How to Appraise the For Sale 'Value' of your business

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THIS INFORMATION IS PROVIDED YOU FOR THE PURPOSE OF ALLOWING YOU TO UNDERSTAND HOW TO APPRAISE THE "VALUE" OF YOUR BUSINESS.

THIS DOCUMENT CONTAINS INFORMATION ON THE FOLLOWING:

* We can help you with the appraisal calculations and risk assessment if necessary as this is report is intended to be a guide only. It is the support material and overall quality, presentation, and systemization of the business and appeal to the buyer that determines the final sale price.

BUSINESS APPRAISAL

Appraising the value of a business is always a difficult job. Invariably the seller wants the maximum possible price and the purchaser wants to pay the minimum price possible. It is often the job of the business broker or agent to appraise the business and analyze its value in order to derive a fair market price. Usually a broker has to temper the analysis with a fair degree of experience and judgment to arrive at a price that will not be so high as to put off any prospective purchaser. Nor be too low as to disadvantage the seller.

A crucial element in determining the price is ‘time’. If a seller wants a million dollars for his business, it can be got – but it may take 20 years! A seller needs to be clearly focused on what his time frame is so that it can be integrated with the price. Too often the focus is on price alone and the expectation that the ‘agent’ has a magic wand that can be waved to create lots of willing buyers desperate to buy the business at <u>any</u> price.

The reality is that the buyers are going to take professional advice before putting any money down. Professionals will be advising them and often it’s the Accountants and Lawyers that have a major influence on the final decision. It is vital therefore that when presenting a business for sale that all the information that would be required by these professionals is available so that they may act in their clients best interest. It also makes for effective decision-making and saves a lot of time.

Clearly if all the required information is not forthcoming then it is unlikely that an agent or anyone else is going to be able to effectively work in the sellers best interest in selling the business. Bear in mind also that the biggest reason that someone buys a business is so they can make money and often the financial consideration is the major determinate. The three major components of appraising a business are, **Stock**, **Plant** and **Goodwill**.

STOCK

The stock figure is usually the sellers estimated wholesale value of stock. Due allowance should be made for obsolete or damaged stock and the actual price paid will be for stock that is actually on hand on the date of possession.

The valuation of such stock is determined by a joint stock take by the seller and purchaser or the appointees. Note that the value of the stock shall not reduce or increase more than the percentage adjustment that is usually inserted on the front page of the Sale and Purchase Agreement.

If the value is exceeded then the purchaser can elect to accept all or any part of the excess. The purchaser, unless he agrees to take the stock, can choose which stock items the vendor will have to retain to stay within the value specified. Of course any value is exclusive of GST. The stock is always the volume of stock on the day of valuation. (S.A.V).

PLANT and EQUIPMENT – Depreciation and Book value

The IRS has allowed business the ability to write off a pro-rata share of the original cost of a capital item overtime. Such as a machine in a factory. This 'write off' is considered as an expense and of course has been calculated into the cost of the goods produced and sold. From this expense a reserve may be accumulated to replace the machine or equipment as it wears out. This is known as *Depreciation.*

The Tax department has long recognized this depreciation expense as a legitimate deduction from taxable income. Accountants establish the book value of an asset by subtracting the accrued depreciation from the original cost. There is however no implication that the book value is what the asset is worth. Book value is simply that proportion, of the original cost, that is left after the accumulation of any accrued depreciation. The book value is <u>**not**</u> what that particular asset is worth to the business.

The value of an asset or plant and equipment to a business, will often lie between the price realized, at say a "fire" sale and the price of a "new" replacement. For example, a hot water cylinder that is plumbed, wired and operating is of far greater value to a business, than the amount of money that it would fetch, say at a garage sale. If "book value" was to be used and it was 10 years old, then that value might well be almost zero. The true value of the water cylinder however, is the *"going concern"* value. This should be a value that has been assigned to it as the **value** to the business.

There are some items of plant that are non-essential to the business and such items will have a minimal value (i.e. a radio). This value could be equal to or less than the book value. Conversely some items will be crucial to the operation of the business and consequently will have a much greater value. It is on this basis that a value is derived at when valuing items of plant in a business.

Any seller wishing to save time and any later arguments about the values of specific items of plant is well advised to have the plant valued by an independent registered Appraiser. Such valuation will solve any future difficulties over how much to pay or ask for plant and will greatly assist in accurately assessing the value of <u>your</u> business.

