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Deal Readiness® Methodology High-Level Business Valuation

This document was prepared for Joe Jones on behalf of PMI Advisors

Disclaimer: In reading this report you accept and acknowledge that this report should not be considered as a valuation report. It is intended as an educational document that demonstrates valuation methodology using the raw financials supplied. No information contained in this report should be considered as conclusive.

Understanding Valuation Concepts

The valuation of a business is extremely complex because of the diversity of companies, industries and individual business performance that need to be considered. The less certain that your business appears as a predictable maintainable future income, then the higher the penalty you will pay in risk factors. In essence this will result in a lower valuation of your business.

Explanation of the Multiples of Earnings Methodology

This “multiples of earnings” methodology generally uses multiples of earnings before tax (adjusted). This method looks at your current earnings (adjusted) and multiplies this by a number usually ranging between 1 and 10.

The number that your adjusted net profit is multiplied by is based on an industry standard or perceived level of risk and investor "return on investment" criteria.

Note that the "adjusted" word means that you take your net profit and

- add back items such as depreciation, abnormal expenses or one-off payments and all salaries to the owner(s). You also add back any personal expenses including motor vehicle, telephone, travel and any other expenses of the owner that is not specifically related to the continuation of the business.
- You then need to subtract a nominal wage that would need to be paid to someone to manage your business if you were not there.

Please note that this valuation potential is based simply by placing the numbers supplied to us into our valuation models. This methodology attempts to value your business by combining existing financial performance with a “multiple” to determine the maintainable profit level into the future. The multiple is calculated by assessing the factors that would determine future risks. Some of these factors are listed in the next section.

Risk and Valuation

In a higher risk situation, the "Multiples of Earnings" methodology, would equate to a lower multiple or would result in the selection of an earnings figure based on historical performance rather than future performance. Most investments involving the acquisition of businesses are obviously motivated by the desire of the investor to make money. The three drivers that generally influence a valuation decision are:

- The amount of money that can be made from the investment;
- The level of risk in achieving those goals and;
- The type of work (industry) that the business operates in.

Some companies have developed intellectual property over years of research and development, packaged it and built it into a recognized brand name. In this case we need a mechanism to not only value what sales are today but also to consider the past development that will stimulate sales in future years. An investor that buys this company will reap the rewards of that R&D.

Examples of business factors that affect valuation

Before you sell your business, you should work on a planned program to review your operation in light of these risk factors. Even if we look at one particular industry and take two similar companies (in terms of their sales and profit performance for the last year) we might justifiably pay more money for one over the other.

Some typical examples that might lead to a marked difference in the valuation:

- One business appears to rely on the Directors and Owners and the other appears to rely on staff members. That means that when a potential buyer takes over the chance of success is much higher. I.e. relies on staff.
- One may be a new company and the other may be an established company with a 5-year trading history.
- One of the companies may have spent a considerable amount on R&D (Research and Development) that will lift their profits in the future.
- One may have developed long term contracts that will ensure the profit for the next 24 months, whereas the other will have to rely on winning contracts or work on a weekly basis.
- One may have an easily identifiable customer base that is very loyal and the other may have a high turnover rate.
- One of the companies may have developed a product that is positioned in a growth market and the other may not.
- One may be in a better geographical segment.
- One may have a brand that is more recognizable.
- One of the companies may have developed a worldwide patent that locks the brand into immediate worldwide distribution.
- One of the companies may be a dominant player in a niche whereas the other is a smaller player with a less of a competitive advantage in a wider marketplace.
- One business may be a strategic fit to the other business and therefore the acquiring business may be able to generate more profit in the future as a result of this strategic fit.

Then of course there are the intangible reasons:

- One has better systems in place when the buyer arrives.
- One appears more professional than the other.
- One negotiates a better deal based on future profits rather than historical performance.

Your business valuation will generally be less if:

- Your sales and profit history are in a downward trend.
- You are a relatively new company
- The market you are operating in is in decline
- Your products and services need considerable investment to continue on-going operations
- Your earnings are fluctuating
- There are competitive or industry trends that will make your business less profitable in the future.

The value of a business will also be assessed differently by different types of buyers. Consider that an investor's view of a business (maximum return on financial investment) will be different from a strategic investor buying a competitor (synergistic view of the merging of enterprises.) Each of these buyers will interpret the financials and risk in a different light and their final assessment of value would vary significantly.

