Business Value Calculation

Sample Company, Inc.

as of

December 31, 200X

BUSINESS ADVISORS GROUP

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Table of Contents

Calculated Values

Month 1, 200X

Ben Sample, President
Sample Company, Inc.
123 Sample Rd.
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We have performed a calculation engagement, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on the Company as of date shown above. The specific calculation procedures are detailed in this report. The calculation procedures were performed solely to assist in the matter of buying or selling the Company; the resulting calculations of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimates of value that result from a calculation engagement are expressed as calculated values.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and methods to be used and the extent of valuation procedures to be performed. A calculation engagement does not include all of the procedures required in a valuation engagement, as that term is defined in the SSVS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as referred to above, the resulting range of calculated values of the Company as of the date shown above was:

Low	Mid	High
$82,712	$92,201	$101,689

These calculated values are subject to the Statement of Assumptions and Limiting Conditions stated in this report. We have no obligation to update this report or the calculated values for information that comes to our attention after the date of this report.

David E. Coffman

Calculation Procedures

Approach

The Company's earnings information from its federal income tax returns or other sources is summarized later in this report. The earnings before taxes (pre-tax earnings) figure agrees with the book net income (pre-tax) as shown on the tax returns or other sources.

The vast majority of small, privately-held companies are sold on an asset-sale basis. A typical asset sale includes the operating assets of a business – inventory; furniture, fixtures and equipment (FF&E); and all intangible assets (goodwill). Real estate may also be included if it is owned by the company. These assets are sold free and clear of all debt. These assets, as a group, comprise an ongoing business enterprise. The procedures described in this report are designed to calculate the value of the operating assets of the Company.

Private Company Transactions

This method uses data from the actual sales of businesses similar to yours. We search the BIZCOMPS database for transactions involving businesses in the same Standard Industrial Classification (SIC) Code or North American Industrial Classification System (NAICS) Code. We may further limit the search by type of business or annual revenue. The search criteria and results are summarized later in this report.

BIZCOMPS contains data from approximately 10,000 transactions involving the sale of privately owned businesses in the U.S. over the previous 10 years. This data is not publicly reported so it is obtained from business brokers and transaction intermediaries. These sources are considered to be reliable.

BIZCOMPS transactions are structured as or converted to asset sales. The Asking Price and Sale Price from BIZCOMPS contains only 2 components – furniture, fixtures and equipment (FF&E) and goodwill. Inventory is not included and must be added to the results of any method using BIZCOMPS ratios. All businesses are considered to be debt-free at closing even if the buyer is incurring new debt to finance the purchase. The seller is responsible for paying off all debt at closing.

The Percentage of Annual Revenue

This method applies the average Sale Price to Annual Revenue ratio to your company's most recent annual revenue to calculate value. This method ignores differences in gross margins and operating expenses (profitability). Therefore, this method often produces the highest or top-line value of the business. This calculation is presented in detail later in this report.

The Multiple of Seller's Discretionary Earnings (SDE)

This method applies the Sale Price to SDE ratio to your business's most recent SDE to calculate value. SDE is equal to a company's earnings before: income taxes, non-recurring income and expenses, depreciation and amortization, interest income or expense, non-operating (discretionary) items, and owners' total compensation for services (including payroll taxes and benefits).

This method is best suited to a business where the salary and perquisites of an owner represent a significant portion of the total benefits generated by the business and/or an owner/manager typically runs the business. Buyers and sellers of small businesses tend to think in terms of their potential personal compensation rather than business profits. They look at the total discretionary earnings to see if it is sufficient to carry the debt structure necessary to buy and/or operate the business, and provide them with adequate compensation. This calculation is presented in detail later in this report. In this case, the calculation produced a value less than the Adjusted Asset Value and was **not included in the range of calculated values.**

Any significant difference between the SDE method and the Percentage of Annual Revenue method is due to differences in profitability. If the SDE method is higher, your business has above average profitability. If the SDE method is lower, your business has below average profitability.

PROS – Since BIZCOMPS is based on actual sales of similar businesses; it is the closest thing to true market value. Data from searches containing a large number of transactions is more statistically sound.

CONS – From the amount of data collected by BIZCOMPS it is difficult to accurately assess the comparability of any one transaction. The number of transactions involving businesses similar to yours may be rather small and statistically insignificant.

Capitalized Cash Flow

The earning capacity of a business is a primary driver of its value. Cash flow is considered a more pure form of earnings and therefore more accurately reflects a company's true earning capacity. The true earning capacity of a business must include adequate compensation for services provided by the owner(s) and real estate rent expense based on market rates; and must exclude any non-recurring and non-operating expenses.

