

DETERMINATION OF RELATIVE VALUE

By Pat Harkins

When you talk about the value of a prospective client's business, how often is he disappointed in the selling price that you recommend? Unfortunately, if you have been in business brokerage for any length of time, this happens much more frequently than you would like. (For purposes of this discussion, we are considering businesses with values of \$3,000,000 or less.) At this juncture, you begin the arduous process of educating your client. Before considering the nuances of his individual business, I like to review several concepts with him. These concepts include:

- 1) *Ninety percent of the profitable businesses will sell for a multiple of Discretionary Cash Flow (DCF) of between 1.6 times DCF and 3.4 times DCF. For support in this regard, I show the clients excerpts from completed sales in the Georgia BBMS System, BIZCOMPS, Pratt Stats and those businesses currently for sale in BizBuySell. (For simplicity purposes, we will define DCF as the aggregate sum of owner's compensation, adjusted depreciation, interest expense, income before taxes along with any other documented discretionary expenditures. Implicit in this process is the normalization of cash flow for non-recurring revenue and/or expense streams.)*
- 2) *This business will compete with not only the businesses in the seller's discipline (manufacturing, wholesale, services, etc.) but with all companies that are for sale. A prospective buyer will examine the portfolio of companies available in his desired geographical region and select that business that provides the greatest value for his invested dollar.*

upon a number of factors that determine overall value. The higher the company ranks among the following factors, the greater will be its selling price as a multiple of DCF:

- 1) *The customer base is well distributed across a number of customers, with no one customer accounting for more than 5% of revenue. Moreover, the company is not reliant upon any one sector of the economy but sells through a cross section of business categories.*
- 2) *The company has a four-year history of increasing revenues and discretionary cash flow coupled with a history of attractive gross-profit margins.*
- 3) *The company operates in a specific niche of the market and has a strategic competitive advantage when measured against its competition. There is nothing foreseen in the future nor are there substitutes that appear to challenge the company's profitability. This factor is enhanced with the presence of specific items of intellectual capital as evidenced by patents, copyrights, et cetera.*
- 4) *When reviewing the tax returns of the selling entity for the past three years, the summation of taxable income, depreciation, interest expense and owner's compensation will be sufficient to fund an 80% loan amortized over 10 years at 150 basis points over prime, plus a cushion of 25% of that debt service, along with a reasonable salary for a new owner. In transactions equal to or less than \$2,500,000, this in itself should permit the financing to be accommodated by an SBA lender provided that the buyer infuses a 20% down payment.*
- 5) *The owner is honest and straightforward and is willing to spend the required amount of time as determined by the buyer to fully transition the prospective candidate into the operation of the company.*

While the aforementioned items are not a comprehensive list of items an owner must consider when pricing his business, they certainly give him a mile-high perspective of how his business compares to the portfolio of all other businesses currently offered for sale and those that have been sold.

MEETING NOTICE:

GABB BYLAWS / RULES AND REGULATIONS OF BBMS DISCUSSION

TUESDAY, SEPTEMBER 25, 2007, 10:30 AM

SOUTH TERRACES BUILDING

115 PERIMETER CENTER PLACE, NE ATLANTA, GA 30346

AFFILIATES CORNER:

SEPTEMBER...BOBBY GOFF, MAGNET BANK

"Please join Bobby as he hosts our Popular Affiliate's Corner Networking starting at 10 AM. Be early for some great complimentary refreshments!"

At what point along the continuum of DCF the business will sell will depend

MEET A MEMBER

JOSH MERRY

Business Analyst
the Business House, Inc. | 770.534.6630
GABB Member: Agent, Since 2006 | Business Broker: 2+ years

How long have you been with the Business House?

I have been working full time with the company for just over 2 years now, but ever since Jeff (my father) started in the company, I have worked part-time.

What role do you play within your company?

I am a full-time business broker. Most of the time, I work with my clients; sometimes, I help out my co-workers with their clients.

What is the focus of your company, and how does it differentiate itself?

Our focus is to advise, appraise and advance our clients' needs and objectives with regard to selling, acquiring or transferring business enterprises in a professional, confidential, expeditious and thorough manner.

What are your company's target markets?

Companies around Metro Atlanta in the service, manufacturing, distributing, and medical segments.

What led you to this line of work?

My father owns a business-brokerage firm.

What experience did you have in doing transactions before you became a broker?

None.

Have you always lived in Atlanta? If not, where else?

While working on my first masters degree, I lived in Savannah, GA, for 2 years. I have also lived in Anderson, SC, and in St. Louis, MO.

Professional Affiliations

I am currently a member of IBBA and GABB.

Personal Affiliations

I am currently an assistant wrestling coach at Riverside Military Academy, in Gainesville, GA. I currently attend Lanier Christian Church.