Deal Readiness Rating®

The Deal Readiness Rating is determined upon completion of a detailed business assessment and is a combination of:

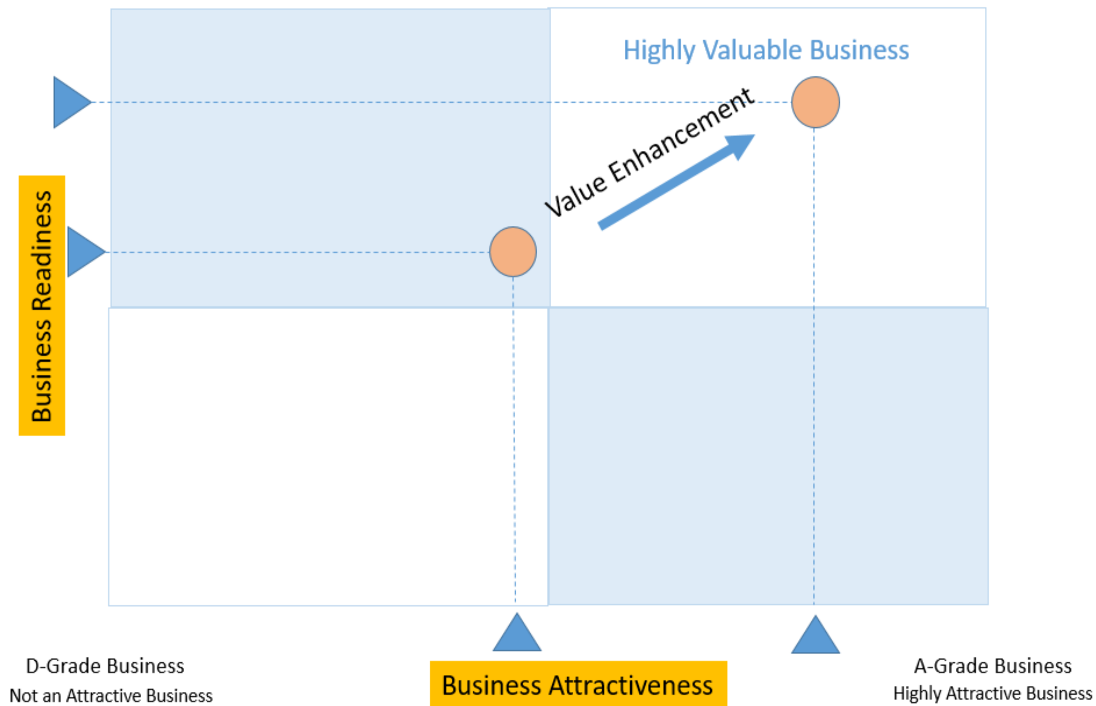
- **The Business Attractiveness Score** – This is intrinsically tied to the risk evaluation of your business, i.e., a riskier business will be less attractive. Furthermore, this logic dictates that the more attractive your business, the more you can sell it for.

- **The Exit Readiness Score –** Even if you appear as an attractive, low-risk investment for a potential buyer, actually, you might not be ready to sell. The majority of business owners are negotiated down in price at the time of due diligence because they are simply not ready. You can increase the amount of money you can sell your business for by making sure you have all the documentation, forms, contracts, financials, systems and processes in place prior to negotiation. Following are the areas addressed in the Assessment.

Business Attractiveness Criteria	Business readiness Criteria
Business Factors	**Business Readiness Areas**
Years of Business Operation	• Valuation Expectations
Management Strength	• Personal Expectations
Customer Loyalty	• Shareholder Goals
Branding	• Payment Considerations
Customer Database	• Value Readiness
IP & Technology	• Credibility and Justification
Staff Contracts	• Brand Issues
Location	• Marketing Documentation & Systems
Reliance	• Employee and Management Issues
Longevity	• Financials
Business Systems	• Management Systems and Forecasts
Forecast Factors	• Company Documentation
Profits	• Intellectual Property
Potential	• Customer Contracts
Revenue	• Expense Contracts
Revenue Streams	• Personal Knowledge
Recurring Revenue Streams	• Systems Processes
Market Factors	• Compliance Issues
Market	• Profit Improvement
Entering the Market	• Government Grants
Competitive Advantages	• Revenue Drivers
Place within Market	• Product Strategies
Economic Prosperity	
Investor Considerations	
Reasons for Selling	
Business Alignment	
Risky Investment	
Market Hype	

The assessment includes an analysis of your current business's readiness and your appeal to external investors. It includes a detailed review of up to 20 categories with up to 200 in-depth questions.