Cash flow is a company's EBITDA (earnings before interest, taxes, depreciation and amortization) less capital expenditures and adjusted for the items mentioned above – owner's compensation, real estate rent, and non-recurring and non-operating (discretionary) expenses.

The capitalized cash flow (CCF) method converts a company's average cash flow into a value using a capitalization rate. The average cash flow is divided by the capitalization rate. The capitalization rate reflects the risk level associated with owning the specific business. Typically, capitalization rates for small businesses range between 20% and 30%. In this case, a capitalization rate of 25% was selected, indicating an average level of risk. This calculation is presented in detail later in this report.

PROS – It works well when a company has a history of stable, growing, or significant cash flow; and minimal tangible assets. It reflects the value of a business from an investment or absentee owner perspective.

CONS – Doesn't work well when a company has marginal or unstable cash flow, and/or significant tangible assets.

Excess Earnings

The excess earnings method provides a logical approach to value a company's intangible assets as a lump sum. It is widely used where identifying and determining the value of specific intangible assets is impractical. The excess earnings method computes the company's value based on the adjusted value of tangible assets plus an additional amount for intangible assets.

A company's tangible assets should provide a current return to the owner. Typically, that rate is the prevailing industry rate of return on assets (pre-tax income/total assets). Any returns produced by the company above the rate on tangible assets are considered to arise from intangible assets. These “excess earnings” are capitalized to estimate the value of the intangible assets.

This method uses net income before tax (pre-tax). I adjust pre-tax income for the same items discussed in the previous section – adequate owner’s compensation, market-based real estate rent, and any non-recurring and non-operating (discretionary) expenses to arrive at economic earnings before tax (EEBT).

The capitalization rate used in the excess earnings method is derived from the capitalization rate used in the capitalized cash flow method by adjusting the rate for the different earnings base (pre-tax income vs. cash flow). The excess earnings capitalization rate equals pre-tax earnings divided by cash flow, then multiplied by the capitalized cash flow method capitalization rate. This calculation is presented in detail on later in this report.

PROS – It is the best way to value the intangible assets (goodwill) of a small company as one lump sum. It reflects the value of a business from an investment or absentee owner perspective.

CONS – It is not intended for use with businesses containing few tangible assets.

Adjusted Asset Value

The adjusted asset value method is often considered the bottom-line value of a business because it excludes goodwill. It is most relevant when a business has negative cash flow or discretionary earnings, or has been operating for less than 1 year. The adjusted asset value may also be used to allocate value, calculated using other methods, between the physical (hard) assets and goodwill. The adjusted asset method approximates the liquidation or minimum value of a business and is **not included in the range of calculated values.**

The adjusted asset value method starts with the book value (cost less accumulated depreciation) of the company’s assets included in the sale. The book values of the Company’s assets were obtained from tax returns or balance sheet data. Where possible the book values are adjusted to an estimate of their current market value. For example, real estate may be adjusted based on a recent appraisal. Some assets may be adjusted to estimates provided by the seller. The source of any market value estimates is disclosed on that schedule. This calculation is presented in detail later in this report.

PROS – It is easy to do and understand.

CONS – It does not place any value on goodwill or other intangible assets. Any market value estimates not based on appraisals or other independent sources may be unreliable.

Industry Rules of Thumb

Some industries have formulas or rules of thumb about how businesses in their industry are valued. We use the rules of thumb published in the Business Reference Guide from Business Brokerage Press. The Guide also provides industry data on expenses that can be used for basic benchmark comparisons. In this case, we did not calculate value using an industry rule of thumb. Industry data is presented later in this report for information purposes only.

PROS – Industry rules of thumb are easy to obtain and apply.

CONS – There is usually no credible evidence to support the source and quality of the data used. The rules do not give adequate consideration to the unique factors that affect the value of a specific business

Calculation Results

The results of the calculation procedures described in this report are summarized below. A detailed description of each calculation is presented on the page indicated. As explained in that section, the Adjusted Asset Value is often considered the bottom-line value of a business. Any method that produced a value below the Adjusted Asset Value was excluded from the range of calculated values.

