Shortterm Marketable Securities + Accounts Receivable)}}{\text{Current Liabilities}}$$


Reviewing the Numbers

CURRENT ASSETS	AMOUNT
Cash	\$500
Checking Account	\$4,500
Inventory	\$15,000
Total	\$20,000
CURRENT LIABILITIES	AMOUNT
Line of Credit	\$10,000
Total	\$10,000

QUICK RATIO is 0.5.

$$\frac{\$20,000 \text{ current assets} - \$15,000 \text{ current inventory}}{\$10,000 \text{ current liabilities}} = 0.5$$

A healthy quick ratio is 1.0 or more.

Reviewing the Numbers

DEBT-TO-WORTH RATIO

How much you owe compared to how much you own?

$$\text{Debt to Worth Ratio} = \frac{\text{Total Liabilities}}{\text{Tangible Net Worth}}$$

- Ratio above 100% means a company cannot pay its debt by selling its assets.
- Ratio below 100% means that a company can settle its liabilities using its assets.

Reviewing the Numbers

ASSETS	AMOUNT
Cash	\$500
Checking Account	\$12,000
Computer	\$7,500
Total	\$20,000
LIABILITIES	AMOUNT
Line of Credit	\$5,000
Long-term Debt	\$5,000
Total	\$10,000

DEBT-TO-WORTH RATIO is 1.

Net worth = Assets – Liabilities

\$10,000 total liabilities / (\$20,000 – \$10,000 net worth) = 1

If the debt-to-worth ratio is greater than 1, your business has more capital from lenders than you. The bank might see this as a risk.

Reviewing the Numbers

RETURN ON INVESTMENT

How earnings compares to our personal investment in the business?


$$\text{Return on Investment Formula} = \left(\frac{\text{Net Profit}}{\text{Cost of Investment}} \right) \times 100$$


Reviewing the Numbers

ITEM	AMOUNT
Earnings	\$20,000
Initial Cost of Investment	\$7,500

ROI is 1.67.

$$(\$20,000 \text{ earnings} - \$7,500 \text{ initial investment}) / \$7,500 \text{ initial investment} = 1.67$$

The higher your ROI, the more your investments turn into income.

