

Broker Opinion of Value Report

ABC CORPORATION

123 Broadway Place
Anytown, USA 98765

As of March 1, 2016

Prepared by:

Lewis Martin, Certified Valuation Analyst

United Financial, LLC
24301 Southland Dr., Suite 409
Hayward, CA 94545

March 1, 2016

Thomas D. Broker, Senior Broker
La Jolla Business Brokerage
101 Main Street
La Jolla, CA 90203

John Smith
1234 Market St.
Encinitas, CA 92045

Dear Mr. John Smith:

This report contains the documents and data we have used to evaluate Smith & Associates. The suggested price is divided between tangible assets and business value, which is based on client information and an expected down payment.

The tangible asset price or asset value represents the current estimated value of the following:

- Inventories for resale or consumption.
- Equipment and vehicles.
- Leasehold improvements.
- Transferable rights and privileges uncontrolled by scarcity.

The estimated current asset value of the company is: \$242,000.

The intangible asset price or business value represents the current estimated value of the following:

- Establishing a customer base which will continue to trade with this company after it is sold.
- Securing a location, designing and constructing a floor plan and securing and installing equipment.
- Management systems in place and producing cash flow.
- Proprietary rights or limited issue permits.
- Free training and available consulting time.

The estimated current intangible value of the company is: \$115,000.

The enclosed report with supporting documents offers a range of suggested prices indicating the extremes of different prices; therefore, our single price conclusion is the average of the maximum and minimum suggested price ranges.

The estimated current market value of the company is: \$357,000.

Respectfully submitted,

Thomas D. Broker

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Overview

Client Data

Smith & Associates
John Smith
1234 Market St.
Encinitas, CA 92045

Authorization

John Smith has authorized this evaluation for Smith & Associates and has provided the evaluator with both the general and financial information necessary to perform this evaluation.

Nature of Assignment

The purpose of this evaluation is to determine the estimated fair market value, based on an asset sale, of Smith & Associates, hereinafter sometimes referred to as the “company”. This opinion will be in the form of a written report based on information collected regarding the company, analysis of that information, and the expertise of the evaluator. Assumptions and limiting conditions are stated in the exhibits to the evaluation report.

Purpose of Evaluation

This report provides the client with an opinion of the company’s fair market value for the purpose of **[Fill This In]**.

Definition of Fair Market Value

Fair market value is the price, in cash or equivalent, that a buyer could reasonably be expected to pay, and a seller could reasonably be expected to accept, if the business were exposed for sale on the open market for a reasonable period of time, both buyer and seller being in possession of the pertinent facts and neither being under compulsion to act.

Ownership

Ownership or title to the business and equipment appraised was not a consideration of this assignment. This report assumes that the business appraised was the property of Smith & Associates, free and clear.

Additional Information Contact

For additional information, contact John Smith, the client. Do not contact the evaluator without written authorization from the client. All information contained in this report is confidential.

Location of the Business

At the time of the evaluation, the business was located at 1234 Market St., Encinitas, CA 92045.

Documents Reviewed by Evaluator

Documents listed as reviewed below have *not* been analyzed by the evaluator and any values derived from such documents or reports may be included in this report. We relied on the expertise of the company's financial advisors supplying this information for any values used.

[Fill This In:]

- [Document #1].
- [Document #2].
- [Document #3].

Interviews

Interviews were conducted by the evaluator using the evaluator's forms and questionnaires.

Environmental Concerns

The evaluator expresses no opinions and has received no information that an environmental concern exists.

Evaluation Effective Date

Values stated are effective as of March 1, 2016. Any difference between the date this report is presented and the effective date could have a bearing on the value opinion stated.

What is Valued in this Report

The evaluator was asked to value the subject company, including all assets of the business, both tangible and intangible.

- Smith & Associates is the valued entity and owned by John Smith. Please refer to the section entitled "Clarification of Value" for a detailed analysis of assets included in this evaluation report.
- Automobiles have *not* been valued but are included in this evaluation report.

- Liabilities have *not* been valued and are *not* included in this evaluation report.
- Intangible assets are valued and included even though they may not be shown on the company's balance sheet.
- Accounts receivable are *not* included in this evaluation report.
- Real estate and improvements have *not* been valued by the evaluator and are *not* included in this evaluation report.

Limitations, Contingencies, and Disclaimer

Please read the following very carefully!

Tax and Legal Advice for Sale or Transfer of Stock

This report represents the opinions of business professionals experienced in the sale and transfer of business assets and values. The evaluation of business assets for a suggested value is extremely complex but can be accomplished with a certain degree of accuracy because asset values can be defined in the marketplace. However, the sale or transfer of stock as a method for disposing of a corporation is considerably more complex because the buyer is assuming liabilities and is subject to a complex set of tax laws.

If you are planning a sale or transfer of stock, we strongly encourage you to consult with your tax attorney and accountant. Tax and legal advice must be given by qualified professionals and based on individual cases.

What is Valued in this Report

This business evaluation report and analysis of value assumes an asset sale and does *not* reflect the stock value of the company. The evaluator has not valued the hard assets or the real estate of the company and has relied on sources deemed reliable to determine the value of all assets listed in this report.

Excluded Assets and Liabilities

This report excludes current assets such as cash, accounts receivable, prepaid expenses, and other liquid assets that would normally show up on the company's balance sheet. It also excludes the company's liabilities. This report assumes that the seller would keep the company's current assets and pay off any debts at the time of sale.

Treatment of Real Estate

This report does *not* take into consideration any real estate that the company owns. However, comparative market rent is deducted from the cash flow to reflect the true earning power of the company, since the ownership of real property is discretionary to a business. If the company being valued owns the real estate, it should be considered an investment asset that would be added to the value opinion in this report.

Disclaimer

This is a business evaluation report and *not* an appraisal. There are a number of significant differences between evaluations and appraisals. An evaluation is not nearly as rigorous as a formal appraisal, and is designed to give a guideline or benchmark value rather than a formal determination of value. Specifically, and at a minimum, a valuation analysis should include the

following conditions for an opinion of value to be considered an appraisal rather than an evaluation:

- Strict adherence to USPAP (Uniform Standard Professional Appraisal Practices) standards.
- A full financial statement's analysis, including Income Statement, Balance Sheets and Cash Flows.
- An in-depth understanding of the financial statements and the company to justify making appropriate adjustments to the Income Statements and Balance Sheets.
- An assurance that all data is accurate and included in the final report.
- A comparison of the valued company's financial statements to industry norms (RMA, trade, or other ratios/percentages) and using this data in building discount and capitalization rates.
- A certifying cover letter with the evaluator's signature.

The formulas used in the various valuation methodologies in this evaluation are based on thousands of evaluations performed over the past fifteen years by business brokers, business buyers, and business sellers in real world buy/sell situations. The business values that result from these methods, although not considered a formal appraisal, have been time tested and have been shown to provide a solid basis for determining business value.

