

The Business Transfer REPORT



- ◆ *Selling A Business*
- ◆ *Who Are Business Buyers?*
- ◆ *Valuation*
- ◆ *Business Financing*

Business Valuations

Determining the value of a business should be the first and foremost step in buying or selling a business.

The value of a business is related to the risks involved in operating it and the future ability of the business to generate cash flow to the owner (cash flow is calculated from an economic viewpoint, rather than from a tax or an accounting perspective). The value of the underlying hard, tangible assets as well as intangible assets also must be considered.

An expert valuation report is based upon standard and acceptable valuation methodology - produced by an expert with years of proven experience, gained by successfully completing thousands of valuations on all types and sizes of businesses in many diverse industries across the U.S. The specific purpose of the business valuation and the size of the subject company determines the depth of analysis and the amount of research required to deliver a credible estimate of value.

The valuation process involves extensive research, financial analysis, and consideration of the elements that drive the value of the business.

Basic factors that influence value are:

- The value of the hard, tangible assets
- The amount of re-casted cash flow (under a normalized earnings scenario)
- The value of intangible assets (licenses, trademarks, etc.)
- Application of industry and/or company specific discounts (as well as premiums, sometimes)

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SELLING YOUR BUSINESS?

Follow These Ten Commandments to Avoid Wrecking the Deal



- 1 PLACE A REASONABLE PRICE ON YOUR BUSINESS** An inflated figure either turns off or slows down potential buyers. Rely on your business broker to arrive at the best “win-win” price. An “unrealistic price” discourages many buyers from even looking at a business.
- 2 CARRY ON “BUSINESS AS USUAL”** Don’t become so obsessed with the distraction that your attention wavers from day-to-day demands, affecting sales, costs, and profits.
- 3 ENGAGE AN EXPERT BUSINESS BROKER** to ensure confidentiality. A breach of confidentiality surrounding the sale of a business can change the course of the transaction and damage a business in the future.
- 4 PREPARE FOR THE SALE WELL IN ADVANCE** A good business broker will prepare an offering portfolio for the business to have ready for qualified buyers. The business owner can help in the process by “housecleaning” - as well as a literal sprucing up of the facilities.
- 5 ANTICIPATE INFORMATION THE BUYERS AND THEIR FINANCING SOURCES MAY REQUIRE** In order to obtain financing, the buyer will need appraisals on assets. Lenders will require at least 3 years of tax returns and the most recent financial statement.
- 6 ACHIEVE LEVERAGE THROUGH BUYER COMPETITION** A good business priced properly many times will create interest from several buyers and create a competitive situation.
- 7 BE FLEXIBLE** Don’t be the kind of seller who wants all-cash at the closing, or who won’t accept any contingent payments or an asset transaction. Depend on the advice of your business broker - their knowledge of financing and tax implications.
- 8 NEGOTIATE, DON’T DOMINATE** You’re used to being your own boss, but be prepared to learn that the buyer may be used to having his way, too. With your business broker’s help, decide ahead of time “when to hold and when to fold.”
- 9 KEEP TIME FROM DRAGGING DOWN THE DEAL** To keep momentum up, work with your business broker to be sure that potential buyers stay on a time schedule and that offers and counter-offers move in a timely fashion.
- 10 BE WILLING TO STAY INVOLVED** Even if you are feeling burnt-out, realize that the buyer may want you to stay within arm’s reach for a while. Consult with business brokers to determine how you can best effect a smooth transition.

Business Valuation *(continued)*

There are three approaches to valuing a business. They are:

- Cost Approach
- Income/Earnings Approach
- Market Approach

Watch any quick-fix "rules of thumb."
The only rule of thumb I've heard is to never rely solely on one method for determining value.

The final step in a valuation report is to make sure that the suggested price for the business meets, what I like to call, "The four (4) minimum requirements of most buyers!" This exercise is, in essence, a sanity check and consists of the appraiser asking these basic questions:

- Will cash flow cover the debt service of the buyout financing?
- Will cash flow provide the next owner/operator a reasonable salary?
- Will cash flow provide for future replacement of equipment and for a cushion of safety in case of fluctuations in the business cycle?
- Will the cash flow provide a return on investment that is at least commensurate with alternative investment opportunities?

Why are Business Valuations needed?

- Determine market value for purpose of sale
- Incentive Stock Options/ESOPs
- Going Public, Going Private
- Adequacy of Life Insurance Coverage
- Corporate or Partnership Dissolutions
- Compensatory Damage Cases
- Obtaining Financing, SBA Loans, Bank Loans
- Gift & Estate Planning
- Divorce
- Buy Sell Agreements
- Mergers and Acquisitions
- Stockholder Disputes
- Eminent Domain Actions



BUSINESS VALUATION - Is There An Easy Rule of Thumb?