BUSINESS VALUATION



Loan
Risk
Profit



Valuing a business

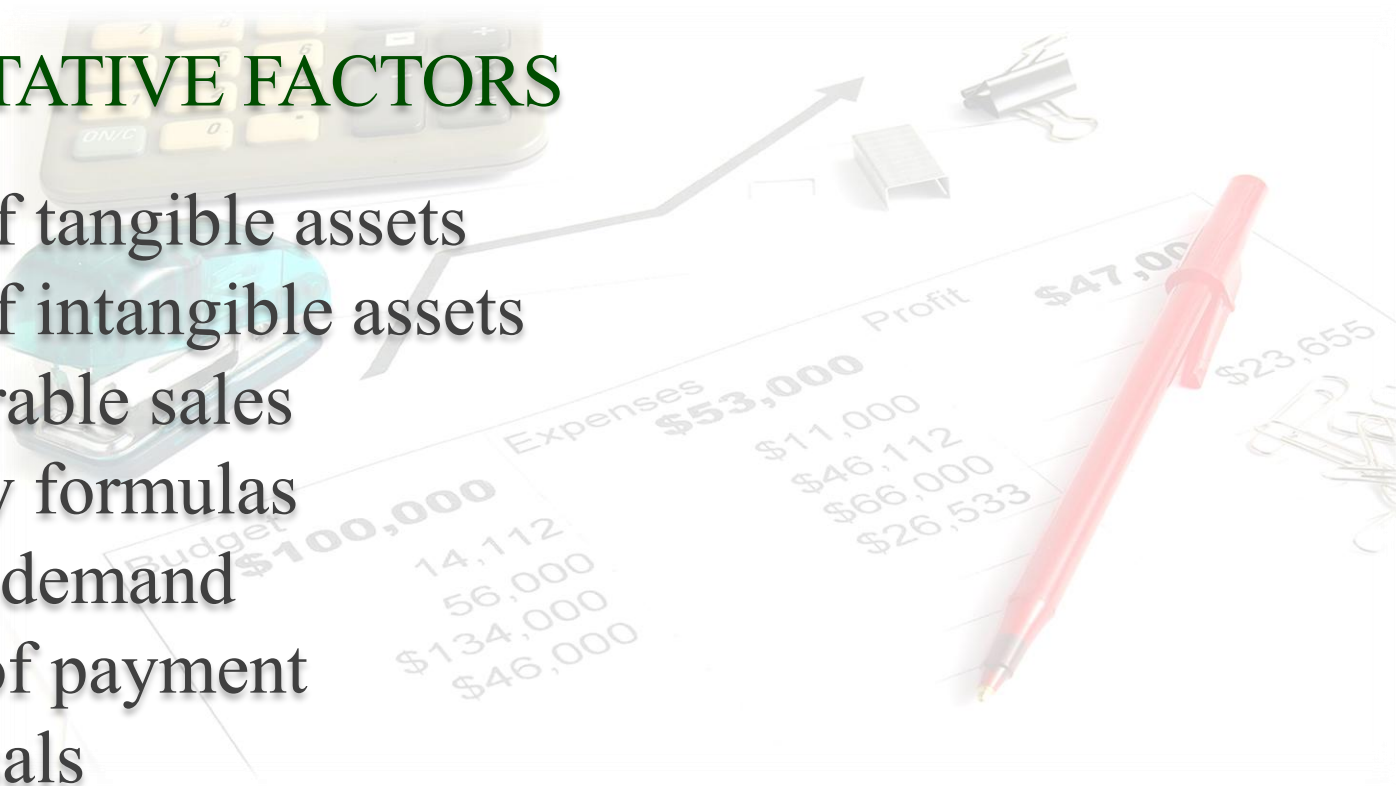


- No exact business appraisal science exists.
- Depending on method used, you'll likely reach different conclusions of a business's value.
- *A range* of value is preferred.
- Current, accurate, complete numbers are critical!

Valuing a business

QUANTITATIVE FACTORS

- Value of tangible assets
- Value of intangible assets
- Comparable sales
- Industry formulas
- Market demand
- Terms of payment
- Appraisals



Valuing a business



QUALITATIVE FACTORS

- Business risk
- Competition
- Personal comfort zone
- How business is viewed by others
- Timing
- Local practices

Valuing a business

NET INCOME

Mainly a tax figure

EBIT

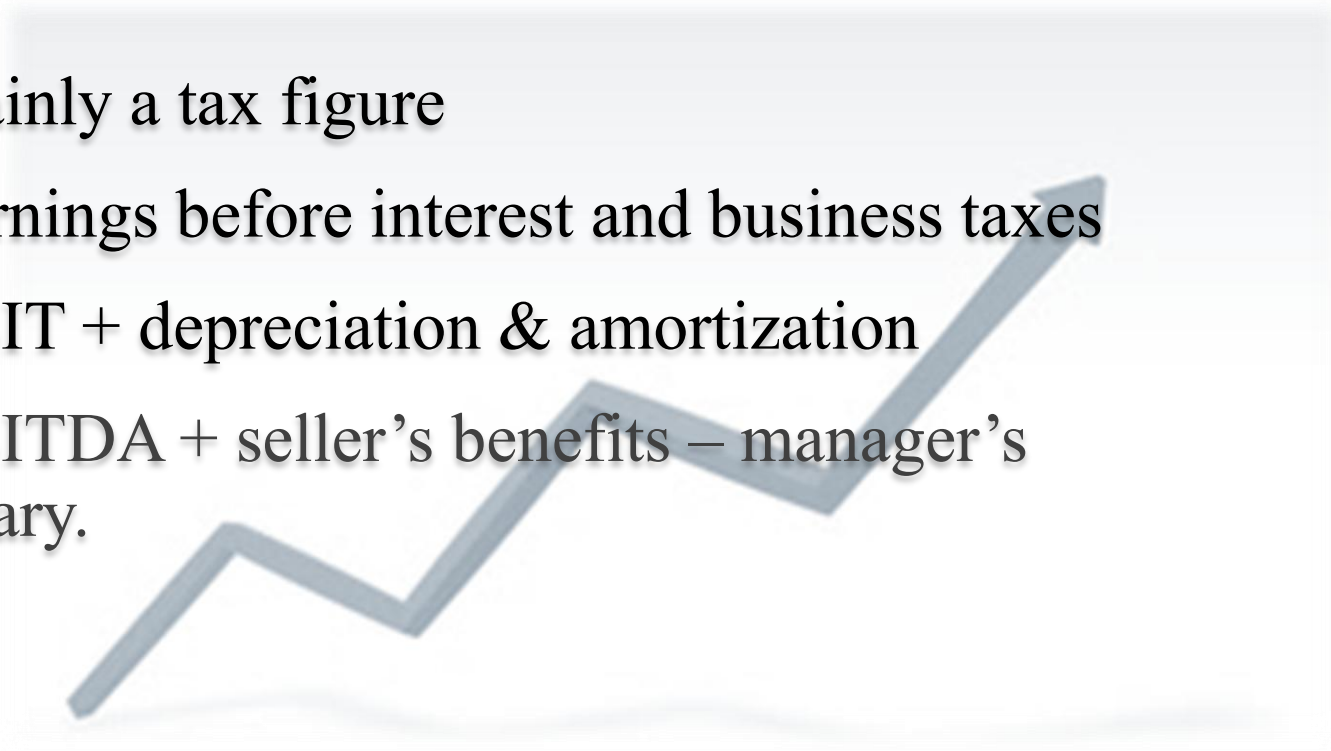
Earnings before interest and business taxes

EBITDA

EBIT + depreciation & amortization

SDE

EBITDA + seller's benefits – manager's salary.



Most small businesses are evaluated on either EBITDA or SDE.

Valuing a business



EBITDA = Earnings Before deductions for Interest, Taxes, Depreciation, and Amortization.

Because financing costs and tax write-offs vary among investors, they should be *added back* to the company's profit to better compare business opportunities.