Contingencies and Limiting Conditions

1. The evaluator, by reason of performing this business evaluation and preparing this report, is not required to give testimony nor be in attendance in court or any other governmental hearing with reference to matters herein, unless prior arrangements have been made with the evaluator relative to such additional employment.
2. The evaluator assumes no responsibility for matters of a legal nature affecting the property valued or the title thereto, nor does the evaluator render any opinion as to the title, which is assumed to be good and marketable. The property is valued as though under responsible legal ownership.
3. The evaluator assumes no responsibility for any environmental problems and has not inspected the property.
4. This evaluation was based on a specific period of time. Data for this period of time has been collected from several sources. The particular business environment and market may not continue in the future, therefore, the evaluator is not making any claims regarding future performance of this business. The evaluator assumes no responsibility for errors in data available from external sources.
5. The selection of the use of fair market value was made by the client. The evaluator assumes no responsibility for the type of value selected as opposed to other types of value.
6. The evaluator was retained by its client, who is thoroughly familiar with the business, and all past and future performance information used in this report has been based on

information provided by the client and other sources deemed to be reliable. The evaluator disclaims any ability of any potential purchaser to generate any future income, cost and expense potential, or expectations as may be stated in this report.

7. All information in this report has been provided by our client, most of which is contained in the questionnaire section of this report, and is assumed to be reliable. No verification of the information has been done by the evaluator, nor has the evaluator made an inspection or on-site visits of the business premises or facilities.
8. Any sketch that may be presented in this report may show approximate dimensions and is included to assist the reader in visualizing the property. The evaluator has made no survey of the property.
9. Information, estimates and opinions furnished to the evaluator and contained in this report were obtained from sources considered reliable and believed to be true and correct. However, no responsibility for the accuracy of such items furnished to the evaluator can be assumed by the evaluator.
10. Possession of this report or a copy thereof does not carry with it the right of publication. It may not be used for any other purpose, in whole or in part, by anyone except the client for whom the evaluation was prepared without the prior written consent of the evaluator.
11. It is assumed that the reader of this report has at least a basic understanding of the subject business's industry, terminology and operations.
12. Other assumptions and limiting conditions are as may be stated in various other sections of this report.

Statistical Summary

For summary purposes we have included a specific amount for **asset value** and **business value** and a conclusive **selling price**.

- We estimate the asset value of this company to be \$242,000.
- We estimate the intangible value of this company to be \$115,000.
- We estimate the market value of this company to be \$357,000.

Our analysis generates a price range representing the highest price a seller could expect and the lowest price a seller should accept.

Method	High Value	Low Value
Asset	\$264,000	\$220,000
Basic	\$330,000	\$264,000
Capitalization	\$146,667	\$88,000
Critical Factor	\$287,624	\$230,099
Debt Capacity	\$277,461	\$172,573
Industry	\$610,000	\$454,000
Discounted Cash Flow	\$994,021	\$455,192
Market Approach	\$240,108	\$208,692
National	\$278,760	\$234,760
Weighted Factors	\$325,650	\$289,466
Multiple Average	\$387,810	\$266,309
Suggested Range	\$387,810	\$266,309

The **suggested price** is calculated based on the information generated by the various formulas, but will account for special situations and inconsistencies.

Suggested Price: \$357,435

Special Conditions

If a particular range value is extremely high or extremely low, do not be alarmed. Extreme deviations are the product of formulas, which consider only one or two business factors, and are not representative of the total business. This report reflects the adjustments and allowances for these extremes in the suggested range value.

If potential buyers used only one method for evaluation and that formula produced one extreme value there would be reason for concern. However, very few buyers consider only one formula; most buyers base their decision on the debt capacity and assets of a business and become generous or conservative based on their beliefs for all the other factors.

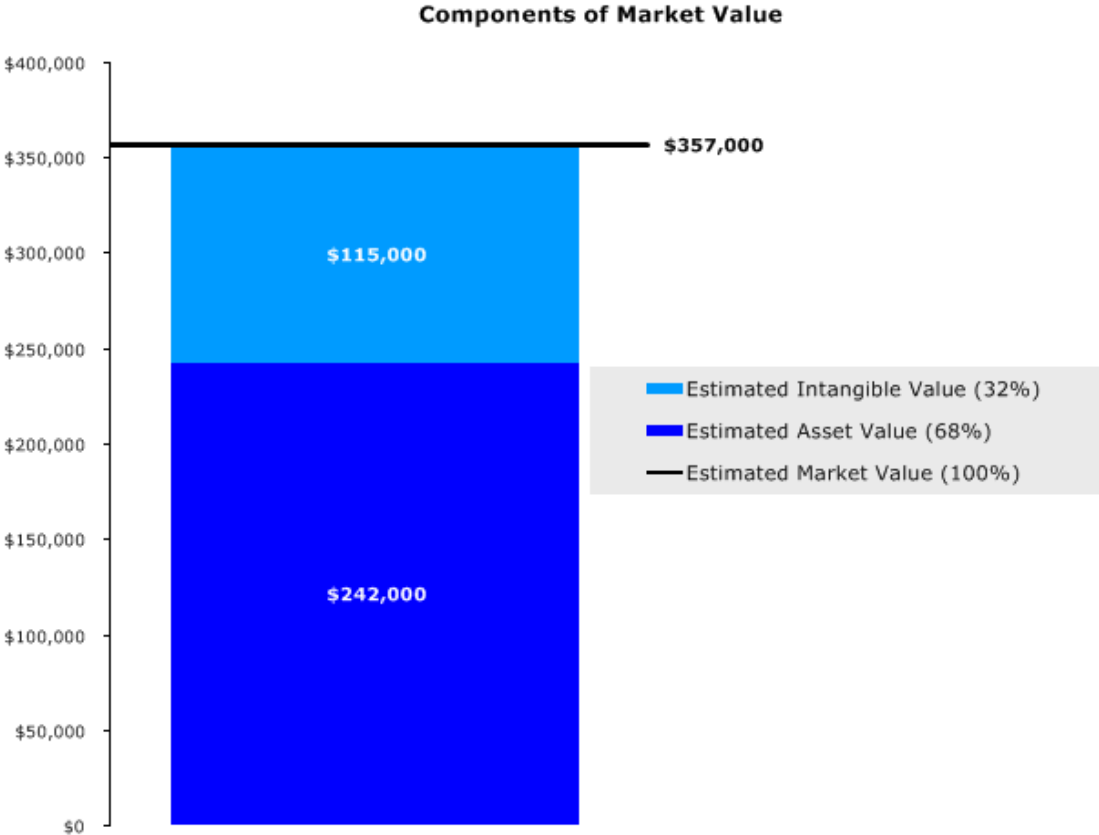
Clarification of Value

The value of the subject company stated in this report does not include real estate or improvements, which are considered to be investment assets. The following should clarify how the final business value was calculated:

Furniture, Fixtures and Equipment		\$140,000
Leasehold Improvements		\$45,000
Value of leased equipment (Market Value - Payoff Value)		\$25,000
Vehicles		\$0
Stock/Supplies		\$10,000
License/Patents		\$0
Total Asset Value - High Value	\$264,000	
Total Asset Value - Low Value	\$220,000	
Total Asset Value - Average Value	<u> </u>	\$242,000
Intangible Value		\$115,000
Total Value		<u> </u> \$357,000

Components of Market Value

The chart below shows how estimated asset value and estimated intangible value combine to equal estimated market value.



