

Compare Apples to Apples: Recommended Adjustments to Transactional Data

By C. Fred Hall III, MBA, CBA, AVA

As discussed in the article “Compare Apples to Apples: Investigating the Differences in Transactional Databases,” published in the March 2013 *Business Valuation Update*, it is possible to reconcile the differences between the Pratt’s Stats, BIZCOMPS, and IBA databases into one table, as Shannon Pratt concluded in *The Market Approach to Valuing Businesses*.¹ What follows is a listing of the adjustments needed to make the three databases directly comparable.

Selling Price (Asset Sale). Sales of most small businesses are structured in a manner where the buyer acquires the inventory, fixtures and equipment (FF&E), and intangibles and the seller keeps the cash and receivables and pays off the company debt. This structure is commonly referred to as an asset sale. Since an asset sale is the most common form of transaction in the sale of a small business, it is desirable to reconstruct all the transactions used in an analysis to reflect the selling price for just those three assets. This results in a direct comparison of the selling prices of all the selected transactions.

As described below, all three databases generally report sufficient transactional data in which a selling price can be reconciled for the total value of the inventory, FF&E, and intangibles that were transferred. To calculate a selling price for each database that will align with the others, we make appropriate adjustments in the reported selling prices to equal the total value of those three

assets. It is fairly common to find insufficient data to make an accurate reconciliation, in which case some guesswork is necessary. Appraisers should use their best judgment to determine whether the lack of data precludes obtaining a good estimate of an asset sale selling price. If so, they should reject that comparable.

Pratt’s Stats: As noted in Nancy Fannon’s book on transaction databases,² Pratt’s Stats states that: “Price is generally considered to be the dollar value consideration [in the form of cash, notes, and/or securities³] paid for the business sold including interest-bearing debt. Therefore, the only price reported by Pratt’s Stats is an invested capital price (which the database refers to as Market Value of Invested Capital, or MVIC).” Fannon also notes that Pratt’s Stats FAQs state that an asset sale typically does not include assumed interest-bearing liabilities and generally, but not always, does not include cash, receivables, prepaid expenses, or real estate.⁴ In most cases when an asset sale also includes cash or receivables, it is noted in the transaction report’s “Additional Transaction Information.” However, if the submitting broker didn’t mention it, the

1 Shannon Pratt, *The Market Approach to Valuing Businesses*, John Wiley and Sons, Inc., 2001, p. 68.

2 Nancy Fannon and Heidi Walker, *The Comprehensive Guide to the Use and Application of the Transaction Databases*, 2009 edition, Business Valuation Resources, LLC, p. 2-3.

3 Pratt’s Stats FAQs, “Definitions: What Is the Legend for Pratt’s Stats Income Data,” from the Business Valuation Resources website www.bvmarketdata.com, p. 3.

4 Pratt’s Stats FAQs, “Definitions: What is the Legend for Pratt’s Stats Income Data,” from the Business Valuation Resources website, www.bvmarketdata.com.

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reported selling price may not be correct. I have found a few instances of this uncommon error.

With the appropriate data available, an asset sale reported in Pratt's Stats can usually be reconstructed to produce the total value allocated to inventory, FF&E, and intangibles. However, read the notes appended to each transaction to confirm which other assets may have been transferred. It is not uncommon that submitting brokers did not provide accurate information; thus, appraisers should use their judgment to determine whether to use the comparable.

The selling price allocation reported in each transaction may indicate that a portion of the price included the covenant-not-to-compete value, consulting agreement value, or earnout value.⁵ Pratt's Stats deducts the portion of the selling price allocated to consulting agreements and earnouts in its MVIC calculation.⁶ BIZCOMPS and IBA only exclude earnout value from their reported selling prices.

Suggested Adjustment to Pratt's Stats Selling Price: To reconcile Pratt's Stats' MVIC with the inventory value, FF&E, and intangibles that generally align with BIZCOMPS and IBA values, deduct any cash, receivables, or nonoperating assets from MVIC that may have been included in the selling price and add back any value allocated to consulting agreements. I find this reconciliation is usually comparable to the other databases' adjusted values. However, review that data carefully. If the available information is insufficient to produce a reasonable estimate of the selling price for the three target assets, the comparable should be rejected.

BIZCOMPS: "BIZCOMPS transactions are all asset sales or have been converted to asset

- Earnouts are that portion of the selling price of a business that are conditional payments. These are payments that a seller will only receive if the buyer achieves certain sales or profitability goals in the future. Since they are amounts that cannot be determined as of the sale date, they are generally excluded from the reported selling price of the business.