All About You

I am a newlywed. I got married in June to a lovely lady named Wendy. She is the head of marketing and catering for a franchisee of Moe's Southwest Grill in Atlanta. As some of you might know, I went off to college on a wrestling scholarship where I wrestled all four years, and I was a three-time NCAA Division II Academy All-American, so that is the sport I love. Just about every spare moment I have I am doing something with wrestling. I am currently an assistant coach at Riverside Military Academy, where we have won 5 straight state champions. In addition to coaching, I also officiate wrestling on both the high school and collegiate levels. I also enjoy running. Just this past 4th of July, half of the members of the Business House, Inc., ran in the Peachtree Road Race, where I placed 438 overall of out 55,000 runners. My goal is to qualify one days for the Boston Marathon.

Accomplishments

Since I am fairly new, I do not have a lot of business brokerage accomplishments besides helping our firm, as a whole, sell companies, but I have currently taken all classes required to sit for the IBBA CBI exam.

MARK JONES

Regional Manager, Territory of GA, SC, NC (with my business partner, George)
Franchise Growth Systems | www.franchisegrowth.com | 404.444.3186
GABB Member: Affiliate, Since 2006

How long have you been with the company?

2 years

What is the market focus of your firm: what does it do?

Franchise Growth Systems acts as an independent sales department for about 20 different franchise concepts, marketing these concepts across the US. Usually, these companies are new franchises and hire us to create and implement a marketing and sales plan. We sell individual locations, multiple locations and, sometimes, entire territories (called a Master Franchise) for these franchises.

Our current list of client franchises include healthcare, fitness centers, fast food, printing industry, automotive repair and one of our newest, a coffee shop to compete with Starbucks.

What role do you play within your company?

I act as the sales rep for each franchise. Franchise sales is governed by the Federal Trade Commission, so it is my responsibility to follow the sales protocol set up by the FTC. There is a great deal of information that a prospective buyer would want to know prior to the purchase. However, the FTC does not allow the Franchisor to disclose this information. It is my job to work with the buyer and help him find the answers and information that the Franchisor is not allowed to disclose to the buyer. I meet with prospects and walk them through the step-by-step process involved in purchasing a franchise.

What is the particular focus of your company, and how does it differentiate itself?

Franchise Growth Systems selects the franchise companies we feel we can help and creates an exclusive marketing agreement with each franchise.

What are your company's target markets?

Many of our clients are referrals from business brokers. As I seem to constantly say, if a broker has a qualified prospect but just cannot find the right existing business for him to buy, do not let him walk out the door. Ask him if he might consider a buying a franchise. We can pay a referral fee of \$5K to \$40K just for making the phone call to me.

What led you to this line of work?

I spent 8 years in banking but finally decided it was not fun any more. I left the bank to run a Master Franchise company here in Atlanta (for 15 years) and have continued on in franchise sales and consulting.

Have you always lived in Atlanta? If not, where else?

I was born and raised right here in the Atlanta area. I graduated from Chamblee High School and then graduated from Georgia State University with a degree in management.

Professional Affiliations

Of course, GABB. Also member of the Building Owners and Managers Association (BOMA) and the North Fulton Chamber of Commerce.

Personal Affiliations

Elder (and founding member of) Chattahoochee Christian Church in Duluth, GA.

All About You

As mentioned earlier, I have lived in the Atlanta my entire life. I was in the 4th grade when they started building I-285. My wife, Darci, was born in Jackson, MS, but moved here when she was 1 year old (almost qualifies as a native, but not quite!) We have been married now for 25 years and have one child, our daughter Rachel. Rachel is 15, attends Northview High, and is on the Varsity Competition Cheerleading Squad.

I play tennis on 2 neighborhood tennis teams, and I enjoy boating on Lake Lanier (I learned long ago it is better to have friends with boats than to own one yourself).

We have a condo on the beach in Florida and go down several times each year. (GABB members qualify for the "Friends & Family Rate").

Accomplishments

My greatest accomplishment to date (other than raising a wonderful daughter) is starting a church. I grew up in the Christian Church (Disciples of Christ) and was asked to work on a committee looking at starting a church in the Johns Creek area where we lived. Along with one other family, we started having Sunday night services using ministers from other Christian Churches in the area (a different minister each week). With the financial help of Peachtree Christian Church in downtown Atlanta, we hired a minister and started regular Sunday morning services. We now have about 100 families and have built our first building on 12 acres we own on Bell Road in North Fulton County.

Tips/Advice for GABB Members

Franchises have about a 75% to 80% success rate. Starting a business is never easy, but a good franchise can provide a proven system that gives you step-by-step guidance and can eliminate many of the mistakes a start-up entrepreneur will make. The perfect candidate for a franchise is someone with business experience, not afraid of sales, and able to follow a step-by-step plan.

WWW.GABB.ORG

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