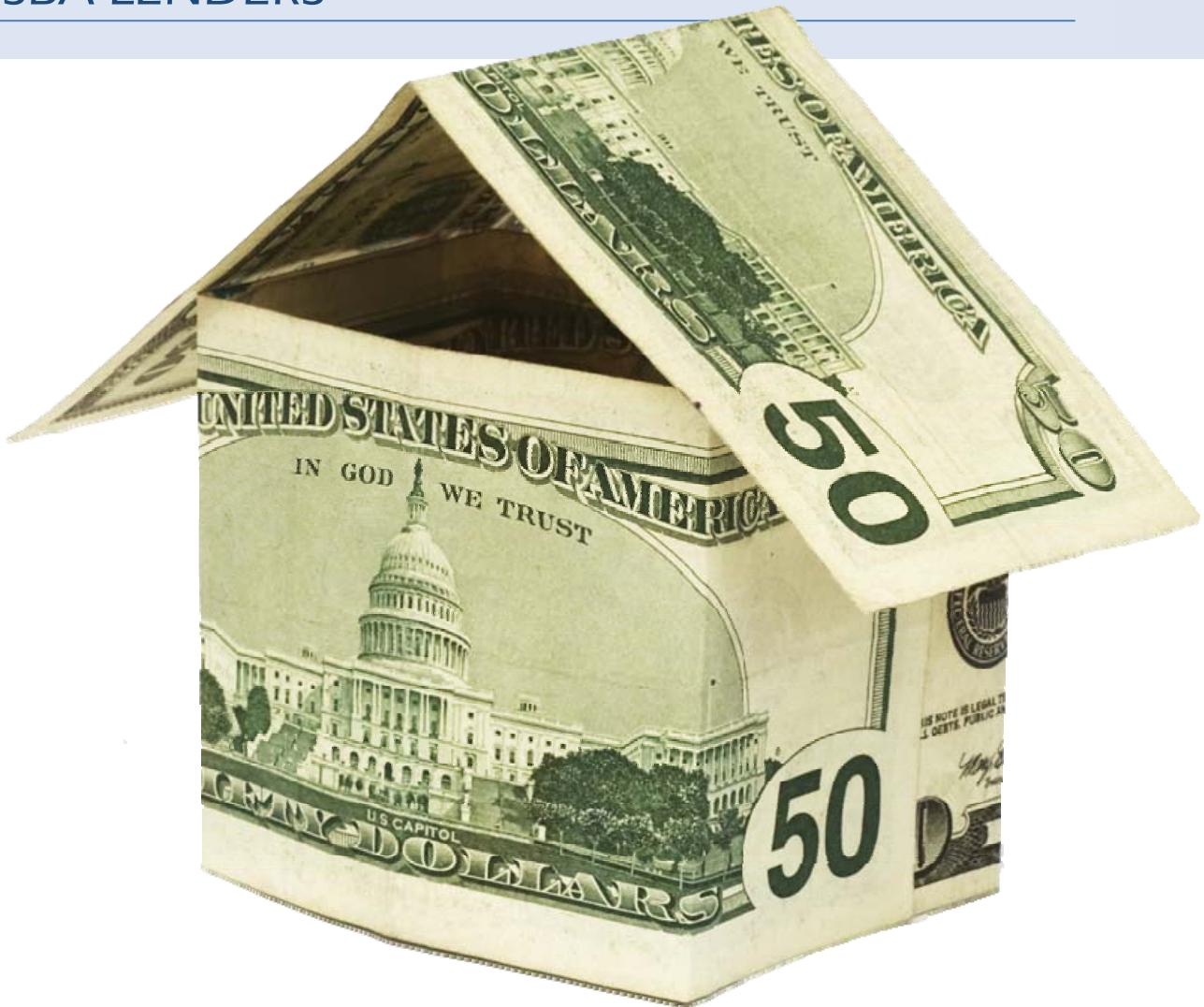


SBA VALUE



VOLUME 1 :: ISSUE 1
RELIANTVALUE.COM

A MONTHLY BUSINESS VALUATION NEWSLETTER
FOR SBA LENDERS



The Market Approach Done Correctly

It's not quite as easy as valuing your home based on your neighbor's sale price. The Market Approach should be very detailed in nature, and the inputs and assumptions should be explained thoroughly.