Valuing a business

EBITDA Calculation	
Net income (loss) from financials	\$ 90,293
Add: Interest	\$ 30,105
Add: Taxes	\$ -
Add: Depreciation	\$ 28,644
Add: Amortization	\$ 40,000
EBITDA (unadjusted)	\$ 189,042

Valuing a business



ARGUMENTS AGAINST EBITDA

- A company may have low liquidity if its assets are difficult to convert into cash, yet still maintain high profitability.
- EBITDA can also be manipulated by changing depreciation schedules.

Valuing a business

SELLER'S DISCRETIONARY EARNINGS (SDE)

Most common measure to value small business.

- Reported earnings are often kept low for tax purposes.
- Discretionary, extraordinary, nonrecurring expenses are added back to show a buyer the true cash flow from operations.
- Most valuation methods are based on a multiple of earnings. Once you know SDE of a business, apply industry multiple to arrive at the value of the business.

Valuing a business

SELLER'S DISCRETIONARY EARNINGS (SDE)

The “bottom-line” profit on the P&L statements, PLUS:

- Compensation paid to all owners, minus one manager's salary.
- Interest expense
- Depreciation and amortization
- Discretionary expenses (owner's auto, cell phone, meals, travel, etc.)
- Adjustments for extraordinary, non-operating revenue or expenses, non-recurring expenses or revenue.

Valuing a business



ADJUSTMENTS TO SDE

- Owner compensation
- Family and friend compensation
- Rents (excessive)
- Non-recurring items

Valuing a business

SDE Calculation	
EBITDA	\$ 189,042
<i>Add:</i> Owner's Compensation	\$ 15,000
<i>Add:</i> Non-Business / Non-Recurring / Owner's "Perks"	\$ 5,000
<i>Add:</i> Rent Paid to Affiliate Holding Company (EPC/OC)	\$ 144,000
<i>Less:</i> Fair Market Rent	\$ (100,000)
Seller's Discretionary Earnings (SDE)	\$ 253,042

Valuing a business

Sample SDE Calculation:

Pre-Tax net income	\$300,000
+ Owner's compensation	\$150,000
+ Interest expense	\$ 50,000
+ Depreciation	\$ 50,000
+ Amortization	\$ 50,000
+ Discretionary expenses	\$100,000
+ Extraordinary or non-recurring expenses	<u>\$ 50,000</u>
= Seller's Discretionary Earnings (SDE) =	\$750,000

Valuing a business



ONCE you've arrived at a clearer, truer picture of actual business earnings, you may then apply different valuation methods used by business appraisers, bankers, and investors....

Valuing a business

THREE VALUATION APPROACHES

1. **Income approach** – Value based on income and cash flow over a period of time.
2. **Asset approach** – Value based on current street value of assets.
3. **Market approach** – Value based on financial ratios from similar transactions involving similar companies.



Valuing a business

1

INCOME APPROACHES

- Capitalization of Earnings
 - ✓ Past and Future Earnings
- Discounted Cash Flow



Valuing a business

CAPITALIZED EARNINGS

- Average net profits *after adjustments*
- Divide by desired “yield” (cap rate)
- Earnings can be *current* or *future* (if predictable)
 - $\$100,000 / .20 = \$500,000$
 - $\$100,000 / .15 = ?$
- Selection of cap rate is subjective, though valuers use a consensus cap rate.



Valuing a business

2

ASSET APPROACHES

These total up all the assets of a business.

- Adjusted Net Asset Value (Going Concern)
- Liquidation Value (Exiting the business)
- Book Value (uses the accounting numbers)



Valuing a business

3



MARKET APPROACHES

Value a business by comparing it to similar businesses recently sold.

Assigning a value to a sole proprietorship based on market value is particularly difficult.

Valuing a business



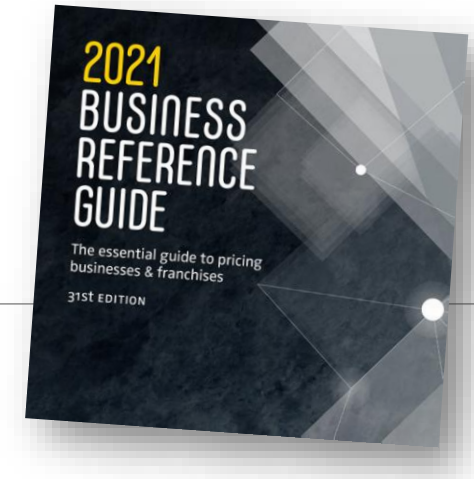
MARKET APPROACHES

- Guideline Public Company Method (public)
- Guideline Company Transactions (closely held)
- Multiple of Discretionary Earnings (SDE)
- Gross Revenue Multiple Method (ignores profits)

Valuing a business

SDE	Multiple	Business Value
\$50,000	1.0 - 1.25	\$50,000 - \$62,500
\$75,000	1.1 - 1.8	\$82,500 - \$135,000
\$100,000	2.0 - 2.7	\$200,000 - \$270,000
\$200,000	2.5 - 3.0	\$500,000 - \$600,000
\$500,000	3.0 - 4.0	\$1,500,000 - \$2,000,000
\$1,000,000	3.25 - 4.25	\$3,250,000 - \$4,250,000

Valuing a business



“RULES OF THUMB”

Business Brokerage Press publishes an annual guide to pricing small businesses in print and online versions.

