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Secrets to Business Valuation

Factors that
Influence
Business Risk



Expert vs Expert



\$2,600,000 or \$7,900,000

Google or General Motors

Google



Covid & PPP



U.S. Small Business
Administration

**PAYCHECK
PROTECTION
PROGRAM**







Financial Records Housekeeping

- Record all sales and expenses
- Eliminate co-mingling assets
- Do your own due diligence
- Eliminate marginal “perks”
- Compliance with taxing authorities
- Clean the balance sheet and income statement
- Organize and make records available





Considerations in Determining Value

- Seller's discretionary earnings/cash flow
- Value of tangible assets
- Value of intangible assets (reputation, goodwill, copyright, etc.)
- Comparable sales
- Replacement value
- Marketability factor
- Market segment
- Territory rights

What Is the Value of Your Business to Buyers?

Value Drivers:

- Earnings stability
- Gross profit percentage
- Reputation/image
- Customer loyalty/continuing customers
- Customer diversity vs. concentration
- Personnel retention/management depth
- Historical and projected growth rates
- Market size and penetration rate
- Key locations

All Three (4?)



**Asset-Based
Approaches**



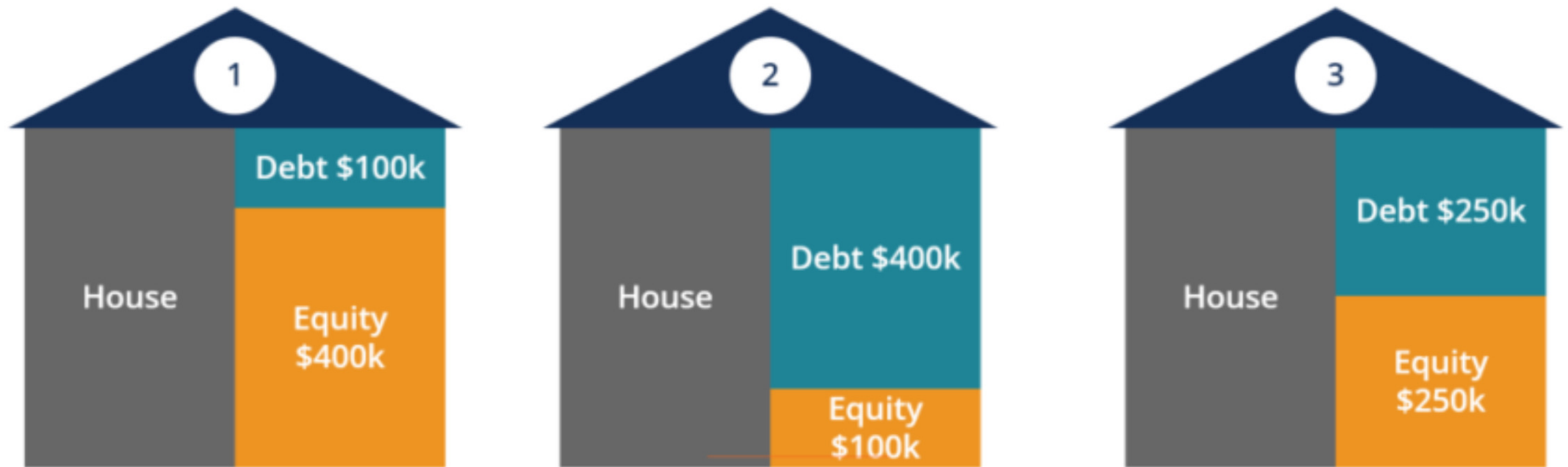
**Earning Value
Approaches**



**Market Value
Approaches**

❖ **SBA 7A**

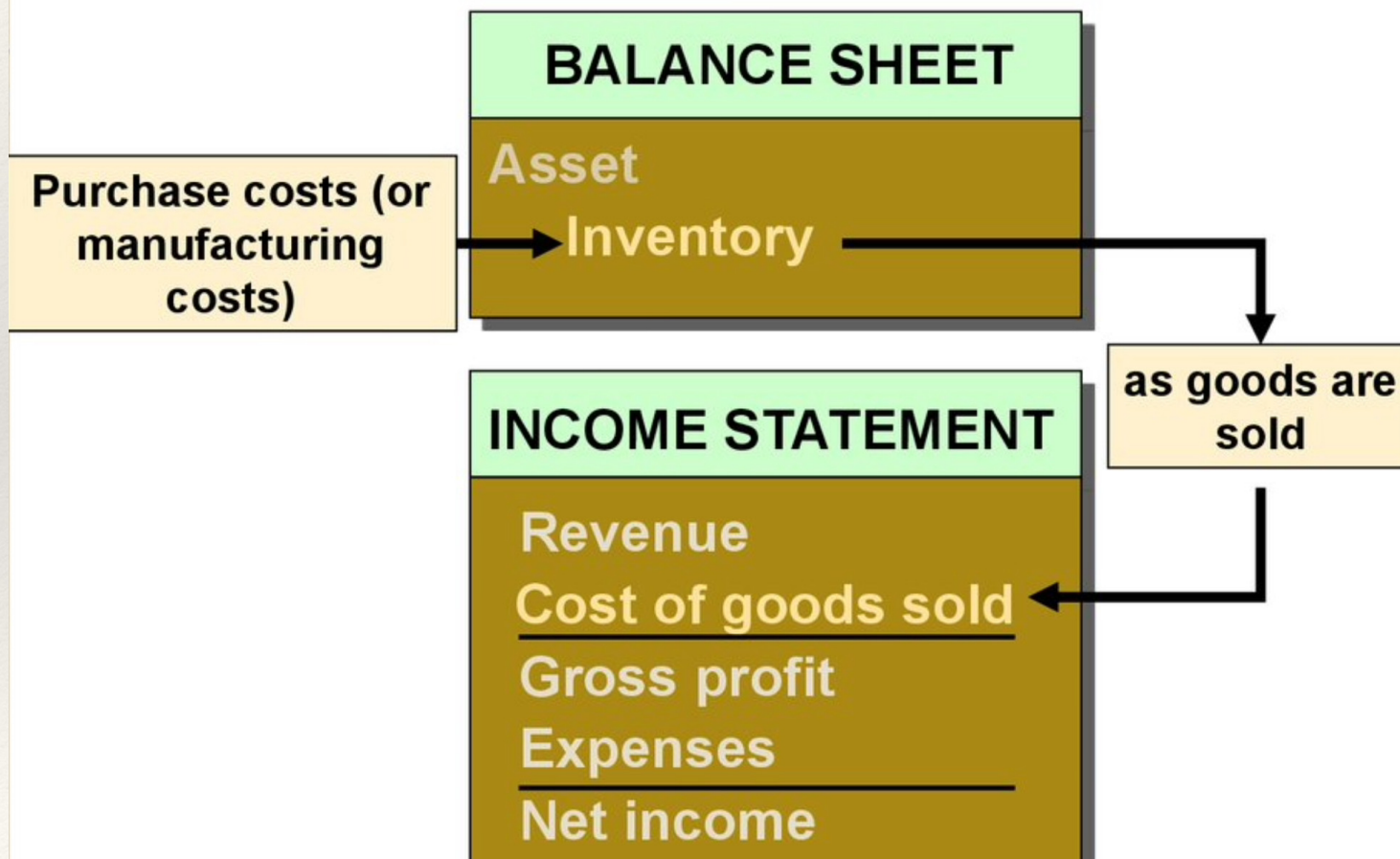
Enterprise Vs Equity



- ❖ Misinterpreting an enterprise value as an equity value will often result in an inflated value