In general, the plan that we create that improves your business value is called value enhancement or value creation. This might then include, profit improvement, revenue growth, strategic planning, better resource planning, business accountability, your business model and vision etc. We will discuss these in more detail as we work with you.



Sometimes a business may look attractive to a potential purchaser but the majority of businesses sold or transferred are valued downward during due diligence or ignored completely if the business does not pass due diligence…that is why we have developed two segments of the assessment to get you ready.

Calculation of Business Value Goal

For Example:

Let’s say that in an industry the range is 1 to 4 times the profit (EBITDA) of $1.6 million. Therefore, the business could be valued at anywhere from $1.6 million (i.e. 1 x $1.6 million) to $6.4 (i.e. 4 x $1.6 million).

The Deal Readiness Rating identifies where you are in terms of risk to the potential purchaser. The higher your score the more valuable your business. Think of the Deal Readiness Rating (shown below as 85%) as a simple scorecard system ranking you somewhere in the range of being classified as a D-grade (1X) company or as an A-grade (4X) company.

If we then assume that out of all the businesses in the industry, this company would be ranked at about 85% or an A-B-grade business, then you could assume that the multiple will be at the higher end of the industry spectrum. In this case, it would be about 3.55 times profit ($5.68 million).

Your Business

In our discussions, we noted several factors relative to your business structure and operations:

- **Your Company Structure:** Limited Liability Company – Registered in Georgia
- **Your Company Shareholders:**

  Joe Jones – 51%
  Peter Jones - 24%
  Sarah Andrews 25%

- **Your annual revenue for the previous year was:** $12,000,000
- **Your Profit (EBITDA) for the previous year was:** $1,200,000

  Add-Backs for your salary, personal expenses, etc. $500,000
  Deduct salary for a replacement executive ($200,000)
  Adjusted Profit (EBITDA) $1,500,000

- **Your Industry:** General Contractor – Industrial
- **Location:** Central Georgia
- **Multiple Range:** 4X to 10X Multiplied by EBITDA
- **Value Range:** $6,000,000 - $15,000,000

See the results on the following pages:

Current Business Health

Deal Readiness Rating 40%

Estimated Value $9,600,000

After Value Optimization

Deal Readiness Rating 80%

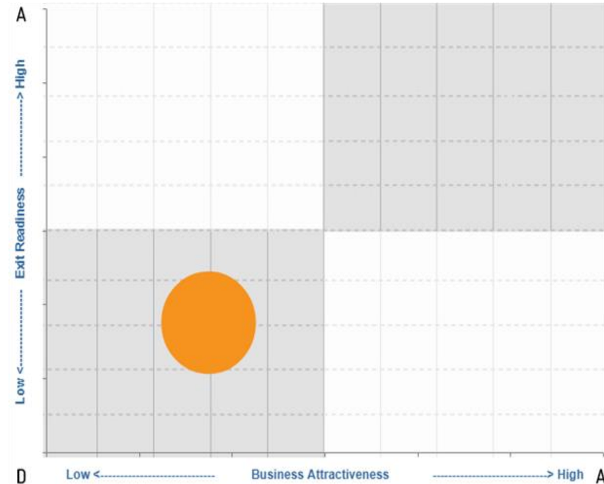
Estimated Value $13,200,000

Value Enhancement $3,600,000

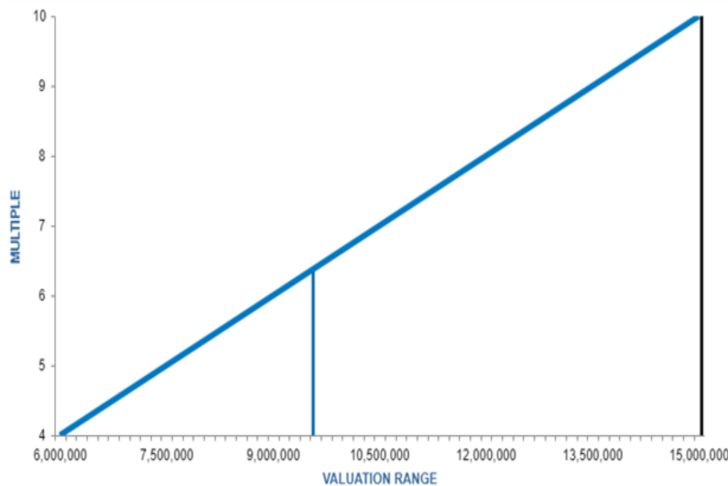
Deal Readiness Rating and Value - Current

In your case, for educational purposes, we estimated a Deal Readiness Rating of 40%.

