

Reviewing a Business Valuation for SBA Loans

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11:00 a.m. Eastern

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at 888-796-6118



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Acknowledgement

*We would like to thank **Mike Size** for his time and providing information regarding his experiences in lending and working on SBA loans from his perspective.*

All opinions, conclusions, and/or recommendations expressed herein are those of the presenter and does not necessarily reflect the views of the SBA.



Curriculum Vitae

- Accredited Valuation Analyst by the National Association of Certified Valuators and Analysts (NACVA)
- Accreditation in progress from the American Society of Appraisers (ASA)
- Completed 2,000+ business valuations



Key Understanding

A business valuation assists the buyer in making a determination that the seller's asking price is supported by historic operations and permits the buyer to make a reasonable return on his or her investment.



When is a business valuation required?

They are required for ALL change of ownership transactions.



When is an independent business valuation required

- a) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less, the lender may perform its own valuation of the business being sold, unless the lender's internal policies and procedures require an independent business valuation from a qualified source.
- b) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment is greater than \$250,000 or if there is a close relationship between the buyer and seller (for example, transactions between family members or business partners), the lender must obtain an independent business valuation from a qualified source.



What is a qualified source?

A “qualified source” is an individual who regularly receives compensation for business valuations and is accredited by one of the following recognized organizations:

- 1. Accredited Senior Appraiser (ASA) accredited through the American Society of Appraisers;
- 2. Certified Business Appraiser (CBA) accredited through the Institute of Business Appraisers;
- 3. Accredited in Business Valuation (ABV) accredited through the American Institute of Certified Public Accountants;
- 4. Certified Valuation Analyst (CVA) accredited through the National Association of Certified Valuation Analysts; and
- 5. Accredited Valuation Analyst (AVA) accredited through the National Association of Certified Valuation Analysts.

A new change to the SOP in 2014 is that a CPA without one of the credentials listed above is not considered a qualified source.



Why Would You Need to Perform an SBA Valuation

- Purchase
- Restructuring
- Make sure the appraiser includes these details.



SBA approved valuation structures

- Asset Sale
- Stock Sale
- Make sure the structure is clearly stated in the appraisal, and how it affects the report.



Standards of Value

- Fair Market Value (approved)
- Fair Value (not approved)
- Strategic Value (not approved)



Signature and Certification

- The report should have the signature of a qualified source.
- The certification should walk the Lender through a series of statements that verify independence.



Report Date vs Valuation Date

- Report Date is the date that the report is completed.
- Valuation Date is the effective date of the appraisal.
 - Should be no more than 6 months from the Report Date.



Description of the Business

- This should be a summary of:
 - History and Operations
 - Company Ownership and Management
 - Employees
 - Sales and Marketing
 - Competition
 - Location
 - Legal and Regulatory
 - Strengths and Weaknesses
 - Expectations and Outlook



Financial Analysis

- A common size analysis of the company compared to similar sized companies in the industry.

Company Size by Assets	\$1M-\$5M	2014	2015	2016	2016
Company Count	2,083	9/30/2014	9/30/2015	9/30/2016	11/30/2016
Income Statement					
Net Sales	100%	100.0%	100.0%	100.0%	100.0%
Gross Margin	37.05%	24.0%	27.5%	29.1%	28.5%
Officer Compensation	3.01%	1.1%	1.3%	1.5%	0.0%
Advertising & Sales	0.22%	0.2%	0.2%	0.2%	0.0%
Other Operating Expenses	29.16%	18.8%	25.9%	24.4%	21.6%
Operating Expenses	32.39%	20.0%	27.4%	26.2%	21.6%
Operating Income	4.66%	4.0%	0.1%	2.9%	6.9%
Balance Sheet					
Cash	19.31%	9.0%	2.3%	9.1%	9.6%
Accounts Receivable	34.97%	14.6%	13.4%	19.6%	14.9%
Inventory	2.11%	11.1%	8.8%	9.0%	11.2%
Total Current Assets	64.01%	40.1%	30.2%	39.9%	42.7%
Property, Plant & Equipment	23.61%	42.3%	47.7%	44.4%	42.2%
Other Non-Current Assets	12.38%	17.7%	22.1%	15.7%	15.1%
Total Assets	100.00%	100.0%	100.0%	100.0%	100.0%
Accounts Payable	27.29%	14.2%	11.6%	10.7%	11.5%
Total Current Liabilities	36.62%	24.5%	23.5%	28.0%	15.7%
Total Long Term Liabilities	16.79%	17.2%	12.1%	8.6%	19.4%
Net Worth	46.60%	58.4%	64.5%	63.4%	64.9%
Financial Ratios					
Quick Ratio	1.48	1.2	0.9	1.1	2.0
Current Ratio	1.75	1.6	1.3	1.4	2.7
Total Debt to Net Worth	1.17	0.4	0.4	0.4	0.4
Fixed Assets to Net Worth	0.52	0.4	0.5	0.4	0.4
Interest Coverage	29.99	11.1	1.3	10.9	21.7