Hidden GL EOY Adjustments

The Flow of Inventory Costs

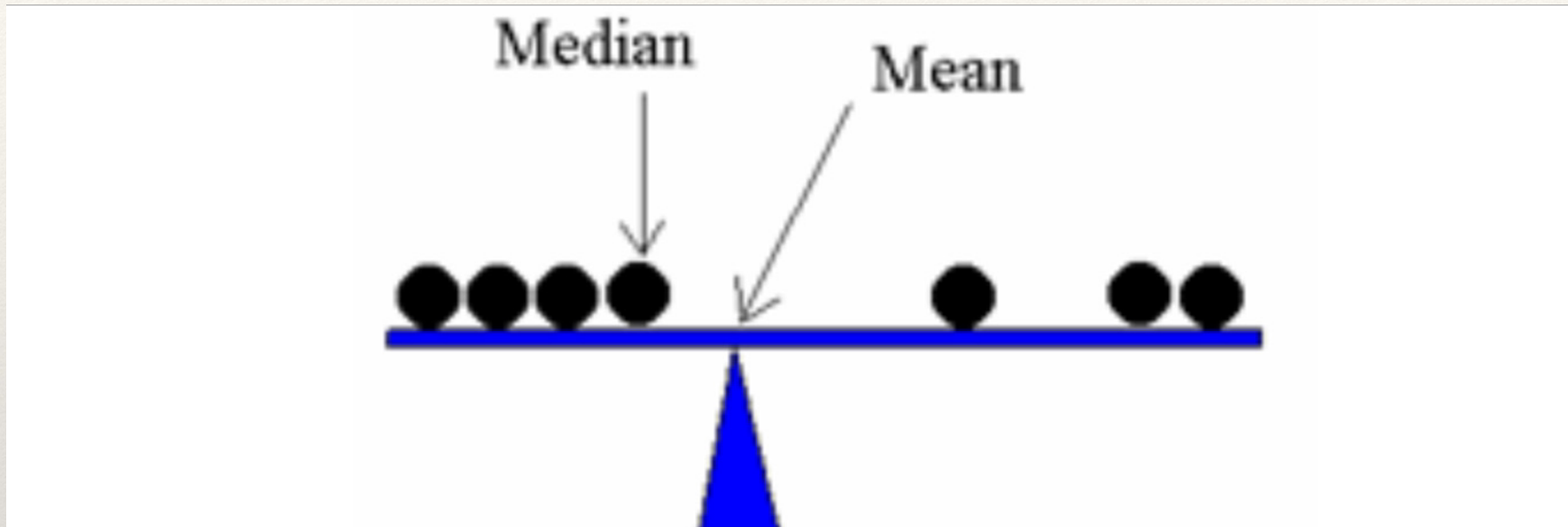


Real Estate Double Dip



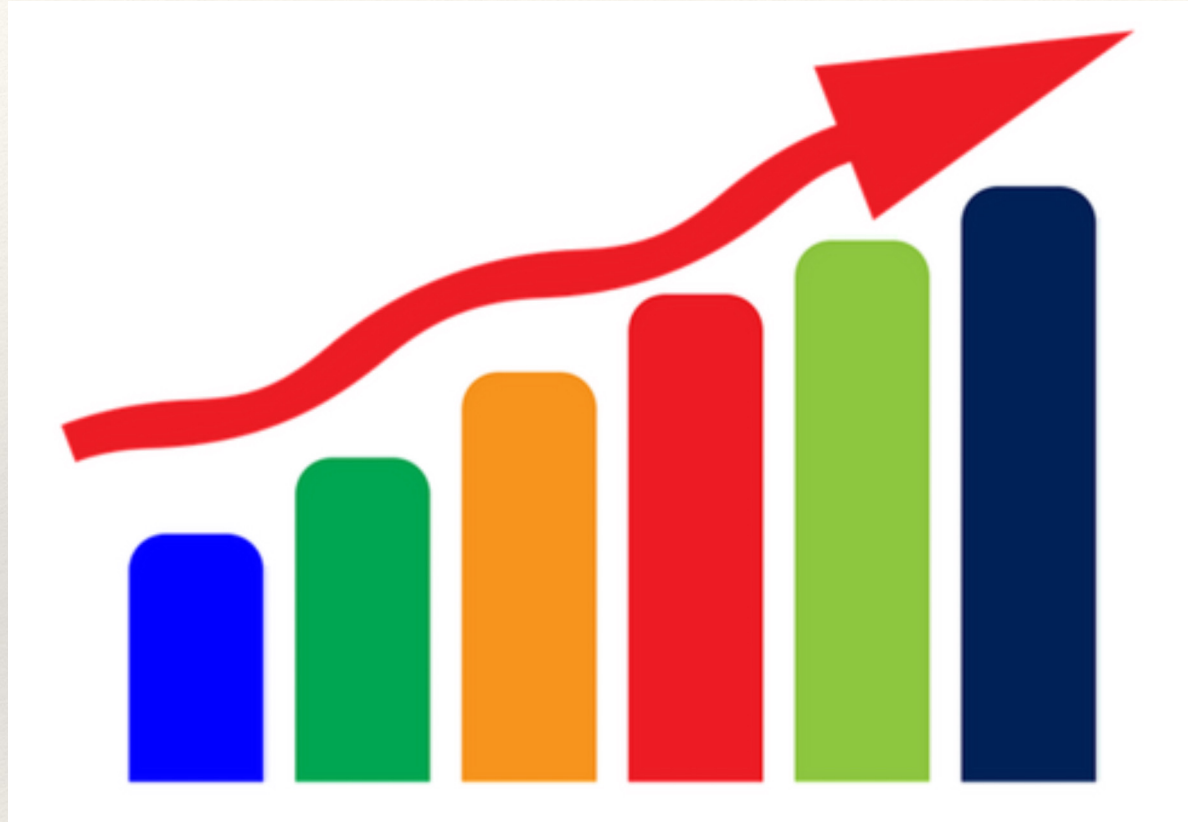
- ❖ Remove, FMV Lease, Conclusion + FMV Real Estate