Value by Method

ASSET METHOD	
Equipment	\$165,000
Improvements	\$45,000
Vehicles	\$0
Stock/Supplies	\$10,000
Licenses/Patents	\$0
Total Assets	\$220,000
Confidence Factor	100%
Asset High	\$264,000
Asset Low	\$220,000

BASIC VALUE FACTORING	
Net Discretionary Cash	\$44,000
Cash Per Month	\$3,667
Months to Profit	18
Accumlated Cash	\$66,000
Basic High	\$330,000
Basic Low	\$264,000

CAPITALIZATION RATE	
High Return %	50%
Low Return %	30%
Capital Rate High	\$146,667
Capital Rate Low	\$88,000

CRITICAL FACTOR	
Financing	9%
Desirability	93%
Lease	67%
Economy	180%
Critical High	\$287,624
Critical Low	\$230,099

DEBT METHOD	
Discretionary Cash	\$125,000
Less Salary	\$60,000
Less Depreciation	\$21,000
Net Discretionary Cash	\$44,000
Interest Rate	10.00%
Fast Payout Years	5
Slow Payout Years	10
Debt High	\$277,461
Debt Low	\$172,573

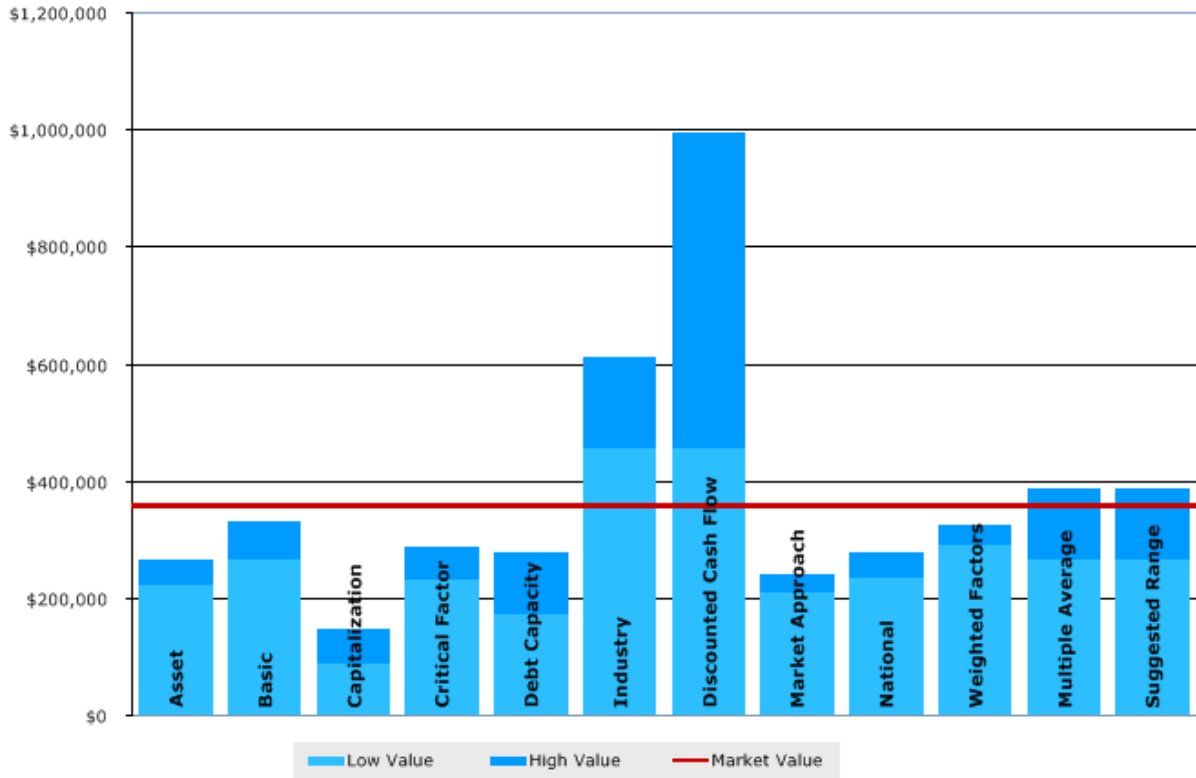
NATIONAL METHOD	
Base Value	\$264,000
Competition	\$0
Management Type	(\$7,920)
Turnover	\$0
Type Of Business	\$44,880
Owner Finance Yrs	\$26,400
Owner Finance Rate	\$63,360
Owner Finance %	\$13,200
Bank Finance Years	\$26,400
Bank Finance Rate	(\$36,960)
Bank Finance %	\$31,680
Number of Employees	\$29,040
Age of Industry	\$71,280
Industry Market	\$63,360
Years Of Operation	\$108,240
Consulting Time	\$42,240
Net Cash - Salary	\$21,120
Local Economy	\$71,280
Labor Market	\$29,040
Skills Required	(\$23,760)
Union Strength	(\$113,520)
Location	(\$166,320)
National Economy	\$31,680
National High	\$278,760
National Low	\$234,760

WEIGHTED	
Target	\$297,000
Labor	79%
Predictability	537%
Management	69%
Competition	56%
Revenue	103%
Longevity	87%
Location	67%
Loanability	9%
Clientele	40%
Liability	50%
Weighted High	\$325,650
Weighted Low	\$289,466

Method Comparison

The chart below shows the range of values calculated using each of the evaluation methods.

Evaluation Methods



Evaluation Methods

A business's value can actually be divided into five components:

1. Market value of assets.
2. Historical trends of revenues expense and cash flow.
3. The value of rights, privileges and knowledge.
4. Estimated stability in the future.
5. Esthetic appeal.

This evaluation report addresses all five components of a business's value through a series of questions, which defines each of these aspects numerically. Software has been used to calculate the valuation methodologies, which was used to determine the suggested price. Not every method will necessarily be used in the evaluation report. The methods used in this report are described below:

Asset Value

The asset value method is used to determine a minimum value range for a business. This amount represents the estimated worth of all tangible and intangible assets.

Asset value must not be determined solely on the basis of book value or an asset's worth in its current application but also must consider replacement value including all installation and testing costs. The upper and lower asset values are determined based on the accuracy of the asset data that was provided to the evaluator.

Upper Value: \$264,000

Lower Value: \$220,000

Basic Method

This method is based on two pricing formulas:

1. The first formula is a **rule of thumb** multiplier that is calculated by adding one year's net cash flow to the business's assets, valued at current market value.
2. The second formula begins with the current market value of the assets and adds a multiple of the monthly discretionary income based on the number of months required to start a similar business and bring it to a break even cash flow position.

\$330,000 Upper Value:

Lower Value: \$264,000

Capitalization Method (Return on Investment)

This method is based on a simple mathematical model, which calculates a total investment based on discretionary cash flow divided by a rate of return associated with the cost of money and the level of risk associated with the valued business.

Upper Value: \$146,667

Lower Value: \$88,000

Critical Factors Method

This method takes into account the critical factors, which will encourage or discourage a potential buyer in investigating and/or purchasing this business. Each factor is explained below.

Upper Value: \$287,624

Lower Value: \$230,099

Percent of Down Payment

This factor is based on the common belief that lending institutions generally require 20% of the total purchase price as a down payment. This factor also considers how large the down payment is in relationship to the business's post-sale cash flows.

Dollars of Down Payment

This factor relates the absolute dollars required as a down payment to the potential number of qualified buyers with that amount of cash or other liquid assets. The larger the cash down payment, the fewer qualified buyers will be available, thereby limiting the demand and consequently reducing the suggested price.

Interest Rate, Interest Type, and Term of Years

This factor relates the various loan types, loan terms and interest rates offered to a potential buyer by the owner and any other available lending institution to the propensity of a buyer to purchase this business.