Deal Structure

- What's included/excluded in the sale.
 - Inventory
 - Cash
 - A/R
 - Personal vehicles



Asset Approach

- Determine the Book Value
- Adjusted Net Asset Method



Income Approach

- Two different types of Cash Flow Methods
 - Capitalized Earnings
 - Discounted Earnings



Typical Adjustments

- Make sure that the adjustments made by the appraiser seem reasonable.
- Analyze Net Discretionary Cash Flow
 - Rent
 - Officer Compensation
 - Vehicle
 - Travel
 - Non-recurring Income/Expenses
 - Other



Market Approach

- Public Comparison
- Private Comparison
- Prior Sales of Interest
- Make sure the pool of comparable sales is adequate. 3-4 would be a minimum.
- The more the better
- Use only one database



Weighting

- Multiple Approaches and Methods have been used. Some form of a weighting system should be used:

<i>Valuation Methods Utilized:</i>				
Capitalization of Earnings Method	9	\$2,439,400	80%	\$1,951,520
Comparable Private Transaction Method - Price-to-Revenue Multiplier	10	\$3,193,300	10%	\$319,330
Comparable Private Transaction Method - Price-to-SDE Multiplier	11	\$2,373,000	10%	\$237,300
Estimated Fair Market Value of 100% Equity				<u>\$2,508,150</u>



Sanity Checks

It is important to consider the reasonableness test of the conclusion. A final step in the valuation process is to assess the “reasonableness” of the values indicated by the various valuation methods. Three sanity checks are:

- 1. Purchase Price Reasonableness Test
- 2. Rate of Return
- 3. Subject Company Multiples



Other items

- Make sure that the appraiser considered:
 - Tax affecting the cash flow
 - Including a CAPEX Reserve
 - A growth rate in line with the company and the industry?
 - Multiple methodologies
 - Discounts – provide detail
 - Historic financial information
 - Statement of Assumptions and Limitations
 - Economic Outlook
 - Industry Outlook
 - Appraiser Qualifications
 - Reference Materials



Conclusion of Value

- The SBA requires that the business valuation be completed as an opinion of value. The NACVA has two acceptable levels of reporting.
 - Conclusion of Value – Opinion
 - Calculation of Value – Non-Opinion



Goodwill Analysis

- Each report should provide the Lender with a Goodwill analysis. It is not necessary to break down the goodwill into its components (customer list, blue sky, patents, goodwill, etc)

Fair Market Value of a 100% Equity Interest	\$2,508,000
Book Value of Debt	\$199,178
Enterprise Value	(rounded) \$2,707,200
Cash (from Sch 2)	\$166,629
Accounts Receivable (from Sch 2)	\$258,538
Inventory (from Sch 2)	\$193,803
Other Current Assets (from Sch 2)	\$123,087
Net Fixed Assets (from Sch 2)	\$733,611
Net Other Assets (from Sch 2)	\$0
Assets Assumed	(rounded) \$1,475,700
Estimated Goodwill (Enterprise Value less Assets Assumed)	(rounded) \$1,232,000



Non-Operating Assets

- Commercial Real Estate
- Stocks and Bonds
- Related entities
- Were these items added back to the value of the operating entity to determine the value of the enterprise?



Typical Documents Include

- Three Years of business income taxes of the selling entity for the three most recent years available, or Profit and Loss statements and Balance Sheets for the selling entity for the three most recent years, if taxes are not available.
- Most current, Interim Profit and Loss statement (must be within 6 months, 3 months preferable, of valuation completion date).
- Most current, Interim Balance Sheet (must be within 3 months, 3 months preferable, of valuation completion date).
- Purchase Agreement/Deal Structure
- Approximate listing of furniture, fixtures, equipment, and sellable inventory at current market value (estimated).
- Marketing materials, photos, or other helpful documentation.
- Signed and Completed management interview/questionnaire.



When in doubt

- Contact the Lender Relations Specialist at your SBA District Office –
<https://www.sba.gov/tools/local-assistance/districtoffices>
- Contact Mike Size, Portside SBA Valuation, at (406)493-1651 or mike@portsidesba.com