6 Ibid.

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sales. As such, the price includes FF&E and goodwill or the intangible value. ... BIZCOMPS maintains that their sales prices exclude inventory ... [but] non-compete and consulting agreements are included.”⁷

Suggested Adjustment to BIZCOMPS Selling Price: To reconcile a BIZCOMPS selling price with Pratt’s Stats and IBA’s adjusted selling price for inventory, FF&E, and intangibles, add inventory to BIZCOMPS reported selling price.

IBA: Raymond Miles reports that the IBA database generally excludes cash, accounts receivable, real estate, and “other assets” (such as deposits and prepaids) from the selling price and generally includes inventory, FF&E, intangibles, and covenants-not-to-compete.⁸ *The Market Analysis Tutorial* on the IBA website also indicates that the selling price includes consulting agreement value.⁹

Although IBA claims that it excludes real estate value from the selling price, our analysis found that of the 42 transactions in which real estate was also transferred, 27 transactions inadvertently included the real estate value in the selling price. In most cases, the inclusion of real estate caused the selling price to appear extraordinarily high with respect to the company’s revenue. Subtracting the real estate value produced a much more reasonable result. Therefore, in transactions involving real estate, look at the data and adjust the selling price if necessary. If unsure, the transaction should be excluded from the analysis. However, over 95% of the time, the IBA and BIZCOMPS adjusted selling price are the same.

Suggested Adjustment to IBA Selling Price: Besides a possible adjustment for real estate,

no additional adjustments are necessary to the IBA selling price to align it with Pratt’s Stats and BIZCOMPS adjusted values for inventory, FF&E, and intangibles.

Suggested Adjustment to Revenues. With very few exceptions, all three databases appear to report revenues in the same manner, so no additional adjustments are needed.

Seller’s Discretionary Earnings (SDE)

Pratt’s Stats: “Pratt’s Stats calculations of Earnings before Interest and Taxes (EBIT) and Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA) also exclude other income and expenses and interest income or tax benefits. Discretionary earnings (SDE), then, is equal to adjusted EBITDA plus owner’s compensation.”¹⁰ Owner’s compensation is the wage paid to one owner.¹¹ Three data fields from the Pratt’s Stats transaction report typically add up to SDE. Those fields are owner’s compensation, operating profit (EBIT), and noncash charges (operating profit plus noncash charges equals EBITDA). In nearly 75% of the transactions from my research, this calculation matched the SDE calculations of IBA and BIZCOMPS. Of the remaining 25% where SDE differed, over half were due to data processing errors. Less than 10% of all transactions had discrepancies due to either minor calculation errors or procedural differences, but it could not be determined from the data which type of discrepancy it was. In other words, the number of procedural differences in SDE found among the databases was fairly small. Regardless, the discrepancies found in my research resulted in Pratt’s Stats’ SDE value averaging 98.2% of IBA and BIZCOMPS values. In other words, the discrepancies do not

7 Ibid.

8 Raymond C. Miles, “How to Use the IBA Market Data Base,” Part XXVIII, 1999, p.2. (Excerpt obtained by request from Dave Miles of ValuSource).

9 Market Analysis Tutorial #3 on IBA website, “IBA Transactional Database Fundamentals,” www.adamdata.com/ibamarketdatabase/tutorials/tutorial3.aspx, 2009, p. 1.

10 Nancy Fannon and Heidi Walker, *The Comprehensive Guide to the Use and Application of the Transaction Databases*, 2009 edition, Business Valuation Resources, LLC, p. 2-8.

11 Pratt’s Stats FAQs, “Definitions: What is Is the Legend for Pratt’s Stats Income Data,” from the Business Valuation Resources website, www.bvmarketdata.com.

appear significant enough or frequent enough to adversely skew the results of one's analysis.

A portion of the discrepancies among the databases in SDE calculations probably can be attributed to the fact that Pratt's Stats requires significantly more data input from the reporting brokers than IBA or BIZCOMPS. As a result, Pratt's Stats analysts can sometimes spot calculation errors made in the submitted data. Thus, many of the discrepancies are not from procedural differences, but rather are computational differences by the other databases due to lack of data. Since all three databases are exposed to poor data reporting by submitting brokers, it is important to carefully review each transaction to determine whether it is reasonable. However, if a selected sample of comparables has duplicate transactions with different values for selling price, revenues, or SDE, the data from Pratt's Stats should probably be used in the analysis. If the transactional data do not appear reliable, they should be excluded from the sample of comparables selected.

Suggested Adjustment to Pratt's Stats SDE: To reconcile SDE from Pratt's Stats' data with IBA and BIZCOMPS values, combine owner's compensation, operating profits, and noncash charges.