GOODWILL

A lot has been said about *Goodwill* some argue that there is no such thing and others say that there is, depending upon which side of the argument best suits them. Our assessment is that <u>Goodwill relates to:</u>

- Historical earnings
- Current earnings
- Potential earnings
- and Risk

These earnings must be both:

(a) Sustainable **and** **(b)** Transferable

Goodwill is dependent upon:

(a) Length of time, costs and risks that would be required to start a similar business.

(b) Profits made from purchasing a business as a going concern, as opposed to starting from scratch.

Goodwill should only be assessed on **excess earnings**. Excess earnings are earnings that exceed a reasonable rate of return on the net tangible assets employed in the business. This excess over and above the average rate of return for a similar business is called *excess earning capacity.*

In our view it is the sustainability of this excess earning capacity that needs to be demonstrated for a business to qualify for a goodwill consideration.

RISK:

Goodwill should also assessed in relation to risk. The following table summarizes the risk factors;

FACTOR	LOW RISK	(+)	HIGH RISK	(-)
1. History Of Business	Long profitable History	+ 0.75	New or unprofitable history	- 0.25
2. Industry Segment	Stable or growing Highly profitable	+ 0.75	Erratic growth Declining Industry	- 0.25
3. Return on Investment	Readily realizable for cash	+ 0.75	Non liquid or easily depleted	- 0.25
4. Technology	Not particularly vulnerable to technological change	+ 0.75	A change in technology could have major impact	- 0.25

If a seller wishes to include goodwill as part of a purchase price, they must be able to document an excess earning capacity and demonstrate that the above average earnings of their business is both sustainable and transferable. i.e. survive a change in ownership of the business.

If a business has these qualities then a goodwill consideration is warranted. The risk factor needs to be analyzed (as per above chart) and a ratio or multiple needs to be derived. **i.e.**

So you will need to determine where **your** business fits between + 0.75 and – 0.25 in each of the four factors.

If the business is totally **low** risk then the multiple = + 3.00
If the business is equally low & high risk the multiple = + 1.00
If the business is totally **high** risk then the multiple = - 1.00

Calculate the risk multiple of **your** business _______+______+______+______=_______**(A)**
1 **2** **3** **4**

Now lets move on to the Appraisal Calculation.

APPRAISAL CALCULATION

Pre Tax Income (From Accounts) $___________________

Plus Add backs (if any)

Interest cost $___________________

Depreciation claimed $___________________

Drawings taken $___________________

Total $___________________

New Sub Total $___________________

Now Deduct

A Reasonable Owners Salary $___________________ (enter nil for food)

*10% "**Going Concern**" value of Plant $_____________________(for Depreciation)

*(see **(C)** below) Total $___________________

Subtract this from new sub total = $__________________**(B)**

Adjusted Sustainable Profit (A.S.P)

LESS

Owners interest on investment (Tangible Assets)

Existing "**Book Value**" of Plant $___________________

Value of Stock $___________________**(D)**

= $_______________ @ % **=** $___________________

(current bank interest rate) (Subtract from **(B)**)

= Excess Earning: $___________________

LESS Tax on Excess Earnings **(only if over $14,500 p.a)**

Company Tax (@ 33% x ___________________) = $___________________

Or Personal Tax (@ 24% x _________________) = $___________________

(Subtract from excess earning)

Tax Paid Excess Earnings = $___________________ **(E)**

RISK MULTIPLIER = _____**(A)** (**+ 1** for Distribution type business)

(E) $___________________ X _________________ **(A)** = $___________________ GOODWILL **(F)**

(Tax paid Excess Earnings) (Multiplier)

APPRAISAL AS A GOING CONCERN:

(F)	GOODWILL	**$**____________
(C)	**"GOING CONCERN"** VALUE OF PLANT	**$**____________
(D)	STOCK	**$**____________
(G)	**=** MOST PROBABLE SELLING PRICE **	**$**____________

** This is the most likely selling price. Not the asking Price.

APPRAISAL VERIFICATION *

1. CAPITALISATION RATE (Return on Investment)

Adjusted Sustainable Profits **(B)** $____________

Most Probable Selling Price **(G)** $____________

Price Earning Ratio

(G) ________ ÷ ________ **(B)** = ____________

Selling price A.S.Profits Price Earning Ratio

Capitalization on (Pre Tax) Earnings

100 ÷ __________ = $\boxed{\quad\%}$ **(H)**

Price Earning Ratio

2. GOODWILL

Adjusted Sustainable Profits **(B)** $____________

Capitalization on (Pre Tax) earnings **(H)** ____________%

(B) A.S.P ÷ Cap. On earnings **(H)** = $____________

LESS Tangible Assets **(C)** + **(D)** - $____________

= GOODWILL **(F)** $____________

(H) is also the 'return on investment' as discussed on the next page (See Business Viability Chart)

* This calculation checks that the previous appraisal calculation is correct. The Goodwill (F) should calculate to be the same.