Industry

This factor weighs the possibility of market saturation, currently predicted survival for an established business and the future stability of profits.

Desire

This factor quantifies the buyer's motivation to buy based on status, visual appeal, profitability, risk and skills required.

Lease

This factor determines if sufficient time is available to repay loans and earn a reasonable return. A rate comparable to similar available spaces is used.

Utility

This factor examines the alternative use of the land and buildings for sale.

Accounts

This factor places value on the ability to collect the accounts receivable and the security of the client base.

Debt Capacity

This method of evaluation is purely a financial model. Direct cash expenses are deducted from direct cash revenues to determine discretionary cash flow. Deductions are then made for an operator's salary and the real depreciation cost of assets. The result is discretionary cash for debt service.

The maximum debt service this business could handle, given the current level of discretionary cash, is calculated based on the number of years financed and an interest rate.

Most evaluators agree that any future increases in revenues, while under the management of a new owner, belong to the new owner. If the previous owner had generated more revenue, the suggested price would reflect this.

Upper Value: \$277,461

Lower Value: \$172,573

Industry Method

This method is based on pricing formulas that have been developed for a specific industry. Most of these industry rules of thumb are based on a capacity or production volume times a dollar value. Other industries simply use a constant times gross or net revenue.

Upper Value: \$610,000

Lower Value: \$454,000

Discounted Cash Flow

This method is based on discounting the forecasted earnings or cash flow stream at a risk-adjusted rate of return. The earnings stream is forecasted for ten years and a terminal value is calculated at the end of ten years. Capitalizing the last period's earnings and then discounting the result to its present value calculate the terminal value. The following table shows how this was calculated:

Discounted Cash Flow

Discount Rate

	Low	High
Discount Rate	16.67%	33.33%
Implied P/E Ratio	6.00	3.00

Projected Earnings

	Earnings	Growth	High PV	Low PV
Current Year	\$125,000			
Projected Y1	\$131,250	5.00%	\$112,497	\$98,440
Projected Y2	\$137,813	5.00%	\$101,244	\$77,523
Projected Y3	\$144,703	5.00%	\$91,117	\$61,051
Projected Y4	\$151,938	5.00%	\$82,003	\$48,079
Projected Y5	\$159,535	5.00%	\$73,801	\$37,863
Projected Y6	\$167,512	5.00%	\$66,419	\$29,818
Projected Y7	\$175,888	5.00%	\$59,775	\$23,482
Projected Y8	\$184,682	5.00%	\$53,796	\$18,493
Projected Y9	\$193,916	5.00%	\$48,415	\$14,563
Projected Y10	\$203,612	5.00%	\$43,572	\$11,469
Average Growth		5.00%		
Compound Growth		5.00%		
Present Value of Projected Earnings			\$732,639	\$420,782

Terminal Value

	High PV	Low PV
Year 10 Earnings	\$203,612	\$203,612
Discount Rate	16.67%	33.33%
Terminal Value	\$1,221,427	\$610,897
Present Value of Terminal Value	\$261,382	\$34,410

Indicated Value

	High PV	Low PV
Present Value of Projected Earnings	\$732,639	\$420,782
Present Value of Terminal Value	\$261,382	\$34,410
Net Excess and Non-Operating Assets	\$0	\$0
Indicated Value	\$994,021	\$455,192

Upper Value: \$994,021

Lower Value: \$455,192

Market Approach Method

This method is based on comparing the business being valued with similar businesses that have been previously sold. Multiples derived from these comparables, such as Price to Revenue and Price to Earnings, are used to determine the value of the business. See Appendix A for details on the Market Approach Methodology.

Upper Value: \$240,108

Lower Value: \$208,692

National Method

This method is based on a series of factors, which resemble many of the factors previously used in the weighted and critical factor methods. However, in spite of oversimplification and the inability of these factors to shift with changing economic conditions, these formulas have been included because they are routinely used by a buyer in evaluating a purchase. The factors detailed below have been taken into consideration.

Upper Value: \$278,760

Lower Value: \$234,760

Finance Years

This factor assumes the greater the loan period the more a buyer will pay.

Financing Rate

This factor considers interest rates and types. It decreases the amount payable to a seller as the cost of financing increases.

Years in Operation

This factor assumes each year of past survival indicates a greater chance of future survival.

Consulting Time

This factor pays for education time from a seller.

Employees

This factor decreases value for a greater number of employees, as having a larger workforce can create greater labor problems.

Net Cash

The greater a business's discretionary cash, the more a buyer should be willing to pay.

Local Economy

A better economy provides more certainty of future success, giving the business a higher value.

Labor Market

This factor assumes labor is a major business cost. If the labor market is soft for this business, labor costs will not rise; the converse is also true. The following directly affect the labor market and therefore the business value: union strength, age of industry, national economy and industry marketplace.

This factor also assumes that if a business requires high-level skills, it poses a higher risk, therefore, it is worth less to a potential buyer.

Union Strength

This factor analyzes how an outside organization can control your business. The less control a business has over its labor force, the less a potential buyer is willing to pay.

Age of Industry

This factor increases value for stability and longevity in proportion to an industry's age.

National Economy

This factor assumes a growing economy increases a business's demand and price. Conversely, a declining economy decreases demand for a particular business and its price.

Industry Market

This factor looks at the future markets for the products or services of this company and industry. The security or risk assigned to the future will directly raise or lower any suggested price.

Weighted Factors

This method assumes that the business value is based on the highest potential value of assets plus the discretionary cash flow multiplied by a factor, which is based on the learning curve for this type of business. The current demand for this industry and business is also taken into account. The business value represents the maximum possible price a buyer would pay given a business at this scale of operation and profit level. Each factor adds or deducts from the target value to arrive at a suggested price. Each of the factors detailed below has an effect on the final suggested price.

Upper Value: \$325,650

Lower Value: \$289,466

Labor

This factor weighs the stability of a company's labor force and the changes, which may reduce profits under a new owner.

Predictability

This factor reviews the company's historical and current trends compared to the local and national economic trends.

Management

This factor estimates the integrity of the current management system and how changes of ownership will impact the business.

Competition

This factor weighs the possibility of a new owner going out of business because of a saturated market.

Revenues

The past and present problems of collecting revenues will probably remain unchanged under new

ownership.

Longevity

The number of years a business entity has survived and grown is usually proportional to the confidence level for future survival. This factor balances lease rates, years at this location, and the utility of this location for this business against current and potential competitive locations.

Loan Ability

This factor weighs this company's ability, based on its own assets, to acquire funding from lenders.

Clientele

This factor weighs the stability of clients and future expectations for revenue from those clients after a management change.

Liability

This factor weighs the hazard level of this business and how easily a bankruptcy situation could occur.

Multiple or Average Value Method

This method is the average of all of the previously described formulas based on theory that a *reasonable* buyer would use more than one of the previous formulas. An average value derived from all of the formulas should represent the actions of a *reasonable* buyer.

Upper Value: \$387,810

Lower Value: \$266,309

Conclusions

All of the formulas described above are calculated and displayed in price ranges with a maximum and minimum level because the data used to calculate these values are based on estimates.

Upper Range Pricing

The **upper range pricing** represents the seller's optimistic view of his business given current market constraints.