Method	Result ($)	Range	Page
Percentage of Annual Revenue	91,188	Included	12
Multiple of Seller's Discretionary Earnings	47,573	Not included	13
Capitalized Cash Flow	82,712	Included – Low	14
Excess Earnings	101,689	Included – High	15
Adjusted Asset Value	59,833	Not included	16
Industry Rules of Thumb	N/A	Not included	17

Pricing Strategies

Setting the initial asking price, also known as list price or the price range is an important factor in determining when and if a business actually sells. The fundamentals of a business like revenue, cash flow, discretionary earnings and risk level used in the calculations shown above, determine a range of values for the business. Where the actual price falls within that range is primarily determined by two factors – URGENCY and TERMS.

URGENCY relates to how quickly the seller needs to sell the business. There is a direct relationship between time and price. The less time a seller has to sell, the lower the price. This makes sense when compared to our everyday shopping experiences. A retailer that is going out of business keeps reducing their prices as the final day gets nearer. In these cases discounts of up to 80 percent are common. Therefore a small business that needs to be sold immediately may be worth much less than its full value. A seller that can wait indefinitely is more likely to get an offer closer to full price.

A lower price in the range of value will attract more potential buyers and is more likely to sell sooner. Conversely, a listing at a higher price in the range will attract fewer buyers and may take longer to sell. An asking price in the middle of the range of value typically provides the seller with the optimum price to sell the business in a reasonable amount of time.

National statistics from the business brokerage industry show that: only 1 out of 5 businesses that are listed for sale - actually sell, and only 1 out of 12 buyers will buy a business. Therefore, exposing a business to the greatest number of QUALIFIED buyers is critical to selling a business in a reasonable period of time.

TERMS relate to the seller's willingness to finance part of the purchase price and are sometimes referred to as the deal structure. Sellers that require all cash at settlement will attract fewer potential buyers, the business may take longer to sell, and may sell at a significantly lower price. Sellers that are willing to finance at least some of the purchase price will attract more potential buyers, take less time to sell, and get a higher price.

We experience this situation when we purchase any expensive item. If we need financing and it is readily available, we can buy it now rather than later and price becomes less important. If we have to pay cash upfront, we are more likely to wait and price becomes very important. The more expensive and difficult to finance an item is the more impact terms will have on price.

Generally financing a small business is very difficult, so terms are a critical factor in pricing. Sellers often overlook this fact. It is easier for a buyer to obtain commercial financing for tangible or hard assets, so sellers are often asked to finance some portion of the goodwill or intangible value of the sale or purchase price.

Sellers that have time to prepare for the sale should focus on improving business fundamentals – increasing sales, controlling operating expenses, managing staffing levels, improving cash flow, and reducing the risk of transferring ownership. By improving these fundamentals over time the whole price range can be moved higher.

A seller that has the ability to allow the business to remain on the market for a reasonable amount of time (typically 6 to 12 months), and is willing to accept some seller financing will ultimately get the best possible price for their business.

Statement of Assumptions and Limiting Conditions

This calculation engagement is subject to the following assumptions and limiting conditions:

1. The calculated values arrived at herein are valid only for the stated purpose as of the date of the valuation.
2. Tax returns, financial statements and other related information provided by the Company or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. We have not audited, reviewed, or compiled the financial information provided to me and accordingly, we express no audit opinion or any other of assurance on this information.
3. Public information, and industry and statistical information have been obtained from sources considered to be reliable. However, I make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. The calculated values arrived at herein are based on the assumption that the current level of management expertise and effectiveness would continue to be maintained, and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.
5. This report and the calculated values arrived at herein are for the exclusive use of my client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and calculated values are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever.
6. Neither all nor any part of the contents of this report should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without my prior written consent and approval.
7. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of me unless previous arrangements have been made in writing.
8. We take no responsibility for any actual or potential liabilities resulting from non-compliance with any federal, state, or local laws or regulations.
9. No change of any item in this report shall be made by anyone other than me, and we shall have no responsibility for any such unauthorized change.
10. We have not visited or inspected the Company's facilities.
11. We have not conducted interviews with the current management of the Company.
12. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. we have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.
13. This valuation reflects facts and conditions existing at the valuation date. Subsequent events have not been considered, and we have no obligation to update my report for such events and conditions.
14. David E. Coffman prepared this report. He has no present or contemplated future interest in the Company, no personal interest with respect to the parties involved, nor any other interest that might prevent me from performing an unbiased valuation. Our compensation is not contingent on an action or event resulting from the analyses, opinions, or conclusions in, or use of, this report.