BIZCOMPS: BIZCOMPS defines SDE as net earnings before interest, taxes, depreciation, and amortization (EBITDA) plus owner's compensation and any nonbusiness or nonrecurring expenses. If there is more than one owner, a hypothetical salary for the lowest paid partner will be deducted from cash flow.¹² BIZCOMPS points out that this is the convention used by Certified Business Intermediaries (CBI) with the International Business Brokers Association (IBBA). BIZCOMPS data are submitted almost exclusively by this group.¹³ The description is fairly similar to the Pratt's Stats' construction, with the exception that Pratt's Stats cites that other income is also deducted from earnings

when calculating SDE. BIZCOMPS does not have a data field for other income, so no adjustment is possible. As pointed out in the research below, the procedural differences occur infrequently and are generally small.

Suggested Adjustment to BIZCOMPS SDE: No adjustments to the BIZCOMPS SDE are needed to align it with the Pratt's Stats adjusted SDE.

IBA: If discrepancies caused by obvious computation errors or real estate transactions are excluded, BIZCOMPS and IBA present the same value for SDE 98% of the time.

Suggested Adjustment to IBA SDE: No further adjustments to SDE are needed to make IBA and BIZCOMPS values align with Pratt's Stats' value.

Stock Sales

IBA: Although all transactions reported in the IBA database are supposed to be assets sales,¹⁴ a few transactions are listed as stock sales. Of the 880 IBA transactions in my research, only three were listed as stock sales. None of those were duplicates of transactions in the other databases, so how IBA presents transactional data on stock sales is not known. No help screen information on the ValuSource or IBA websites or conversations on the subject with ValuSource's Dave Miles offer clarification.

Suggested Adjustment to IBA Stock Sale Selling Price: Any transaction listed as a stock sale in the IBA database should usually be excluded from the transactional analysis.

BIZCOMPS: As noted above, all BIZCOMPS transactions that were stock sales have been converted to an equivalent asset sale value. We are not told which transactions were stock sales. However, as noted above, the selling price listed by BIZCOMPS is always the total value for FF&E and intangibles only. Thus, it is presumed that

12 Jack Sanders, *BIZCOMPS 2011 User Guide*, Business Valuation Resources, 2011, p.16.

13 *Ibid.*, p. 7.

14 Raymond C. Miles, *How to Use the IBA Market Database*, Part XXVIII, 1999, p. 2. (Excerpt obtained by request from Dave Miles of ValuSource.)

all stock sale prices have been converted to this value.

Suggested Adjustment to BIZCOMPS Stock Sale Selling Price: By adding inventory to the listed selling price, we convert any stock sale price to the value of the inventory, FF&E, and intangibles, which generally align with adjusted selling prices from the Pratt's Stats and IBA databases discussed above.

Pratt's Stats: Pratt's Stats reports both asset sales and stock sales and generally provides significant data describing each transaction. Pratt's Stats assumes that what is typically transferred in a stock sale is the "entire legal entity of the company, [including] all assets and liabilities unless otherwise specified in the purchase agreement, [with the exception of] excess or non-operating assets that have been liquidated and/or transferred prior to the sale or at the point of sale."¹⁵ However, unless a specific allocation of the selling price is noted in the "Additional Information" section of the transaction report or the "Asset Data" field is marked "Data is a Purchase Price Allocation," it is generally difficult to determine what assets and liabilities were actually transferred. Consequently, accurate asset sale reconciliation may not be possible. Thus, if specific allocation information is not available or the critical data fields for assets and liabilities contain N/A entries, that comparable should probably be rejected.

As noted above, the selling price listed by Pratt's Stats (MVIC) is equal to total consideration paid (cash, notes, and/or securities) plus any interest-bearing debt assumed, less amounts for earn-outs and employment/consulting agreements. To align the Pratt's Stats selling price with those of IBA and BIZCOMPS, we add back the consulting agreement value. However, since the entire corporate balance sheet may have been transferred in a sale, a number of adjustments

must be made to reconcile MVIC to an equivalent asset sale price that we defined earlier.

The first step in the reconciliation process is to determine what, if any, liabilities were assumed in the transaction. If the "Debt Assumed" field in the transaction report is labeled "N/A," Pratt's Stats could not definitively determine whether any interest-bearing debt was assumed. If no other information is available, this comparable may need to be rejected. However, if the "Debt Assumed" field has either a zero or a dollar amount, the information describing the business sale clearly identified the level of interest-bearing debt assumed.¹⁶ It is also necessary to identify all the non-interest-bearing debt that was also assumed. This information is generally only available when a specific allocation of the purchase agreement is itemized in the "Additional Information" section. However, if zeros are found in the data fields for "Liabilities Assumed," "Long-Term Liabilities," and "Total Liabilities," then Pratt's Stats determined that no liabilities were assumed in the transaction.