Upper Value: \$387,810

Lower Range Pricing

The **lower range pricing** represents the buyer who is primarily concerned with financial rewards including return on investment and return on equity, and will buy a business based on conservative financial estimates.

Lower Value: \$266,309

Suggested Price Range

The **suggested price range** is based on all of the evaluation methods. It is strongly based on the multiple average but occasionally differs for a variety of reasons.

The first thing that will cause a variation between the multiple average and the suggested price comes from inconsistent data used to calculate various valuation methodologies contained in this report. If there is too much inconsistency, bizarre results may be produced. If this occurs, the suggested price will be discounted based on the degree of inconsistency that was encountered.

Suggested Price

The methods used to sell the business can affect the **suggested price**. The accuracy of data used in this report will have a substantial affect on the suggested price. If the data is not accurate, the methodologies this report relies upon will generate a suggested total price range, which is wide and often unrepresentative.

Suggested Price: \$357,435

Justification for Purchase

The Justification for Purchase test provides a means to test the reasonableness of the proposed selling price of the business. It is not a method for estimating the value of a business or other property, as are the other valuation methods included in this report.

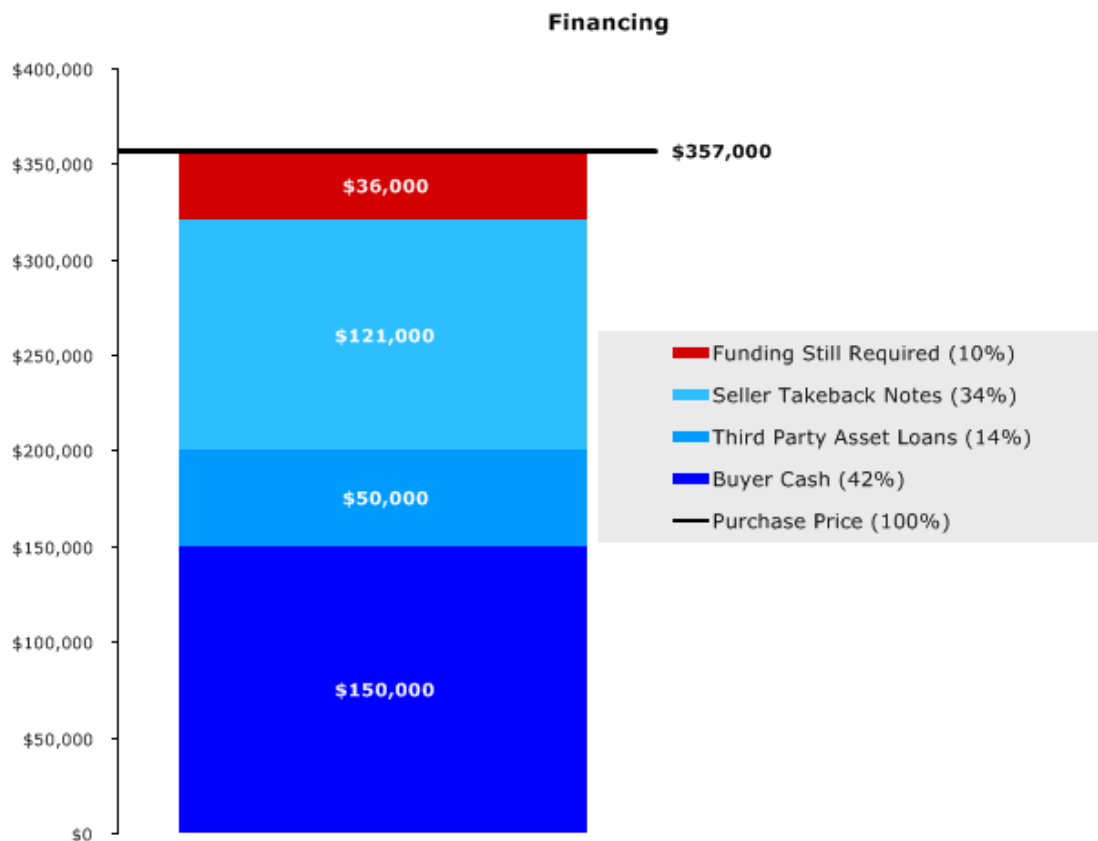
- The estimated purchase price is \$357,000.
- The expected down payment is \$150,000.

The balance is paid through an asset loan and a seller take back loan. The asset loan will be paid in equal monthly installments over a period of 5 years with a 10.00% annual interest rate. The seller take back loan will be paid in equal monthly installments over a period of 8 years with a 12.00% annual interest rate.

The derived cash flow will be available for capital additions and buyer's compensation. The following table describes all of the assumptions used for a hypothetical purchase of this business:

Justification Assumptions				
Financing				
	Amount	Percent	Term in Years	Interest Rate
Purchase Price	\$357,000			
Buyer Cash	\$150,000	42.02%		
Third Party Asset Loans	\$50,000	14.01%	5	10.00%
Seller Takeback Notes	\$121,000	33.89%	8	12.00%
Amount Funded	\$321,000	89.92%		
Funding Still Required	\$36,000	10.08%		
Post-Sale Cash Flow				
Discretionary Income	\$125,000			
Include managers salary?	2	(1=Yes, 2=No)		
First Year Income Growth	5.00%			
Subsequent Years Growth	5.00%			
Income Tax Rate	40.00%			
Investment Hurdle Rate	28.00%			

The chart below shows how the purchased will be financed.



Post Sale Cash Flow

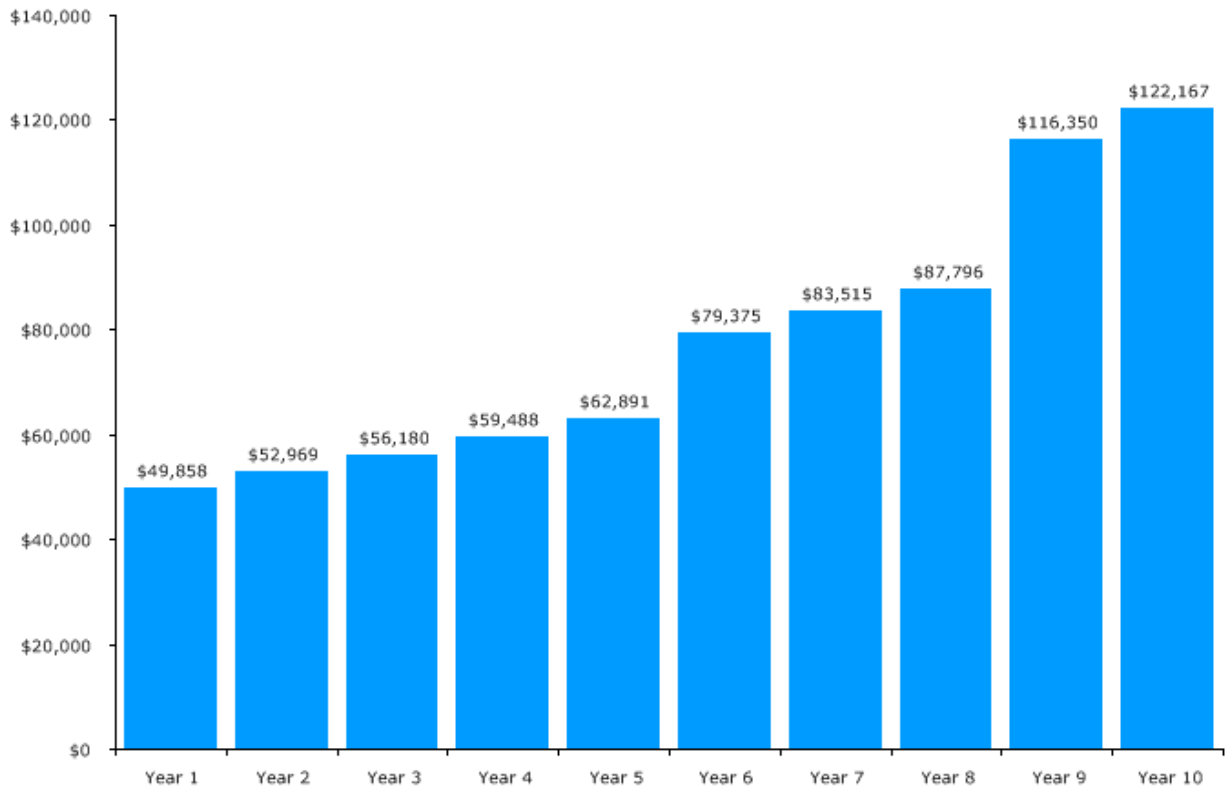
In the following post sale cash flow, the derived cash flow was developed from the last year's actual cash flow less the principal and interest payments from the debt to purchase the business. This cash flow will be the new buyer's discretionary cash flow before taking a salary.