While there are no “comps” when it comes to selling a small business, looking at multiples for similar businesses in the same industry, and (preferably) a similar geographic market can be the next best thing.

Valuing a business

EARNOUT is a contractual provision that the seller of a business will get future compensation if the business achieves certain financial goals.

- Differing expectations of a business between seller and buyer are usually resolved through an earnout.
- The earnout eliminates uncertainty for the buyer only pays a portion of the sale price upfront; remainder based on future performance. The seller receives the benefits of future growth.

Valuing a business



Although the Income Approach is the most popular valuation method, for most businesses, some *combination* of business valuation methods will be the fairest way to set a selling price.

Asset Sale or Stock Sale?



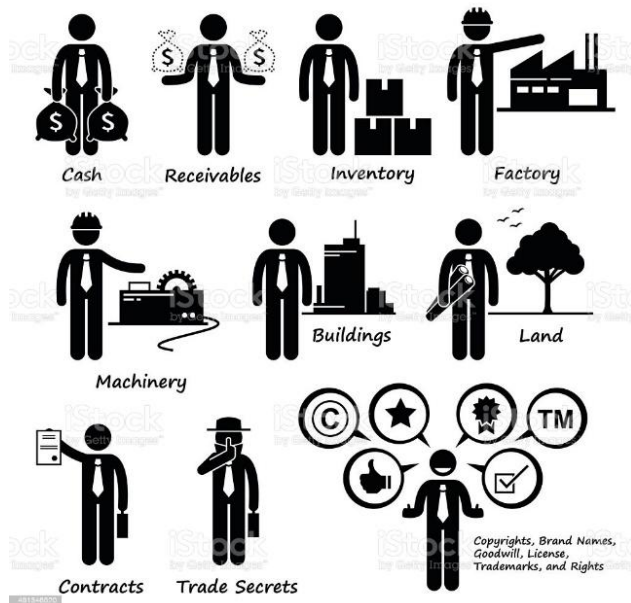
- An ASSET SALE is the purchase of individual assets and liabilities.
- A STOCK SALE is the purchase of the owner's shares in a company.

Pros and Cons?

Asset Sale or Stock Sale?

- Buyer in asset sale can depreciate the new purchase price.
- Asset buyer establishes a new tax basis. Stock purchasers inherits current basis.
- Asset buyer not responsible for previous debts or other liabilities.
- Stock sales might be preferable if the current entity has non-transferable rights to assets you desire, e.g. liquor license.
- Stock sales involve C-Corps and S-Corps only.
- You may need a securities license to broker a stock sale.

Asset Sale



In an ASSET SALE, different assets are acquired.

- How much of the price is for equipment or inventory?
- How much for goodwill, franchise license, or intellectual property?

Asset Sale

WHAT ASSETS ARE BEING SOLD?

1. Parties specifically list the assets and liabilities being acquired.
2. Parties indicate that the buyer is acquiring ALL assets *except for* certain excluded assets, and no liabilities except certain liabilities.





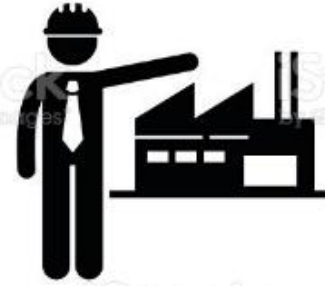
Cash



Receivables



Inventory



Factory



Machinery



Buildings



Land



Contracts



Trade Secrets



Copyrights, Brand Names,
Goodwill, License,
Trademarks, and Rights

Asset Allocation



WHAT IS ASSET ALLOCATION?

- *Asset Allocation* is how a company's value is divided up for income tax reporting.
- Capital Gain vs. Ordinary Income
- While specific rules must be followed, allocating also requires creativity, education and experience.

NOT the business broker's job!



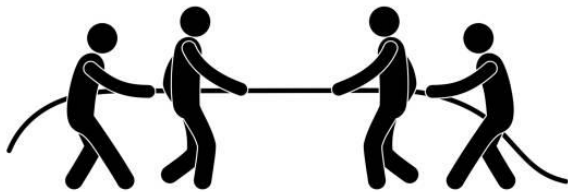
Asset Allocation

CONFLICTING MOTIVES

Value of business assets should be their “fair market value.” But more often, it’s based upon negotiations between the parties.

- The buyer wants to minimize upfront sales taxes to be paid at closing, and the tax basis of the new business to be depreciated.
- The seller wants to maximize how much of the gain will be taxed at capital gains rates vs. ordinary income rates—or not taxed at all!

Asset Allocation



- PRECISE VALUATION** of each asset is NOT necessary; what's more important is agreement between the two parties at the time of sale.
- Tax courts have been inclined to accept allocations within an “arms length” contract.
 - Failure to agree increases likelihood of audit.
 - A CPA should be consulted.

Form **8883**
(December 2008)
Department of the Treasury
Internal Revenue Service

**Asset Allocation Statement
Under Section 338**

OMB No. 1545-1806

▶ Attach to your income tax return. ▶ See separate instructions.