Certifications and Representations of David E. Coffman

I certify that to the best of my knowledge and belief:

1. The analyses, opinions, and conclusion of value included in the valuation report are subject to the reported scope limitations, and the assumptions and limiting conditions specified on Page 6, and they are the personal analyses, opinions, and conclusion of value of the valuation analyst.
2. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable. The valuation analyst has not performed any corroborating procedures to substantiate that data.
3. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services, the Professional Standards of the National Association of Certified Valuation Analysts, and the Uniform Standards of Professional Appraisal Practice.
4. The parties to which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties.
5. The analyst's compensation is fee-based and is not contingent on the outcome of the valuation.
6. No one provided significant professional assistance to the person signing this report.
7. I am in compliance with the American Institute of Certified Public Accountants Accredited in Business Valuation (ABV) and National Association of Certified Valuation Analysts (CVA) re-certification requirements.
8. I do not have any direct or indirect, present or contemplated future interest in the Company.
9. Disclosure of the contents of this report is subject to the requirements of the National Association of Certified Valuation Analysts, and other professional organizations of which I am a member, related to review by their duly authorized representatives.

David E. Coffman

Professional Qualifications of David E. Coffman

Academic and Professional Credentials

- Certified Public Accountant (CPA) since 1978. Licensed in PA & NJ.
- Certified Valuation Analyst (CVA) since 1997.
- Accredited in Business Valuation (ABV) since 2001.
- Certified in Financial Forensics (CFF) since 2008.
- Bachelor of Science, Business Administration, Bloomsburg University, May 1976.

Position and Experience

- President & CEO of Business Valuations & Strategies PC, Harrisburg, PA. Founded in 1997.
- President & CEO of Business Advisors Group PC, Seaside Park, NJ. Founded in July 2008.
- Over 10 years of business valuation experience.
- Performed more than 100 business valuation engagements.
- Over 30 years of experience advising, owning and operating small businesses.

Professional Affiliations

- American Institute of Certified Public Accountants
- New Jersey Society of Certified Public Accountants
- Pennsylvania Institute of Certified Public Accountants, Past President of the North and South Central Chapters
- American Society of Appraisers – Associate Member
- National Association of Certified Valuation Analysts

Sample Company, Inc.						
Summarized Earnings Data						
	2006		**2005**		**2004**	
	$	**%**	**$**	**%**	**$**	**%**
Sales	218,094	100.0%	233,555	100.0%	215,120	100.0%
Cost of sales	73,994	33.9%	79597	34.1%	78046	36.3%
Gross Profit	144,100	66.1%	153,958	65.9%	137,074	63.7%
Labor/Payroll						
Owner's compensation	0	0.0%	0	0.0%	0	0.0%
Other salaries & wages	46,439	21.3%	49,409	21.2%	52,776	24.5%
Payroll taxes	4,983	2.3%	5,860	2.5%	6,146	2.9%
Employee benefits	0	0.0%	0	0.0%	89	0.0%
Total	51,422	23.6%	55,269	23.7%	59,011	27.4%
Occupancy						
Rent	26,624	12.2%	27,120	11.6%	23,407	10.9%
Utilities & telephone	12,450	5.7%	12,488	5.3%	10,174	4.7%
Total	39,074	17.9%	39,608	16.9%	33,581	15.6%
Operations						
Credit card fees	2,507	1.1%	2,999	1.3%	1,748	0.8%
Vehicle expenses	0	0.0%	0	0.0%	0	0.0%
Supplies	2,263	1.0%	3,105	1.3%	6,088	2.8%
Laundry	1,574	0.7%	546	0.2%	1,001	0.5%
Royalties	13,208	6.1%	15,933	6.8%	12,912	6.0%
Insurance	3,519	1.6%	3,653	1.6%	3,041	1.4%
Repairs & maintenance	945	0.4%	2,166	0.9%	1,627	0.8%
Total	24,016	10.9%	28,402	12.1%	26,417	12.3%
Sales/Marketing						
Advertising & promotion	5,732	2.6%	1,108	0.5%	2,646	1.2%
General & Administrative						
Interest expense	1,333	0.6%	3,600	1.5%	335	0.2%
Professional fees	1,700	0.8%	1,700	0.7%	290	0.1%
Office expenses	2,481	1.1%	5,298	2.3%	5,422	2.5%
Miscellaneous	0	0.0%	654	0.3%	1,364	0.6%
Charitable contributions	0	0.0%	196	0.1%	125	0.1%
Travel & entertainment	0	0.0%	325	0.1%	68	0.0%
Total	5,514	2.5%	11,773	5.0%	7,604	3.5%
Non-Cash						
Amortization	1,793	0.8%	1,793	0.8%	1,718	0.8%
Depreciation	312	0.1%	312	0.1%	9,301	4.3%
Total	2,105	0.9%	2,105	0.9%	11,019	5.1%
Total expenses	127,863	58.6%	138,265	59.2%	140,278	65.2%
Operating Income	16,237	7.4%	15,693	6.7%	(3,204)	-1.5%
Non-Recurring Items	0	0.0%	0	0.0%	0	0.0%
Earnings Before Taxes (EBT)	16,237	7.4%	15,693	6.7%	(3,204)	-1.5%