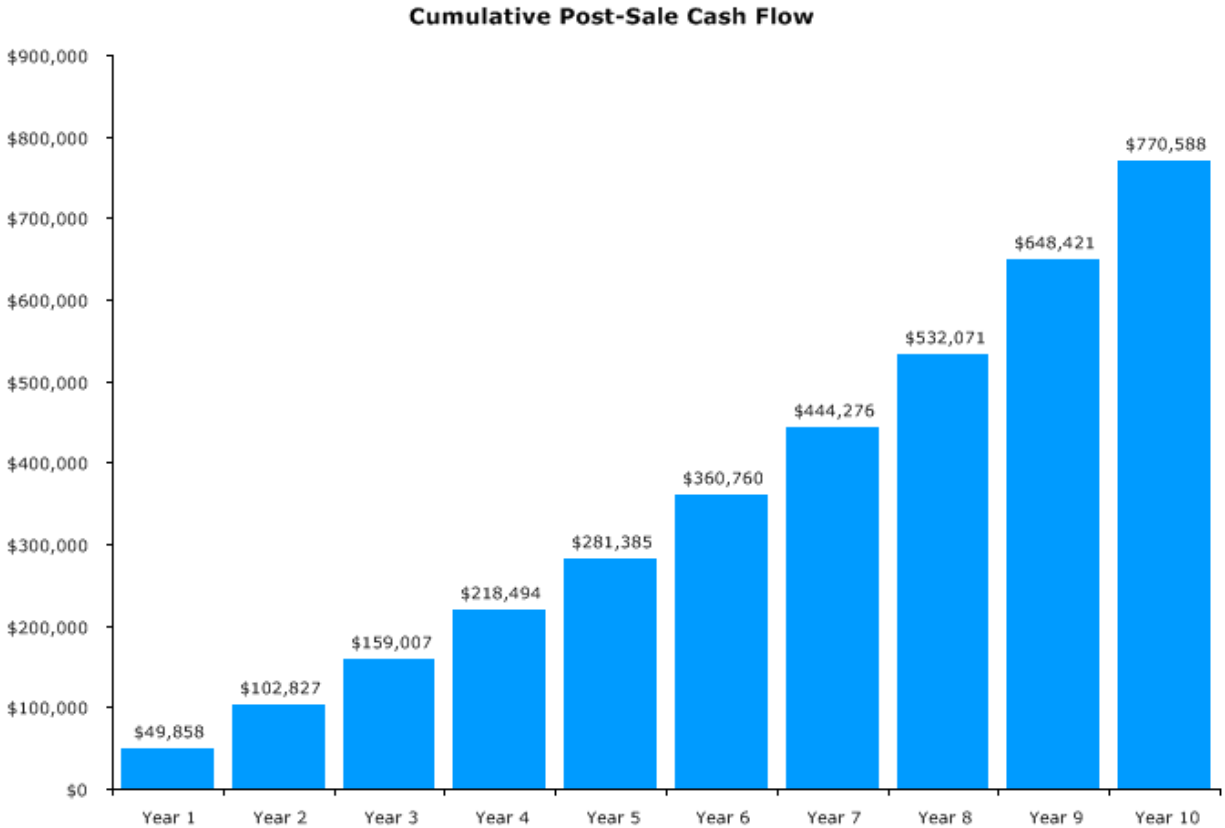
The evaluator makes no representations or warranties, nor gives any assurance that a prospective buyer will do as well as indicated in this report. If a buyer relies upon this information, the buyer shall accept all the inherent risks of doing so.

Year	Income	Managers Salary	Total Interest	Taxes	Total Principal	Cash Flow
1	\$131,250		\$18,638	\$45,045	\$17,709	\$49,858
2	\$137,813		\$16,572	\$48,496	\$19,775	\$52,969
3	\$144,703		\$14,262	\$52,176	\$22,085	\$56,180
4	\$151,938		\$11,680	\$56,103	\$24,667	\$59,488
5	\$159,535		\$8,793	\$60,297	\$27,554	\$62,891
6	\$167,512		\$6,167	\$64,538	\$17,432	\$79,375
7	\$175,888		\$3,956	\$68,773	\$19,643	\$83,515
8	\$184,682		\$1,465	\$73,287	\$22,134	\$87,796
9	\$193,916		\$0	\$77,566	\$0	\$116,350
10	\$203,612		\$0	\$81,445	\$0	\$122,167

The following two chart show the projected annual and cumulative post-sale cash flow.

Annual Post-Sale Cash Flow





Reasonability Analysis

The following analysis is based on the purchase terms described above. All of the calculations are based on after debt cash flows. If the purchase and growth assumptions are correct, the following analysis will provide a guideline to determine the reasonableness of the purchase price and terms.

Sanity Check

Post Purchase Details

First Year Return on Down Payment	33.24%
Months to Repay Down Payment	36
Annual Return on Purchase Price	13.97%
Years to Pay Total Purchase	7

Ratios

Price to Earnings	2.86
Price to Earnings after Management Compensation	5.49
Price to Revenue	0.46
Price to Assets	1.48

Investment Return Analysis

Internal Rate of Return	38.61%
Investment Hurdle Rate of 28.00% Met?	Yes
Net Present Value	\$56,564
Three Year Return on Investment	106.00%

Appendix A: Market Approach Method Details

Overview

The company was evaluated using direct market comparables from two sources: the Institute of Business Appraisers (IBA) and from BIZCOMPS®. IBA Market Data is a database of over thirty-three thousand closely-held business sales. BIZCOMPS® is a database of over ten thousand closely-held business sales. Both data sources contain Price to Revenue and Price to Earnings ratios, which we have used to determine the fair market value of \$357,000.

What Is Valued Using this Method

The evaluator was asked to value the subject company, including all assets and liabilities of the business, both tangible and intangible.

- Assets (including A/R and Inventory) are *not* included in the final company value.
- Liabilities (including A/P and notes payable) are *not* included in the final company value.
- Real estate and improvements have *not* been valued by the appraiser and are *not* included in the final value.