Business Overview | **Income Approach**
Economic Report and Outlook | **Market Approach**
Industry Report and Outlook | **Asset-Based Approach**
Financial Ratio Analysis | **Rules of Thumb (Sanity Check)**
Annualized Interim P&L | **Purchase Justification Test**



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*Cost of a typical 100% controlling, asset-sale business valuation (for lenders only). Prices can vary depending on complexity of business.

The Market Approach Done Correctly

What SBA Lenders Should Look for When Reviewing Business Valuations.

by **Neal Patel, CBA**

There are three main approaches to business valuation: Market Approach, Income Approach, and Asset-Based Approach. Contrary to what many business valuation companies may practice, reports compiled for SBA valuation purposes should contain ALL THREE of these valuation approaches.

At the end of the report, the appraiser must assign a weight to each one of these approaches, and explain the weights depending on different factors. The Market Approach is arguably the most important valuation method when conducting appraisals for SBA transactions. It is the most direct approach for establishing the market value of a business. Specifically, the Transaction Method, also known as the "Direct Market Data Method", locates similar companies that have been bought or sold and compares them to the business being valued. It is the most popular method to use in court during expert testimony regarding valuation, because unlike the income approach, in which a development of a capitalization rate is very subjective, there is hard data on comparable transactions available for this method.

Layman's Terms

Here is a simple example of the Market Approach: the appraiser searches databases for the sales price of 10 liquor stores that are similar to the subject business. If each of these 10 stores sold for 3 times their seller's discretionary earnings, the logical conclusion would be that the subject liquor store will sell for 3 times its discretionary earnings. Of course, there are many components of the subject business that must be examined before arriving at this conclusion. But I mention the foregoing to show that this is a very simple method, and therefore, even buyers and sellers will use some simplified form of the Market Approach to determine the final sale price in their purchase agreement.

Because a majority of the final value weight is usually assigned to the Market Approach, this approach should be very detailed in nature, and the multiples derived from different databases should be explained thoroughly. It is surprising to see so many

valuation companies simply pasting a chart into their valuation report that looks something like "HIGH and LOW multiples... we picked the average for our FINAL VALUE". Is this type of report really worth a few thousand dollars?

The Three Databases

In order to determine the value of a business using the market approach in an SBA business valuation, *at least two of these three databases* should be searched:

- The Institute of Business Appraisers (IBA)
- Pratt's Stats
- BizComps

The following information should be available to the reader:

1. Initial number of transactions that the search returned.
2. Which parameters were set to obtain the final transactions?
 - a. Are annual revenues similar to the subjects'?
 - b. How many duplicate transactions were removed?
 - c. Were other transactions eliminated? Why?
3. What was the coefficient of variance (CofV) for each multiple from the original data search, and how does it compare to the CofV in the final search?

The point is, any reader should be able to pull a database search for the same SIC code, and arrive at the same final transactions that the appraiser did, using the same exact parameters. If the reader cannot, how does he/she know that the appraiser didn't make a mistake in arriving at the final multiples (yes, we make mistakes), or even worse, if the appraiser made up the multiples (no, we don't make them up, but you get the point).

Real Life Example

On the following page, I extracted a table from a liquor store report that I recently completed. This is the initial result from pulling data on all of the transactions for SIC code 5921 (Liquor Store), from the IBA Database:

ABOUT RELIANT

Real Life Example Continued...

# of Transactions 409	(000's)		Price / Sales	Price / Earnings
	Annual Sales	Discretionary Earnings		
High	\$7,800	\$370	6.89	128.00
Mean	\$571	\$71	0.37	4.18
Median	\$429	\$60	0.32	2.23
Low	\$0	(\$3)	0.03	0.13
	Standard Deviation		0.42	10.00
	Coefficient of Variance (CofV)		1.11	2.39

The reader is clearly able to determine that there were 409 transactions for this SIC code, along with the high/low sales prices, earnings and multiples. Additionally, we see both CofV's are higher than 1.0, which means there is disparity in the data. (Valuation multiples with the lowest CofV are those with the least dispersion around their respective means and may be the better indicators of value. –Pratt's Stats FAQ)

Next, I explain to the reader how I was able to arrive at the final 14 transactions.