- Your Business Attractiveness Score was calculated at 44%
- Your Exit Readiness Score was calculated at 36%



The Value Range provides you with an awareness of how your EBIT or EBITDA may affect valuation.



This is an educational and awareness tool and not meant as a valuation. It provides an informal assessment of your business based upon a number of factors. Initially your EBITDA and multiple range are calculated to give an approximate valuation spread.

Based upon your results from the Deal Readiness Rating, you are plotted on the above chart from a worst in class to best in class businesses category for your industry.

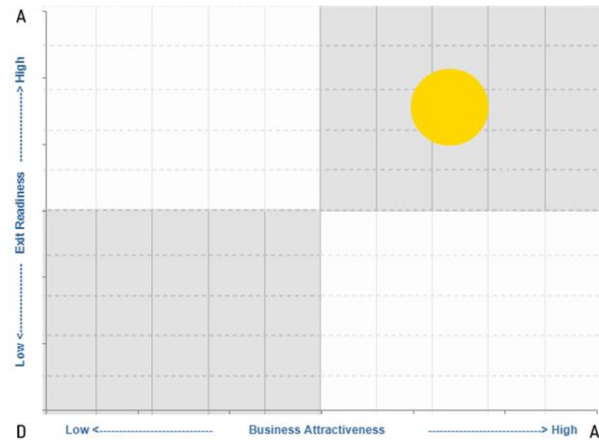
EBITDA	1,500,000
Value Range	6,000,000 - 15,000,000
Multiple Range	4x - 10x
Deal Readiness Rating	40%

Estimated Value **$9,600,000**

Deal Readiness Rating and Value - After Optimization

As an example, in your case, after we have worked with you to optimize your business operations and value, we have estimated a Deal Readiness Rating of 80%.

- Your Business Attractiveness Score was calculated at 78%
- Your Exit Readiness Score was calculated at 81%



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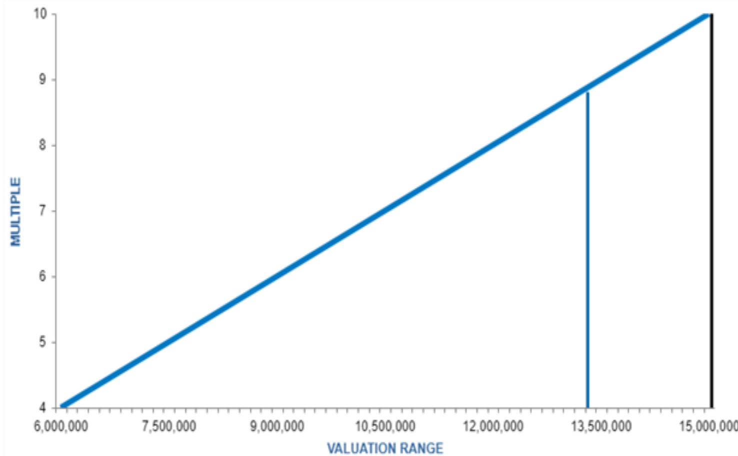

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Based upon your results from the Deal Readiness Rating, you are plotted on the below chart from a worst in class to best in class businesses category for your industry.

EBITDA	1,500,000
Value Range	6,000,000 - 15,000,000
Multiple Range	4x - 10x
Deal Readiness Rating	80%

Estimated Value **$13,200,000**

Understanding the Deal Readiness® process:

One of the first questions a buyer will ask is why the owner is selling, and the owner needs to be able to provide a genuine and consistent answer. There are many legitimate reasons for exiting a business. These include wanting to sell to someone with more resources who can take the business to the next level, selling to someone who is younger and more energetic, or lifestyle reasons such as spending more time with the family or dealing with health issues.

Why Buyers Buy - What Makes a Business Attractive?

The primary reason someone buys a business is to get a return on the investment. Each potential acquisition will be judged on the level of future profits the buyer believes the business can generate, the level of risk attached to reaching these targets and the attractiveness of the industry in which the business operates.

The first criterion a potential buyer will look for is a sound financial history. Ideally, the business will have recorded a steady increase in profit for the last two to three years, with a similar increase in sales over the same period. If the profits and sales figures are inconsistent or showing a downward trend, it may be better for the owner to delay putting the business on the market until the financial results improve.