Appraisal Methodology and Value

IBA Market Data

IBA Market Data provides Price to Revenue (P/R) and Price to Discretionary Earnings (P/DE) ratios, which are based on total reported consideration (i.e. cash, liabilities assumed, etc.) excluding real estate. In other words, all of the sales prices reported in the database exclude real estate from the underlying transaction.

In order to use IBA Market Data ratios to calculate a company's value, we multiplied each base (i.e. revenues or DE) by the relevant multiple (P/R or P/DE). Specifically, we compared the net gross revenues and re-cast earnings (DE) of Smith & Associates to the IBA transaction data. The result is a range of values based on gross revenues and DE.

BIZCOMPS®

BIZCOMPS® provides Price to Revenue (P/R) and Price to Seller's Discretionary Earnings (P/SDE) ratios, which are based on intangibles and furniture, fixtures and equipment (FF&E) only. In other words, all of the sales prices reported in the database are based on a buyer purchasing a business's intangibles and FF&E only. All other assets and liabilities are *not* reflected in BIZCOMPS® statistics.

In order to use BIZCOMPS® ratios to calculate a company's value, we multiplied each base (i.e. revenues or SDE) by the relevant multiple (P/R or P/SDE). Specifically, we compared the net gross revenues and re-cast earnings (SDE) of Smith & Associates to the BIZCOMPS®

transaction data. The result is a range of values based on gross revenues and SDE.

Weighting the Indicated Values

To obtain a range of value from the Market Approach Method, we weighted the four indicated values calculated using the IBA and BIZCOMPS® data. You need to be aware that this range of values derived from these two sources of transaction data are estimates only and this should *not* be considered a formal appraisal.

Calculation of Value

After selecting appropriate comparable business sales data from IBA Market Data and from BIZCOMPS®, the value was calculated as shown below.

Market Approach		
Revenue Multiples		
Data Source	IBA	BIZCOMPS®
Revenue	\$780,000	\$780,000
P/R Ratio	0.34	0.33
Indicated Value	\$265,200	\$257,400
Weight	25%	25%
Weighted Value	\$66,300	\$64,350
Earnings Multiples		
Data Source	IBA	BIZCOMPS®
Earnings	\$125,000	\$125,000
Adjustments	\$0	\$0
Adjusted Earnings	\$125,000	\$125,000
P/E Ratio	1.50	1.50
Indicated Value	\$187,500	\$187,500
Weight	25%	25%
Weighted Value	\$46,875	\$46,875
Comparative Company Value		
Total Weighted Value		\$224,400
Plus/Minus Range		7.00%
High Value (Plus 7.00%)		\$240,108
Low Value (Minus 7.00%)		\$208,692

Appendix B: Evaluation Principles

Evaluation

A business evaluation is an investigation into the law of probabilities with respect to business value. Through the evaluator's experience, training, and integrity, we are able to project the activities of buyers and sellers in the marketplace into an estimation of value. In reaching a conclusion, comparison of businesses usually involves adjustments due to the individuality and uniqueness of each business. Transactions are often influenced by sentiment, personal bias, individual needs, politics, state of mind, and other conditions not considered by the impartial evaluator.

A business evaluation cannot be guaranteed, nor can it be proven. The opinion of value can, however, be substantiated and the final opinion is the result of a thorough professional analysis of a large amount of data. An evaluation must not be considered absolute but should be used as a basis of negotiations between concerned parties, whatever their interests.

The evaluation process as followed in the preparation of this report is an orderly procedure for arriving at an estimate of value. By following this procedure, the evaluator begins with a preliminary study of the issues and defines the basis from which the opinion of value is to be made. Once the data has been collected, a systematic approach is taken to analyzing the data and selecting appropriate valuation methodologies.

In assignments to estimate fair market value, the ultimate goal of the valuation process is a supported conclusion that reflects the evaluator's study of all influences on the value of the company being appraised. Therefore, the evaluator studies the business from various perspectives. Various questions are raised and answered through research of the industry and the financial capabilities of the subject business. Some of the questions researched may be found in the supporting data section of this report.

The various valuation approaches are interrelated, and each involves gathering and analyzing specific pieces of data relating to the company being analyzed. From the analysis, the evaluator derives separate indications of value, of which one or more may be used in determining the final value.

To complete the evaluation process, the evaluator integrates the information drawn from market research, analysis of data, and from numerous valuation techniques to form a conclusion. This conclusion may be an estimate of value or a range in which the value may fall. An effective integration depends on an evaluator's skill, experience, and judgment.

Principles of Evaluation

Every evaluation method and technique must comply with and is limited to the following principles if the final results are to be considered significant.

Principle 1: What a reasonable buyer will pay a reasonable seller.

The term “reasonable” in this context is used in the economic sense. The buyer and seller are each assumed to be comparing alternative investments and when the economic incentive to purchase is equal to the economic incentive to sell, a deal is made.

Principle 2: For evaluation purposes, a business is defined as an organized method of producing revenues routinely over a period of time.

The value of a business is divided into two (2) components:

1. The asset value represents the value of machinery, equipment, buildings and land, usable stock and other legal rights.
2. The business value or **goodwill value** of a business represents the premium value a buyer will pay the seller for organization and historically recorded cash flows.

Additionally, when comparing alternative investments, there is no economic incentive to invest capital in a business which has not or is realistically not capable of producing a net income in excess of the operator’s salary plus a reasonable return on investment.

Principle 3: Accuracy depends upon the standard use of terms, methods, and disclosure of information.

This report is only as good as the data it is based upon. This report makes adjustments for minor mistakes in judgment or interpretation of questions; however, accounting or financial data is taken at face value.

The report includes documents and source notes when possible. The inclusion of source materials with any evaluation will have many effects:

- Transfer liability from personal opinion to fact.
- Add credibility to the results.
- Ensure accuracy of data.
- Ensure a source of future reference.

Principle 4: All estimated values are limited by time.

Any sales price is subject to change as the market conditions change. Therefore, the suggested price is valid only for a short time relative to the size and scale of a given business, in a given industry, and in a given market. Documentation of the data used in this report will provide the basis for analyzing how this data will change over time.

Fair Market Value

The single most important market factor to impact the value of a business is the supply and demand of an equally desirable substitute that is available in the marketplace. According to the principle of substitution, the value of a thing (business) tends to be determined by the cost of acquiring an equally desirable substitute. A buyer will pay no more for a business than the cost of purchasing a similar business. This concept is the basis of fair market value and is the overriding methodology in this evaluation report.

There are three approaches to determining the value of any asset:

1. The **cost approach**, which considers the cost of purchasing or producing the business.
2. The **market data approach**, which values the business based on current sales in the marketplace for the same or similar business.
3. The **income approach**, which is a financial analysis consisting of capitalizing an income stream based on the cost of money and a risk rate that reflects current market conditions.

In this report you will find as many methods, under each approach, as is reasonably applicable to valuing the subject business. In order to arrive at a supportable value, we have chosen those methods that would best apply to the purchase of the subject business as reflected by the marketplace.

The Internal Revenue service established Revenue Ruling 59-60 as the standard for the valuation of closely held companies. The following summarizes the key factors to consider:

- History and Nature of the Business.
- Economic Outlook.
- Book Value.
- Earning Capacity of the Enterprise.
- Dividend Paying Capacity of the Enterprise.
- Goodwill and Intangible Assets.
- Recent Sales of Stocks.
- Market Value of Comparable Companies.