BUSINESS VIABILITY CHART

This is what the buyers accountant will tell them about whether or not purchasing the business is a worthwhile ‘investment’ in terms of pure economics.

PURCHASE PRICE	6.5% AT BANK	ANNUAL INCOME	EQUIVALENT NET PROFIT	% RETURN ON INVEST.
$100,000	6,500	30,000	36,500	37%
$200,000	13,000	40,000	53,000	27%
$300,000	19,500	40,000	59,500	20%
$400,000	26,000	50,000	76,000	19%
$500,000	32,500	50,000	82,500	17%
$600,000	39,000	50,000	89,000	15%
$700,000	45,500	50,000	95,500	14%
$800,000	52,000	60,000	112,000	14%
$900,000	58,500	60,000	118,500	13%

To calculate if a business is a worthwhile investment in financial terms we can use the above chart.

1. Take the total investment (asking price) and calculate the interest you could receive on your money

   i.e. on $200,000 the interest from a bank @ 6.5% equates to $13, 000 pa

2. Add to this the amount you are currently earning at your present job or what you could realistically expect to earn. If the business requires both of you to work in it then both your incomes need to be calculated into the above chart.

3. This will now give you a minimum figure that the net profit needs to be for the business to be viable for you.

   i.e. If the price is $100,000 and the interest is 6.5% and your annual income is currently $30,000. The proposed business will need to provide a net profit of $36,500 (i.e. 37%) to be as good financially than, what they are currently doing. In other words the percentage return from the business needs to exceed the value shown in the % return on investment column to make better economic sense.

The following Loan Repayment table on the next page will help you to calculate the monthly repayments for a buyer if they borrow money to buy your business. This should also be the amount that your business needs to make (at least) in profit per month for it to be a viable business at the asking price.

THE TEN DIFFERENT KINDS OF BUYERS THAT YOU ARE LIKELY TO MEET WHEN SELLING YOUR BUSINESS

1. The buyer who tells you money is no problem
(usually the opposite is true – its no problem because he has none)

2. The buyer who tells you he's going to get the money from his wealthy and doting Uncle Charley. (Uncle Charley may mean well but when was the last time anyone sold a business that somebody else paid for?)

3. The buyer who thinks he's going to borrow all the money from the Bank. (Find out which bank he intends to borrow from and get there first!)

4. The buyer who is going to retire sometime in the future and wants a business to supplement his income. (Usually these types want a business that makes huge amounts of money with very little or nil input required from them).

5. The buyer who represents an investor group or is looking for a "wealthy" friend. (Usually doesn't have any money himself and is using his connections as a 'free-ride' to look).

6. The buyer with a need (unemployed). (Usually a serious buyer but has no conception of the money needed to buy a business).

7. The buyer who is out of touch with reality. (He thinks he can buy a business earning $100,000 net pa for $100 down payment and the seller will let him pay it off).

8. The buyer who tells you up front that he doesn't do anything with out his lawyer or accountant. (Find out whom his advisers are and try to deal directly with them).

9. The buyer who has been looking for years (and knows what is for sale all over town). (The proverbial "tire kicker" chances are if he hasn't bought something by now – he never will).

10. The ready, willing and able buyer. (These are the ones you want to spend time with and ultimately sell your business to).

Unfortunately buyers don't have numbers stuck on their heads, so you have to ascertain which type of buyer they are and deal with each accordingly. Some good advice is, Find out early! It could save you a lot of wasted time.

The following is typical of the information required by any serious purchaser. This would be the minimum information that you would need to supply to an agent or purchaser to facilitate a sale.

BUSINESS LISTING INFORMATION

1. Copy of the lease detailing:

Term	Rights of Renewal
Commencement	Final Expiry
Rent Review Dates	Present rental
Rates	OPEX

2. Financial Details:

Sales/ Turnover Gross Profit Net Profit

3. History:

How long have you owned it? Previous owners?