Potential buyers are reassured if they see the business has been systemized to such an extent that the absence of the previous owner will have almost no effect on its operations. A good starting point is for a business owner to look at what he or she does for the business and identify other staff members who have the potential to take over specific responsibilities.

Industry trends also influence buying decisions. At any given time, certain industries or business trends will be in favor. For example, businesses that manufacture and sell ecologically friendly products would have struggled a decade ago but in today’s environment there is a great deal of marketing mileage to be made from an ecologically responsible product or service.

Negating Risk Factors

Buyers assess any business through the filter of risk. If the business is well organized and driven by strong systems that make employees accountable, it becomes less risky for a new owner.

A strategic investor is generally looking to expand or eliminate a competitor. They might be looking to expand and see the strategic benefits of the following:

- Products or services to add to their base
- Intellectual property

- New distribution channels
- Locking in supply
- New ways of approaching customers
- Management expertise
- Brand expansion
- International expansion
- Competitor buyout
- Employee Skills

Certain factors provide the potential buyer with security:

- Ensuring there is a sound financial history.
- Records of a steady increase in profit for the last two to three years, with a similar increase in sales over the same period.
- Positioning the business as a good low risk return on the investment.
- Highlighting an established customer base, sound internal systems, market awareness and credibility, an operational framework and cash flow.
- Highlighting positive industry trends.
- Highlighting company awards, testimonials or even an ecologically responsible product or service.
- Ensuring the business does not appear to be reliant on the owner and that there is a succession of employees who could take over the existing owner's job when he/she departs.

Buyers will minimize their risk by carrying out a thorough due diligence and investigation of the business. Sellers can maximize their position by being prepared for the scrutiny that prospective purchasers will put the business under. The more prepared the seller the higher the ultimate price they may negotiate.

Moving forward to harvest the wealth of your business

We would suggest that there are three stages that you will encounter as you proceed to the sale or merger of your business.

Stage 1 – Assessment

Business Operations/Risk Assessment - We interview the Owner/CEO and senior management (optional) for input in up to 20 functional areas, including HR, IT, Legal, Financial and Operations, to name a few. We then combine this information with financial analysis to build the +60-page Assessment Report that establishes a clear definition of the current business health so that those shortcomings can be improved before launching the business sale process.

Emergency Operations Plan (EOP) - For a closely-held business, one of the first steps in de-risking the business is to develop an EOP. This is usually a high-level 2-4-page document that informs key people, advisors, and family members about how the business will operate when the person currently in charge is not available.

Stage 2 – Plan Development & Implementation

Business Strategic/Action Plans – We develop a disciplined plan that produces fundamental decisions and actions that shape and guide what an organization is, who it serves, what it does, and why it does it, with a focus on the future. Effective strategic planning articulates not only where an organization is going and the actions needed to make progress, but also how it will know if it is successful.

Business Continuity Plan - This is an important tool for risk management as it provides a structured way to identify the sources of business disruption and assess their probability and harm. Effective business continuity planning is a process that moves through five major steps.

Stage 3 – Board of Advisors – Monthly Meetings

Board of Advisors - Monthly coordination meetings, attended by members of the Board of Advisors and selected external advisors are essential in moving toward the business sale goal. Without a monthly meeting, too often business owners lose sight of their goal and become absorbed in customer and personnel issues of running their businesses.

Investment Banker / M&A Advisor - We would suggest at this point that discussions be held with an M&A Advisor to review the business sale processes and talk to you about your specific situation. Also, you would get a better understanding of the value of your business. You will also need to develop:

- A set of due diligence checklists,
- An information memorandum,
- A tax and legal plan
- Other documentation and processes that will be needed to secure a transaction.

The next steps are contacting prospective buyers and negotiating the sale of your business.

Return on Investment (ROI)

Our Deal Readiness® Methodology is focused on improving how your company may appear to potential buyers. However, by optimizing your company's business processes, you will also increase the efficiency of your company's operations, resulting in increased profitability and business value, even if a business sale is a few years away. However, in the meantime you will be much better prepared to respond to that unsolicited offer that appears out of nowhere!

The Return on Investment (ROI) in our methodology is often in excess of 1,000% ... which is 10 times the amount paid for our services.

Exit Strategy = Business Strategy

- Exit Strategy is about creating, harvesting, and preserving family wealth for generations to come.
- It is about implementation of good business practices.
- Focusing on enterprise value drives positive outcomes for all including better lifestyle.
- Investment is justifiable with growth of enterprise value as the goal.
- Working as a team uncomplicates the process and improves the experience for owners.