Sample Company, Inc.
Private Company Transactions

Search Criteria

SIC Code
5812 - Eating places

NAICS Code
722211 - Limited service restaurants

Additional search criteria:
Annual revenue $500,000 or less
Description - Fast food

Search Results

Number of tranactions	163
Averages:	
Asking price (AP)	119,294
Annual revenue (AR)	257,736
Seller's discretionary earnings (SDE)	58,117
Sales price (SP)	99,448
Ratios:	
SP to AR	0.39
SP to SDE	1.71
SP to AP	0.83

Source - BIZCOMPS

Sample Company, Inc.
Private Company Transactions

Percentage of Annual Revenue

Company's Sales - 2006	218,094
Multiple - Sales Price to Annual Revenue	0.39
Value of FF&E and Goodwill	85,057
Add:	
Inventory	6,131
Value of Inventory, FF&E and Goodwill	91,188

Sample Company, Inc.
Private Company Transactions

Multiple of Seller's Discretionary Earnings (SDE)

SDE Calculation

Earnings Before Taxes	16,237
Add back:	
Owner/officer:	
Compensation	0
Payroll taxes (estimate)	0
Interest expense	1,333
Amortization	1,793
Depreciation	312
Discretionary expenses (non-operating):	
Vehicle expenses	0
Travel & entertainment	0
Charitable contributions	0
Equipment rent - Related party	4,560
Non-recurring items	0
Total SDE	24,235
Multiple - Sales Price to SDE Ratio	1.71
Value of FF&E and Goodwill	41,442
Add:	
Inventory	6,131
Value of Inventory, FF&E and Goodwill	47,573

Sample Company, Inc.
Capitalized Cash Flow

Adjusted Cash Flow

	2006	2005	2004
Earnings before taxes	16,237	15,693	(3,204)
Add back:			
Amortization	1,793	1,793	1,718
Depreciation	312	312	9,301
Interest expense	1,333	3,600	335
Equipment rent - Related party	4,560	4,560	3,690
Total	24,235	25,958	11,840
Average	20,678		
Capitalization Rate	25%		
Value of operating assets	82,712		
Add:			
Value of non-operating net assets	0		
Value of Inventory, FF&E and Goodwill	82,712		

Sample Company, Inc.
Excess Earnings

	2006	2005	2004	Average
Total Assets - Book				
Total	83,624	100,735	97,369	93,909
Industry Return on Assets*	8.7%	7.2%	6.0%	7.3%
Adjusted Pre-tax Earnings				
Earnings before taxes	16,237	15,693	(3,204)	
Adjustments:				
Equipment rent - Related party	4,560	4,560	3,690	
Total	20,797	20,253	486	13,845

Capitalization Rate

Cash flow rate - mid		25.0%
Pre-tax earnings	X	13,845
Cash flow	/	20,678
Excess earnings rate	=	16.7%

Excess Earnings Method

Total assets		93,909
Industry return	X	7.3%
Expected earnings	=	6,855
Pre-tax earnings		13,845
Excess earnings (pre-tax less expected)		6,990
Capitalization rate	/	16.7%
Value of intangible assets	=	41,856
Value of tangible net assets	+	59,833
Value of Inventory, FF&E and Goodwill	=	101,689

Footnotes

* - Source: RMA Annual Statement Studies 2006-2007, NAICS 722211, Limited Service Restaurants

Sample Company, Inc.
Adjusted Asset Value
12/31/200X

	Book value	Adjustments	Adjusted value
Inventory	6,131		6,131
Leaseholds & Equipment	31,202		31,202
Franchise fee	16,001	6,499	22,500
Organization & startup costs	4,913	(4,913)	0
Total	58,247	1,586	59,833

Adjustments

None

Sample Company, Inc.
Industry Data - Rules of Thumb

Franchise

1 35 percent of annual sales

Fast Food

1 35 to 45 percent of annual sales plus inventory
2 1 to 1.5 times SDE plus FF&E and inventory

Source: 2007 Business Reference Guide, Business Brokerage Press