In other words, if: 1) specific allocation information is not available in the "Additional Information" section; or 2) the "Asset Data" field is not marked "Data Is a Purchase Price Allocation"; or 3) any of the liabilities fields are marked with N/As, it will be difficult to make an accurate asset sale reconciliation and the comparable should be rejected.

It is necessary to identify all liabilities assumed (both interest-bearing and non-interest-bearing debt) because total consideration plus total debt assumed equals the total debt and equity used to make the purchase. From basic accounting, we know that total debt and equity also equals total assets. Once we establish the total asset value of the transferred business, it is simple to subtract the value of all the assets acquired except for inventory, FF&E, and intangibles. The resulting value is an equivalent asset sale value

15 Pratt's Stats FAQs, "Definitions: What Is Typically Assumed to Be Transferred in a Stock Sale," from the Business Valuation Resources website www.bvmarketdata.com.

16 Nancy Fannon and Heidi Walker, *The Comprehensive Guide to the Use and Application of the Transaction Databases*, 2009 Edition, Business Valuation Resources, LLC, p. 2-3.

(inventory, FF&E, and intangibles) that generally aligns with the IBA and BIZCOMPS selling prices.

Suggested Adjustments to Pratt's Stats' Stock Sale Selling Price: The following is the formula used to reconcile the selling price of a stock sale to an equivalent asset sale price. A

sample transaction from Pratt's Stats follows this formula. Again, this reconciliation generally can only be done accurately when the transaction report includes a selling price allocation in the "Additional Information" section or the "Asset Data" field is marked "Data Is a Purchase Price Allocation."

MVIC (cash, stock, notes, IB debt assumed)	\$13,994,000
Plus: assumed non-interest-bearing debt	625,000
Plus: employment/consulting agreement	-0-
Less: cash	(0)
Less: accounts receivable	(856,000)
Less: other assets (prepaids and for-sale assets)	<u>(1,572,000)</u>
Asset sale value equivalent	\$12,191,000

(The value of inventory, fixtures, and goodwill)

Customer Relationships—Attrition

Pratt's Stats® Transaction Report <small>Prepared: 1/22/2013 7:22:24 AM (PST)</small>			
Seller Details		Source Data	
Target Name:	Accurel Systems International Corporation	Public Buyer Name:	IMPLANT SCIENCES CORP
Business Description:	Commercial Laboratory the Provides Advanced Technology Services to Users and Manufacturers of Semiconductors	B-K Date:	3/11/2005
SIC:	8734 Testing Laboratories	B-K/A Date:	4/13/2005
NAICS:	541380 Testing Laboratories	Other Filing Type:	N/A
Sale Location:	Sunnyvale, CA, United States	Other Filing Date:	N/A
Years in Business:	16	CIK Code:	0001068874
Number Employees:	N/A		
Income Data		Asset Data	
Data is "Latest Full Year" Reported	Yes	Data is Latest Reported	Yes
Data is Restated (see Notes for any explanation)	No	Data is "Purchase Price Allocation agreed upon by Buyer and Seller"	No
Income Statement Date	12/31/2004	Balance Sheet Date	12/31/2004
Net Sales	\$8,151,567	Cash Equivalents	\$373,697
COGS	<u>\$5,870,011</u>	Trade Receivables	\$856,637
Gross Profit	\$2,281,556	Inventory	\$0
Yearly Rent	N/A	Other Current Assets	<u>\$88,639</u>
Owner's Compensation	N/A	Total Current Assets	\$1,318,973
Other Operating Expenses	N/A	Fixed Assets	\$4,163,861
Noncash Charges	\$1,427,287	Real Estate	\$0
Total Operating Expenses	<u>\$1,677,951</u>	Intangibles	\$190,898
Operating Profit	\$603,605	Other Noncurrent Assets	<u>\$87,678</u>
Interest Expenses	<u>\$253,015</u>	Total Assets	<u>\$5,761,410</u>
EBT	\$502,634	Long-term Liabilities	\$2,062,908
Taxes	<u>\$11,218</u>	Total Liabilities	<u>\$3,402,650</u>
Net Income	<u>\$491,416</u>	Stockholder's Equity	<u>\$2,358,752</u>
Transaction Data			
Date Sale Initiated:			N/A
Date of Sale:			3/9/2005
Days to Sell:			N/A
Asking Price:			N/A
Market Value of Invested Capital*:			\$13,994,000
Debt Assumed:			\$2,694,000
Employment Agreement Value:			N/A
Noncompete Value:			N/A
Amount of Down Payment:			\$9,650,000
Stock or Asset Sale:			Stock
Company Type:			S Corporation
Was there an Employment/Consulting Agreement?			No
Was there an Assumed Lease in the sale?			Yes
Was there a Renewal Option with the Lease?			No
*Includes noncompete value and interest-bearing debt; excludes real estate, employment/consulting agreement values, and all contingent payments.			
Additional Transaction Information			
Was there a Note in the consideration paid? No		Was there a personal guarantee on the Note? No	
Terms:			
Consideration: 418,194 shares of the Buyer's common stock with a fair value of \$3,650,000 based upon a fair value per share of \$8.728; \$6,000,000 in cash; and \$1,650,000 in shareholder notes. In addition, the Buyer assumed debt and capital leases of \$2,694,000. The Buyer incurred direct acquisition costs in the amount of \$1,100,000; these costs have been backed out of the Selling Price.			
Assumed Lease (Months): N/A		Terms of Lease: Future minimum lease payments total \$3,152,000 beyond 12/31/2009	
Noncompete Length (Months): N/A		Noncompete Description: N/A	
Employment/Consulting Agreement Description:			
Additional Notes:			
EBT includes Gain on sale of fixed assets of \$125,907 and Miscellaneous income of \$26,137.			
Purchase Price Allocation: Accounts receivable \$856,000, Prepaid expenses and other assets \$172,000, Property, plant and equipment \$4,719,000, Goodwill and other intangibles \$8,572,000, Assets held for sale \$1,400,000, Other liabilities (\$625,000), Debt and capital leases (\$2,694,000), Total \$12,400,000.			
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Summary. The following is a summary of typical adjustments to the three databases to make their data points comparable.