REVENUE HISTORY	COMPANY-A	COMPANY B
1997	\$6,000,000	\$18,000,000
1998	\$8,000,000	\$15,000,000
1999	\$12,000,000	\$12,000,000
Total Debt:	\$1,500,000	\$7,000,000
Avg. Equipment Age:	3 1/2 yrs.	20 yrs.
Owner's Cash Flow:	\$350,000	\$100,000
Owner's Vacation:	6-8 wks	None. Business can't run without owner!

Similar Industry, Similar Customer Base, Same Amount of Revenues

	COMPANY-A	COMPANY B
Revenues:	\$12,000,000	\$12,000,000
Net Income:	\$1,500,000	\$1,500,000

WOULD YOU VALUE THESE TWO COMPANIES THE SAME???

-By Brian Wendler CPA, CFP, CCB, President and Founder
 Ross, Wendler & Steen - Business & Brokerage Services

RWS performs professional valuations and provides brokerage deal structuring advisory services across the US for BBN, the largest business brokerage organization in America.

The SBA Today

Financing Resources in Today's Economy



You're ready to sell your business or, perhaps to become your "own boss" and purchase a business... So why is financing sometimes such an obstacle in putting a business sale/purchase together? Because traditional lenders (banks) have historically been "collateral based" and many non-traditional lenders (non-bank lenders, insurance companies, leasing companies,) who DO understand how to make loans based upon cash flow... are caught up in mergers, reorganizations, declining secondary market conditions and new credit policies. So what is the best way to clarify, up front, what the financing commitment will look like? *Make sure that your Business Broker professional obtains a pre-approval by a lender who understands your industry. Then structure your contract negotiations according to the written pre-approval document.*

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OBTAINING A FINANCING "PRE-APPROVAL"

Many lenders are dependent on a broker's expertise in shepherding deals from inception to the closing table. Your broker will: (1) select a lender who specializes in the kind of industry you are financing and (2) review the lender requirements for loan processing including...

- Ascertaining that the size of the loan request and collateral available fit the lender's current "credit box"
- Knowing the paperwork process... who does what, who makes the loan decision, who closes the loan
- Loan approval/closing time table

The best business brokers will be able to talk to you about ways to structure the loan to maximize the loan amount (...and keep seller financing to a minimum).

DOCUMENTS YOUR BROKER NEEDS TO GET A LOAN "PRE-APPROVAL" FOR A BUSINESS

- Three years' business tax returns from the seller
- Interim financial statements
- Listing cover sheet describing the business opportunity
- Also, many marketing materials that you have in your file can only help the lender!

DOCUMENTS YOUR BROKER NEEDS TO "PREQUALIFY" A BUYER

- Three years' personal tax returns
- Personal financial statements
- Resume



WHAT THE LOAN WILL LOOK LIKE

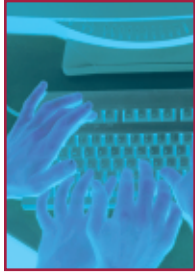
- SBA guaranteed
- Term of 7-10 years, minimum
- Including in the "total project cost" contract price, working capital and closing costs
- Cash equity of about 15%

TRANSAMERICA is out to revolutionize the way SBA lending is done. We can offer you a level of expertise and resources few other SBA lenders can match. And you can work with us, confident we will provide you with unparalleled service - and the loan you need to succeed.

Call 1-888-404-7300 and ask for Kay Chidester.

Due Diligence - Know the Business before you buy.

So you have found a business you think you want to buy. The seller has provided you with basic information that leads you to believe that the business concept and customer base can support the price that is being negotiated.



Where do you go from here to obtain assurance that the representations made to you can be relied upon? Due diligence is the process of obtaining an understanding of how a business is run and evaluating the representations made by the seller. While this may seem rather simple, there are many issues that need to be addressed as part of the due diligence process.

One of the procedures performed during the due diligence is an analysis of certain financial data and ratios to determine whether the business is operating within the industry norm. If there are significant variations, they should be investigated. Another procedure that can be used is to obtain outside or third party confirmation of the data provided by the seller. Frequently, due diligence will also include interviewing

employees and management of the business to corroborate the data provided by the seller.

Seeking independent advice from professionals with experience in the buying and selling of businesses can keep you from making a costly mistake. Perhaps the most important reason to obtain professional assistance during this process is to have someone who can look at the transaction from a business perspective without becoming emotionally attached to the deal.

Should you elect to engage a professional to assist you during the due diligence process, the extent of the work that the professional will perform should be agreed upon by both parties and confirmed with an engagement letter so that both parties are aware of their obligations throughout the process. Make sure you invest the time and money before you complete the largest purchase of your life.