Part I Filer's Identifying Information

1a Name as shown on return

1b Identifying number as shown on return

1c Check applicable box (see instructions):
☐ Old target
☐ New target

1d Was a valid and timely Form 8023 filed?
If yes, enter the date filed ▶ ☐ Yes ☐ No

Part II Other Party's Identifying Information

2a Name of other party to the transaction

2b Other party's identifying number

Address (number, street, and room or suite no.)

City or town, state, and ZIP code

Part III Target Corporation's Identifying Information

3a Name and address of target corporation

3b Employer identification number

3c State or country of incorporation

Part IV General Information

4a Acquisition date

4b What percentage of target corporation stock was purchased:
(i) During the 12-month acquisition period? _____ %
(ii) On the acquisition date? _____ %

5a Stock price

\$

5b Acquisition costs/Selling costs

\$

5c Target liabilities

\$

5d AGUB/ADSP

\$

- 6** Was the filer listed in Part I, above, a member of an affiliated group of corporations before the acquisition date?
- 7** Was the target corporation a member of an affiliated group before the acquisition date? ☐
- 8** Is the target corporation or any target affiliate:
a A controlled foreign corporation? If "No," check here if it was a CFC at any time during the preceding 5 years ▶ ☐
b A foreign corporation with income, gain, or loss effectively connected with the conduct of a trade or business within the United States (including U.S. real property interests)?
c A qualifying foreign target under Regulations section 1.338-2(e)(1)(iii)?
d A corporation electing under section 1504(d) or section 953(d)?
e A domestic international sales corporation (DISC)?
f A passive foreign investment company (PFIC)?
g If the answer to item 8f is "Yes," is the PFIC a pedigreed qualified electing fund?

Yes	No

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 33707Y

Form **8883** (12-2008)

Asset Allocation



ASSET CATEGORIES OR TAX CLASSES

Class I	Cash
Class II	Marketable Securities
Class III	Accounts Receivable
Class IV	Inventory
Class V	Furniture, Equipment, Real Estate (tangibles)
Class VI	Code 197 Intangibles (<i>no Goodwill & Going-Concern</i>)
Class VII	Goodwill and Going-Concern Value

Asset Allocation

WORKING CAPITAL

In most business deals, purchase price includes “working capital” of the business, *including* cash on hand, liquid securities, accounts receivable and accounts payable.

- Valuations based on EBITDA assume that working capital (including A/R) comes along with the business at no additional price.
- If the seller wants to keep the A/R, the purchase price is adjusted downward dollar for dollar.

Asset Allocation



INVENTORY

Value of goods and wares that will be sold to customers or converted into products to be sold (stock on shelves, raw materials, food in a restaurant), the “stock in trade.”

- Typically, a floating number often reconciled the day before closing.

Asset Allocation



FURNITURE, FIXTURES & EQUIPMENT (FF&E) values are the most common allocation categories in business sale.

- Sellers want to place a lower value on FF&E rather than pay *recapture tax* on depreciated assets sold above book value.
- Buyer want to place a higher value on FF&E, particularly in states with low sales tax rates, and since FF&E assets can be depreciated over 5–7 years (vs. 15 years).
- Plus, IRC Section 179 immediate write-offs!

Asset Allocation



REGISTERED MOTOR VEHICLES

Motor vehicles should be listed separately because sales tax is not collected at closing; instead, it is paid by the buyer to the DMV when the vehicle title transfer occurs.

The value of vehicles for sales tax purposes should not be arbitrarily determined by the parties; rather, based on fair market value from a reputable source, such as Kelley's Blue Book.

Asset Allocation

SECTION 197 INTANGIBLES

- Copyrights, trademarks, trade secrets, etc. have value even though they don't have physical form.
- They do *not* include Goodwill, a separate tax allocation category.
- Businesses can write-off the cost of intangible assets over a 15-year amortization period.

Asset Allocation

NON-COMPETITION CLAUSES are frequently included in a business sale; usually a restriction by a geographic diameter surrounding the business location. “Non-competes” are common in employment contracts and in contracts for the purchase of a business.

- Forbidding the seller from opening (or working for) a competing business in the same area.
- Attaching a time limit to competing activity.
- Often voided by courts.

Asset Allocation

NON-COMPETITION CLAUSES

- Attorneys for buyer will sometimes push for a prescribed amount (e.g. \$250,000) that can be enforced if the seller violates the non-competition agreement.
- The more common practice is to place no value in the purchase docs so that damages are not limited.
- Buyers can amortize Non-Competition values over 15 years.

Asset Allocation

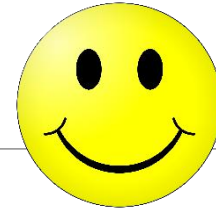
TRAINING AND TRANSITION SERVICES

Traditionally included portion of the sale of the business.

- For the Buyer, dollars allocated to Training and Transition can be fully deducted as a current year expense.
- For the Seller, any compensation will be considered Ordinary Income and subject to self-employment tax.

The terms, such as length of the transition period, can be negotiated.

Asset Allocation

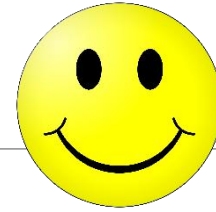


GOODWILL

Often equated to as “Blue Sky” or the company’s reputation, market share, staff infrastructure, and earning potential of the business.