Market Method No Detail



- ❖ Harmonic
- ❖ Coefficient of Variation
- ❖ Age, Size, Target vs Global
- ❖ NAISC Wing Span

Growth Rate No Reference



❖ Fact vs Fiction

“Growth Potential”?

- Buyers will not **pay** money for “growth potential”
- They will **pay** only for current and past performance of the seller’s business



Tangible Assets Not FMV



- ❖ Certified M&E Appraisal > 50%

Liberal Normalized Adjustments

- ❖ Owner Compensation = Reasonable Compensation?
- ❖ Depreciation
- ❖ Interest
- ❖ Capital Cost Investment - 3YA
- ❖ Contributions

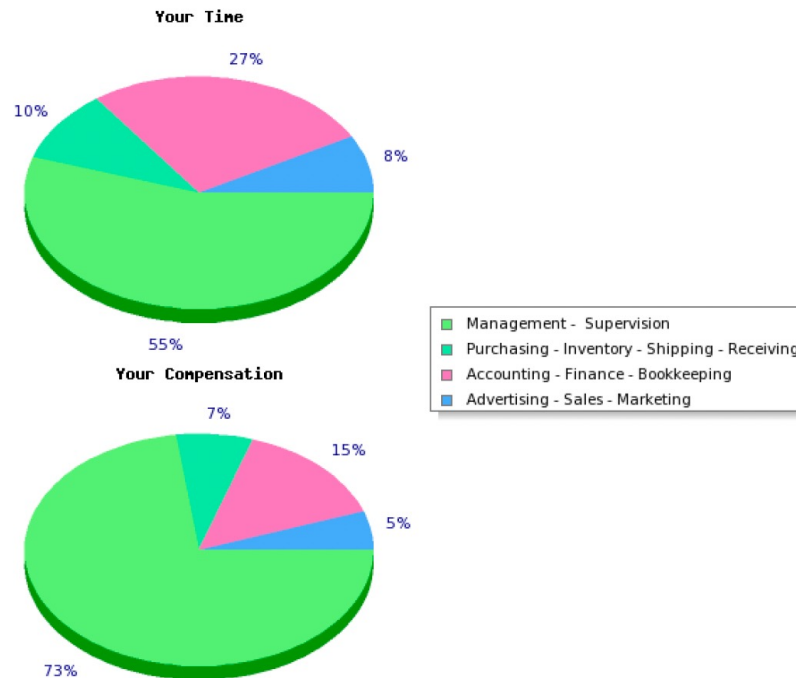
Subjective No More

2020 Report for Joe Smith of Wood Factory

Your estimated annual Reasonable Compensation: \$107,883

Thank you for entrusting Roland Davis of Davis Business Appraisers with your Reasonable Compensation analysis. This report provides a reasonable estimate of the value of services rendered to your company based on the duties and responsibilities that you perform annually. The valuation of most businesses requires the owner(s) and key managers to have their compensation *Normalized*. Reasonable Compensation is defined as "The hypothetical replacement cost of an owner or key manager of a business".