Cost Approach

In considering the cost approach, we must remember that the cost of something does not necessarily determine its selling price. This is true in a rapidly changing market, which is highly affected by technological changes or variances in supply and demand. This is especially true if a company is very young and has not yet established enough of a track record to make a confident analysis of the future performance.

Also, in the case of a business, all serious practitioners of business valuation agree that book value is not necessarily an adequate proxy for representing the underlying net asset value of a business for valuation purposes, much less for representing the value of the business itself. However, book value is a figure that is available for almost all businesses. Furthermore, it is a value that different businesses have arrived at by some more or less common set of rules, usually some variation within the scope of generally accepted accounting principles (GAAP). Also, each asset or liability number that is a component of book value as shown in the financial statements represents a specific set of obligations that can be identified in detail by referring to the company's records, assuming that the bookkeeping is complete and accurate. Therefore, book value usually provides the most convenient starting point for an asset value approach to the valuation of a business interest.

The nature and extent of adjustments that should be made to book value for the business valuation depend on many factors. One, of course, is the purpose for the evaluation. Another,

which is frequently a limiting factor, is the availability of reliable data on which to base the adjustments both for the subject company and for other companies which might be compared in the course of the valuation.

One concept for fixed assets is **value in use**, the value of the operating assets to the owner/user, or buyer who will use it in a similar manner. Value in use is the value that includes consideration for the unique relationship of the item to a particular business such as the subject. There is a value for an item, which is already in place and is ready to use. The value might be the item's retail price, plus applicable taxes, freight, and installation charges. The summation of these costs, after proper deductions for depreciation and obsolescence, is the value in use of that item. This value may be different from its fair market value to a buyer who will not use the equipment at its present location. A definition for value in use is as follows:

The value of an economic good to its owner/user is based on the production (privacies in income; utility or amenity form) of the economic good to a specific individual. This is a subjective value, however, and may not necessarily represent the market value.

We, therefore, have to subjectively estimate the value in use of the subject's assets based on past experience with assets of a similar nature.

Income Approach

The income approach is especially meaningful if assets are used to produce income, such as in the valuation of a business. However, it still takes root from the market data approach because it is an analysis of what the current market is paying by determining a comparable return that can be capitalized into a comparable purchase price.

Market Data Approach

In other types of valuations, mainly real estate, the market data approach indisputably will always yield the most accurate results. It is a true representation of the current marketplace because it is what the market is paying for the same or similar asset. However, in the case of a business, using public or private comparable sales price-to-earnings or income-to-sales ratios may be the least reliable for several reasons, among which are:

- No two businesses are alike.
- Business sales are not recorded and, therefore, information gathered is usually sketchy.
- Accounting records are not necessarily standardized between the comparable companies. There is no standard definition of net profit or income, revenue, cost of sales, and many other financial statement items.
- Some comparable sales include assets that the subject business does not have and these assets are not valued separately, so the evaluator cannot make proper adjustments.

The market data approach can be very useful when analyzing data drawn from the market as to what types of ROI (return on investment) ratios are customary, or data based on Price-to-Earning ratios that buyers are willing to pay in order to purchase a certain type of business.

Stock Price Data from Publicly Traded Companies

It can be argued that the use of stock prices of publicly-owned companies to estimate the market

value of privately held companies is a source of comparable data. However, many business evaluators realize that to estimate the market value of a privately held business by using this data is seriously flawed in several respects:

- Publicly held companies, whose stock is listed on the major exchanges, are usually much larger than the closely-held businesses that are being appraised. This difference in size raises serious questions as to whether the two are, in fact, comparable.
- Prices of publicly traded stock reflect the sale of very fractional ownership interests. On the other hand, the evaluator's objective is usually to estimate the market value of a major ownership interest, frequently, one hundred percent ownership of the closely held business.
- Selecting appropriate publicly traded companies is tantamount to guess work, and, thus, cannot be relied upon.
- The price to earnings ratio represents the ratio of a current stock to an earnings-per-share figure that can be from a few weeks to several months old.
- Probably the greatest fallacy of attempting to use publicly traded stock prices to estimate the value of a closely held business lies in the psychology of the investor. The potential buyer for a closely held business is almost always concerned with the anticipated performance of the business itself. Of course, it is sometimes argued that the trend of stock prices of a publicly held company is strongly influenced by the company's performance. However, it is demonstrable that, whereas this does tend to be true in the long run, there are many influences on stock that tend to be of short-term nature, and that strongly influence stock prices while bearing relatively little long-term relationship to the company's performance. Therefore, using the prices of publicly traded stocks is not recommended as a means of estimating the value of closely held businesses.

Comparable Transactions

Still another source of market data is, of course, information on actual sales of companies, such as the subject, in the evaluator's local community. It is unlikely, however, that there will be enough information available on sales similar to the subject to provide a statistically sound basis for estimating the business's market value. However, as mentioned above, when analysis based on research on potential buyers for this kind of investment is made, important insight into what a buyer is willing to pay for a particular business can assist the evaluator in determining an accurate opinion of value. This analysis must include such factors as industry risk, the local and national economy, competition, barriers to entry, and the future potential of Smith & Associates.

In this report we may include information or make comments on similar business sales that might have a bearing on our opinion of value. However, it is very important to remember that it is a difficult task to quantify how similar or dissimilar are two businesses, and, therefore, using price to earnings ratios and price to revenue ratios from comparable sales has a built in uncertainty. It is possible that if no comparable sales information is available, or if it's too unreliable, the evaluator may elect not to use the market data approach in this valuation.

Correlation of Methods

It is important to note that under guidelines set by the “The Uniform Standards of Professional Evaluation Practice” (Standards Rule 9-5), the Internal Revenue Service (Revenue Ruling 59-60), as well as most evaluation societies, the evaluator is required to use all approaches for which reliable data is available and applicable. The use of as many approaches and methods within these approaches is useful to the extent that it will establish a range of values for the entity being appraised.

Revenue Ruling 59-60 (in Section 3, “Approach to Valuation”) recognizes the fact that appraising is not an exact science: “[a] sound valuation will be based upon all the relevant facts, but the element of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and determining their aggregate significance.”

Sometimes it will be obvious that the analyst should rely on a single approach, such as methods under the cost approach whereby earnings are insignificant to the value of the assets. An example of this would be a new enterprise with little or no longevity or profits, where projections would be meaningless. Another example would be a company that has longevity, but insignificant profits, and would be a candidate for liquidation. In other cases, it may be apparent that several methods would be appropriate for the final value conclusion. When this is the case, the evaluator must look to the real world to determine which method or methods should receive the most weighting.

Service companies can represent a significant problem to the evaluator in that there are few assets that would give a buyer confidence should the business someday fail. In any case, risk is the most important factor to consider in an evaluation. As stated earlier, and acknowledged in Revenue Ruling 59-60, value is based on anticipated expectations of the buyer as to future performance. In other words, what a company did in the past has no significance to its value if that trend is not anticipated in the future.

Although assets play an important role in risk calculations, one must remember that earnings and the anticipation of an increasing income stream are the overriding factor in the purchase of a business. The process of elimination and an analysis of methods both suggest that the income approach methods are clearly the most representative of current market value.