- Limit annual sales range to \$900M to \$1.3MM (subject business grosses \$1.1MM)
- Remove any transactions that have a Price / Earnings multiple over 8x (determined to be outliers using regression analysis included in report)
- Remove businesses with descriptions that include check cashing sales, drive through store, and deli sales (unrelated to subject business)

The following data remains:

# of Transactions 14	(000's)		Price / Sales	Price / Earnings
	Annual Sales	Discretionary Earnings		
High	\$1,300	\$273	0.51	4.78
Mean	\$1,109	\$141	0.31	2.71
Median	\$1,118	\$123	0.30	2.77
Low	\$941	\$46	0.10	1.18
	Standard Deviation		0.13	1.01
	Coefficient of Variance (CofV)		0.41	0.37

By comparing the two different tables, the reader can see that the CofV for both multiples is closer to 0.40, which shows much lower dispersion from the mean than the initial search result. A majority of the time, the median multiples are used instead of the mean as the measure of central tendency, thus minimizing the effect of any extreme value. In this specific report, I chose the median multiples for both, as the subject business was very similar to the industry as a whole (if different multiples were selected, explain why!).

The above tables and explanations are just partial excerpts from a valuation report I compiled, but they should give SBA lenders a good idea of what they should be looking for when reviewing business valuations. Since the Market Approach is usually weighted so heavily in the reconciliation section of the appraisal report, this method should be completely transparent and the appraiser should provide as much detail as possible to make it easy for the reader to understand how the final multiples were calculated. As an SBA lender, you should receive reports with this level of granularity; otherwise, it is difficult for you to ensure the information you are receiving is accurate or reasonable.

Mission Statement

Our certified appraisers use their unique business ownership and valuation experience to produce high quality reports in a timely and efficient manner. Our firm strives to provide excellent service through collaboration and open communication with our clients.

Contact Us

Feel free to contact Neal Patel with any comments or topic suggestions for future newsletters. You can also request a sample valuation report from us at any time.

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9:00am to 5:30pm, EST



Recent Reliant Value Multiples

SIC Code	Business Type	Value (inc. inventory)	Final Value Multiples*		State or Region
			Price to Sales	Price to SDE**	
5921	Liquor Store	\$ 500,000	0.46	3.5	MA
5921	Liquor Store	\$ 790,000	0.37	3.2	TX
5541	Gasoline Station	\$ 920,000	N/A	2.7	NC
5411	C-Store (no gas)	\$ 390,000	0.38	3.1	NJ
3479	Powder Coating	\$ 440,000	0.72	2.6	North East
7389	Business Services	\$ 675,000	0.62	2.4	IL
5812	Eating and Drinking	\$ 1,200,000	0.32	2.3	FL
5812	Eating and Drinking	\$ 625,000	0.36	2.8	CA
1799	Specialty Construction	\$ 530,000	0.76	2.4	North East
8351	Child Day Care Center	\$ 520,000	0.79	3.9	NJ

* Sales and SDE are appraiser's projections

**SDE = Seller's Discretionary Earnings

Recent Transactions

Find Out What Businesses Are Selling For in the SBA Marketplace

Reliant Business Valuation conducts certified valuations for SBA Lenders around the nation. Each month, we will show you some recent transactions, and their respective sales and earnings multiples. Do not use this data for valuation purposes, but simply as industry rules of thumb. Remember, you might see different multiples for the same business type, and this is normal. Valuation is more than just applying multiples – the appraiser must take into account various factors, and must consider the financial strength of each individual business compared to the industry in order to attain an accurate value.



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UPCOMING EVENTS

- SBA America East
 - Portland, ME
- NAGGL
 - Anaheim, CA



Conference for SBA Lenders

August 29 – September 1, 2010
Holiday Inn - Portland, ME

Reliant Business Valuation is proud to be an **exhibitor** at the annual America East Conference for SBA Lenders. Please stop by our booth and drop off your business card during any of the three days, and you'll have a chance to win a FREE APPLE IPOD TOUCH (3rd Gen) (\$200 value)! We'll have other cool giveaways, along with copies of demonstration reports and newsletters.



October 26 – 28, 2010
Disney Hotel - Anaheim, CA

Reliant Business Valuation is proud to be a **SILVER SPONSOR** and **exhibitor** at this year's NAGGL Annual Conference in Anaheim, CA. Please take a moment to visit us at **booth #50** to get your card stamped, and have a chance to win a FREE APPLE IPAD 16GB (\$500 value)! The conference will be held at the Disney Land Hotel & Resort, with a Disney Pirates Theme, so bring your pirate hooks, eye patches and gold coins!