The calculated salary of **\$107,883** was determined to be Reasonable Compensation based on the type of work performed, the skill level of the work performed and the number of hours the work is performed annually. You told us that you work **1924** hours per year in **Virginia Beach city, VA**. Our analysis indicates the annual salary of \$107,883 would be a reasonable cost to hire employee(s) to perform the duties and responsibilities that you currently perform.

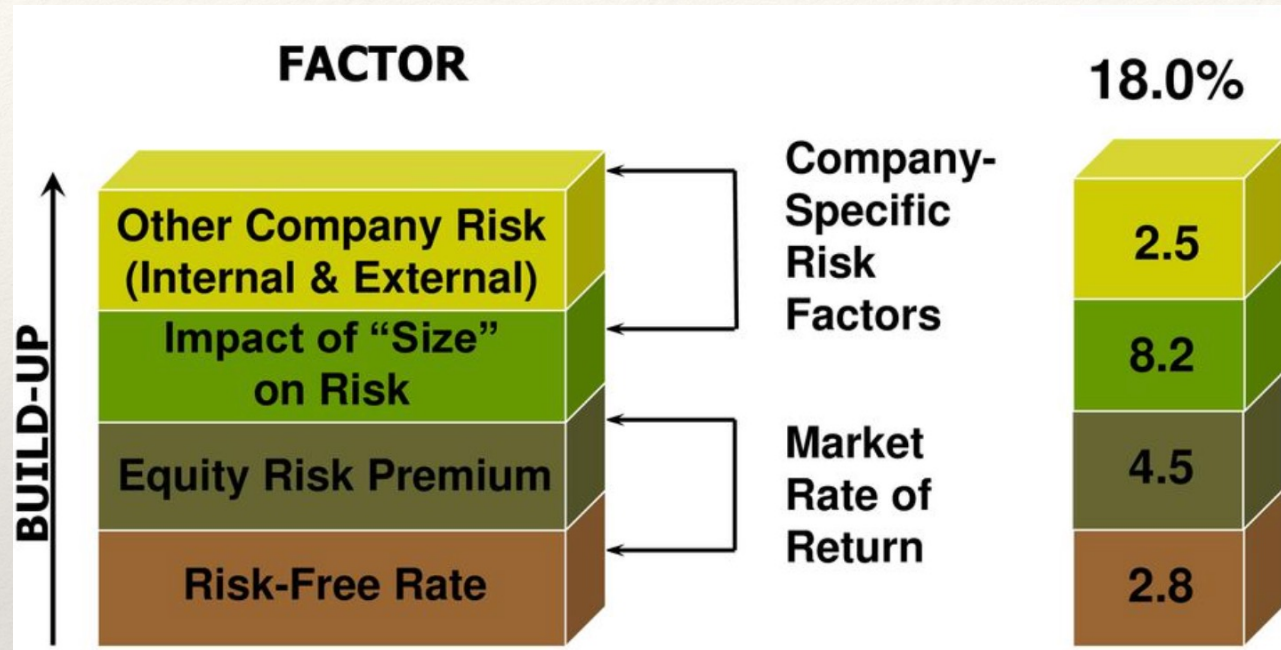


Wrong Income Method



- ❖ Capitalization of Cash Flow - Consistent
- ❖ Discounted Cash Flow - Erratic
- ❖ Cash vs Accrual (Compilation, Review, Audit)

Public vs Private



- ❖ From 1926
- ❖ Dramatically Larger – Be in Range
- ❖ Explain Reasoning for Percentage Decisions

Discounts or Not



Tax Effect or Not



Traits of a Marketable Business

- Increasing Revenue & Cash Flow
- Complete Financial Documentation
- Continuity of Ownership
- Facility Lease (6-8%)
- Terms of Sale
- Condition of Premises
- Existing Management & Personnel

What, Why, How, Financing, Opportunity

For More Information

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