- Robert P. Symanski, CPA

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The Business Buyers: Who Are They?

Buyers of small businesses are most likely replacing lost jobs or searching for a happier alternative to corporate life. Buyers of mid-sized and large operations are, typically, private investment companies seeking businesses to build and eventually sell for a profit. This is the broadest possible look at the types of buyers out there.

1. Individual Buyer This is typically an individual who will purchase a business and be directly involved with the day-to-day management of the company. Many of them have come out of corporate America and are first time buyers. Others are buyers who have owned a business in the past and are looking to once again become their "own boss." They generally will attempt to match the type of background or experience that they have with a given business opportunity. The individual buyer usually seeks a business that is financially healthy that will pay them a reasonable salary and any debt service required to purchase the business. Their financing sources are generally SBA loans, owner financing or loans from family members. They very rarely will pay all cash for a business. These buyers will usually limit themselves to transactions involving less than \$1 million, cash.

2. Strategic Buyer This buyer is almost always a company, having as its goal entering new markets, increasing market share, gaining new technology, or eliminating some element of competition. In essence, it is part of this buyer's "strategy" (hence the name) to acquire other businesses as part of a long-term plan. Strategic buyers can be either in the same business as the company under consideration, or a competitor. Strategic buyers will be looking chiefly at businesses with sales over \$20

million, with a proprietary product and/or unique market share, and effective management in place and willing to remain.

3. Synergistic Buyer The synergistic category of buyer is usually a company looking to grow by acquiring products or services of a complementary nature. The joining of the two companies will produce more, or be worth more, than just the sum of their parts. They now have the opportunity to sell the existing customer base additional products or services.

4. Industry Buyer This type is often a competitor or highly similar operation. This buyer already knows the industry well and, therefore, does not generally pay for the expertise and knowledge of the seller. The industry buyer is interested mainly in combining manufacturing facilities, consolidating overhead, and utilizing the combined sales forces, or expanding their operation geographically. These buyers will pay for assets, but in most cases, they will not pay for goodwill, covenants not to compete, or seller consulting agreements.

5. Financial Buyer Financial buyers are influenced by a demonstrated return on investment, coupled with their ability to get financing on as large a portion of the purchase price as possible. Working on the theory that debt is the lowest cost of capital, these buyers purchase businesses with the sole purpose of making the maximum amount of money with the least amount of their capital invested.



Type of Buyer	Less than \$3 million	\$3 to \$10 Million	\$10 million +
Individuals	44%	26%	4%
Public Companies	28%	21%	17%
Private Companies	11%	14%	14%
Investment Groups	17%	29%	18%

Each type of buyer has distinctive characteristics that correlate to the motivation behind the purchase of a particular company. In addition, the price each is willing to pay for a company is directly proportional to the motive. The relative sizes of acquisitions by different buyer types (compressed into their broader categories) is shown in the above chart.



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Price Justification

Evaluating a price when buying or selling a business creates anxiety for both buyer and seller. Numerous approaches can be used to calculate the value of a business.

Each approach has both positive and negative characteristics.

In the final analysis, the buyer must believe that the cost of the business is justified.

A handy method to evaluate the reasonableness of a price is the Price Justification.

The Price Justification helps show whether the discretionary cash flow generated by the business is sufficient to justify the price paid. The basic formula is as follows:

<i>Owner's Discretionary Cash Flow</i>	Net Income plus add-backs that accrue to the benefit of cash flow to the owner, including the owner's salary. Buyers will typically use a three-year average.
LESS	
<i>Annual Debt Service</i>	Principal and interest payments to service the debt used to buy the business.
LESS	
<i>Manager's Salary</i>	Market rate salary that would be paid to a manager to run the business.
LESS	
<i>Return on Down Payment</i>	This is the amount that the down payment for the business would have earned if invested elsewhere. Use 10% as a benchmark.
LESS	
<i>Capital Expenditures</i>	This is the amount that must be paid in a typical year to maintain and replace the furniture, fixtures, equipment and other fixed assets of the business. A benchmark might be to replace all assets over a five-year period. Therefore, the market value of such assets divided by five is reasonable.
LESS	
<i>Miscellaneous Expenses</i>	This is an extra amount to acknowledge the fact that unexpected expenses do happen. A reasonable figure is 10% of operating expenses.
EQUALS	
<i>Cash Flow Remaining</i>	This is the cash remaining after all the new owner's obligations are met.

If, and only if, the cash flow remaining is sufficient to make the new owner feel justified in taking on the risk of owning the new business, will the purchase be completed. This is also a great sanity check for sellers to go through to help them determine whether the price and terms they are asking are reasonable.