Summary of Adjustments to the Databases to Make Data Points Comparable

I. PRATTS STATS DATABASE

Selling Price:

<u>Sample Stock Sale to Asset Sale Price**</u>		<u>Sample Asset Sale Price</u>	
Market Value of Invested Capital*	\$850,000	Market Value of Invested Capital*	\$850,000
Plus Employment Agreement Value	\$50,000	Plus Employment Agreement Value	<u>\$50,000</u>
Less any acquired Cash	(\$30,000)	Adjusted Asset Sale Price	<u>\$900,000</u>
Less acquired Accounts Receivable	(\$220,000)		
Less Other Cur, Non-Cur Assets acquired	(\$5,000)		
Less Interest-bearing Debt Assumed	(\$50,000)		
Plus Total Liabilities Assumed	<u>\$125,000</u>		
Adjusted Asset Sale Price	<u>\$720,000</u>		

* MVIC (Market Value of Invested Capital) equals Total Consideration paid (in the form of cash, notes, or stocks), plus any assumed interest-bearing debt, less any value allocated to Earnouts and Employment Agreements.

** Asset Data field must indicate "Asset Data = "Allocation"" or NOTES field lists actual allocation breakout.

Seller's Discretionary Earnings (SDE):

Pratt's Stats usually calculates SDE similarly to Bizcomps and IBA databases. However, they typically obtain more data from submitting brokers and therefore their calculated value for SDE may differ. However, in most cases, Pratt's Stats' transactional data when applied to following formula yields the same or nearly the same value as Bizcomps and IBA.

<u>Sample SDE Calculation</u>	
Owner's Compensation	\$75,000
Non-Cash Charges	\$22,000
Operating Profit	<u>\$57,000</u>
Cash Flow (SDE)	<u>\$154,000</u>

II. BIZCOMPS DATABASE

Selling Price:

BIZCOMPS Database separates Inventory value from the Selling Price and Listing Price. To make BIZCOMPS' Selling Price and Listing Prices comparable to Pratt's Stats and IBA adjusted data, Inventory must be added to the BIZCOMP selling price.

<u>Sample Selling Price Calculation</u>	<u>SDE</u>	<u>Revenue</u>
BIZCOMP Sale Price	No adjustment necessary	No adjustment necessary
Inventory		
Adjusted Asset Sale Price		

(= Inventory, Fixed Assets, and Goodwill)

III. IBA DATABASE

Selling Price:

The IBA Database includes the Real Estate Value in the Selling Price of a Transaction. To make IBA's Selling Price comparable to Pratt's Stats and BIZCOMPS databases, any Real Estate Value was subtracted from the Selling Price.

<u>Sample Selling Price Calculation</u>	<u>SDE</u>	<u>Revenue</u>
Sale Price	No adjustment necessary	No adjustment necessary
Real Estate		
Adjusted Asset Sale Price		

(= Inventory, Fixed Assets, and Goodwill)

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