- It’s what’s left over after everything else is allocated.
- It covers intangibles like customer lists, corporate culture, processes and practices of the business that helps its owners earn their living.
- It’s *how* and *why* that makes people do business with the company.

Asset Allocation



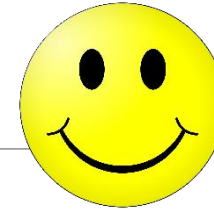
GOODWILL

Although difficult to value and allocate, determining goodwill can make a company more valuable.

Goodwill is commonly the largest tax allocation.

- Buyers can depreciate goodwill value over 15 years.
- Seller's goodwill enjoys favorable capital gains rates.

Asset Allocation



ASSETS THAT CAN BE CATEGORIZED AS GOODWILL

Company's brand name/recognition

Solid customer base/supplier lists

Good customer relationships

Company website/domain name

Copyrights, trademarks, patents

Licenses and permits

Good employee relations

Expectation of future economic benefits

Managerial and executive talent and innovation

Processes and training systems

Reputation among customers and vendors

Proprietary technology

Trade secrets

IRS Asset Class		Seller's Preference	Buyer's Preference
Class I	Cash and Cash-like assets	No preference as no taxable gain or loss as amount matches tax basis	No preference
Class II	Securities	No preference as no taxable gain or loss as amount matches tax basis	No preference
Class III	Accounts Receivable	No preference as no taxable gain or loss as amount matches tax basis	No preference
Class IV	Inventory	Low amount to minimize ordinary income	High amount as it is an immediate deduction against ordinary income
Class V	Other Tangible Property:		
	• <i>Personal property</i>	Low amount to minimize gain treated as ordinary income	High amount as it is a deduction against ordinary income, but sales tax may have to be paid.
	• <i>Real Estate</i>	High amount affording capital gains treatment	Low amount as long depreciation term
Class VI	Covenants Not to Compete & Other Intangible Property:		
	• <i>Covenant Not to Compete</i>	Normally low amount as taxed as ordinary income over term of covenant	Normally low amount as deducted over 15 years, as for goodwill
	• <i>Other Intangible Property</i>	High amount as taxed as long term capital gain	Normally low amount as deducted over 15 years, as for goodwill
Class VII	Goodwill & Going Concern Value	High amount as taxed as long term capital gain	Low amount as deducted over 15 years

Asset Allocation

MORE OFTEN tax allocation negotiations come down to Goodwill vs. FF&E, with a few dollars sprinkled over other categories to make the deal look good to the IRS.

- Impacts seller more than the buyer, so give-and-take is common sense.
- Have client's tax specialist help with the Asset Allocation.
- **STRONGLY** recommended that Buyer and Seller report the transaction identically to the IRS.

Asset Allocation

KEY EVENTS DURING BUSINESS TRANSITION

1. Previous and new owners share acquisition news with company employees together.
2. Meet with key staff to assuage their fears, and answer questions about training and development of the company moving forward.
3. Knowledge and skill transfer from one business owner to the other, new owner's one big opportunity for learning the reins of the business and they should take advantage of it.

Asset Allocation

KEY EVENTS DURING BUSINESS TRANSITION

4. Introduction of the new owner to key contacts such as vendors, suppliers, or big customers.
5. Review details of significant contracts, so important details do not get lost in the transition.
6. Training of the new business owner on all processes of the business.



Listing Marketing Selling

Working with Sellers

Listings
are king!



WHY?

Working with Sellers

PACKAGING THE LISTING

- Financial statements
- Equipment inventory
- Real estate info
- Photos
- Market information
- Executive summary
- Seller Discretionary Earnings
- Anomalies or “spikes”
- Pro-forma
- Franchise information
- Confidentiality Agreement
- Broker Cooperation



Working with Sellers

- Tax returns for the last 3 years Federal Tax Return
- Interim Profit and Loss Statement (P&L), including balance sheet
- Last 3 years Profit and Loss Statement (P&L), including balance sheet
- Average value of inventory of saleable product on hand at any time
- Equipment List
- Copy of tax bill on real estate; if the real estate included in the sale
- Copy of any real estate appraisal that is available
- Lease information

Business Brokerage Deal Cycle



Working with Buyers



“Hi, my name is Marty Rueter with Coldwell Banker Commercial here in Atlanta. The reason for my call... I’ve just listed a high volume car wash not too far away from you, and thought you may want to expand your enterprise...”

The objective ALWAYS is a face-to-face meeting.



Buyer Consultation

A close-up photograph of a person in a dark pinstripe suit and a red tie, seated at a desk. Their right hand is holding a black pen and is in the process of signing a document. Their left hand is resting on the desk near the document. A watch is visible on their left wrist. The document has some text and a signature line. The background is a plain, light-colored wall.

Closing the Deal

Closing the Deal

BUYER-SELLER MEETING

Often a “make or break” get-together, ensure this meeting goes as smoothly as possible:

- Buyers need to be educated on the process of selling a business; what’s expected, and that following your suggestions will dramatically increase the chances of a successful outcome.
- Buyers must be ready to go with good questions (appropriate, logical) to show they understand the business.

