



BUSINESS VALUATIONS FOR SBA PURPOSES

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CATEGORIES OF APPRAISALS

- Real Estate
- Equipment and Tangible Property
- Business Enterprise
- Intangible Property

Note: The term appraisal is the same as valuation

SBA SOP 50 10 5(J): CHANGE OF OWNERSHIP

- Determining the value of a business is the key component to the analysis of any loan application for a change in ownership.
- Change in ownership typically re-evaluates what the business assets are worth and may identify new intangible assets.
- A business valuation helps the buyer determine that the seller's asking price is supported by an independent qualified source.

SOP 50 10 5(H) APPRAISAL REQUIREMENTS

- If the amount being financed (including 7(a), 504, seller and other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less – the lender may perform it's own appraisal.

SOP 50 10 5(H) APPRAISAL REQUIREMENTS (CONTINUED)

- If the amount being financed (including 7 (a), 504, seller, or other financing) minus the appraised value of real estate is greater than \$250,000 or if there is a close relationship* between buyer and seller – the lender must obtain an independent business appraisal from a qualified source.

* Close relationship is between existing owners or family members

QUALIFIED SOURCE

- ✓ Accredited in Business Valuation (ABV) through the American Institute of CPAs.
- ✓ Certified Valuation Analyst (CVA) through the National Association of Certified Valuation Analysts.
- Accredited Senior Appraiser (ASA) accredited through the American Society of Appraisers.
- Others: Certified Business Appraiser, Accredited Business Certified Appraiser

SPECIAL PURPOSE PROPERTIES

- Is a limited market property with a unique physical design, special construction materials, or a layout that restricts its utility to a specific use.
- Same thresholds apply.
- Real estate appraisal must be completed by a Certified General Real Property Appraiser with experience of no less than 4 similar properties within last 36 months.
- **Must allocate separate values to the individual components of transaction: land, building, equipment, intangible assets.**

SCOPE OF WORK

- Retained by lender
- Identify if asset purchase or stock purchase
- Report must include:
 - Opinion of value
 - Qualifications of appraiser
 - Signature and certification
- May not use appraisal prepared for the buyer or seller. **MUST BE INDEPENDENT!**

INTERESTING POINT

- Lender must obtain a copy of the financial information relied upon by the individual who performed the appraisal and verify that information against the seller's IRS transcripts to ensure accuracy of the information.
- *Nearly impossible to do!*

INITIAL CONSIDERATIONS

- Discuss with lender:
 - Nature of business
 - Size of business
 - Nature of the transaction
 - Who is buyer/seller
 - Nature of tangible and intangible assets
 - Is real estate and/or equipment appraisal needed?

STEPS IN AN SBA APPRAISAL

- Engagement letter with lender
- Information request sent to bank's client
- Retainer
- Review information with client
- Valuation analysis
- Report (usually draft sent first to verify information)

SAMPLE OF INFORMATION REQUESTED

- 5 years financial statements and interim statement
- 5 years tax returns
- Owner/key management compensation – 5 year history
- Current fixed asset/depreciation list
- Other background information in the information request.

BASIC ASSUMPTIONS

- Standard of Value: Fair market value of the enterprise
 - Willing Buyer/Willing Seller
 - No compulsion to buy or sell
 - Both knowledgeable of the facts
 - Cash price
- Premise of Value: Going concern
 - Will continue in business as currently run

VALUATION METHODS WE USE

- Income approach
 - Capitalized returns (multiple of earnings)
 - Discounted cash flows
- Net asset value
- Market approach

INCOME APPROACH

- Most often use Capitalized Returns Method
 - Based on adjusted historical cash flows of business.

Example:	
Adjusted cash flow of ABC Company	\$1,000,000
Divided by the Capitalization rate	18%
Fair Market Value (assuming no discounts)	\$5,555,555
Round to	\$5,555,000

Same as 5.6 multiple

ARRIVING AT ADJUSTED CASH FLOW

- Determine historical cash flow
- Add back:
 - Non-cash items such as depreciation and amortization
 - Excess/discretionary benefits to owners
 - Normalize officer salary (Convert to market rate compensation, increase or decrease)
 - Normalize rents
 - Add interest expense/deduct interest income

ARRIVING AT THE CAPITALIZATION RATE

Most information is obtained from published studies:

Risk free rate – 20 year treasury rate <ul style="list-style-type: none"> Historical average since 1926 or current 	4.0%
Equity risk premium	5.0%
Risk Premium for size	5.5%
Appraiser Judgement <ul style="list-style-type: none"> Company and industry risk premium 	3.5%
Capitalization rate	18%

ENTERPRISE VALUE

- Value of total assets less current liabilities.
- Different from equity value

EXAMPLE OF ENTERPRISE VALUE

Example:

Fair Market Value as calculated		\$5,555,000
	Current Assets	\$2,500,000
	Less current liabilities	(1,000,000)
	Net working capital	1,500,000
	Equipment at FMV	2,000,000
	Goodwill and other intangibles	2,055,000
	Total Enterprise value	\$5,555,000

This is the value of assets you will lend against!



COMPARE TO FMV OF EQUITY VALUE

Current Assets		\$2,500,000
Equipment at FMV		2,000,000
Goodwill and other intangibles		2,055,000
Total Assets		\$6,555,000
Current Liabilities		\$1,000,000
Long – term debt	\$5,555,000	2,500,000
Equity		3,055,000
		\$6,555,000

DISCOUNTED CASH FLOWS

- SBA prefers Capitalized Returns Method because it is based on historical information.
- However if there is substantial proof of future growth in cash flows, the DCF method will produce a higher value.
- Requires a 5 year cash flow projection that appraiser and bank are comfortable with.
- These cash flows are discounted back to present value using a discount rate.

MARKET APPROACH

- Find comparable companies in various data bases.
 - Transactions
 - Public company price earnings ratios
 - Apply these ratios to subject company cash flows
- Very difficult to find comparable companies so not used very often.

THE REPORT

- We prepare a Summary Report
 - Opinion letter
 - Company background information
 - Industry information
 - Economic information
 - Financial analysis of the company
 - Conclusion of value
 - Method used (including calculation exhibits)
 - Methods not used

Q & A

CONTACT DETAILS



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