4. Staffing

Full time	Hours per week
Part time	Hours

5. Hours of Operation:

Mon	Fri
Tues	Sat
Wed	Sun
Thurs	

6. Price breakdown:

Plant $ Stock $ Goodwill $ Total $

7. Business Name: **Phone:**

8. Business Postal Address:

9. Business Address: Phone:

10. Name of your Attorney: Name of your Accountant:

11. Why do you want to sell?

12. What is the main Business activity?

13. What are some important 'positive' points about this business (i.e. what could you say to sell this business)?

14. Who is your competition?

15. Can you provide copies of Financials? YES NO

16. Can you provide a copy of your lease? YES NO

FREE BUSINESS CONSULTATION OFFER

At **Crisp Seminars.com** we are passionate about business and profits. We have identified that most business owners today face one of two problems. They are either not making enough money or it's a nightmare running their business because they don't have adequate systems in place and are too busy working in their business to spend any time working on their business.

At **Crisp Seminars.com** teach business owners powerful sales and marketing systems that assist business owners to make loads more cash from their endeavours and to implement systems that will free them from the day to day running of the business. After all if you are not making money and having fun, why are you in business?

Crisp Seminars.com is committed to making your business 'work for you' (not the other way around). If a minimum 33% increase to your existing bottom line within the next 6 months is of interest to you – please contact us. We will reveal several strategies that will unlock a significant amount of cash from your business. The usual charge of $297 for this consultation will be FREE with this offer. You can contact us at:

www.CrispSeminars.com/business
P.O Box 26856, Scottsdale AZ 85255
602 531 7845 Or fax: 480 634 7692

TO: Crisp Seminars.com Fax: **(480) 634 7692**

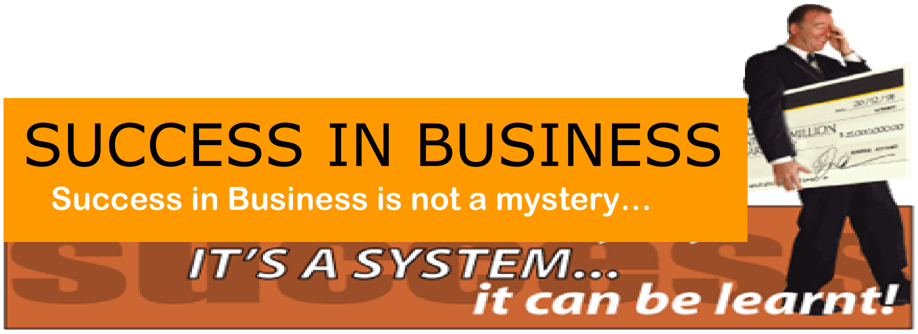
Please contact me about a confidential **FREE** no obligation one hour consultation (valued at $297.00) to show me how I can improve my bottom line by at least 33% within the next 6 months.

Name: ________________________________ Phone: ___________________

Address: ________________________________ Fax: _____________________

________________________________ Email:____________________

________________________________ Mobile:___________________



Massively increase your Business income - FAST!!!!

In just one session with Peter Crisp AREINZ, MPINZ, International Business Speaker & Trainer he will you show you how you could achieve at least a **33% increase** right now!!

You will quickly see that he has a unique perspective on how you can become a success in your business faster and easier than ever before and Peter gets straight to the point in identifying the key issues and breaks through the seemingly 'complex' business of building a successful business. Using easy to understand, but **simple** concepts that are very educational that will arm you with the knowledge, the motivation and the tools to achieve the success and the wealth from your business that YOU want.

As a salesperson for a major New Zealand company he won Salesperson of the Year in 1996 thru to 1999 and achieved an award for exceeding TWENTY FIVE MILLION DOLLARS in sales (1998) He has been a successful property investor, business owner, a published author, and holds a Masters degree and currently is activity involved in the Real Estate investment market in Phoenix.

He is an experienced public speaker and motivational presenter and as both an international real estate and business success expert and has a unique perspective and ability to break the complexity of business down to simple and easy to understand concepts that de-mystifies the success process.

At this 'How to massively increase your business income' seminar you will learn:

- **250 Ways to increase your Business Profits**
- **How to create lots of new customers quickly and almost for free**
- **Learn how to massively increase profits with out spending a cent.**
- **How to create a customer loyalty and incentive program that will blow them away!**
- **Why thinking like a traditional business owner will often keep you broke.**
- **Learn exactly what your most valuable business asset really is.**

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