Closing the Deal

LETTER OF INTENT (LOI) outlines essential agreements *before* contracts are executed.

- LOI's resemble contracts, but not binding on the parties in their entirety if there are disclaimers.
- Some LOI provisions survive indefinitely even if the deal is never executed (e.g. confidentiality, non-solicitation of employees).
- Initial draft may be prepared by business broker, or buyer's counsel.

Closing the Deal



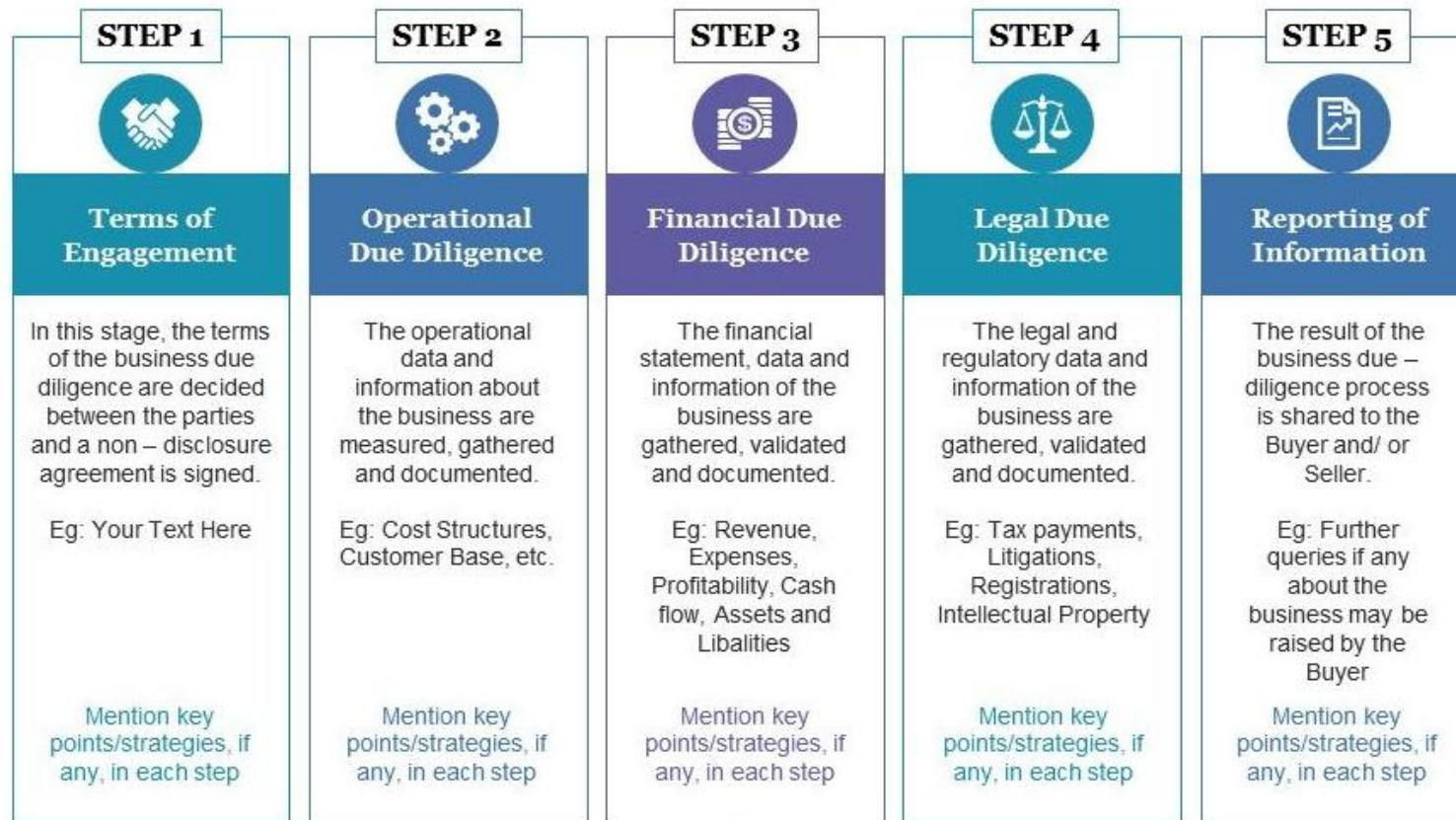
YOUR COMMISSION

Make sure you're getting
paid... *beforehand.*

Closing the Deal



Due Diligence

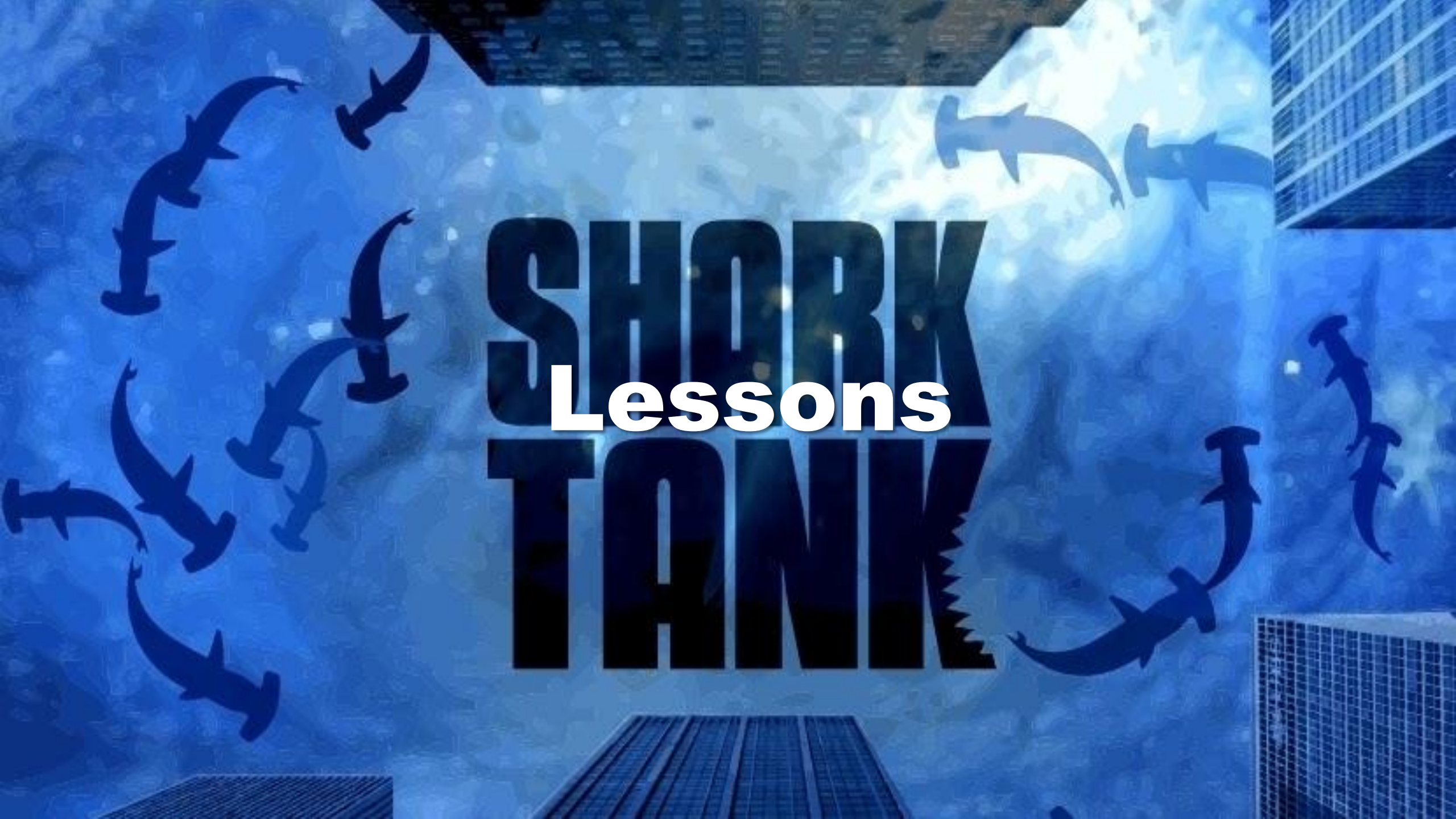


Closing the Deal



BUSINESS TRANSFER MECHANICS

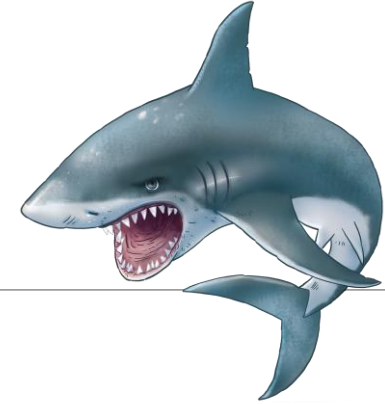
- Bill of Sale
- Assignment and Assumption Agreement
- Intellectual Property Assignment

The image features a blue-tinted background with a low-angle view of skyscrapers reaching towards a cloudy sky. Numerous shark silhouettes are scattered throughout the scene, swimming in various directions. The title 'SHARK TANK' is written in large, bold, black capital letters, with the word 'Lessons' in white lowercase letters with a black outline centered over it.

SHARK TANK

Lessons

Lessons from Shark Tank



1. Know your numbers.

How are you valuing your business, how much money you are going to make, Potential is great, but numbers talk.

2. Understand that money has no feelings.

It's about making a profit for the investors, nothing more, nothing less. How, exactly, will you do that? How you feel about your business is fairly irrelevant.

3. Have a real business that can be scaled.

The business cannot be *you* doing the labor, unless that labor can be duplicated in mass quantities.

Lessons from Shark Tank



4. Have real (not false) confidence and be emotionally intelligent.

It's all about the numbers, but then not entirely. Be a cheerleader for your business. But ready to answer two key questions many entrepreneurs can't answer -- *What will you do with my money? How will I get my investment back?*

5. Be unique in the marketplace.

The products that get attention are usually those that are different and clearly serve a market need. If the need is already being met by well-entrenched competitors, it can still be a good idea if it's a new, cheaper or a more clever way of doing it.



*Thank
You!*